Public Document Pack

Governance Committee

Monday, 10th February, 2020
at 5.00 pm

PLEASE NOTE TIME OF MEETING

Committee Room 1 - Civic Centre

This meeting is open to the public

Members of the Committee

Councillor Keogh (Chair)
Councillor Kataria (Vice-Chair)
Councillor G Galton
Councillor Harwood
Councillor Professor Margetts
Councillor Spicer
Councillor White

Contacts

Director of Legal and Governance
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PUBLIC INFORMATION

Role of the Governance Committee

Information regarding the role of the Committee's is contained in Part 2 (Articles) of the Council's Constitution.

02 Part 2 - Articles

It includes at least one Councillor from each of the political groups represented on the Council, and at least one independent person, without voting rights, who is not a Councillor or an Officer of the Council.

Access – Access is available for disabled people. Please contact the Democratic Support Officer who will help to make any necessary arrangements.

Public Representations At the discretion of the Chair, members of the public may address the meeting on any report included on the agenda in which they have a relevant interest. Any member of the public wishing to address the meeting should advise the Democratic Support Officer (DSO) whose contact details are on the front sheet of the agenda

The Southampton City Council Strategy (2016-2020) is a key document and sets out the four key outcomes that make up our vision.

- Southampton has strong and sustainable economic growth
- Children and young people get a good start in life
- People in Southampton live safe, healthy, independent lives
- Southampton is an attractive modern City, where people are proud to live and work

Smoking policy – The Council operates a no-smoking policy in all civic buildings.
Mobile Telephones:- Please switch your mobile telephones to silent whilst in the meeting
Use of Social Media:- The Council supports the video or audio recording of meetings open to the public, for either live or subsequent broadcast. However, if, in the Chair's opinion, a person filming or recording a meeting or taking photographs is interrupting proceedings or causing a disturbance, under the Council's Standing Orders the person can be ordered to stop their activity, or to leave the meeting.
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Any person or organisation filming, recording or broadcasting any meeting of the Council is responsible for any claims or other liability resulting from them doing so.
Details of the Council's Guidance on the recording of meetings is available on the Council's website.

Dates of Meetings: Municipal Year 2019/20

2019	2020
10 June	10 February
29 July	20 April
9 September	
11 November	
9 December	

CONDUCT OF MEETING

Terms of Reference

The terms of reference of the Governance Committee are contained in Part 3 of the Council's Constitution.

03 - Part 3 - Responsibility for Functions

Rules of Procedure

The meeting is governed by the Council Procedure Rules as set out in Part 4 of the Constitution.

Business to be discussed

Only those items listed on the attached agenda may be considered at this meeting.

Quorum

The minimum number of appointed Members required to be in attendance to hold the meeting is 3.

DISCLOSURE OF INTERESTS

Members are required to disclose, in accordance with the Members' Code of Conduct, ***both*** the existence ***and*** nature of any "Disclosable Pecuniary Interest" or "Other Interest" they may have in relation to matters for consideration on this Agenda.

DISCLOSABLE PECUNIARY INTERESTS

A Member must regard himself or herself as having a Disclosable Pecuniary Interest in any matter that they or their spouse, partner, a person they are living with as husband or wife, or a person with whom they are living as if they were a civil partner in relation to:

(i) Any employment, office, trade, profession or vocation carried on for profit or gain.

(ii) Sponsorship:

Any payment or provision of any other financial benefit (other than from Southampton City Council) made or provided within the relevant period in respect of any expense incurred by you in carrying out duties as a member, or towards your election expenses. This includes any payment or financial benefit from a trade union within the meaning of the Trade Union and Labour Relations (Consolidation) Act 1992.

(iii) Any contract which is made between you / your spouse etc (or a body in which the you / your spouse etc has a beneficial interest) and Southampton City Council under which goods or services are to be provided or works are to be executed, and which has not been fully discharged.

(iv) Any beneficial interest in land which is within the area of Southampton.

(v) Any license (held alone or jointly with others) to occupy land in the area of Southampton for a month or longer.

(vi) Any tenancy where (to your knowledge) the landlord is Southampton City Council and the tenant is a body in which you / your spouse etc has a beneficial interests.

(vii) Any beneficial interest in securities of a body where that body (to your knowledge) has a place of business or land in the area of Southampton, and either:

a) the total nominal value of the securities exceeds £25,000 or one hundredth of the total issued share capital of that body, or
b) if the share capital of that body is of more than one class, the total nominal value of the shares of any one class in which you / your spouse etc has a beneficial interest that exceeds one hundredth of the total issued share capital of that class.

Other Interests

A Member must regard himself or herself as having an, 'Other Interest' in any membership of, or occupation of a position of general control or management in:

Any body to which they have been appointed or nominated by Southampton City Council

Any public authority or body exercising functions of a public nature

Any body directed to charitable purposes

Any body whose principal purpose includes the influence of public opinion or policy

Principles of Decision Making

All decisions of the Council will be made in accordance with the following principles:-

- proportionality (i.e. the action must be proportionate to the desired outcome);
- due consultation and the taking of professional advice from officers;
- respect for human rights;
- a presumption in favour of openness, accountability and transparency;
- setting out what options have been considered;
- setting out reasons for the decision; and
- clarity of aims and desired outcomes.

In exercising discretion, the decision maker must:

- understand the law that regulates the decision making power and gives effect to it. The decision-maker must direct itself properly in law;
- take into account all relevant matters (those matters which the law requires the authority as a matter of legal obligation to take into account);
- leave out of account irrelevant considerations;
- act for a proper purpose, exercising its powers for the public good;
- not reach a decision which no authority acting reasonably could reach, (also known as the "rationality" or "taking leave of your senses" principle);
- comply with the rule that local government finance is to be conducted on an annual basis. Save to the extent authorised by Parliament, 'live now, pay later' and forward funding are unlawful; and
- act with procedural propriety in accordance with the rules of fairness.

AGENDA

1 **APOLOGIES**

To receive any apologies.

2 **DISCLOSURE OF PERSONAL AND PECUNIARY INTERESTS**

In accordance with the Localism Act 2011, and the Council's Code of Conduct, Members to disclose any personal or pecuniary interests in any matter included on the agenda for this meeting.

NOTE: Members are reminded that, where applicable, they must complete the appropriate form recording details of any such interests and hand it to the Democratic Support Officer.

3 **STATEMENT FROM THE CHAIR**

4 **MINUTES OF PREVIOUS MEETING (INCLUDING MATTERS ARISING)** (Pages 1 - 4)

To approve and sign as a correct record the Minutes of the meeting held on 11th November 2019 and to deal with any matters arising, attached.

5 **HR REPORT ABSENCE DATA** (Pages 5 - 14)

Report of the Service Director HR and OD detailing the HR Absence Data for Quarter 3 2019/20, attached.

6 **TREASURY MANAGEMENT STRATEGY AND PRUDENTIAL LIMITS 2020/21 TO 2023/24** (Pages 15 - 52)

Report of the Service Director for Finance (S151) seeking approval of the Treasury Managment Strategy & Prudential Limits 2020/21 to 2023/24, attached.

7 **ANNUAL GOVERNANCE STATEMENT 2019-20** (Pages 53 - 58)

Report of the Chief Financial Officer seeking approval of the assurance gathering process to support development of the 2019-20 Annual Governance Statement, attached.

8 **INTERNAL AUDIT PROGRESS REPORT 2019-20** (Pages 59 - 78)

Report of the Chief Internal Auditor detailing the Internal Audit Progress Report 2019/20, attached.

9 **EXTERNAL AUDIT PLAN YEAR ENDING 31ST MARCH 2020** (Pages 79 - 120)

Report of External Auditor detailing the External Audit Plan for year ending 31st March

2020, attached.

Thursday, 30 January 2020 Director of Legal and Governance

GOVERNANCE COMMITTEE

MINUTES OF THE MEETING HELD ON 11 NOVEMBER 2019

Present: Councillors Keogh (Chair), Bunday, G Galton, Harwood, Professor Margetts, Spicer and White

23. **APOLOGIES AND CHANGES IN MEMBERSHIP**

The Committee noted the resignation of Councillor Kataria and the appointment of Councillor Bunday in place thereof in accordance with the provisions of Council Procedure Rule 4.3.

24. **MINUTES OF PREVIOUS MEETING (INCLUDING MATTERS ARISING)**

RESOLVED: that the minutes for the Committee meeting on 30th September 2019 be approved and signed as a correct record.

25. **HR REPORT COUNCIL APPRAISALS**

The Committee received and noted the report of the Service Director Human Resources and Organisational Development detailing the revised Council Performance Review Process following the introduction of Business World in October 2019.

26. **ANNUAL REPORT ON INTERNAL COMPLAINTS/LOCAL GOVERNMENT OMBUDSMAN COMPLAINTS 2018/19**

The Committee received and noted the report of the Director Legal and Governance detailing the Annual Report on Internal Complaints/Local Government Ombudsman Complaints 2018/19.

The Committee particularly noted that there had been a 14.7% increase in Adult Services complaints which had been attributed to the changes in the charging policy and had been expected as a result. It was also noted that there was an expectation that next year would continue to see an increase as there were a number of significant changes that would be taking place in Adult Services which would present as a challenge.

The Committee suggested that it may be helpful for an audit scope to be considered for service areas in the future.

27. **NO ASSURANCE AUDIT - PURCHASE PRE-PAID CARDS**

The Committee received a presentation from Vanessa Shahani, Service Lead Business Services providing an update on progress regarding the Purchase Pre-Paid Cards Limited Assurance Audit. The Committee noted that there were 101 holders of the purchase pre-paid cards, 43 in the local authority and 58 in schools. Cards were provided by contract with Lloyds bank and were pre-loaded with amounts from £500-£1000 for use of low value purchases that could not be bought through other means.

In terms of progress it was noted that the introduction of Business World in October 2019 would do more for managers in monitoring spend, Capita had now been insourced which meant procurement was in-house and the whole pay journey procurement could be reviewed. In addition it was noted that early stages of procurement were in place for a hotel and travel portal which would go live early in the new financial year. Joint training workshops provided by procurement and a/c payable team were planned for January/February for all card holders.

The Committee were assured that progress was being made and that improvements would become "business as usual" for the future and that there would be a report back to Governance Committee as part of the Audit Plan at the end of the financial year.

28. **NO ASSURANCE AUDIT - WATER QUALITY**

The Committee received a presentation from Ian Moss, Service Lead Health, Safety and Employee Wellbeing providing an update on progress regarding the Water Quality Limited Assurance Audit.

The Committee noted that whilst a limited assurance audit had been provided work was being undertaken to address the points raised but they had been unable to be evidenced until February 2019. A Gap analysis that had been undertaken had also identified training needs which had already been provided for caretakers and the "responsible person".

The Committee were assured that progress was being made for those areas that were the direct responsibility of the Local Authority and that there would be a report back to Governance Committee as part of the Audit Plan at the end of the financial year.

29. **RISK MANAGEMENT REPORT 2019**

The Committee received and noted the report of the Service Director Finance and Commercialisation detailing the Risk Management Report 2019 which provided a summary of the Council's Risk Management Framework together with information on the arrangements and initiatives in place to manage the risk.

30. **EXTERNAL AUDIT ANNUAL LETTER 2018/19**

The Committee received and noted the report of the External Auditor detailing the Annual Audit Letter 2018-19 which summarised key findings from across the range of the auditor's work and responsibilities under statute and the Code, in relation to the 2018/19 audit.

The Committee noted that this was Helen Thompson's last meeting as External Auditor due to Public Sector requirements of a rotational policy every 5years and Helen had served 5years for Southampton. The Committee thanked Helen for her work and commitment and wished her well for the future.

31. **REVIEW OF PRUDENTIAL LIMITS AND TREASURY MANAGEMENT MIDYEAR 2019/20**

The Committee considered the report of the Director of Finance and Commercialisation (S151 Officer) detailing the Treasury Management activities and performance for 2019/20 to date against the approved Prudential Indicators for External Debt and Treasury Management.

The Committee particularly noted that in relation to the current investment strategy forecast returns with a current weighted average rate was 1.58% with the average being 1.22%.

The Committee also suggested that it would be beneficial for the Council's Treasury Management Advisors to do an All Member briefing ahead of the Council's Budget meeting in 2020.

RESOLVED:

(i) That the Treasury Management activities for 2019/20 and performance against the Prudential Indicators be noted;

(ii) That the continued proactive approach to Treasury Management had led to reductions in borrowing costs and safeguarded investment income during the year be noted; and

(iii) That authority continued to be delegated to the S151 Officer to make any future changes which benefitted the authority and to report back at the next Treasury update.

32. INTERNAL AUDIT PROGRESS REPORT 2019-20

The Committee received and noted the report of the Chief Internal Auditor detailing the Internal Audit Progress report for the period 17th September to 30th October 2019.

The Committee noted that the plan was on track together with movement that had taken place within it and that there we no areas of "no assurance".

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DECISION-MAKER:		**GOVERNANCE COMMITTEE**		
SUBJECT:		**QUARTERLY HR DATA**		
DATE OF DECISION:		10TH FEBRUARY 2020		
REPORT OF:		SERVICE DIRECTOR HR AND OD		
CONTACT DETAILS				
AUTHOR:	**Name:**	**Janet King**	Tel:	023 8083 2378
	E-mail:	**Janet.king@southampton.gov.uk**		
Executive Director	**Name:**	**Mike Harris**	Tel:	023 8083 2882
	E-mail:	Mike.harris@southampton.gov.uk		

STATEMENT OF CONFIDENTIALITY

None. This report contains no personal information relating to specific individuals.

BRIEF SUMMARY

The Governance Committee requested quarterly, council wide information on key employment data covering sickness absence disciplinaries, dismissals, referrals to the police, suspensions and grievances. Additional summary information on levels of staff sickness was requested from September 2018 onwards.

Sickness absence levels in key front lines areas remain high and of concern and focused work is in place for these areas.

RECOMMENDATIONS:

	(i)	To note the Quarter 3 2019/20 HR statistics as requested.

REASONS FOR REPORT RECOMMENDATIONS

1. Data requested by Governance Committee for review.

ALTERNATIVE OPTIONS CONSIDERED AND REJECTED

2. N/A

DETAIL (Including consultation carried out)

3. **Quarter 3:**

In the period October 2019 – December 2019 the Council had a total of 26 dismissals:

- 0 on disciplinary grounds
- 0 for capability
- 1 via settlement agreement
- 19 as a result of service restructures
- 6 for sickness absence
- 0 during probationary period
- 1 Step 3 grievance resolution cases

During Q3 there was 1 suspension.

HR received 1 appeal in Q3 in respect of a flexible working request where the decision was in favour of the employee

4.	Overall sickness levels for the council showed an average 11.29 days per employee (3.09%). The sector "average" is 8.5 days. Short term absence accounts for 90% of the overall absence occurrences, whilst long term sickness accounts for 10% of the overall absence occurrences. The HR team provide managers with detailed absence data monthly.
5.	The HR team provide managers with monthly absence data and detail down to individual case level. HR work with managers to identify and address "hot spots" and underlying issues against which to target interventions including information, support, occupational health appointments, phased return and in some cases, dismissal. Workshops are in place for 2020 to help improve management oversight and attention to absence and look at improving understanding of and attention to reasons for absence and reducing the overall levels of sickness. Other initiatives include the introduction of free flu jabs for staff (Winter 2019 clinics held), the training of Wellbeing Champions to help spot early signs of stress and mental health issues, a pilot flexible working scheme to improve work/life balance and improved accommodation under the SWoW project. A continued focus on absence is a priority for 2020/21.
RESOURCE IMPLICATIONS	
Capital/Revenue	
6.	None
Property/Other	
7.	none
LEGAL IMPLICATIONS	
Statutory power to undertake proposals in the report:	
8.	S 111 LGA 1972, S1 Localism Act 2011
Other Legal Implications:	
9.	None
RISK MANAGEMENT IMPLICATIONS	
10.	None
POLICY FRAMEWORK IMPLICATIONS	
11.	None
KEY DECISION?	**No**
WARDS/COMMUNITIES AFFECTED:	none
SUPPORTING DOCUMENTATION	
Appendices	
1.	Q3 HR table of data (Summary)
2.	Q3 Sickness absence data (Summary)

Documents In Members' Rooms

1.	None	
Equality Impact Assessment		
Do the implications/subject of the report require an Equality and Safety Impact Assessment (ESIA) to be carried out.		**No**
Data Protection Impact Assessment		
Do the implications/subject of the report require a Data Protection Impact Assessment (DPIA) to be carried out.		**No**
Other Background Documents **Other Background documents available for inspection at:**		
Title of Background Paper(s)		**Relevant Paragraph of the Access to Information Procedure Rules / Schedule 12A allowing document to be Exempt/Confidential (if applicable)**
1.	None	

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Southampton City Council - Quarterly Governance Stats

Quarter 3 (Oct. '19 - Dec. '19)																
Service Area	**Disciplinaries**			**Dismissals**								**Resolutions**	**Suspensions**		**Appeals**	
	Final WW	*Dismissed*	*Referral to Police*	*Total Dismissals*	*Capability*	*Disciplinary*	*Health*	*Probation*	*Restructures*	*Other*	*Commentary*	*Step 3 Resolutions*	*Total Suspensions*	*Length of Suspensions*	*Number*	*Number upheld*
Adults, Housing & Communities	0	0	0	16	0	0	3	0	12	1	Various areas have gone through restructures as a result of the resource review, which accounts for a high number of dismissals via restructures this quarter	1	1	Suspended since 20/11/19	1	1
Children & Families	0	0	0	0	0	0	0	0	0	0		0	0		0	0
Digital & Business Operations	0	0	0	4	0	0	0	0	4	0		0	0		0	0
Finance & Commercialisation	0	0	0	0	0	0	0	0	0	0		0	0		0	0
Growth	0	0	0	4	0	0	1	0	3	0		0	0		0	0
Human Resources & Org Development	0	0	0	0	0	0	0	0	0	0		0	0		0	0
Intelligence Insight & Communications	0	0	0	0	0	0	0	0	0	0		0	0		0	0
Legal & Governance	0	0	0	1	0	0	1	0	0	0		0	0		0	0
Public Health	0	0	0	0	0	0	0	0	0	0		0	0		0	0
Quality & Integration	0	0	0	0	0	0	0	0	0	0		0	0		0	0
Transactions & Universal Services	0	0	0	2	0	0	1	0	0	1		0	0		0	0
Southampton City Council (Total)	0	0	0	27	0	0	6	0	19	2		1	1		1	1

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Sickness Absence Report: January 2019 - D

Select Report:	SCC
Status	

Target = < 8.5 days = Green, 8.5 - 10 days = Amber, > 10 days = Red

Team	Metric	Sickness Absence Days Per Employee	FTE Days Lost	No. of Staff with 5 or more occurences of sickness absence	No. of Staff with 10 or more days sickness absence	Total Staff who hit a Trigger Point
	Target	8.5				
	Status					
SCC		11.29	34,213	147	617	651
Adults, Housing & Communities		12.25	12,188	53	238	251
Children & Families		11.19	6,257	19	106	113
Digital & Business Operations		8.65	1,809	12	37	38
Finance & Commercialisation		6.25	1,292	6	26	26
Finance Capital		3.51	24	0	1	1
Growth		5.58	1,479	4	31	33
HR & Organisational Development		2.36	123	0	2	2
Intelligence, Insight & Comms		2.82	317	2	4	6
Legal & Governance		7.41	481	2	8	8
Public Health		0.20	1	0	0	0
Quality & Integration		9.86	397	4	7	9
Transactions & Universal Services		16.92	9,736	44	155	161

Metric
Sickness Absence Days Per Employee
FTE Days Lost
No. of Staff with 5 or more occurences of sickness absence
No. of Staff with 10 or more days sickness absence
Total Staff who hit a Trigger Point
Short Term Sickness Absence %
Long Term Sickness Absence %

Definition
Total FTE days lost over a rolling 12 months/total FTE headcount
Total FTE days lost over a rolling 12 months
Total staff with 5 or more occassions of absence
Total staff who have had a total of 10 or more days absence
Total staff who have reached a trigger point
Occasions of short term absence
Occassions of long term absence

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DECISION-MAKER:		GOVERNANCE COMMITTEE		
SUBJECT:		TREASURY MANAGEMENT STRATEGY AND PRUDENTIAL LIMITS 2020/21TO 2023/24		
DATE OF DECISION:		10 FEBRUARY 2020		
REPORT OF:		SERVICE DIRECTOR FINANCE (S151)		
CONTACT DETAILS				
AUTHOR:	**Name:**	Steve Harrison	**Tel:**	023 8083 4153
	E-mail:	steve.harrison@southampton.gov.uk		
Director	**Name:**	John Harrison	**Tel:**	023 8083 4897
	E-mail:	john.harrison@southampton.gov.uk		
STATEMENT OF CONFIDENTIALITY				
NOT APPLICABLE				

BRIEF SUMMARY

With overall annual expenditure in excess of £600M and an extensive capital programme, the Council is required to actively manage its cash-flows on a daily basis. The requirement to invest or to borrow monies to finance capital programmes, and to cover daily operational needs is an integral part of daily cash and investment portfolio management.

