South Somerset District Council

Public Document Pack

Informal Consultative Meeting of Audit Committee

Thursday 28th October 2021

10.30 am

A virtual meeting via Zoom Meeting Software

The following members are requested to attend this meeting:

Chairman: Martin Carnell
Vice-chairman: Mike Hewitson

Robin Bastable	Malcolm Cavill	Paul Maxwell
Mike Best	Brian Hamilton	Vacancy
Dave Bulmer	Tim Kerley	

Any members of the public wishing to address the meeting at Public Question Time need to email democracy@southsomerset.gov.uk by 9.00am Wednesday 27th October 2021.

The meeting will be viewable online by selecting the committee meeting at:
https://www.youtube.com/channel/UCSDst3IHGj9WoGnwJGF_soA

For further information on the items to be discussed, please contact
democracy@southsomerset.gov.uk

This Agenda was issued on Wednesday 20 October 2021.

Jane Portman, Chief Executive

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

Information for the Public

In light of the coronavirus pandemic (COVID-19), Audit Committee will meet virtually via video-conferencing to consider reports. As of 7 May 2021 some interim arrangements are in place for committee meetings.

At the meeting of Full Council on 15 April 2021 it was agreed to make the following changes to the Council's Constitution:

a) To continue to enable members to hold remote, virtual meetings using available technology;

b) To amend Part 3 (Responsibility for Functions) of the Council's Constitution to allow those remote meetings to function as consultative bodies and delegate decisions, including Executive and Quasi-Judicial decisions, that would have been taken by those meetings if the Local Authorities and Police and Crime Panels (Coronavirus) (Flexibility of Local Authority and Police and Crime Panel Meetings) (England and Wales) Regulations 2020 had continued in force to the Chief Executive (or the relevant Director in the Chief Executive's absence) in consultation with those meetings and those members to whom the decision would otherwise have been delegated under Part 3 of the Constitution;

c) The delegated authority given under (b) will expire on 31 July 2021 unless continued by a future decision of this Council;

For full details and to view the report please see -
https://modgov.southsomerset.gov.uk/ieListDocuments.aspx?CId=137&MId=2981&Ver=4

Further to the above, at the meeting of Full Council on 8 July 2021, it was agreed to extend the arrangements for a further 6 months to 8 January 2022.

For full details and to view the report please see -
https://modgov.southsomerset.gov.uk/ieListDocuments.aspx?CId=137&MId=3033&Ver=4

Information about Audit Committee

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

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

The terms of reference of the Audit Committee are:

Internal Audit Activity

1. To approve the Internal Audit Charter and annual Internal Audit Plan;
2. To receive quarterly summaries of Internal Audit reports and seek assurance from management that action has been taken;
3. To receive an annual summary report and opinion, and consider the level of assurance it provides on the council's governance arrangements;

4. To monitor the action plans for Internal Audit reports assessed as “partial” or “no assurance;”
5. To consider specific internal audit reports as requested by the Head of Internal Audit, and monitor the implementation of agreed management actions;
6. To receive an annual report to review the effectiveness of internal audit to ensure compliance with statutory requirements and the level of assurance it provides on the council’s governance arrangements;

External Audit Activity

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

Regulatory Framework

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

Financial Management and Accounts

13. To review and approve the annual Statement of Accounts, external auditor’s opinion and reports to members and monitor management action in response to issues raised;
14. To provide a scrutiny role in Treasury Management matters including regular monitoring of treasury activity and practices. The committee will also review and recommend the Annual Treasury Management Strategy Statement and Investment Strategy, MRP Strategy, and Prudential Indicators to Council;
15. To review and recommend to Council changes to Financial Procedure Rules and Procurement Procedure Rules;

Overall Governance

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

Members questions on reports prior to the Meeting

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

Audit Committee

Meetings of the Audit Committee are usually held bi-monthly including at least one meeting with the Council's external auditor, although in practice the external auditor attends more frequently. However during the coronavirus pandemic these meetings will be held remotely via Zoom video-conferencing and the starting time may vary.

Agendas and minutes of this committee are published on the Council's website at http://modgov.southsomerset.gov.uk/ieDocHome.aspx?bcr=1

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

Public participation at meetings (held via Zoom)

Public question time

We recognise that these are challenging times but we still value the public's contribution to our virtual meetings.