This report explains the context within which the Council's treasury management activity operates and sets out a proposed strategy for the coming year in relation to the Council's cash flow, investment and borrowing, and the management of the associated risks, including the loss of invested funds and the revenue effect of changing interest rates.

Investment limits within this report have been increased to allow for a possible change in strategy.

GOVERNANCE COMMITTEE

It is recommended that Governance Committee:

	(i)	Approve the Council's Treasury Management (TM) Strategy and Indicators for 2020/21 to 2023/24, as detailed in appendix 1.
	(ii)	Note that at the time of writing this report it has been assumed that the budget proposals within the Medium Term Financial Strategy, Budget and Capital Programme 2020/21 to 2022/23 report, to be submitted to Council on the 26 February 2020, will be approved. Should the recommendations change and have any impact on the Prudential Indicators this will be reported to Council on 26 February 2020.
	(iii)	Continue to delegate authority to the Chief Financial Officer (CFO) to approve any changes to the Prudential Indicators or borrowing limits that will aid good treasury management. The CFO will report any amendments and in year revisions to the TM Strategy as part of quarterly financial and performance monitoring.
	(iv)	Endorse the proposal to continue to explore an alternative Treasury Strategy to generate additional income that can support local services, whilst maintaining a prudent approach.

REASONS FOR REPORT RECOMMENDATIONS	
1.	In order to comply with Part 1 of the Local Government Act 2003, and the established TM procedures that have been adopted by the Council, each year the Council must set certain borrowing limits and approve the Treasury Management Strategy, as detailed in Appendix 1.
2.	This report only covers treasury investments, investments held for service purposes or for commercial profit are considered in a separate report being taken to Full Council on 26 February 2020.
ALTERNATIVE OPTIONS CONSIDERED AND REJECTED	
3.	Alternative options for borrowing would depend on decisions taken on the review of the capital update report being taken at Full Council on 26 February 2020.
DETAIL (Including consultation carried out)	
	CONSULTATION
4.	The proposed Capital Update report on which this report is based has been subject to separate consultation processes.
	BACKGROUND
5.	Since 2012, the Council has pursued a strategy of internal borrowing – minimising external borrowing by running down its own investment balances and only borrowing short term to cover cash flow requirements. This has both reduced the credit risk exposure and saved the Council money in terms of net interest costs. If opportunities arise long term borrowing would be considered as demonstrated earlier in the year when the benchmark gilt rates for PWLB loans fell to historic lows and a £90M 15 year EIP (Equal Instalment Payment) loan was taken at 1.12% to secure this advantageous rate and add some certainty to the debt portfolio. Rates have since risen and for comparative purposes the same loan would be around 2.5% an increase of 138 base points or £13,800 for each £1M borrowed, a saving of £1.2M per annum.
6.	As reported previously consideration is also being given to an alternative Treasury Strategy which could generate income to support local services. This would be to invest further in external pooled funds which would require the Council to externalise some or all of debt long term which is currently being financed internally. To assist with this appraisal the Council has consulted its financial advisers, Arlingclose, to analyse the scope within the Council’s current and projected balance sheet for longer-term investment, and analyse suitable longer-term asset classes and investment options available to the Council, although following the rise in the PWLB margin by 1% this will be more difficult to achieve. Any change to the current strategy would require approval by full council and additional Treasury Training would be provided to assist members in understanding the risks and implications of any change to the current strategy.
7.	The strategy takes into account the impact of the Council’s proposed revenue budget and capital programme, to be report to Council on 26 February 2020, on the balance sheet position, the prudential indicators and the current and projected treasury position.

	There is no longer a requirement to include indicators relating to Prudence, Affordability & Sustainability in the Treasury Strategy as they are now reported as part of the Capital Strategy which will be approved at Council on 26 February. The economic background and outlook for interest rates (Annex 2 to Appendix 1) has also been taken into account in developing this strategy.
8.	The Council acknowledges that effective TM will provide support towards the achievement of its business and service objectives. It is committed to achieving value for money, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management. To assist the Council in carrying out its TM function, it has appointed TM Advisors (Arlingclose), who advise on strategy and provide market information to aid decision making. However it should be noted that the decisions are taken independently by the CFO taking into account this advice and other internal and external factors.
9.	In accordance with the MHCLG Guidance, Governance committee will be asked to approve a *revised Treasury Management Strategy Statement* should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates; material change to the Council's capital programme or in the level of its borrowing or investment balances.
10.	The core elements of the 2020/21 Treasury strategy are : • To extend the use of short term variable rate debt to take advantage of the current market conditions of low interest rates. • To constantly review longer term forecasts and to lock into longer term rates through a variety of instruments as appropriate during the year, in order to provide a balanced portfolio against interest rate risk. • To secure the best short term rates for borrowing and investments consistent with maintaining flexibility and liquidity within the portfolio. • To invest surplus funds prudently, the Council's priorities being: - Security of invested capital - Liquidity of invested capital - An optimum yield which is commensurate with security and liquidity. • To approve borrowing limits that provide for debt restructuring opportunities and to pursue debt restructuring where appropriate and within the Council's risk boundaries.
RESOURCE IMPLICATIONS	
Capital/Revenue	
11.	The revenue and capital implications are considered as part of ongoing monitoring which is reported to Cabinet each quarter and as part of the budget setting process.

12.	The forecast for borrowing costs in 2020/21 is £16.9M. This is made up of borrowing of £10.5M based on an average debt portfolio of £359.7M at an average interest rate of 2.91% plus MRP and other costs of £6.4M. Investment income for 2020/21 is forecast at £1.3M based on an average portfolio of £45M at an average of 3.26%. If actual levels of investments and borrowing, and/or interest rates differ from those forecast, performance against budget will be correspondently different
Property/Other	
13.	None
LEGAL IMPLICATIONS	
Statutory power to undertake proposals in the report:	
14.	Local Authority borrowing is regulated by Part 1, of the Local Government Act 2003, which introduced the new Prudential Capital Finance System.
15.	From 1 April 2004, investments are dealt with, not in secondary legislation, but through guidance. Similarly, there is guidance on prudent investment practice, issued by the Secretary of State under Section 15(1) (a) of the 2003 Act. A local authority has the power to invest for "any purpose relevant to its functions under any enactment or for the purposes of the prudent management of its financial affairs". The reference to the "prudent management of its financial affairs" is included to cover investments, which are not directly linked to identifiable statutory functions but are simply made in the course of treasury management. This also allows the temporary investment of funds borrowed for the purpose of expenditure in the reasonably near future; however, the speculative procedure of borrowing purely in order to invest and make a return remains unlawful.
Other Legal Implications:	
16.	None
POLICY FRAMEWORK IMPLICATIONS	
17.	This report has been prepared having regard with the CIPFA Code of Practice on Treasury Management.

KEY DECISION?	No
WARDS/COMMUNITIES AFFECTED:	None
SUPPORTING DOCUMENTATION	
Appendices	
1.	Treasury Management Strategy 2020-21
2.	Treasury Management Practices
3.	Glossary of Treasury Terms
Documents In Members' Rooms	
1.	Treasury Management Policy Statement
2.	Economic and Interest Outlook
Equality Impact Assessment	

Do the implications/subject of the report require an Equality Impact Assessment (EIA) to be carried out.		**No**
Privacy Impact Assessment		
Do the implications/subject of the report require a Privacy Impact Assessment (PIA) to be carried out.		**No**
Other Background Documents		
Title of Background Paper(s)	Relevant Paragraph of the Access to Information Procedure Rules / Schedule 12A allowing document to be Exempt/Confidential (if applicable)	
1.	None	

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Southampton City Council

TREASURY MANAGEMENT STRATEGY

2020/21 – 2023/24

Contents

	SECTION 1 - INTRODUCTION
1.1	**BACKGROUND**
1.1.1	Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code)* which requires the Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.
1.1.2	Overall responsibility for treasury management remains with the Council. No TM activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. Our current policy is shown in Annex 1.
1.1.3	Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy.
1.2	**EXTERNAL CONTEXT**
1.2.1	Annex 2 summarises the economic outlook and events in the context of which the Council operated its treasury function during 2019/20 and forecast movement in interest rates.
1.2.2	For the purpose of setting the budget, it has been assumed that new investments for 2020/21 will be made at an average rate of 1.12% for short term and 4.25% for long term, and that new long-term loans taken over the period of the strategy will be borrowed at an average rate of 3.25%.
1.3	**LOCAL CONTEXT**
1.3.1	At 31 December 2019 the Council held £363M of debt (£293M borrowing plus £70M other long term liabilities) and £105M investments which is set out in further detail in Annex 3.
1.3.2	The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), which is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. The CFR is reduced by the application of resources such as capital receipts, grants or revenue funds.
1.3.3	While usable reserves and working capital are the underlying resources available for investment.
1.3.4	The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. Table 1 shows that the Council has an increasing CFR due to the impact of the capital programme and a decreasing working balance surplus and will therefore need to borrow up to £574M over the forecast period (row 10).

1.3.5	Table 1: Balance Sheet Summary and Forecast

		31-Mar-19 Actual £M	31-Mar-20 Forecast £M	31-Mar-20 Forecast Movement in year £M	31-Mar-21 Forecast £M	31-Mar-22 Forecast £M	31-Mar-23 Forecast £M	31-Mar-24 Forecast £M
1	General Fund CFR	334.02	357.07	23.05	571.81	619.35	710.72	713.62
2	Housing CFR	162.73	178.53	15.80	207.52	238.91	282.67	321.38
3	**Total CFR**	**496.75**	**535.60**	**38.85**	**779.33**	**858.26**	**993.39**	**1035.00**
4	Less Other Debt Liabilities*	(71.07)	(67.83)	3.24	(64.43)	(60.62)	(57.11)	(53.76)
5	**Loans CFR**	**425.68**	**467.77**	**42.09**	**714.90**	**797.64**	**936.28**	**981.24**
6	Less External Borrowing	(246.34)	(256.87)	(10.53)	(231.59)	(222.84)	(216.84)	(210.84)
7	Internal (over) Borrowing	**179.34**	**210.90**	**31.56**	**483.31**	**574.80**	**719.44**	**770.40**
8	Less Usable Reserves	(154.28)	(128.43)	25.85	(121.36)	(117.80)	(114.77)	(113.00)
9	Less Working Capital Surplus	(92.94)	(82.94)	10.00	(82.94)	(82.94)	(82.94)	(82.94)
10	**New Borrowing or (Investments)**	**(67.88)**	**(0.47)**	**67.41**	**279.01**	**374.06**	**521.73**	**574.46**

** finance leases, PFI liabilities and transferred debt which form part of the Council's total debt*

*** shows only loans to which the Council is committed and excludes optional refinancing*

1.3.6 Table 1 shows that the Council's CFR is rising over the next 4 years. This is due to increased investment, summarised below are the major projects expected to undertaken:

- Building new homes (HRA)
- Green City Charter investment
- Property Investment Fund
- Bitterne Community Hub
- Flood Defence Works
- School Expansion Programme
- Highways and Integrated Transport Programme
- Improving Outdoor Leisure Facilities

1.3.7 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council expects to comply with this recommendation during 2019/20, as our committed borrowing (row 10) is significantly below our loans CFR (row 5).

1.4 **Liability Benchmark**

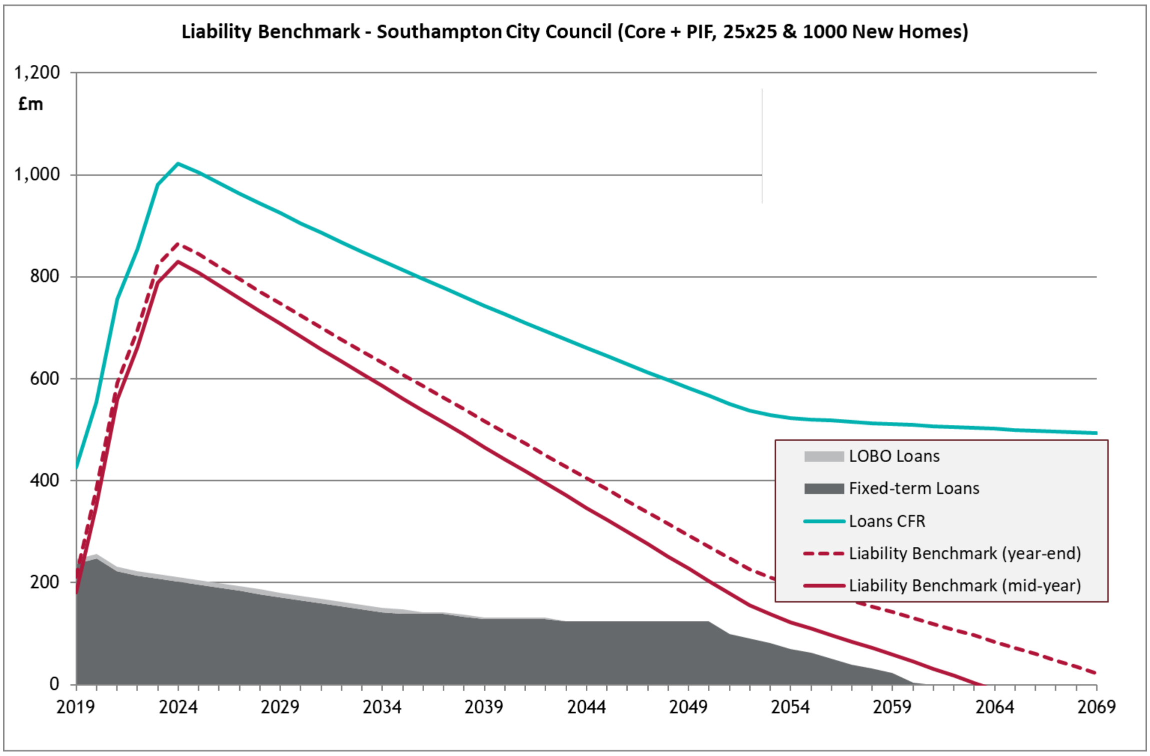
1.4.1 To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as Table 1 above, but that cash and investment balances are kept to a minimum level of £10M at each year-end to maintain sufficient liquidity but to further minimise credit risk.

1.4.2	Table 2: Liability benchmark

	31-Mar-19 Actual £M	31-Mar-20 Forecast £M	31-Mar-20 Forecast Movement in year £M	31-Mar-21 Forecast £M	31-Mar-22 Forecast £M	31-Mar-23 Forecast £M	31-Mar-24 Forecast £M
Loans CFR	**425.68**	**467.77**	**42.09**	**714.90**	**797.64**	**936.28**	**981.24**
Less Usable Reserves	(154.28)	(128.43)	25.85	(121.36)	(117.80)	(114.77)	(113.00)
Less Working Capital Surplus	(92.94)	(82.94)	10.00	(82.94)	(82.94)	(82.94)	(82.94)
Plus Minimum Investments	10.00	10.00	0.00	10.00	10.00	10.00	10.00
Liability Benchmark	**188.46**	**266.40**	**77.94**	**520.61**	**606.90**	**748.57**	**795.31**
Less Committed External Borrowing	(246.34)	(256.87)	(10.53)	(231.59)	(222.84)	(216.84)	(210.84)
Minimum Borrowing Need	**(140.82)**	**(63.41)**	**77.41**	**216.07**	**311.12**	**458.79**	**511.52**

1.4.3 The long term liability benchmark assumes minimum revenue provision based on the life of the asset and income, expenditure and reserves all increasing by inflation. This is shown in the chart below.

1.4.4



1.4.5 This demonstrates that even with lower investment balances that there is still an underlying need for the council to borrow during 2020/21 as our actual committed debt at £232M will be below the benchmark of £521M.

SECTION 2 - BORROWING STRATEGY

2.0 The Council currently holds £293M of loans, an increase of £47M since the 31 March 2019 and reflects the Council's increased capital programme. The balance sheet forecast in Table 1 above shows that the Council expects the total loans CFR to increase by £42M in 2019/20 and by a further £247M in 2020/21 bringing our estimated loans CFR to £715M.

	Committed borrowing at the end of 2020 is £257M, an increase of £11M from the actual position at 31 March 2019, this increase reflects the £90M loan taken from the PWLB in September offset by maturities in year. If the forecast capital programme for the year is achieved then further borrowing of up to £66M will be required by 31 March 2020 as shown in Table 1.
2.1	**Objectives**
2.1.1	The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.
2.2	**Strategy**
2.2.1	Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.
2.2.2	By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2020/21 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.
2.2.3	If it was cost effective the Council could also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing.
2.2.4	Alternatively, the Council may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period. In addition, the Council may borrow further short-term loans to cover unexpected cash flow shortages.
2.3	**Sources of Borrowing**
2.3.1	The approved sources of long-term and short-term borrowing are: • Public Works Loan Board (PWLB) and any successor body • any institution approved for investments (see below) • any other bank or building society authorised to operate in the UK • any other UK public sector body • UK public and private sector pension funds (except HCC Pension Fund) • capital market bond investors • UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

2.3.2	In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities: • leasing • hire purchase • Private Finance Initiative • sale and leaseback
2.3.3	The Council has previously raised the majority of its long-term borrowing from the PWLB, but it is now relatively expensive following the government's 1% increase in the margin over gilt's. The Council continues to investigate other sources of finance, such as local authority loans, bank loans and other sources of long-term loans which may be available at more favourable rates. This will also reduce over-reliance on one source of funding in line with the CIPFA code.
2.3.4	**UK Municipal Bonds Agency plc (MBA)**
2.3.5	MBA was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities may be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. A report setting out in full the details, options and risks of the MBA was considered by full Council on 10 February 2016 and any initial proposal to borrow from the Agency will therefore need be the subject of a separate report to both Governance Committee and Full Council.
2.3.6	MBA confirmed in January 2020 that it is set to issue the first bond
2.3.7	**Lender's Option Borrower's Option Loans (LOBOs)**
2.3.8	The Council holds £9M of LOBO loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBOS have options during 2020/21 and although the Council understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Council will take the option to repay LOBO loans at no cost if it has the opportunity to do so.
2.4	**Short Term and Variable Rates**
2.4.1	Included within the PWLB portfolio is £35M of variable rate Loans, which are helping to keep the overall cost of borrowing down. Whilst in the current climate of low interest rates this remains a sound strategy, these together with short term loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators. Financial derivatives may be used to manage this interest rate risk but in line with the CIPFA code, the Council would seek and consider external advice before entering into any agreement to ensure that it fully understands the implications.

2.5	**Debt Rescheduling**
2.5.1	The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.
	SECTION 3 - INVESTMENT STRATEGY
3.0	The Council invests its money for three broad purposes: • because it has surplus cash as a result of its day-to-day activities (known as **treasury management investments**), • to support local public services by lending to or buying shares in other organisations (**service investments**), and • to earn investment income (known as **commercial investments** where this is the main purpose).
3.1	**Objectives**
3.1.1	The CIPFA Code require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested, however it should be noted that a lower rate is an acceptable offset for higher credit and less risk, for example a covered bond.
3.2	**Negative Interest Rates**
3.2.1	If the UK enters into a recession in 2020/21 or thereafter, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.
3.3	**Strategy**
3.3.1	As we have an increasing borrowing requirement our overall treasury strategy is to minimise both external borrowing and investments and to only borrow to the level of its net borrowing requirement. The reasons for this are to reduce credit risk, take pressure off the Council's lending list and also to avoid the cost of carry existing in the current interest rate environment. For longer term investments the Council aims to continue to diversify into more secure and/or higher yielding asset classes during 2020/21.

	The majority cash used for cash flow purposes is invested in money market funds or with other Local Authorities.
3.4	**Business Model**
3.4.1	Under the new IFRS 9 standard, the accounting for certain investments depends on the Authority's "business model" for managing them. The Authority aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.
3.5	**Approved Counterparties**
3.5.1	The Council may invest its surplus funds with any of the following counterparty types, subject to the cash limits (per counterparty) and time limits detailed below. This is the absolute limit and the working limit will be monitored against actual cash flows and movement on reserves together with advice from our financial advisors and will be adjusted each quarter as necessary in agreement with the CFO.
3.5.2	Table 3: Approved Investment counterparties and Limits

Credit Rating	Banks Unsecured £M	Banks Secured £M	Government & Local Authorities £M	Corporates £M	Registered Providers £M
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£5M 5 years	£20M 20 years	£20M 50 years	£5M 20 years	£10M 20 years
AA+	£5M 5 years	£20M 10 years	£20M 25 years	£5M 10 years	£10M 10 years
AA	£5M 4 years	£20M 5 years	£20M 15 years	£5M 5 years	£10M 10 years
AA-	£5M 3 years	£20M 4 years	£20M 10 years	£5M 4 years	£10M 10 years
A+	£5M 2 years	£20M 3 years	£10M 5 years	£5M 3 years	£10M 5 years
A	£5M 13 months	£20M 2 years	£10M 5 years	£5M 2 years	£10M 5 years
A-	£5M 6 months	£20M 13 months	£10M 5 years	£5M 13 months	£10M 5 years
None	£1M 6 months	n/a	£5M 25 years	£0.5M 5 years	£5M 5 years
Pooled funds	£10M per fund for MMF, other funds (e.g. CCLA or REITS) subject to specific advice				

3.6	**Investment Institutions**
3.6.1	**Credit Rating:** Investment limits are set by reference to the lowest published long-term credit rating from a selection of external credit ratings. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.
3.6.2	**Banks Unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.
3.6.3	**Banks Secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.
3.6.4	**Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.
3.6.5	**Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment or to a maximum of £1M per company as part of a diversified pool in order to spread the risk widely.
3.6.6	**Registered Providers:** Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.
3.6.7	**Pooled Funds:** Shares or units in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

	Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.
3.6.8	**Real estate investment trusts:** Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.
3.6.9	**Operational bank accounts**: The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept to a minimum. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.
3.6.10	The Chief Financial Officer (CFO), under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. Decisions taken on the core investment portfolio will be reported quarterly to Cabinet.
3.7	**Risk Assessment and Credit Ratings**
3.7.1	Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then: • no new investments will be made, • any existing investments that can be recalled or sold at no cost will be, and • full consideration will be given to the recall or sale of all other existing investments with the affected counterparty. Where a credit rating agency announces that a rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.
3.8	**Other Information on the Security of Investments**
3.8.1	The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press and analysis and advice from the Authority's treasury management adviser. No investments will be made with an organisation if

	there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.
3.8.2	When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.
3.9	**<u>Investment Limits</u>**
3.9.1	The Council's revenue reserves and balances available to cover investment losses (excluding Schools, capital and HRA) are forecast to be £60M at 31st March 2020. In order that there is no immediate pressure on available reserves in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government and specified investments such as property funds) will be £20M. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors in Table 4 below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.
3.9.2	<u>Table 3 –Investment Limits</u>

	Cash limit
Any single organisation, except the UK Central Government & specified funds (subject to specific advice)	£20M each*
UK Central Government	unlimited
Any group of organisations under the same ownership	£20M per group*
Any group of pooled funds under the same management	25% per manager unless under specific advice
Negotiable instruments held in broker's nominee account	£50M per broker
Foreign countries	£10M per country
Registered Providers and registered social landlords	£10M in total
Unsecured investments with Building Societies	£5M in total
Loans to unrated corporates	£1M in total
Real estate investment trusts (REITS)	£20M each*
Money Market Funds**	£10M* per fund and no more than 0.50% of any investments fund in total for non-government funds

	**This is the absolute limit and the working limit will be monitored against actual cash flows and movement on reserves together with advice from our financial advisors and will be adjusted each quarter as necessary in agreement with the CFO.* ***We would not normally invest more than 50% of our overall investment portfolio in MMF on the advice of our advisors, however as part of our revised strategy to reduce short term investments and move into longer term investments, there will be occasions as bonds mature when this limit is exceeded. This advice is with regards to cash flow risk, however we feel this is mitigated by spreading over a number of funds and not just the highest yielding ones and having funds in other instant access accounts. In addition money can be borrowed short term from the market on the day.*
3.10	**Liquidity Management**
3.10.1	The Council undertakes high level cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium term financial plan and cash flow forecast.
	SECTION 4 - TREASURY MANAGEMENT INDICATORS
4.0	The Council measures and manages its exposure to treasury management risks using the following indicators.
4.1	**Background**
4.1.1	The Authority typically receives its income (e.g. from taxes and grants) before it pays for its expenditure (e.g. through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local authorities and central government. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy.
4.1.2	During the financial year the Council's investment balances have ranged between £45M and £152M and are currently £105M. Borrowing has ranged from £218M and £311M and is currently £293M
4.2	**Security**
4.2.1	The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk. The average rating of our current portfolio is AA- which is above the target.

	Target
Portfolio average credit rating	A

4.3	**Liquidity**
4.3.1	The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments and has set a £10M minimum threshold on cash available in instant access accounts, if balances were to fall below this limit we would consider taking short term loans which are available without given prior notice and at competitive rates.

4.4	**Interest Rate Exposure**
4.4.1	This indicator is set to control the Council's exposure to interest rate risk. The upper limits is based on the one-year revenue impact of a 1% rise or fall in interest rates for existing variable rates on long term loans and assumed short term borrowing, offset by variable investments. The limit are set at:

Interest rate risk indicator	£M
Upper limit on one-year revenue impact of a 1% **rise** in interest rates	1.5
Upper limit on one-year revenue impact of a 1% **fall** in interest rates	0.5

4.4.2	The main risk to the authority comes through the use of short term borrowing in place of fixed term long term debt which for 2020/21 is forecast at £26M. A 1% increase over the forecast rate would equate to £0.26M, plus a possible ongoing impact on an increase in the long term rate.
4.4.3	The Authority has more exposure to an increase in interest rates than a reduction as our debt portfolio is higher than our investments. A fall in interest rates of 1% would see investment income fall by about £0.5M but this would be offset by reduction in debt charges.
4.5	**Maturity Structure of Borrowing**
4.5.1	This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing as set below. There has been a small increase in the upper limit from 45 to 50% for the period under 12 months to allow for the potential increase in temporary borrowing during 2021.
4.5.2	

Refinancing rate risk indicator	Lower Limit %	Upper Limit %
Under 12 Months	0	50
12 months and within 24 months	0	50
24 months and within 5 years	0	50
5 years and within 10 years	0	55
10 years and within 20 years	0	60
20 years and within 30 years	0	65
30 years and above	0	75

4.5.3	Time periods start on the first day of each financial year and the maturity date of borrowing is the earliest date on which the lender can demand repayment. Although all LOBOs are now in their call options they are not expected to be called in the near future so are shown as uncertain, but as they only represent 3% of the total debt portfolio an early call would not pose a material risk in refinancing.
4.5.4	Details of our current level of debt and maturity is shown in Table 6 below. This shows that all debt is within existing levels.

4.5.5 Table 5 – Current Debt

Debt Maturity Profile	Lower Limit %	Upper Limit %	Actual Debt as at 31/12/2019 £M	Average Rate as at 31/12/2019 %	% of Debt	Compliance with set Limits?
Under 12 months	0	50	54.42	1.74%	19	Yes
12 months and within 24 months	0	50	9.94	2.86%	3	Yes
24 months and within 5 years	0	50	18.00	1.12%	6	Yes
5 years and within 10 years	0	55	30.00	1.12%	10	Yes
10 years and within 20 years	0	60	43.00	1.61%	15	Yes
20 years and within 30 years	0	65	5.00	4.60%	2	Yes
30 years and within 40 years	0	75	101.10	3.74%	34	Yes
40 years and within 50 years	0	75	22.75	3.60%	8	Yes
Uncertain*	0	5	9.00	4.86%	3	Yes
* Lobo's			**293.21**	**2.66%**	**100**	

4.6 **Principal Sums Invested for Periods Longer than a Year**

4.6.1 The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end are shown below. Limits have been increased for future years to allow for the alternative investment strategy referred to in the main report if it were to be adopted.

4.6.2

	Current £M	2020/21 £M	2020/21 £M	2021/22 £M	2022/23 £M
Limit on principal invested beyond year end	40	100	100	100	100

SECTION 5 - RELATED MATTERS

5.0 There are a number of related matters that the CIPFA Code requires the Council to include in its Treasury Management Strategy.

5.1 **MONITORING AND REPORTING**

5.1.1 The Chief Financial Officer will report to the Governance Committee on TM activity / performance as follows:

(a) A mid-year review against the strategy approved for the year.

(b) An outturn report on its treasury activity, no later than 30 September after the financial year end.

5.1.2 In addition, a quarterly update will be presented to Cabinet as part of Quarterly Revenue Financial Monitoring.

5.2 **Policy on Use of Financial Derivatives**

5.2.1 Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local

	authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).
5.2.2	The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.
5.2.3	Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.
5.2.4	In line with the CIPFA code, the Council would seek and consider external advice before entering into any agreement to ensure that it fully understands the implications.
5.3	**Markets in Financial Instruments Directive**
5.3.1	The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.
5.4	**Housing Revenue Account Self-Financing and Limit on Indebtedness**
5.4.1	On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/ credited to the respective revenue account.
5.4.2	Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance. This balance will be measured and interest transferred between the General Fund and HRA at an agreed rate. Housing Legislation does not allow impairment losses to be charged to the HRA and consequently any credit related losses on the Council's investments will be borne by the General Fund alone. It is therefore appropriate that the General Fund is compensated for bearing this risk, and all interest transferred to the HRA should be adjusted downwards. The rate will be based on investments with the Debt Management Office. The rate of return on comparable investments with the government is lower and often referred to as the risk-free rate.
5.4.3	Following the Chancellor's announcement in the 2018 Autumn Budget, restrictions relating to HRA borrowing have been lifted. This means that the previous HRA debt cap of £199.6m has been removed, and there is now the emphasis for councils to plan their new build strategy and financing at a local level. The process for identifying priorities and sites for new build developments is now taking place and is

	expected to form the basis of a new delivery strategy incorporating affordability and prudence. As part of the new build strategy relevant Prudential Indicators will be agreed.
5.4.4	The HRA Business Plan supports a number of council strategies, including the Medium Term Financial Strategy, to ensure plans are affordable and budgets are aligned to the assumptions detailed in those strategies. The specific HRA Business Plan can be seen in the report being submitted to Council on 26 February 2020.
5.4.5	The HRA by default will underwrite any programmes that are unable to self-fund
5.5	**OTHER OPTIONS CONSIDERED**
5.5.1	The CLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer, having consulted with relevant officers and members believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

5.5.2

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

EXISTING INVESTMENT & DEBT PORTFOLIO POSITION AND PROJECTIONS

	31-Mar-19 Actual £M	31-Mar-19 Average Rate %	31-Dec-19 Actual £M	31-Dec-19 Average Rate %	31-Mar-20 Forecast £M	31-Mar-20 Forecast Average %
Long Term Borrowing						
Public Works Loan	197.34	3.30	278.86	2.62	247.87	2.88
LOBO Loans from Banks	9.00	4.86	9.00	4.86	9.00	4.89
	206.34	**3.36**	**287.86**	**2.72**	**256.87**	**2.95**
Short Term Borrowing						
Other Local Authorities	40.00	0.75	5.00	0.87	57.45	0.88
Other			0.35	0.87	0.35	0.86
Total External Borrowing	**246.34**	**3.03**	**293.21**	**2.66**	**314.68**	**2.78**
Other Long Term Liabilities						
PFI Schemes	56.88	8.82	55.44	8.82	54.00	9.01
Deferred Debt Charges (HCC)	14.55	2.61	14.19	2.61	13.83	2.60
Total Gross External Debt	**317.77**	**4.08**	**362.84**	**4.08**	**382.51**	**3.78**
Investments:						
Managed In-House						
Government & Local Authority	(9.00)	0.79	(40.00)	0.77		
Cash (Instant access)	(26.06)	0.77	(29.60)	0.66	(10.00)	0.66
Cash (Notice Account)			(5.00)	0.95	(5.00)	0.95
Short Term Bonds	(1.60)	1.21	0.00	0.00		
Long Term Bonds	(6.03)	3.15	(3.01)	5.30	(3.00)	5.30
Managed Externally						
Pooled Funds (CCLA)	(27.00)	4.40	(27.00)	4.42	(27.00)	4.42
Total Investments	**(69.69)**	**4.03**	**(104.61)**	**4.00**	**(45.00)**	**3.26**
Net Debt	**248.08**		**258.23**		**337.51**	

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	TREASURY MANAGEMENT PRACTICES
1.	This organisation has adopted and has implemented the key principles of the CIPFA Treasury Management in the Public Services Code of Practice and Cross Sectoral Guidance Notes. This, together with the other arrangements detailed in the operational manual, are considered vital to the achievement of proper corporate governance in treasury management, and the responsible officer will monitor and, if and when necessary, report upon the effectiveness of these arrangements.
	TMP 1 - RISK MANAGEMENT GENERAL STATEMENT
2.	The Council regards a key objective of its treasury management activities to be the security of the principal sums it invests. Accordingly, it will ensure that robust due diligence procedures covering all external investment. The Section 151 Officer will design, implement and monitor all arrangements for the identification, management and control of treasury management risk, will report at least annually on the adequacy/suitability thereof, and will report, as a matter of urgency, the circumstances of any actual or likely difficulty in achieving the organisation’s objectives in this respect, all in accordance with the procedures set out in TMP 6 Reporting requirements and management information arrangements. In respect of each of the following risks, the arrangements which seek to ensure compliance with these objectives are set out in the operational manual.
	Credit and counterparty risk management
3.	The Council will ensure that its counterparty lists and limits reflect a prudent attitude towards organisations with whom funds may be deposited, and will limit its investment activities to the instruments, methods and techniques referred to in TMP4 Approved instruments, methods and techniques. It also recognises the need to have, and will therefore maintain, a formal counterparty policy in respect of those organisations from which it may borrow, or with whom it may enter into other financing arrangements.
	Liquidity risk management
4.	The Council will ensure it has adequate though not excessive cash resources, borrowing arrangements, overdraft or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives. The Council will only borrow in advance of need where there is a clear business case for doing so and will only do so for the current capital programme or to finance future debt maturities.
	Interest rate risk management
5.	The Council will manage its exposure to fluctuations in interest rates with a view to containing its interest costs, or securing its interest revenues, in accordance with the amounts provided in its budgetary arrangements as amended in accordance with TMP6 Reporting requirements and management information arrangements. It will achieve this by the prudent use of its approved instruments, methods and techniques, primarily to create stability and certainty of costs and revenues, but at the same time retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of interest rates. This should be the subject to the consideration and, if required, approval of any policy or budgetary implications.

	Exchange rate risk management
6.	The Council will manage its exposure to fluctuations in exchange rates so as to minimise any detrimental impact on its budgeted income/expenditure levels.
	Inflation risk management
7.	The Council will keep under review the sensitivity of its treasury management assets and liabilities to inflation, and will seek to manage the risk accordingly in the context of its wider exposure to inflation.
	Refinancing risk management
8.	The Council will ensure that its borrowing, private financing and partnership arrangements are negotiated, structured and documented, and the maturity profile of the monies so raised are managed, with a view to obtaining offer terms for renewal or refinancing, if required, which are competitive and as favourable to the organisation as can reasonably be achieved in the light of market conditions prevailing at the time. It will actively manage its relationships with its counterparties in these transactions in such a manner as to secure this objective, and will avoid overreliance on any one source of funding if this might jeopardise achievement of the above.
	Legal and regulatory risk management
9.	The Council will ensure that all of its treasury management activities comply with its statutory powers and regulatory requirements. It will demonstrate such compliance, if required to do so, to all parties with whom it deals in such activities. In framing its credit and counterparty policy under TMP1[1] credit and counterparty risk management, it will ensure that there is evidence of counterparties' powers, authority and compliance in respect of the transactions they may effect with the organisation, particularly with regard to duty of care and fees charged. The Council recognises that future legislative or regulatory changes may impact on its treasury management activities and, so far as it is reasonably able to do so, will seek to minimise the risk of these impacting adversely on the Council.
	Fraud, error and corruption and contingency management
10.	The Council will ensure that it has identified the circumstances which may expose it to the risk of loss through fraud, error, corruption or other eventualities in its treasury management dealings. Accordingly, it will employ suitable systems and procedures, and will maintain effective contingency management arrangements, to these ends.
	Market risk management
11.	The Council will seek to ensure that its stated treasury management policies and objectives will not be compromised by adverse market fluctuations in the value of the principal sum it invests, and will accordingly seek to protect itself from the effects of such fluctuations.
	TMP 2 - PERFORMANCE MEASUREMENT
12.	The Council is committed to the pursuit of value for money in its treasury management activities, and to the use of performance methodology in support of that aim, within the framework set out in its treasury management policy statement. Accordingly, the treasury management function will be the subject of ongoing

	analysis of the value it adds in support of the Council's business or service objectives and performance will be measured against relevant benchmarks.
	TMP 3 - DECISION-MAKING AND ANALYSIS
13.	The Council will maintain full records of its treasury management decisions, and of the processes and practices applied in reaching those decisions, both for the purposes of learning from the past, and for demonstrating that reasonable steps were taken to ensure that all issues relevant to those decisions were taken into account at the time.
	TMP 4 - APPROVED INSTRUMENTS, METHODS AND TECHNIQUES
14.	The Council will undertake its treasury management activities by employing only those instruments, methods and techniques detailed in its annual Investments Strategy, and within the limits and parameters defined in TMP1 Risk management. The Council has reviewed its classification with financial institutions under MIFID II and will set out in its annual Investment Strategy those organisations with which it is registered as a professional client.
	TMP 5 - ORGANISATION, CLARITY AND SEGREGATION OF RESPONSIBILITIES, AND DEALING ARRANGEMENTS
15.	The Council considers it essential, for the purposes of the effective control and monitoring of its treasury management activities, for the reduction of the risk of fraud or error, and for the pursuit of optimum performance, that these activities are structured and managed in a fully integrated manner, and that there is at all times a clarity of treasury management responsibilities. The principle on which this will be based is a clear distinction between those charged with setting treasury management policies and those charged with implementing and controlling these policies, particularly with regard to the execution and transmission of funds, the recording and administering of treasury management decisions, and the audit and review of the treasury management function. If and when it is intended, as a result of lack of resources or other circumstances, to depart from these principles, the Section 151 Officer will ensure that the reasons are properly reported in accordance with TMP6 Reporting requirements and management information arrangements, and the implications properly considered and evaluated. The Section 151 Officer will ensure that there are clear written statements of the responsibilities for each post engaged in treasury management, and the arrangements for absence cover. The Section 151 Officer will also ensure that at all times those engaged in treasury management will follow the policies and procedures set out. The Section 151 Officer will ensure there is proper documentation for all deals and transactions, and that procedures exist for the effective transmission of funds. The delegations to the Section 151 Officer in respect of treasury management are set out in the Council's Financial Regulations and Scheme of Delegation for Financial Management. The Section 151 Officer will fulfil all such responsibilities in accordance with the Council's policy statement and TMPs and the CIPFA Standard of Professional Practice on Treasury Management.
	TMP 6 - REPORTING REQUIREMENTS AND MANAGEMENT INFORMATION ARRANGEMENTS
16.	The Council will ensure that regular reports are prepared and considered on the implementation of its treasury management policies; on the effects of decisions taken and transactions executed in pursuit of those policies; on the implications of changes, particularly budgetary, resulting from regulatory, economic, market or

	other factors affecting its treasury management activities; and on the performance of the treasury management function. The Chief Financial Officer will report to the Governance Committee on TM activity / performance as follows: (a) A mid-year review against the strategy approved for the year. (b) An outturn report on its treasury activity, no later than 30 September after the financial year end. In addition, a quarterly update will be presented to Cabinet as part of Quarterly Revenue Financial Monitoring The Council's Governance Committee has responsibility for the scrutiny of treasury management policies and practices.
	TMP 7 - BUDGETING, ACCOUNTING AND AUDIT ARRANGEMENTS
17.	The Section 151 Officer will prepare, and full Council will approve and, if necessary, from time to time will amend, an annual budget for treasury management, which will bring together all of the costs involved in running the treasury management function, together with associated income. The matters to be included in the budget will at minimum be those required by statute or regulation, together with such information as will demonstrate compliance with TMP1 Risk management, TMP 2 Performance Measurement, and TMP 4 Approved instruments, methods and techniques. The Section 151 Officer will exercise effective controls over this budget, and will report upon and recommend any changes required in accordance with TMP 6 Reporting requirements and management information arrangements. The Council will account for its treasury management activities, for decisions made and transactions executed, in accordance with appropriate accounting practices and standards, and with statutory and regulatory requirements in force for the time being.
	TMP 8 - CASH AND CASH FLOW MANAGEMENT
18.	Unless statutory or regulatory requirements demand otherwise, all monies in the hands of the Council will be under the control of the Section 151 Officer, and will be aggregated for cash flow and investment management purposes. Cash flow projections will be prepared on a regular and timely basis, and the Section 151 Officer will ensure that these are adequate for the purposes of monitoring compliance with TMP1 Liquidity risk management.
	TMP 9 – MONEY LAUNDERING
19.	The Council is alert to the possibility that it may become the subject of an attempt to involve it in a transaction involving the laundering of money. Accordingly, it will maintain procedures for verifying and recording the identity of counterparties and reporting suspicions, and will ensure that staff involved in this are properly trained. The present arrangements, including the name of the officer to whom reports should be made, are detailed in the Council's Anti-Money Laundering Policy.
	TMP 10 - TRAINING AND QUALIFICATIONS
20.	The Council recognises the importance of ensuring that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them. It will therefore seek to appoint individuals who are both capable and experienced, and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills. The responsible officer will recommend and implement the necessary

	arrangements. The responsible officer will ensure that elected members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and those responsibilities. Those charged with governance recognise their individual responsibility to ensure that they have the necessary skills to complete their role effectively.
	TMP 11 - USE OF EXTERNAL SERVICE PROVIDERS
21.	The Council recognises that responsibility for treasury management decisions remains with the Council at all times. However, the Council recognises that there may be value in employing external providers of treasury management services, in order to acquire access to specialist skills and resources. When it employs such service providers, it will do so following a full evaluation of the costs and benefits, and will also ensure that the terms of their appointment are properly agreed and documented, and subjected to regular review. Where services are subject to formal tender or re-tender arrangements, legislative requirements will always be observed. The monitoring of such arrangements rests with the Section 151 Officer.
	TMP 12 - CORPORATE GOVERNANCE
22.	The Council is committed to the pursuit of proper corporate governance throughout its businesses and services, and to establishing the principles and practices by which this can be achieved. Accordingly, the treasury management function and its activities will be undertaken with openness and transparency, honesty, integrity and accountability.

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GLOSSARY OF TREASURY TERMS

Amortised Cost Accounting: Values the asset at its purchase price, and then subtracts the premium/adds back the discount linearly over the life of the asset. The asset will be valued at par at its maturity.
Asset Life Method - MRP: As detailed under MRP, this is a charge to revenue to repay capital expenditure financed by borrowing. There are a number of options for a prudent provision for new borrowing under the Prudential system (for which no Government support is being given and is therefore self-financed) including the option to make provision over the estimated life of the asset for which the borrowing is undertaken.
Authorised Limit (Also known as the Affordable Limit): A statutory limit that sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) for the Council. It is measured on a daily basis against all external borrowing items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities).
Balances and Reserves: Accumulated sums that are maintained either earmarked for specific future costs or commitments or generally held to meet unforeseen or emergency expenditure.
Bail - in Risk: Following the financial crisis of 2008 when governments in various jurisdictions injected billions of dollars into banks as part of bail-out packages, it was recognised that bondholders, who largely remained untouched through this period, should share the burden in future by making them forfeit part of their investment to "bail in" a bank before taxpayers are called upon. A bail-in takes place before a bankruptcy and under current proposals, regulators would have the power to impose losses on bondholders while leaving untouched other creditors of similar stature, such as derivatives counterparties. A corollary to this is that bondholders will require more interest if they are to risk losing money to a bail-in.
Bank Rate: The official interest rate set by the Bank of England’s Monetary Policy Committee and what is generally termed at the “base rate”. This rate is also referred to as the ‘repo rate’.
Basis Point: A unit of measure used in finance to describe the percentage change in the value or rate of a financial instrument. One basis point is equivalent to 0.01% (1/100th of a percent). In most cases, it refers to changes in **interest rates** and **bond yields**. For example, if interest rates rise by 25 basis points, it means that rates have risen by 0.25% percentage points. If rates were at 2.50%, and rose by 0.25%, or 25 basis points, the new interest rate would be 2.75%. In the bond market, a basis point is used to refer to the yield that a bond pays to the investor. For example, if a bond yield moves from 5.45% to 5.65%, it is said to have risen by 20 basis points. The usage of the basis point measure is primarily used in respect to yields and interest rates, but it may also be used to refer to the percentage change in the value of an asset such as a stock.
Bond:

A certificate of debt issued by a company, government, or other institution. The bond holder receives interest at a rate stated at the time of issue of the bond. The repayment date is also set at the onset but can be traded during its life, but this will affect the price of a bond which may vary during its life.

Capital Expenditure:

Expenditure on the acquisition, creation or enhancement of capital assets.

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 underlying borrowing need.

Certainty Rate:

The government has reduced by 20 basis points (0.20%) the interest rates on loans via the Public Works Loan Board (PWLB) to principal local authorities who provide information as specified on their plans for long-term borrowing and associated capital spending.

CD's:

Certificates of Deposits with banks and building societies

Capital Receipts:

Money obtained on the sale of a capital asset.

Comprehensive Spending Review (CSR):

Comprehensive Spending Review is a governmental process in the United Kingdom carried out by **HM Treasury** to set firm expenditure limits and, through public service agreements, define the key improvements that the public can expect from these resources. Spending Reviews typically focus upon one or several aspects of public spending while the CSR focuses upon each government department's spending requirements from a zero base (i.e. without reference to past plans or, initially, current expenditure).

Constant Net Asset Value (CNAV)

These are Money Market Funds which maintain a stable price of £1 per share when investors redeem or purchase shares which mean that that any investment will not fluctuate in value.

Corporate Bonds:

Corporate bonds are bonds issued by companies. The term is often used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies.

Cost of Carry:

The "cost of carry" is the difference between what is paid to borrow compared to the interest which could be earned. For example, if one takes out borrowing at 5% and invests the money at 1.5%, there is a cost of carry of 3.5%.

Counterparty List:

List of approved financial institutions with which the Council can place investments with.

Covered Bond:

Covered bonds are debt securities backed by cash flows from mortgages or public sector loans. They are similar in many ways to asset-backed securities created in securitisation, but covered bond assets remain on the issuer's consolidated balance sheet (usually with an appropriate capital charge). The covered bonds continue as obligations of the issuer (often a bank); in essence, the investor has recourse against the issuer and the collateral, sometimes known as "dual recourse."
CPI : Consumer Price Index – the UK's main measure of inflation.
CPIH: Additional measure of consumer price inflation including a measure of owner occupiers' housing costs
Credit Rating: Formal opinion by a registered rating agency of a counterparty's future ability to meet its financial liabilities; these are opinions only and not guarantees.
Department for Communities and Local Government (DCLG) : The DCLG is the UK Government department for Communities and Local Government in England. It was established in May 2006 and is the successor to the Office of the Deputy Prime Minister, established in 2001.
Debt Management Office (DMO): The DMO is an Executive Agency of Her Majesty's Treasury and provides direct access for local authorities into a government deposit facility known as the **DMADF**. All deposits are guaranteed by HM Government and therefore have the equivalent of a sovereign triple-A credit rating.
Diversification /diversified exposure: The spreading of investments among different types of assets or between markets in order to reduce risk.
European Investment Bank (EIB): The European Investment Bank is the European Union's non-profit long-term lending institution established in 1958 under the Treaty of Rome. It is a "policy driven bank" whose shareholders are the member states of the EU. The EIB uses its financing operations to support projects that bring about European integration and social cohesion.
Federal Reserve: The US central bank. (Often referred to as "the Fed").
Floating rate notes (FRNs) : Floating rate notes (FRNs) are debt securities with payments that are reset periodically against a benchmark rate, such as the three-month Treasury bill or the three-month London inter-bank offer rate (LIBOR). FRNs can be used to balance risks incurred through other interest rate instruments in an investment portfolio.
FTSE 100 Index: The FTSE 100 Index is a share index of the 100 companies listed on the London Stock Exchange with the highest market capitalisation. It is one of the most widely used stock

indices and is seen as a gauge of business prosperity for business regulated by UK company law. The index is maintained by the FTSE Group, a subsidiary of the London Stock Exchange Group.

General Fund:

This includes most of the day-to-day spending and income.

Gilts:

Gilts are bonds issued by the UK Government. They take their name from 'gilt-edged': being issued by the UK government, they are deemed to be very secure as the investor expects to receive the full face value of the bond to be repaid on maturity.

Gross Domestic Product (GDP):

Gross Domestic Product measures the value of goods and services produced with in a country. GDP is the most comprehensive overall measure of economic output and provides key insight as to the driving forces of the economy.

The G7:

The G7, is a group consisting of the finance ministers of seven industrialised nations: namely the US, UK, France, Germany, Italy, Canada and Japan. They are seven of the eight (China excluded) wealthiest nations on Earth, not by GDP but by global net wealth. The G7 represents more than the 66% of net global wealth ($223 trillion), according to Credit Suisse Global Wealth Report September 2012.

IFRS:

International Financial Reporting Standards.

International Labour Organisation (ILO):

The ILO Unemployment Rate refers to the percentage of economically active people who are unemployed by ILO standard and replaced the Claimant Unemployment Rate as the international standard for unemployment measurement in the UK.. Under the ILO approach, those who are considered as unemployed are either out of work but are actively looking for a job or out of work and are waiting to start a new job in the next two weeks. ILO Unemployment Rate is measured by a monthly survey, which is called the Labour Force Survey in United Kingdom. Approximately 40,000 individuals are interviewed each month, and the unemployment figure reported is the average data for the previous three months.

LIBID:

The London Interbank Bid Rate (LIBID) is the rate bid by banks on Eurocurrency deposits (i.e. the rate at which a bank is willing to borrow from other banks). It is "the opposite" of the LIBOR (an offered, hence "ask" rate, the rate at which a bank will lend). Whilst the British Bankers' Association set LIBOR rates, there is no correspondent official LIBID fixing.

LIBOR:

The London Interbank Offered Rate (LIBOR) is the rate of interest that banks charge to lend money to each other. The British Bankers' Association (BBA) work with a small group of large banks to set the LIBOR rate each day. The wholesale markets allow banks who need money to be more fluid in the marketplace to borrow from those with surplus amounts. The banks with surplus amounts of money are keen to lend so that they can generate interest which it would not otherwise receive.

LOBO:

Stands for Lender Option Borrower Option. The underlying loan facility is typically very long-term - for example 40 to 60 years - and the interest rate is fixed. However, in the LOBO facility the lender has the option to call on the facilities at pre-determined future dates. On these call dates, the lender can propose or impose a new fixed rate for the remaining term of the facility and the borrower has the 'option' to either accept the new imposed fixed rate or repay the loan facility. The upshot of this is that on the option exercise date, the lender could propose an extreme fixed rate, say 20 per cent, which would effectively force the repayment of the underlying facility. The borrower's so called 'option' is only the inalienable right to accept or refuse a new deal such as a fixed rate of 20 per cent.

Maturity:

The date when an investment or borrowing is repaid.

Maturity Structure / Profile:

A table or graph showing the amount (or percentage) of debt or investments maturing over a time period. The amount or percent maturing could be shown on a year-by-year or quarter-by quarter or month-by-month basis.

Minimum Revenue Provision (MRP):

An annual provision that the Council is statutorily required to set aside and charge to the Revenue Account for the repayment of debt associated with expenditure incurred on capital assets.

Money Market Funds (MMF):

An open-end mutual fund which invests only in money markets. These funds invest in short term debt obligations such as short-dated government debt, certificates of deposit and commercial paper. The main goal is the preservation of principal, accompanied by modest dividends. The fund's net asset value remains constant (eg £1 per unit) but the interest rate does fluctuate. These are liquid investments, and therefore, are often used by financial institutions to store money that is not currently invested. Risk is extremely low due to the high rating of the MMFs; many have achieved AAA credit status from the rating agencies:

- **Constant net asset value (CNAV)** refers to funds which use amortised cost accounting to value all of their assets. They aim to maintain a net asset value (NAV), or value of a share of the fund, at €1/£1/$1 and calculate their price to two decimal places known as "penny rounding". Most CNAV funds distribute income to investors on a regular basis (distributing share classes), though some may choose to accumulate the income, or add it on to the NAV (accumulating share classes). The NAV of accumulating CNAV funds will vary by the income received.
- **Variable net asset value (VNAV)** refers to funds which use mark-to-market accounting to value some of their assets. The NAV of these funds will vary by a slight amount, due to the changing value of the assets and, in the case of an accumulating fund, by the amount of income received.

This means that a fund with an unchanging NAV is, by definition, CNAV, but a fund with a NAV that varies may be accumulating CNAV or distributing or accumulating VNAV.

Multilateral Development Banks:

See Supranational Bonds below.

Municipal Bonds Agency
An independent body owned by the local government sector that seeks to raise money on the capital markets at regular intervals to on-lend to participating local authorities.

Non Specified Investment:

Investments which fall outside the CLG Guidance for **Specified investments** (below).

Operational Boundary:

This linked directly to the Council's estimates of the CFR and estimates of other day to day cash flow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

Premiums and Discounts:

In the context of local authority borrowing,

(a) the premium is the penalty arising when a loan is redeemed prior to its maturity date and
(b) the discount is the gain arising when a loan is redeemed prior to its maturity date.

If on a £1 million loan, it is calculated that a £150,000 premium is payable on premature redemption, then the amount paid by the borrower to redeem the loan is £1,150,000 plus accrued interest. If on a £1 million loan, it is calculated* that a £50,000 discount receivable on premature redemption, then the amount paid by the borrower to redeem the loan is £950,000 plus accrued interest. PWLB premium/discount rates are calculated according to the length of time to maturity, current market rates (plus a margin), and the existing loan rate which then produces a premium/discount dependent on whether the discount rate is lower/higher than the coupon rate.

******The calculation of the total amount payable to redeem a loan borrowed from the Public Works Loans Board (PWLB) is the present value of the remaining payments of principal and interest due in respect of the loan being repaid prematurely, calculated on normal actuarial principles. More details are contained in the PWLB's lending arrangements circular.*

Property:

Investment property is property (land or a building or part of a building or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both.

Prudential Code:

Developed by CIPFA and introduced on 01/4/2004 as a professional code of practice to support local authority capital investment planning within a clear, affordable, prudent and sustainable framework and in accordance with good professional practice.

Prudential Indicators:

Indicators determined by the local authority to define its capital expenditure and asset management framework. They are designed to support and record local decision making in a manner that is publicly accountable; they are not intended to be comparative performance indicators

Public Works Loans Board (PWLB):

This is a statutory body operating within the United Kingdom Debt Management Office, an Executive Agency of HM Treasury. The PWLB's function is to lend money from the

National Loans Fund to local authorities and other prescribed bodies, and to collect the repayments.
Quantitative Easing (QE): In relation to the UK, it is the process used by the Bank of England to directly increase the quantity of money in the economy. It *"does not involve printing more banknotes. Instead, the Bank buys assets from private sector institutions – that could be insurance companies, pension funds, banks or non-financial firms – and credits the seller's bank account. So the seller has more money in their bank account, while their bank holds a corresponding claim against the Bank of England (known as reserves). The end result is more money out in the wider economy"*. Source: Bank of England.
Regularity Method - MRP: As detailed under MRP, this is a charge to revenue to repay capital expenditure financed by borrowing. There are a number of options for a prudent provision and this is for debt prior to 2008 which is supported by the Government through the RSG system. Although regulation 28 is revoked by regulation 4(1) of the 2008 Regulations, authorities are able to calculate MRP as if it were still in force.
Repo Rate: The interest rate at which the central bank in a country repurchases government securities (such as Treasury securities) from commercial banks. The central bank raises the repo rate when it wishes to reduce the money supply in the short term, while it lowers the rate when it wishes to increase the money supply and stimulate growth.
Revenue Expenditure: Expenditure to meet the continuing cost of delivery of services including salaries and wages, the purchase of materials and capital financing charges.
RPI: Retail Prices Index is a monthly index demonstrating the movement in the cost of living as it tracks the prices of goods and services including mortgage interest and rent. Pensions and index-linked gilts are uprated using the RPI index.
(Short) Term Deposits: Deposits of cash with terms attached relating to maturity and rate of return (Interest).
Specified Investments: Term used in the CLG Guidance and Welsh Assembly Guidance for Local Authority Investments. Investments that offer high security and high liquidity, in sterling and for no more than one year. UK government, local authorities and bodies that have a high credit rating.
Supported Borrowing: Borrowing for which the costs are supported by the government or third party.
Supranational Bonds: Instruments issued by supranational organisations created by governments through international treaties (often called **multilateral development banks**). The bonds carry a AAA rating in their own right. Examples of supranational organisations are the European Investment Bank, the International Bank for Reconstruction and Development.

Treasury (T) -Bills: Treasury Bills are short term Government debt instruments and, just like temporary loans used by local authorities, are a means to manage cash flow. Treasury Bills (T-Bills) are issued by the Debt Management Office and are an eligible sovereign instrument, meaning that they have a AAA-rating.
Temporary Borrowing: Borrowing to cover peaks and troughs of cash flow, not to fund capital spending.
Treasury Management Code: CIPFA's Code of Practice for Treasury Management in the Public Services, initially brought in 2003, subsequently updated in 2009 and 2011.
Treasury Management Practices (TMP): Treasury Management Practices set out the manner in which the Council will seek to achieve its policies and objectives and prescribe how it will manage and control these activities.
Unsupported Borrowing: Borrowing which is self-financed by the local authority. This is also sometimes referred to as Prudential Borrowing.
Variable Net Asset Value (VNAV): Redemptions and investments in Money Market Funds (MMF's) are on the basis of the fund's Net Asset Value (NAV) per share. The NAV of any money market fund is the market value of the fund's assets minus its liabilities and is stated on a per share basis. The net value of the assets held by an MMF can fluctuate, and the market value of a share may not always be exactly the amount that has been invested.
Yield: The measure of the return on an investment instrument.

DECISION-MAKER:		Governance Committee		
SUBJECT:		Annual Governance Statement 2019-20		
DATE OF DECISION:		10th February 2020		
REPORT OF:		Executive Director Finance and Commercialism		
CONTACT DETAILS				
AUTHOR:	**Name:**	Peter Rogers	Tel:	023 8083 2835
	E-mail:	peter.rogers@southampton.gov.uk		
Director	**Name:**	John Harrison	Tel:	023 8083 4897
	E-mail:	john.harrison@southampton.gov.uk		

STATEMENT OF CONFIDENTIALITY
None
BRIEF SUMMARY
In accordance with the Accounts and Audit Regulations the Council is required to develop and publish an Annual Governance Statement ('AGS'). The AGS reports on the extent to which the Council has complied with its Code of Corporate Governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in the year, and on any planned changes in the coming period.

RECOMMENDATIONS:		
	(i)	To note and approve the assurance gathering process to support the development of the 2019-20 AGS (Appendix 1).

REASONS FOR REPORT RECOMMENDATIONS	
1.	The Governance Committee has responsibility to provide independent assurance on the adequacy of the risk management framework and the internal control and reporting environment, including (but not limited to) the reliability of the financial reporting process and the annual governance statement.
ALTERNATIVE OPTIONS CONSIDERED AND REJECTED	
2.	None - the development and publication of an AGS is a requirement under the Accounts and Audit Regulations.
DETAIL (Including consultation carried out)	
3.	Regulation 6 (1) of the Accounts and Audit (England) Regulations 2015 requires that the relevant body must conduct a review at least once a year of the effectiveness of its system of internal control and to prepare a statement on internal control in accordance with proper practices.
4.	The purpose of the AGS, which is published with the Statement of Accounts, is to provide an accurate representation of the corporate governance arrangements in place during the year and to identify or highlight those areas where there are significant gaps or where improvements are required.
5.	The AGS is produced following a review of the Council's governance arrangements. The review requires the systems and processes that comprise the Council's corporate governance arrangements to be brought together and reviewed.

6.	The 'assurance gathering process' to support development of a robust AGS remains unchanged from the previous year. This is on the basis that the process is considered to be aligned with good practice and that the council's external auditors, Ernst & Young, did not identify any areas of concern when considering the AGS. This is reflected in their 'Annual Audit Letter for the year ended 31 March 2019' presented to the Governance Committee at the November 2019 meeting. The external auditors, as part of their programme of work considered the AGS and concluded that the 2018-19 AGS "was consistent our understanding of the Council" and did not identify any areas of concern.
7.	The key elements of the assurance gathering process comprise completion of the updated 'Assurance Framework' document together with 'Annual Governance - Self Assessment Statements'. Both the documents cover the key processes and systems that comprise the Council's governance arrangements and are intended to identify any areas where improvement or further development is required. In respect of the latter, it is necessary for a slightly amended approach to be adopted for this year in recognition of the recent changes in senior management arising out of the 'resources review'. This transitional arrangement will require input and assurances be sought from a combination of Executive Directors and Heads of Service.
8.	The Council has in place a 'Controls Assurance Management Group' (comprising the Section 151 Officer, Chair of the Governance Committee, Monitoring Officer, Executive Director Business Services [Deputy Chief Executive] and the Chief Internal Auditor) which is responsible for evaluating the assurances and supporting evidence provided, and for drafting the AGS. This reflects CIPFA/Solace guidance which confirms that authorities should nominate an individual or group of individuals within the authority who have appropriate knowledge and expertise and levels of seniority to: • Consider the extent to which the authority complies with the principles of good governance; • Identify systems, processes and documentation that provide evidence of compliance; • Identify the individuals and committees responsible for monitoring and reviewing the systems, processes and documentation identified; • Identify issues that have not been addressed in the authority and consider how they should be addressed; and • Identify the individuals who would be responsible for undertaking the actions that are required.
9.	As per Appendix 1, the draft AGS will be presented to the Governance Committee on two occasions for review and approval prior to being forwarded to the Chief Executive and Leader of the Council for signing.
RESOURCE IMPLICATIONS	
Capital/Revenue	
10.	None
Property/Other	
11.	None
LEGAL IMPLICATIONS	

Statutory power to undertake proposals in the report:	
12.	The Accounts and Audit (England) Regulations 2015 require that the Council must each financial year conduct a review of the effectiveness of the system of internal control and prepare an AGS for approval by a committee or members of the authority. The AGS must be approved in advance of the relevant authority approving the statement of accounts.
Other Legal Implications:	
13.	None
RISK MANAGEMENT IMPLICATIONS	
14.	The assurance gathering process as detailed in the body of the report together with process and timelines document (Appendix 1) manage the risk in respect of the need to comply with the Accounts and Audit Regulations.
POLICY FRAMEWORK IMPLICATIONS	
15.	None

KEY DECISION?	**No**
WARDS/COMMUNITIES AFFECTED:	n/a

SUPPORTING DOCUMENTATION

Appendices	
1.	AGS 2019-20: Process and Timelines

Documents In Members' Rooms

1.	None

Equality Impact Assessment	
Do the implications/subject of the report require an Equality and Safety Impact Assessment (ESIA) to be carried out.	**No**
Data Protection Impact Assessment	
Do the implications/subject of the report require a Data Protection Impact Assessment (DPIA) to be carried out.	**No**

Other Background Documents
Other Background documents available for inspection at:

Title of Background Paper(s)		**Relevant Paragraph of the Access to Information Procedure Rules / Schedule 12A allowing document to be Exempt/Confidential (if applicable)**
1.	None	

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Agenda Item 7

APPENDIX 1

Appendix 1

Annual Governance Statement 2019/20 - Process and timelines

Action	Meeting / Target Date	Lead/Responsible body
Review of the Code of Corporate Governance against current CIPFA/SOLACE guidance.	27th Jan - 3rd Feb 2020	Risk & Insurance Manager
Review the type and scope of assurances sought via 'AGS - Self Assessment Statement' document to ensure that they remain fit for purpose.	27th Jan - 3rd Feb 2020	Risk & Insurance Manager
Report to Governance Committee to outline the assurance gathering process to support development of the 2019-20 AGS.	10th Feb 2020	Governance Committee
Issue 'AGS Self Assessment Statements' to Service Directors for completion via Heads of Service	14th Feb 2020	Executive Directors / Heads of Service
Return of completed 'AGS Self Assessment Statements' and completion of Assurance Framework document.	2nd March 2020	Risk & Insurance Manager
Review /validation of self assessments by Internal Audit.	3rd - 12th March 2020	Chief Internal Auditor
Draft AGS developed in consultation with Controls Assurance Management Group. NOTE: further ad hoc meetings may be required and will be arranged as necessary.	23rd March 2020	Controls Assurance Management Group
Executive Management Board review of the draft 2019-20 AGS.	2nd April 2020	Executive Management Board
Issue draft '2019-20 AGS' to Finance for inclusion in the draft Statement of Accounts	9th April 2020	Risk & Insurance Manager
Report to Governance Committee to review draft 2019-20 AGS.	15th June 2020	Governance Committee
Final draft Controls Assurance Management Group for noting.	June 2020 (date tbc)	Controls Assurance Management
Final draft AGS to Executive Management Board	July 2020 (date tbc)	Executive Management Board
Report to Governance Committee for final approval of AGS.	27th July 2020	Governance Committee
Signed by Chief Executive and Leader of the Council.	31st July 2020	Risk & Insurance Manager

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DECISION-MAKER:		**GOVERNANCE COMMITTEE**		
SUBJECT:		**INTERNAL AUDIT PROGRESS REPORT 2019-20**		
DATE OF DECISION:		**10th FEBRUARY 2020**		
REPORT OF:		**CHIEF INTERNAL AUDITOR**		

CONTACT DETAILS

AUTHOR:	**Name:**	**Elizabeth Goodwin**	**Tel:**	**023 8083 4616**
	E-mail:	**Elizabeth.Goodwin@southampton.gov.uk**		
Director	**Name:**	**John Harrison**	**Tel:**	**023 8083 4897**
	E-mail:	**John.Harrison@southampton.gov.uk**		

STATEMENT OF CONFIDENTIALITY

N/A

BRIEF SUMMARY

The Public Sector Internal Audit Standards 2017 (PSIAS), requires the Chief Internal Auditor (CIA) to provide periodical updates to the Governance Committee on:

- Progress made against the agreed annual audit plan.
- Results of audit activities and
- Management's response to risk that in the CIA's judgement maybe unacceptable to the Authority

All other PSIAS requirements are communicated in either the charter or annual audit opinion, which are reported separately to this committee at various times throughout the year.

There are a total of 75 audit reviews in the revised plan for 2019/20. To date 65 (87%) of the audits have been completed or an in progress as at 24th January 2020. This represents 32 (43%) audits where the report has been finalised, 7 (9%) where the report is in draft and 26 (35%) audits currently in progress.

Internal Audit Progress for the period 31st October 2019 to 24th January 2020 is covered in the attached Appendix 1.

RECOMMENDATIONS:

	(i)	That the Governance Committee notes the Internal Audit Progress report for the period 31st October 2019 to 24th January 2020.

REASONS FOR REPORT RECOMMENDATIONS

1.	In accordance with the Public Sector Internal Audit Standards the Chief Internal Auditor is required to provide an update on progress against the annual audit plan to the Governance Committee for information.

ALTERNATIVE OPTIONS CONSIDERED AND REJECTED

2.	None

DETAIL (Including consultation carried out)

3.	None

RESOURCE IMPLICATIONS		
<u>Capital/Revenue</u>		
4.	None	
<u>Property/Other</u>		
5.	None	
LEGAL IMPLICATIONS		
<u>Statutory power to undertake proposals in the report</u>:		
6.	The Accounts and Audit (England) Regulations 2015 state 'a relevant body must undertake an effective internal audit to evaluate the effectiveness of its risk management, control and governance processes, taking into account the Public Sector Internal Auditing Standards.	
<u>Other Legal Implications</u>:		
7.	None	
RISK MANAGEMENT IMPLICATIONS		
	The report is for note only, there is no decision to be made.	
POLICY FRAMEWORK IMPLICATIONS		
8.	None	
KEY DECISION?	**No**	
WARDS/COMMUNITIES AFFECTED:		None
<u>SUPPORTING DOCUMENTATION</u>		
Appendices		
1.	Internal Audit Progress Report for the period 31st October 2019 to 24th January 2020.	

Documents In Members' Rooms

1.	None
Equality Impact Assessment	
Do the implications/subject of the report require an Equality and Safety Impact Assessment (ESIA) to be carried out.	**No**
Data Protection Impact Assessment	
Do the implications/subject of the report require a Data Protection Impact Assessment (DPIA) to be carried out.	**No**
Other Background Documents **Other Background documents available for inspection at: Internal Audit, Civic Centre, Municipal, Lower Ground Floor, Previously Room 65.**	
Title of Background Paper(s): None	**Relevant Paragraph of the Access to Information Procedure Rules / Schedule 12A allowing document to be Exempt/Confidential (if applicable)**

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SOUTHAMPTON
CITY COUNCIL

Internal Audit Progress Report 10th February 2020

Elizabeth Goodwin, Chief Internal Auditor

1. Introduction

Internal Audit is a statutory function for all local authorities.
The requirement for an Internal Audit function in local government is detailed within the Accounts and Audit (England) Regulations 2015 as to:

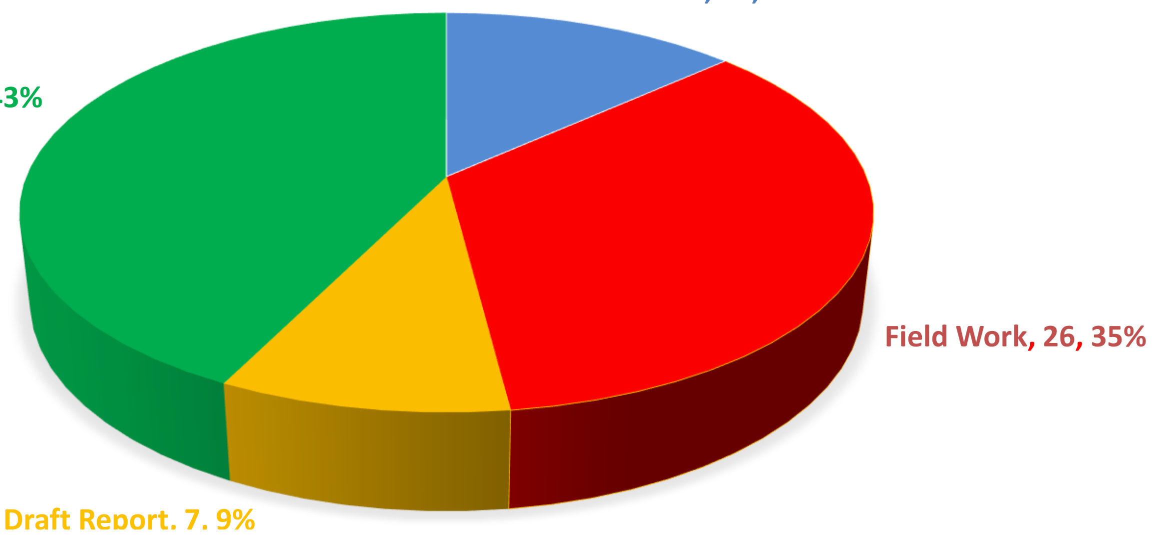
> *Undertake an effective internal audit to evaluate the effectiveness of its risk management, control and governance processes, taking into account public sector internal auditing standards or guidance*

The standards for 'proper practices' are laid down in the Public Sector Internal Audit Standards [the Standards – updated 2016].

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes

This report includes the status against the 2019/20 internal audit plan.

2. Audit Plan Progress as of 24th January 2020



There are a total of 75 reviews in the revised plan 2019/20.

To date, 65 (87%) have been completed or are in progress as at 24th January 2020. This represents 32 (43%) audits where the report has been finalised, 7 (9%) where the report is in draft and 26 (35%) audits currently in progress.

Status	Audits
Identified	**10**
Fieldwork	**26**
Draft Report	**7**
Final Report	**32**
Total	**75**

3. Ongoing Internal Audit Involvement

Internal Audit has undertaken work or provided advice in the following areas. (For reference, advice is only recorded when the time taken to provide the advice exceeds one hour):

- Anti-Money Laundering - This includes receipt of instances of large cash payments received and onward reporting if deemed appropriate.
- National Fraud Initiative (NFI) to facilitate national data matching carried out by the Cabinet Office
- Audit Planning and Consultation - This includes regular consultation with Directors and revision of the plan following subsequent research into individual assignments.
- Routine advice on controls and risk management.
    - PCI DSS – Advice provided to Finance regarding how payments are taken generally across the authority.
    - Write off – Advice provided on write off procedures and the current debt project being undertaken.
- Freedom of Information (FOI) Request
- 6 Investigations which are in various stages. A more detailed report of concluded investigations will form part of the annual fraud report which will be presented to the Governance Committee in due course.

4. Audit Plan Status/Changes

The following changes have been made to the plan since the September Governance Committee.

Audits removed from the Audit Plan:

- Mount Pleasant School – At the request of the school, it will be performed in quarter 1 of the 2020/21 financial year.
- Valuation Property, Plant & Equipment (Tech Forge) – Delayed until next financial year due to Business World implications.
- Public Health Outcomes – Delayed until next financial year due to additional work activities required to be carried out.
- ICU Quality Monitoring - Delayed until next financial year due to additional work activities required to be carried out.

5. Areas of Concern

There are no ‘no assurance’ opinion audits being reported on this period, all other findings are noted below.

6. Assurance Levels

Internal Audit reviews culminate in an opinion on the assurance that can be placed on the effectiveness of the framework of risk management, control and governance designed to support the achievement of management objectives for the area under review.

Assurance Level	Description / Examples
Assurance	*No issues or minor improvements noted within the audit but based on the testing conducted, assurance can be placed that the activity is of low risk to the Authority*
Reasonable Assurance	*Control weaknesses or risks were identified but overall the activities do not pose significant risks to the Authority*
Limited Assurance	*Control weaknesses or risks were identified which pose a more significant risk to the Authority*
No Assurance	*Major individual issues identified or collectively a number of issues raised which could significantly impact the overall objectives of the activity that was subject to the Audit*
NAT	*No areas tested*

Audits rated No Assurance are specifically highlighted to the Governance Committee along with any Director's comments. The Committee is able to request any director attends a meeting to discuss the issues.

7. Exception Risk Ranking

The following table outline the exceptions raised in audit reports, reported in priority order and are broadly equivalent to those previously used.

Priority Level	Description
Low Risk (Improvement)	*Very low risk exceptions or recommendations that are classed as improvements that are intended to help the service fine tune its control framework or improve service effectiveness and efficiency. An example of an improvement recommendation would be making changes to a filing system to improve the quality of the management trail.*
Medium Risk	*These are control weaknesses that may expose the system function or process to a key risk but the likelihood of the risk occurring is low.*
High Risk	*Action needs to be taken to address significant control weaknesses but over a reasonable timeframe rather than immediately. These issues are not 'show stopping' but are still important to ensure that controls can be relied upon for the effective performance of the service or function. If not addressed, they can, over time, become critical. An example of an important exception would be the introduction of controls to detect and prevent fraud.*
Critical Risk	*Control weakness that could have a significant impact upon not only the system function or process objectives but also the achievement of the Council's objectives in relation to: The efficient and effective use of resources, The safeguarding of assets, The preparation of reliable financial and operational information, Compliance with laws and regulations and corrective action needs to be taken immediately.*

Any critical exceptions found the will be reported in their entirety to the Governance Committee along with Director's comments

8. 2019/20 Audits completed to date (24th January 2020)

Better Care Fund

Exceptions Raised

Critical	High	Medium	Low
0	0	1	0

Overall Assurance Level

Reasonable

Assurance Level by Scope Area

Achievement of Strategic Objectives	NAT
Compliance with Policies, Laws & Regulations	Assurance
Safeguarding of Assets	Reasonable
Effectiveness and Efficiency of Operations	Assurance
Reliability and Integrity of Data	Assurance

The medium risk relates to the in-year figures received from the Clinical Commissioning Group being accepted on trust with limited evidence of any sample testing or checking undertaken to support the figures.

Petty Cash

Exceptions Raised

Critical	High	Medium	Low
0	0	1	0

Overall Assurance Level

Reasonable

Agreed actions were scheduled to be implemented by November 2019

Assurance Level by Scope Area

Achievement of Strategic Objectives	NAT
Compliance with Policies, Laws & Regulations	Reasonable
Safeguarding of Assets	Assurance
Effectiveness and Efficiency of Operations	Assurance
Reliability and Integrity of Data	NAT

The medium risk relates to a lack of valid receipts for 2/10 transactions sample tested Further analysis found a further 4/263 transactions had the description 'lost receipt'. Similarly for another petty cash account 2/10 transactions sampled did not include valid receipts. This monetary value for all transactions is low, the limit being £50.

National Non Domestic Rates (NNDR)

Exceptions Raised

Critical	High	Medium	Low
0	0	1	0

Overall Assurance Level

Reasonable Assurance

Agreed actions were scheduled to be implemented by December 2019

Assurance Level by Scope Area

Achievement of Strategic Objectives	NAT
Compliance with Policies, Laws & Regulations	Assurance
Safeguarding of Assets	Reasonable
Effectiveness and Efficiency of Operations	NAT
Reliability and Integrity of Data	NAT

The medium risk relates to testing identifying 1/10 payment plans tested had become voided in May 2019 and it had not been moved onto the next enforcement stage. The plan had been in place since October 2016 and 29 successful payments brought the arrears down to £743.62.

Council Tax

Exceptions Raised

Critical	High	Medium	Low
0	1	1	0

Overall Assurance Level

Reasonable Assurance

Agreed actions are scheduled to be implemented by March 2020

Assurance Level by Scope Area

Achievement of Strategic Objectives	NAT
Compliance with Policies, Laws & Regulations	NAT
Safeguarding of Assets	Reasonable
Effectiveness and Efficiency of Operations	Assurance
Reliability and Integrity of Data	NAT

The high risk exception raised relates to a lack of a corporate write off policy. The medium risk relates to sample testing only being undertaken on 1/4 National Fraud Initiative reports in relation to Single Payer Discount.

Edge of Care (Family Engagement)

Exceptions Raised

Critical	High	Medium	Low
0	0	2	0

Overall Assurance Level

Reasonable Assurance

Agreed actions are scheduled to be implemented by March 2020

Assurance Level by Scope Area

Achievement of Strategic Objectives	Assurance
Compliance with Policies, Laws & Regulations	Reasonable
Safeguarding of Assets	NAT
Effectiveness and Efficiency of Operations	Assurance
Reliability and Integrity of Data	NAT

The first medium risk relates to noted inconsistencies in relation to 15 closed cases. For example testing was unable to evidence 1/15 referral documents, 1/15 cases did not have intervention goals and scores recorded in Paris, 8/15 case files did not include care worker risk assessments and the average time taken from allocation to closure was 35.6 weeks which is higher than the 12 weeks specified in the service specification. The second medium risk relates to 10/15 cases where the social workers were not present at the joint visit alongside the Edge of Care worker and referred family. This is not a statutory requirement and the social worker was present from there on in.

Blue Badge

Exceptions Raised

Critical	High	Medium	Low
0	1	0	0

Overall Assurance Level

Reasonable Assurance

Agreed actions are scheduled to be implemented by February 2020

Assurance Level by Scope Area

Achievement of Strategic Objectives	Assurance
Compliance with Policies, Laws & Regulations	Assurance
Safeguarding of Assets	Limited
Effectiveness and Efficiency of Operations	NAT
Reliability and Integrity of Data	Assurance

The high risk relates to the 'eBadge' system, which contains personal data for blue badge holders, not having any automatic retention scheduling or data cleaning capabilities meaning the authority cannot currently comply with its privacy notice.

Short Breaks

Exceptions Raised

Critical	High	Medium	Low
0	2	1	0

Overall Assurance Level

Limited Assurance

Agreed actions are scheduled to be implemented by July 2020

Assurance Level by Scope Area

Achievement of Strategic Objectives	Assurance
Compliance with Policies, Laws & Regulations	Reasonable
Safeguarding of Assets	NAT
Effectiveness and Efficiency of Operations	Limited
Reliability and Integrity of Data	NAT

The first high risk relates to 2/10 short break annual review being overdue a review. The second high risk relates to 2/10 not having an up to date (up to a year) Education, Health and Care Plan and 5/8 did not record the short break provision in section H1 and/or H2 as per statutory requirements. The medium risk relates to the Local Offer Annual Report published to the intranet not having been reviewed or updated since 2016.

HMO Licensing

Exceptions Raised

Critical	High	Medium	Low
0	3	1	0

Overall Assurance Level

Limited Assurance

Agreed actions are scheduled to be implemented by July 2020

Assurance Level by Scope Area

Achievement of Strategic Objectives	NAT
Compliance with Policies, Laws & Regulations	Limited
Safeguarding of Assets	Limited
Effectiveness and Efficiency of Operations	Limited
Reliability and Integrity of Data	NAT

The first high risk relates to a backlog in licence condition monitoring although subsequent to the audit review a plan of action has been put in place. The second high risk relates to the discounted rate being applied over the grace period set out in the fees and charges policy resulting in a loss of income. The third high risk exception relates to a lack of monitoring of applications to highlight where insufficient action has been undertaken. The medium risk exception relates to the authority not promptly undertaking action where applications have been submitted with missing items.

Bassett Green Primary School

Exceptions Raised

Critical	High	Medium	Low
0	6	4	0

Overall Assurance Level

Limited Assurance

Agreed actions are scheduled to be implemented by July 2020

Assurance Level by Scope Area

Achievement of Strategic Objectives	Reasonable
Compliance with Policies, Laws & Regulations	Limited
Safeguarding of Assets	Limited
Effectiveness and Efficiency of Operations	Limited
Reliability and Integrity of Data	Assurance

The first high risk relates to the retention period for recruitment and vetting checks which were being held for longer than necessary. The second high risk relates to there being an unclear income management trail for uniform payments. The third high risk relates to there being no lettings charging policy which is required for approval by the full governing body. A martial arts group being setup without relevant checks being undertaken i.e. qualification, DBS check or obtaining signed acceptance of terms and conditions. The fourth high risk relates to insufficient record keeping for cash held. The fifth high risk relates to the lack of a CCTV Policy and the final high risk relates to the mini bus mileage not being recorded for journeys made by the primary school. The medium risks cover insufficient minutes and agenda for the Finance & Resources Committee, petty cash exceeding the cash limit, no written conditions for the use of the mini bus and there being no consistency in the recording of assets in inventory or evidence of physical checks being completed.

Disabled Facilities Grant – Additional Funding

Grant Verification – Based on testing completed there is sufficient evidence to support that the authority is adhering to the conditions of the grant. A statement to that effect has been provided as required by the grant determination.

Perinatal Mental Health Grant (Path 2)

Grant Verification – Based on testing completed there is sufficient evidence to support that the authority is adhering to the conditions of the grant. A statement to that effect has been provided as required by the grant determination.

9. Follow-up Action Categorisation

The following table outlines the follow up categories used to describe the outcome of follow up testing completed.

Follow Up Categories	Description
Open	*No action has been taken on agreed action.*
Pending	*Actions cannot be taken at the current time but steps have been taken to prepare.*
In Progress	*Progress has been made on the agreed action however they have not been completed.*
Implemented but not Effective	*Agreed action implemented but not effective in mitigating the risk.*
Closed: *Verified*	*Agreed action implemented and risk mitigated, verified by follow up testing.*
Closed: *Not Verified*	*Client has stated action has been completed but unable to verify via testing.*
Closed: *Management Accepts Risk*	*Management has accepted the risk highlighted from the exception.*
Closed: *No Longer Applicable*	*Risk exposure no longer applicable.*

10. Audits in Draft

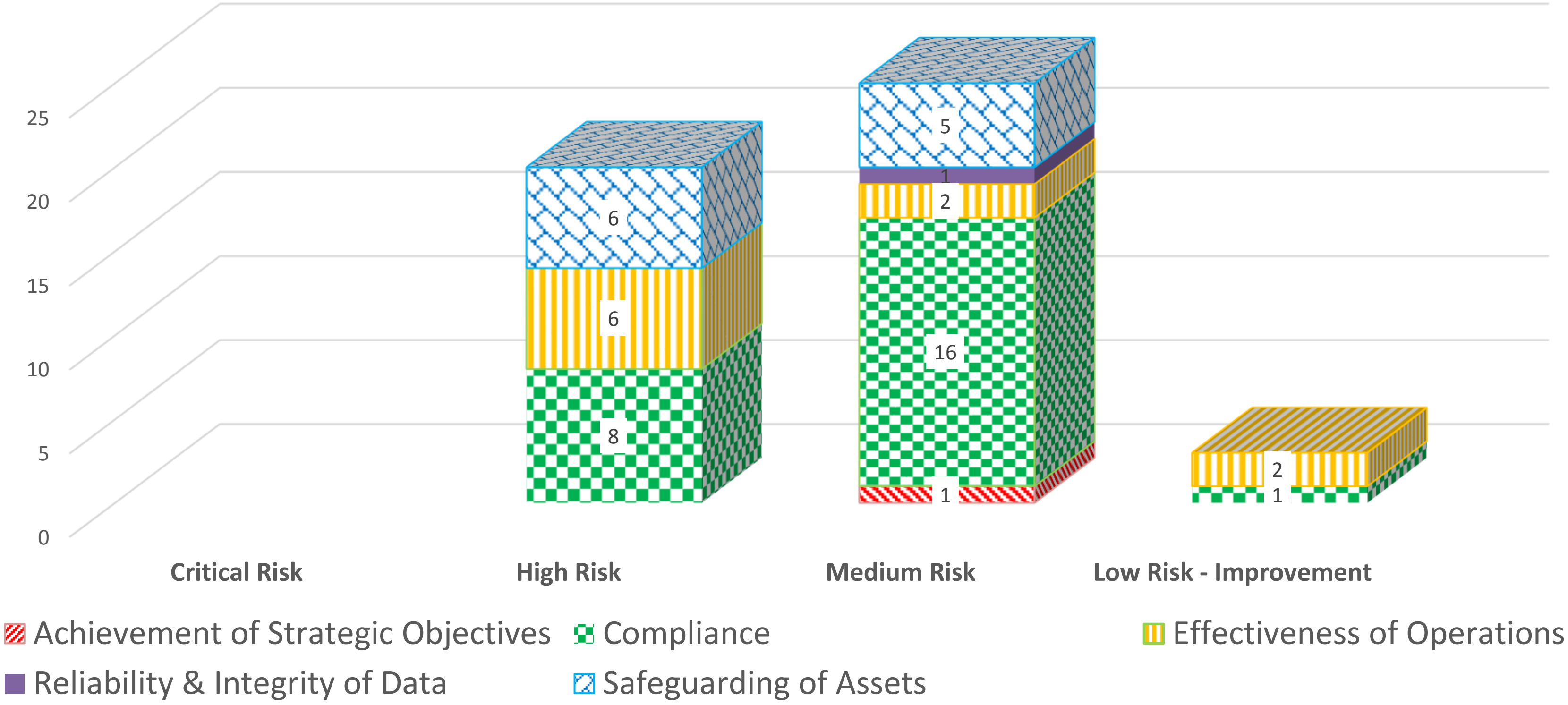
Audit	Directorate	Draft Since	Projected Issue	Revised	Comments
Insurance	Finance & Commercialisation	24/01/2020	February	April	At final review stage.
Museums	Growth	30/01/2020	February	April	Delayed due to limited availability of key contact.
Direct Payments	Adults, Housing & Communities	30/01/2020	November	April	Delayed due to additional testing and sickness absence.
Health and Safety	Human Resources & OD	24/01/2020	November	April	At final review stage.
IT Applications	Digital & Business Operations	24/01/2020	n/a	April	
Pest Control	Transactions & Universal Services	13/01/2020	n/a	April	
Treasury Management	Finance & Commercialisation	24/01/2020	n/a	April	

11. Audits in Progress

Audit	Directorate	Delayed	Projected Issued Date	Revised Issued Date	Comments
Asbestos Construction Design Management	Corporate	Yes	February	April	Delay in providing documentation for site visits.
Voids	Adults, Housing & Communities	Yes	February	April	Delayed due to work pressures in the audit team.
Business World	Finance & Commercialisation	n/a	March	April	Work will be ongoing throughout the year.
Family Matters Grant	Children & Families	n/a	March	April	Grant is verified on a quarterly basis.
Perinatal Mental Health	Growth	n/a	March	April	Grant is verified throughout the year.

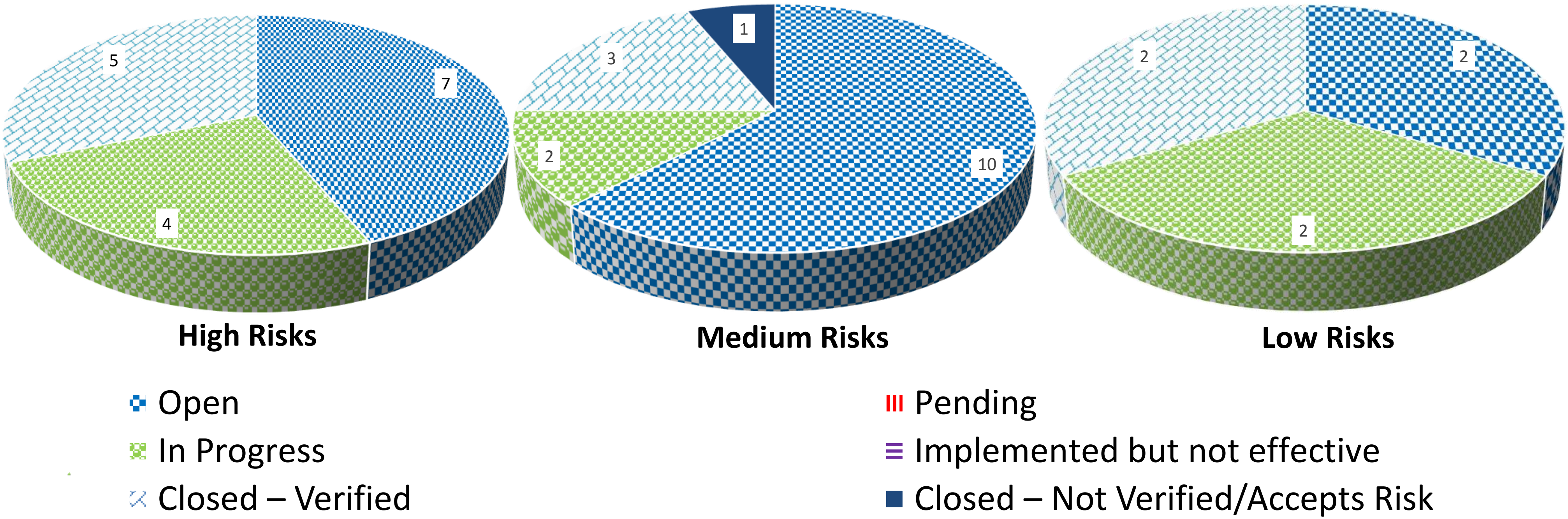
Asbestos (follow up)	Corporate	n/a	April		
Asset Management	Growth	n/a	April		
Bank Account	Finance & Commercialisation	n/a	April		
Contract (Electric Cars)	Growth	n/a	April		
Customer Services	Intelligence & Business Insight	n/a	April		
Data Management	Digital & Business Operations	n/a	April		
Events	Intelligence & Business Insight	n/a	April		
Flood Risk Management	Transactions & Universal Services	n/a	April		
Housing Benefit	Finance & Commercialisation	n/a	April		
Housing Depot	Adults, Housing & Communities	n/a	April		
Housing Rents & Debt	Finance & Commercialisation	n/a	April		
Independent Fostering	Children & Families	n/a	April		
IT Procurement & Disposal	Digital & Business Operations	n/a	April		
Learning & Development	Human Resources & OD	n/a	April		
Leaseholder Charges	Adults, Housing & Communities	n/a	April		
Mobile Devices	Digital & Business Operations	n/a	April		
Recruitment & Retention	Human Resources & OD	n/a	April		
St Monica School	Children & Families	n/a	April		
Trees Income Collection	Transactions & Universal Services	n/a	April		
Procurement	Digital & Business Operations	n/a	TBC		
Project (Governance)	Growth	n/a	TBC		

12. Exception Analysis to Date



	Achievement of Strategic Objectives	Compliance	Effectiveness of Operations	Reliability & Integrity	Safeguarding of Assets	Total
Critical Risk						0
High Risk		8	6		6	20
Medium Risk	1	16	2	1	5	25
Low Risk - Improvement		1	2			3
Grand Total	**1**	**25**	**10**	**1**	**10**	**48**

13. Follow Up Analysis



	Open	Pending	In Progress	Implemented but not effective	Closed – Verified	Closed – Not Verified	Closed – Management Accepts Risk	Closed – No Longer Applicable
High Risk	7		4		5			
Medium Risk	10		2		3	1		
Low Risk	2		2		2			
Grand Total	**19**		**8**		**10**	**1**		

The Internal Audit Service follows up all audits where at least 1 high risk exception has been raised. These audits are followed up in the next financial year to allow for agreed actions to be sufficiently implemented. Any critical risk exceptions are followed up within 3 months due to the potential severity of the risks identified. The overall position of the exceptions followed up currently through 2019/20 shows that **26%** have been closed by audit, however **74%** remain open and or are in progress.

DECISION-MAKER:		**GOVERNANCE COMMITTEE**		
SUBJECT:		**EXTERNAL AUDIT PLAN YEAR ENDING 31 MARCH 2020**		
DATE OF DECISION:		**10 FEBRUARY 2020**		
REPORT OF:		**EXTERNAL AUDITOR**		
CONTACT DETAILS				
AUTHOR:	**Name:**	**DAVID WHITE**	**Tel:**	**02380 382042**
	E-mail:	**dwhite@uk.ey.com**		
Director	**Name:**	**KEVIN SUTER**	**Tel:**	**02380 382159**
	E-mail:	**ksuter@uk.ey.com**		

STATEMENT OF CONFIDENTIALITY		
NONE		
BRIEF SUMMARY		
The audit plan sets out how we will carry out our responsibilities as external auditor. Its purpose is to provide the Governance Committee with a basis to review our proposed scope and audit approach for 2019/20. The 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.		
RECOMMENDATIONS:		
	(i)	The Governance Committee is invited to comment on and note External Audit Plan Year Ending 31 March 2020 as attached.
REASONS FOR REPORT RECOMMENDATIONS		
1.	Issued in accordance with the Local Audit and Accountability Act 2014, the National Audit Office's Code of Audit Practice, the Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA) Ltd, auditing standards and other professional requirements.	
ALTERNATIVE OPTIONS CONSIDERED AND REJECTED		
2.	None	
DETAIL (Including consultation carried out)		
3.	The External Audit Plan Year Ending 31 March 2020 has been provided to relevant senior managers for comment prior to being submitted into committee papers.	
RESOURCE IMPLICATIONS		
Capital/Revenue		
4.	N/A	
Property/Other		
5.	N/A	

LEGAL IMPLICATIONS	
<u>Statutory power to undertake proposals in the report</u>:	
6.	Local Audit and Accountability Act 2014, the National Audit Office's Code of Audit Practice, the Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA) Ltd, auditing standards and other professional requirements
<u>Other Legal Implications</u>:	
7.	N/A
RISK MANAGEMENT IMPLICATIONS	
8.	N/A
POLICY FRAMEWORK IMPLICATIONS	
9.	N/A

KEY DECISION?	No
WARDS/COMMUNITIES AFFECTED:	N/A

<u>SUPPORTING DOCUMENTATION</u>

Appendices	
1.	The External Audit Plan Year Ending 31 March 2020

Documents In Members' Rooms

1.	None
Equality Impact Assessment	
Do the implications/subject of the report require an Equality and Safety Impact Assessment (ESIA) to be carried out.	No
Data Protection Impact Assessment	
Do the implications/subject of the report require a Data Protection Impact Assessment (DPIA) to be carried out.	No

Other Background Documents
Other Background documents available for inspection at: N/A

Title of Background Paper(s)		**Relevant Paragraph of the Access to Information Procedure Rules / Schedule 12A allowing document to be Exempt/Confidential (if applicable)**
1.	**N/A**	

Southampton City Council

Audit planning report

Year ended 31 March 2020

January 2020

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Agenda Item 9

Appendix 1

EY

Building a better working world

23 January 2020

Governance Committee Members
Southampton City Council
Civic Centre
Southampton, Hampshire, SO14 7LY

Dear Governance 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 Governance 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. Our planning procedures remaining ongoing, and we will update the Governance Committee should any further matters come to our attention that impact the assessment of key issues or our audit scope.

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

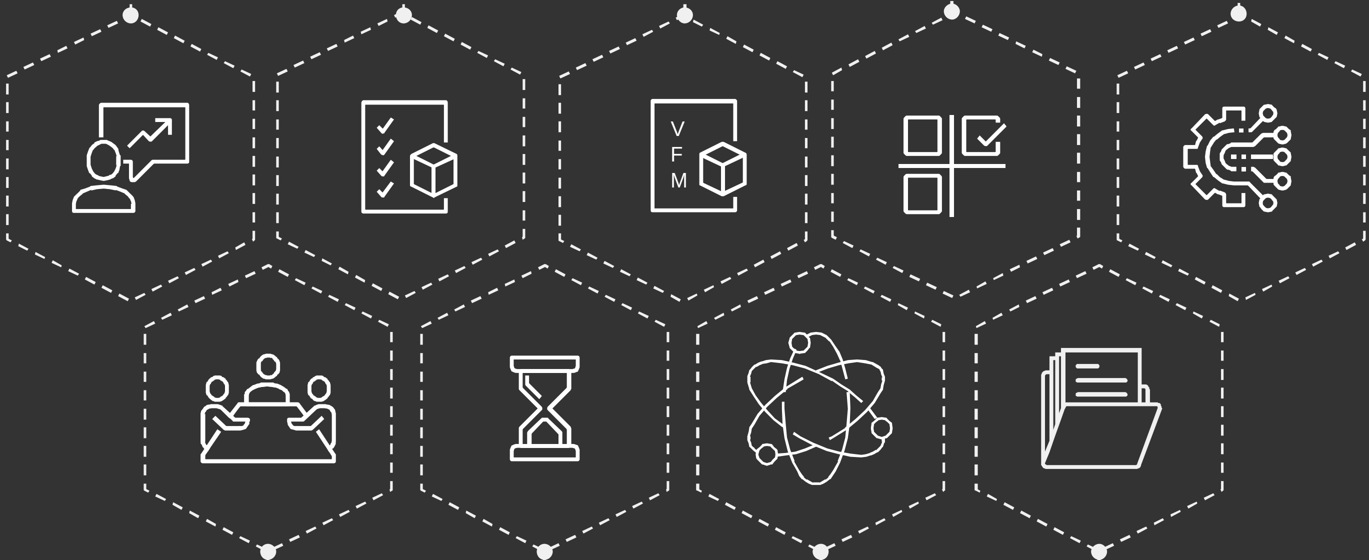
We welcome the opportunity to discuss this report with you on 10 February 2020 as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully

Kevin Suter.

Kevin Suter
For and on behalf of Ernst & Young LLP
Enc

Contents



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Public Sector Audit Appointments Ltd (PSAA) issued the “Statement of responsibilities of auditors and audited bodies”. It is available from the PSAA website (https://www.psaa.co.uk/audit-quality/statement-of-responsibilities/).The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The “Terms of Appointment and further guidance (updated April 2018)” issued by the PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and in legislation, and covers matters of practice and procedure which are of a recurring nature.

This report is made solely to the Governance Committee and management of Southampton City Council in accordance with the statement of responsibilities. Our work has been undertaken so that we might state to the Governance Committee, and management of Southampton City 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 Governance Committee, and management of Southampton City 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 Governance Committee with an overview of our initial risk identification for the upcoming audit and any changes in risks identified in the current year.

Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from PY	Details
Misstatements due to fraud or error	Fraud risk	No change in risk or focus	As identified in ISA 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that would otherwise appear to be operating effectively.
Risk of fraud in revenue and expenditure recognition, through inappropriate capitalisation of revenue expenditure	Fraud risk	No change in risk or focus	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. We have assessed the risk is most likely to occur through the inappropriate capitalisation of revenue expenditure.
New Ledger System	Significant risk	Increase in risk and focus	The Council introduced its new Business World financial management system with effect from 01 October 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. 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.
Valuation of Land and Buildings	Inherent risk	No change in risk or focus	The fair value of Property, Plant and Equipment (PPE) and Investment Properties (IP) represent significant balances in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet, covering both those assets that are revalued within the year and the continuing material accuracy of those valued in prior periods.

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 Governance 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	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 Hampshire County Council. Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates. In 2018/19, late changes were required to disclosures in the financial statements arising from the McCloud legal judgement. There could be further impact for 2019/20 should any further developments arise.
PFI Accounting	Inherent risk	No change in risk or focus	The Council has two PFI arrangements which are material to our audit. PFI accounting is a complex area, and a detailed review of these arrangements was undertaken by our internal specialist in 2017/18. We will review the accounting entries and disclosures in relation to PFI in 2019/20, with a focus on the correction of the non-material audit differences identified in 2017/18, and any significant changes since the specialist's review.
IFRS 16 Leases	Inherent risk	New accounting standard	It is currently proposed that IFRS 16 will be applicable for local authority accounts from 01 April 2020. There are transitional arrangements within the standard and although the 2020/21 Accounting Code of Practice for Local Authorities has yet to be issued, CIPFA have issued some limited provisional information which begins to clarify what the impact on local authority accounting will be. Whether any accounting statutory overrides will be introduced to mitigate any impact remains an outstanding issue. Within the 2019/20 financial statements ,the Council will need to make disclosures, required under IAS8, in relation to the expected impact of this new standard on the 2020/21 financial statements.

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Overview of our 2019/20 audit strategy

Materiality

Planning materiality
£12m

Materiality has been set at £11.985m, which represents 1.8% of the prior years gross expenditure on provision of services.

Performance materiality
£9m

Performance materiality has been set at £8.989m, which represents 75% of planning materiality.

Audit differences
£0.6m

We will report all uncorrected misstatements relating to the primary statements (comprehensive income and expenditure statement, balance sheet, housing revenue account and collection fund) greater than £0.599m. Other misstatements identified will be communicated to the extent that they merit the attention of the Governance Committee.

Audit team changes

Key changes to our team are set out below.

Kevin Suter, Partner in Charge

- Kevin takes over from Helen Thompson as the Engagement Lead.
- Kevin has significant public sector audit experience of over 20 years, with a portfolio of Local Authorities, Health Sector bodies, Local Government Pension Fund and National Park Authority audits.

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 Southampton City 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 assess independently the risks associated with providing an audit opinion, and to undertake appropriate procedures in response to that assessment. Our Terms of Appointment with PSAA allow them to vary the fee dependent on "the auditor's 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, 15 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 Southampton City Council's audit, we will discuss these with management as to the impact on the scale fee.

02 Audit risks

Our response to significant risks

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

Misstatements due to fraud or error*	What is the risk?	What will we do?
	The financial statements as a whole are not free of material misstatements whether caused by fraud or error. As identified in ISA (UK) 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. We identify and respond to this fraud risk on every audit engagement.	We will: • enquire of management about risks of fraud and the controls put in place to address those risks; • understand the oversight given by those charged with governance of management's processes over fraud; • consider the effectiveness of management's controls designed to address the risk of fraud; • perform mandatory procedures regardless of specifically identified fraud risks, including testing of journal entries and other adjustments in the preparation of the financial statements; • review accounting estimates for evidence of management bias; and • evaluate the business rationale for significant unusual transactions.

Our response to significant risks (continued)

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 fraud in revenue and expenditure recognition, through inappropriate capitalisation of revenue expenditure*

Financial statement impact

We have assessed that the risk of fraud in revenue and expenditure recognition is most likely to occur through the inappropriate capitalisation of revenue expenditure. This would have the impact of reducing revenue expenditure and increasing additions to Property, Plant and Equipment.

What is the risk?

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

We have assessed the risk is most likely to occur through the inappropriate capitalisation of revenue expenditure, as there is an incentive to reduce expenditure which is funded from Council Tax. 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.

What will we do?

We will:

- test PPE additions using lowered testing thresholds, to ensure they are appropriately supported by documentary evidence, and that the expenditure incurred and capitalised is clearly capital in nature; and
- seek to identify and understand the basis for any significant journals transferring expenditure from non-capital codes to PPE additions or from revenue to capital codes on the general ledger at the end of the year.

Our response to significant risks (continued)

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 Ledger System

Financial statement impact

The completeness and accuracy of data in the Council's financial management system, and specifically its general ledger, is crucial to the production of materially accurate financial statements, impacting all of the primary statements and many of the disclosure notes.

What is the risk?

The Council introduced its new Business World financial management system with effect from 01 October 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.

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 from the old system to its new general ledger. It is also key to ensure the correct implementation of processes and controls related to the new systems, such as timely control account reconciliations.

What will we do?

- We will meet with officers to discuss and understand the process for implementing the new financial management system.
- We will 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.
- We will have regard to the findings of any work by Internal Audit in 2019/20 in relation to the new ledger system.
- We will 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.

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?
Valuation of Land and Buildings The value of Property, Plant and Equipment (PPE) and Investment Properties (IP) represent significant balances in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet. The Council's balance sheet date is 31 March 2020, and it is required to demonstrate the material accuracy of all its assets and liabilities as at that date. This is irrespective of when the valuation assessment last occurred. For Southampton City Council the valuation process each year is undertaken as at 1 April, which is 12 months before the balance sheet date. Therefore, procedures will need to be undertaken by the Council to demonstrate that there are no material changes in the intervening period. Additionally, in the prior year a material adjustment was required to ensure that assets not subject to valuation during the year were still materially correct as at 31 March. Procedures to verify the material correctness as at 31 March 2020 will need to be undertaken by the Council to demonstrate that the remaining asset base is not materially misstated.	We will: • consider the work performed by the Council's valuer, including the adequacy of the scope of the work performed, their professional capabilities and the results of their work; • sample test key asset information used by the valuers in performing their valuation (e.g. floor plans to support valuations based on price per square metre) and challenge the key assumptions used by the valuer; • consider the annual cycle of valuations to ensure that assets have been valued within a 5 year rolling programme as required by the Code for PPE and annually for IP. We have also considered if there are any specific changes to assets that have occurred and that these have been communicated to the valuer; • consider changes to useful economic lives as a result of the most recent valuation; • consider the adequacy of processes management have implemented to ensure the material accuracy of the assets at 31 March since the valuation date; and • test accounting entries have been correctly processed in the financial statements.

Audit risks

Other areas of audit focus (continued)

What is the risk/area of focus?	What will we do?
Pension Liability Valuation The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by Hampshire County Council. 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. At 31 March 2019 this totalled £460 million. The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the County Council. Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates. In the prior year the 'McCloud' judgement impacted the estimate and resulted in an amendment of the net pension liability. We anticipate this will again be a key assumption in estimating the pension liability. We would expect the Authority's actuary to be basing their assumptions taking into account the Authority's specific membership profile and how it has been impacted by the judgement. We also note that there may be further developments in this area, potentially again coming after the balance sheet date.	We will: • liaise with the auditors of Hampshire Pension Fund, to obtain assurances over the information supplied to the actuary in relation to Southampton City Council; • assess the work of the Pension Fund actuary (Aon Hewitt) 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 • review and test the accounting entries and disclosures made within the Council's financial statements in relation to IAS19.

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Other areas of audit focus (continued)

What is the risk/area of focus?	What will we do?
PFI accounting The Council has two PFI arrangements which are material to our audit. PFI accounting is a complex area, and a detailed review of these arrangements was undertaken by our internal specialist in 2017/18. We will review the accounting entries and disclosures in relation to PFI in 2019/20, with a focus on any significant changes since the specialist's review.	We will: • review assurances brought forward from prior years regarding the appropriateness of the PFI financial models; • review the PFI financial models for any significant changes, and if identified consider engaging relevant experts to review the models to ensure they are still working as expected; • ensure the PFI accounting models have been updated for any service or other agreed variations and confirm consistency of current year models with prior year brought forward assurances; • agree outputs of the models to the accounts, and review the completeness and accuracy of disclosures.
IFRS 16 Leases It is currently proposed that IFRS 16 will be applicable for local authority accounts from 01 April 2020. Whilst the definition of a lease remains similar to the current leasing standard (IAS 17), for local authorities who lease a large number of assets the new standard will have a significant impact, with nearly all current leases being included on the balance sheet. There are transitional arrangements within the standard and although the 2020/21 Accounting Code of Practice for Local Authorities has yet to be issued, CIPFA have issued some limited provisional information which begins to clarify what the impact on local authority accounting will be. Whether any accounting statutory overrides will be introduced to mitigate any impact remains an outstanding issue. Within the 2019/20 financial statements ,the Council will need to make disclosures, required under IAS8, in relation to the expected impact of this new standard on the 2020/21 financial statements.	Until the 2020/21 Accounting Code is issued and any statutory overrides are confirmed there remains some uncertainty in this area. It is clear is that the Authority will need to undertake a detailed exercise to identify all leases and capture the relevant information for the production of financial statement information. The Authority must therefore ensure that all lease arrangements are fully documented and they have the relevant information to draft the required disclosures in the 2019/20 financial statements, and to support the full implementation of the standard in the 2020/21 year. We will: • review the Authority's process for detailed identification and review of the leases it holds; • Challenge the information recorded to ensure compliance with IFRS 16; and • Ensure appropriate disclosures are recorded in the 2019/20 financial statements.

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.

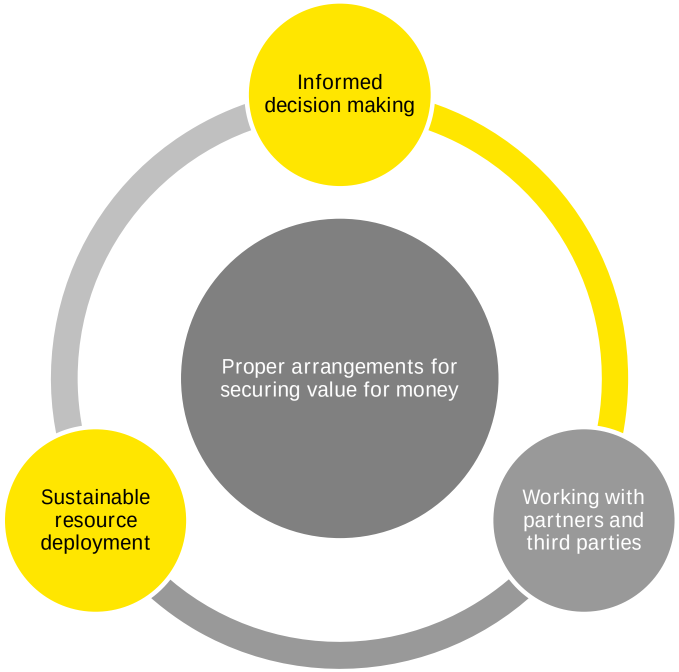
In considering your proper arrangements, we will draw on the requirements of the CIPFA/SOLACE framework for local government to ensure that our assessment is made against a framework that you are already required to have in place and to report on through documents such as your annual governance statement.

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 has therefore considered both the potential financial impact of the issues we have identified, and also the likelihood that the issue will be of interest to local taxpayers, the Government and other stakeholders. Work performed to date has resulted in the identification of one significant risk, noted on the following page, which we view as relevant to our value for money conclusion. Our planning procedures remaining ongoing, and we will update the Governance Committee should any further risks be identified.



Value for Money Risks

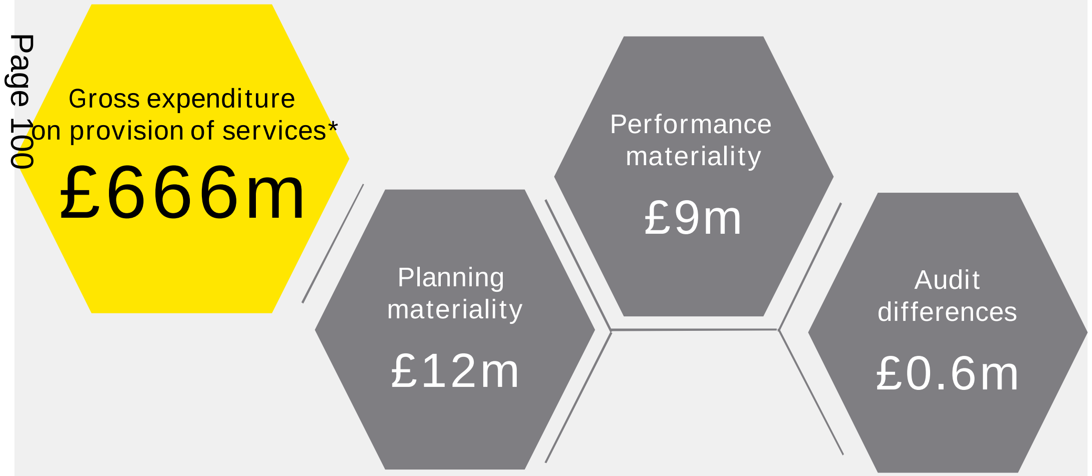
What is the significant value for money risk?	What arrangements does the risk affect?	What will we do?
The OFSTED inspection of children's social care services, undertaken in November 2019, graded the service "requires improvement to be good" across the 4 main areas covered by the report: • The impact of leaders on social work practice with children and families • The experiences and progress of children who need help and protection • The experiences and progress of children in care and care leavers • Overall effectiveness The report comments on a number of areas where improvements are required going forward, to bring the service up to the level needed to achieve a Good rating in a future inspection.	Informed decision making	We will: • Compare the detailed findings of the OFSTED report with the NAO's value for money criteria, to assess the significance of the individual findings to our responsibilities; • Compare the detailed findings with those reported when the previous OFSTED inspection was carried out in 2014 (when the overall outcome was also "requires improvement"), to assess the significance of any changes in reported judgments; and • Review the appropriateness of the arrangements put in place by the Council to address the findings of the OFSTED report and to monitor progress against agreed action plans.

04 Audit materiality

Materiality

Materiality

For planning purposes, materiality for 2019/20 has been set at £12m. This represents 1.8% of the Council's prior year gross expenditure on provision of services. It will be reassessed throughout the audit process. We have set materiality using gross revenue expenditure as our expectation is that users of the Council's accounts are focussed on how it uses its resources to provide services to local people. We have used 1.8% based on our assessment of the Council's financial position, levels of public interest, lack of planned reorganisations and sources of borrowing. We have provided supplemental information about audit materiality in Appendix C.



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

Key definitions

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

Performance materiality – the amount we use to determine the extent of our audit procedures. We have set performance materiality at £8.989m 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 prior years.

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, housing revenue account and collection fund. 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 Committee, or are important from a qualitative perspective.

Specific materiality – We have also set a materiality of £1k for remuneration disclosures, related party transactions, members' allowances and exit packages, which reflects our understanding that an amount less than our materiality would influence the economic decisions of users of the financial statements in relation to these areas.

05 Scope of our audit

Our Audit Process and Strategy

Objective and Scope of our Audit scoping

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

We issue an audit report that covers:

1. Financial statement audit

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

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

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

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

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

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

Our Audit Process and Strategy (continued)

Audit Process Overview

Our audit involves:

- identifying and understanding the key processes and internal controls; and
- substantive tests of detail of transactions and amounts.

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

Analytics

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

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

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

The successful use of analytics and a technologically enabled audit is an underpinning concept of our contract with PSAA. We expect the Council's new financial system should significantly improve our ability to capture and use the financial information compared to prior years. As we understand the new system and processes to produce your statement of accounts, we will consider the extent this assumption remains valid and the impact on the scale fee.

Internal audit

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

06 Audit team

Audit team

Audit team structure:

Kevin Suter
Associate Partner

David White
Manager

Adam Le-Huray Baker
Senior

Zolani Mzinani
Senior

Specialists (as required)

- EY Real Estates
- Actuaries

Audit team changes

Key changes to our team:

Kevin Suter, Associate Partner

- Kevin takes over from Helen Thompson as the Associate Partner (Engagement Lead) for the engagement.

Adam Le-Huray Baker and Zolani Mzinani, Audit Seniors

- Adam and Zolani take over from Shabbir Hussain to lead the team on site.

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	Southampton CC in house property valuers (management specialist)
Pensions disclosure	Aon Hewitt (management specialist) PwC (consulting actuary) and EY Actuaries (auditor specialists)

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In accordance with Auditing Standards, we will evaluate each specialist's professional competence and objectivity, consider 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 an indicative timetable showing the key stages of the audit and the deliverables we will 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 Governance Committee and we will discuss them with the Governance Committee Chair as appropriate. We will also provide updates on corporate governance and regulatory matters as necessary.

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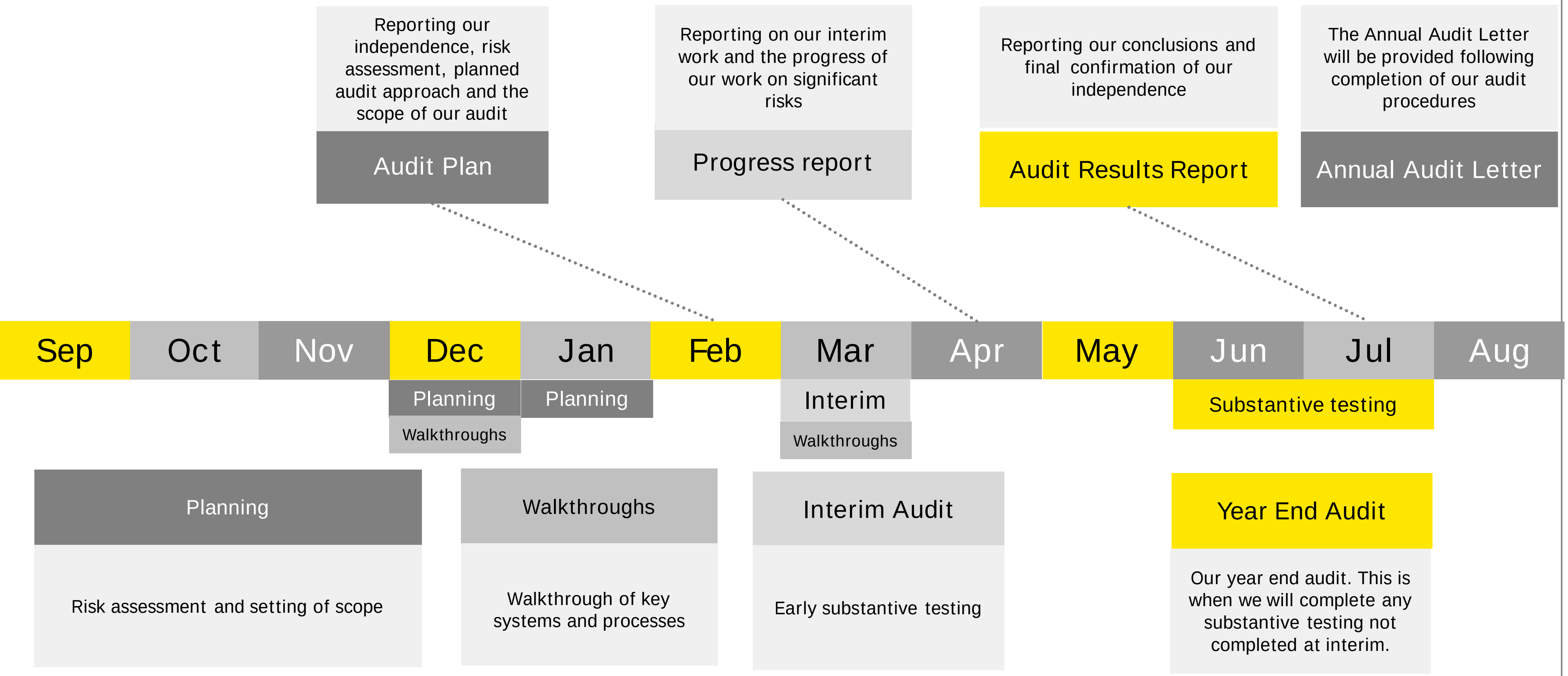

08 Independence

Introduction

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

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

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

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

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

Relationships, services and related threats and safeguards

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

Overall Assessment

Overall, we consider that the safeguards that have been adopted appropriately mitigate the principal threats identified and we therefore confirm that EY is independent and the objectivity and independence of 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, no non-audit services have been undertaken, therefore the current ratio of non-audit fees to audit fees is zero. No additional safeguards are required.

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

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

Self review threats

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

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

Management threats

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

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

Relationships, services and related threats and safeguards

Other threats

Other threats, such as advocacy, familiarity or intimidation, may arise.

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

Other communications

EY Transparency Report 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/en_uk/who-we-are/transparency-report-2019

09 Appendices

Fees

Public Sector Audit Appointments Ltd (PSAA) has published the fee scale for the audit of the 2019/20 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
	£	£	£
Audit Fee – Code work	109,891	109,891	110,271
Additional Fee: New ledger system significant risk	9,700	-	-
Additional Fee: Value for money significant risk	2,300		
Total fees	121,891	109,891	110,271

All fees exclude VAT

Overall assumptions

The agreed fee presented is based on the following general 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.

The outline timetable on page 28 is contingent on the above factors.

We also make reference on page 23 to the assumptions made regarding a technologically supported audit and the expected improvements from your new financial ledger enabling the use of our audit analytics tools.

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.

Fee variations

2019/20 fee includes an indicative additional fees of £12,000. We are required to carry out additional procedures in relation to the significant risk identified as a result of the migration to a new ledger system in 2019/20, and as a result of the identified value for money significant risk. The additional fee is our initial estimate of the required work to discharge our statutory duties, based on the PSAA's published rates. However, we will scope the additional work and fee in detail, and the final fee will be subject to agreement with the Section 151 Officer following completion of our work. The final additional fee may be higher or lower, depending on the 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.

2018/19 final fee includes an additional fee of £380 for work in relation to housing benefit income and expenditure, which was covered by the fee for certification of the housing benefit subsidy claim until 2017/18. This additional fee has been agreed with management, but remains subject to agreement with PSAA.

Required communications with the Governance Committee

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

		Our Reporting to you
Required communications	What is reported?	When and where
Terms of engagement	Confirmation by the Governance Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Our responsibilities	Reminder of our responsibilities as set out in the engagement letter	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Planning and audit approach	Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.	Audit planning report
Significant findings from the audit	• Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures • Significant difficulties, if any, encountered during the audit • Significant matters, if any, arising from the audit that were discussed with management • Written representations that we are seeking • Expected modifications to the audit report • Other matters if any, significant to the oversight of the financial reporting process	Audit results report

Appendix B

Required communications with the Governance Committee (continued)

		Our Reporting to you
Required communications	What is reported?	When and where
Going concern	Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including: • Whether the events or conditions constitute a material uncertainty • Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements • The adequacy of related disclosures in the financial statements	Audit results report
Misstatements	• Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation • The effect of uncorrected misstatements related to prior periods • A request that any uncorrected misstatement be corrected • Corrected misstatements that are significant • Material misstatements corrected by management	Audit results report
Fraud	• Enquiries of the Governance Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity • Any fraud that we have identified or information we have obtained that indicates that a fraud may exist • A discussion of any other matters related to fraud	Audit results report
Related parties	• Significant matters arising during the audit in connection with the entity's related parties including, when applicable: • Non-disclosure by management • Inappropriate authorisation and approval of transactions • Disagreement over disclosures • Non-compliance with laws and regulations • Difficulty in identifying the party that ultimately controls the entity	Audit results report

Appendix B

Required communications with the Governance Committee (continued)

Required communications	What is reported?	Our Reporting to you When and where
Independence	Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as: • The principal threats • Safeguards adopted and their effectiveness • An overall assessment of threats and safeguards • Information about the general policies and process within the firm to maintain objectivity and independence	Audit Planning Report Audit Results Report
External confirmations	• Management's refusal for us to request confirmations • Inability to obtain relevant and reliable audit evidence from other procedures	Audit results report
Consideration of laws and regulations	• Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off • Enquiry of the Governance Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Committee may be aware of	Audit results report
Internal controls	• Significant deficiencies in internal controls identified during the audit	Management letter / Audit results report
Representations	Written representations we are requesting from management and/or those charged with governance	Audit results report
Material inconsistencies and misstatements	Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	Audit results report

Appendix B

Required communications with the Governance Committee (continued)

		Our Reporting to you
Required communications	What is reported?	When and where
Auditors report	• Any circumstances identified that affect the form and content of our auditor's report	Audit results report
Fee Reporting	• Breakdown of fee information when the audit plan is agreed • Breakdown of fee information at the completion of the audit • Any non-audit work	Audit planning report Audit results report

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. • Reading other information published with the financial statements, and reporting whether it is materially inconsistent with our understanding and the financial statements; and • Maintaining auditor independence.

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 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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