If you would like to address the virtual meeting during Public Question Time, please email democracy@southsomerset.gov.uk by 9.00am on Wednesday 27th October 2021. When you have registered, the Chairman will invite you to speak at the appropriate time during the virtual meeting.

The period allowed for participation in Public Question Time shall not exceed 15 minutes except with the consent of the Chairman and members of the Committee. Each individual speaker shall be restricted to a total of three minutes.

This meeting will be streamed online via YouTube at:
https://www.youtube.com/channel/UCSDst3IHGj9WoGnwJGF_soA

Virtual meeting etiquette:

- Consider joining the meeting early to ensure your technology is working correctly.
- Please note that we will mute all public attendees to minimise background noise. If you have registered to speak during the virtual meeting, the Chairman or Administrator will un-mute your microphone at the appropriate time. We also respectfully request that you turn off video cameras until asked to speak.
- Each individual speaker shall be restricted to a total of three minutes.
- When speaking, keep your points clear and concise.
- Please speak clearly – the Councillors are interested in your comments.

Recording and photography at council meetings

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

The full 'Policy on Audio/Visual Recording and Photography at Council Meetings' can be viewed online at:
http://modgov.southsomerset.gov.uk/documents/s3327/Policy%20on%20the%20recording%20of%20council%20meetings.pdf

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Informal Consultative Meeting of Audit Committee

Thursday 28 October 2021

Agenda

Preliminary Items

1. Minutes

To approve as a correct record the minutes of the previous meeting held on 30th September 2021.

2. Apologies for absence

3. Declarations of Interest

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

4. Public question time

5. Date of next meeting

Councillors are requested to note that the next Audit Committee meeting is scheduled to be held at 10.00am on 25th November 2021 (venue to be confirmed).

Items for Discussion

South Somerset District Council

Redmond Review into the effectiveness of local audit and the transparency of local authority financial reporting

SLT Lead	Karen Watling, Chief Finance Officer
Lead Officer:	Karen Watling, Chief Finance Officer
Contact Details:	Karen.Watling@southsomerset.gov.uk

Purpose of the Report

1. To provide the Audit Committee with a summary of the current audit framework applicable to local government and the issues existing within this framework.

2. To brief the Committee on the outcomes arising from the Redmond Review into the effectiveness of local audit and the transparency of local authority financial reporting, and the potential implications for local government.

Public Interest

3. Local public services account for a significant amount of public spending. In 2019-20, local authorities, local police and local fire bodies spent nearly £100 billion delivering their services, which many local taxpayers rely on every day. South Somerset District Council (SSDC) alone spent £142 million in 2020/21 (£100,128,500 revenue expenditure and £42,177,000 on capital expenditure).

4. Financial statements are the main way in which local public bodies account for how they use their resources. Local public bodies must prepare and publish financial statements setting out their financial performance for the year. To do this, bodies need to maintain proper accounting records and ensure they have effective systems of internal control.

5. Taxpayers, national bodies and other stakeholders reasonably expect that the auditor will normally be able to assure that the financial statements have been properly prepared, are free from material error, and that the body has proper arrangements in place to secure value for money.

6. Where the auditor is satisfied that the financial statements present a true and fair view, they issue an unqualified opinion. Where they are not satisfied, or where they have other matters to which they wish to draw attention, they give a qualified or ‘non-standard’ report. Where the auditor considers that a particular matter is sufficiently serious to draw to public attention more widely, including informing the relevant Secretary of State, they may choose to make a statutory recommendation requiring a public response or issue a Public Interest Report (PIR).

7. Local authorities have faced significant challenges since 2010-11 as funding has reduced and demand for key services has grown. Not only are the risks from poor governance greater in the current context as the stakes are higher,

but the process of governance itself is more challenging and complex as activities become more varied, complicated and commercial in many councils, including SSDC. External audit is one of the checks and balances in the system and plays a key role. Any proposed changes to the existing arrangements for preparing financial statements and their audit are therefore important to understand in terms of governance and the stewardship of public funds.

Recommendations

8. That the Audit Committee notes this briefing on the local audit framework, the changes proposed to it arising from the Redmond Review, and the implications for local government.

The current local audit framework

Figure 1: Roles and responsibilities for the audit of local bodies

System oversight

Ministry of Housing, Communities & Local Government: has oversight of local authorities and holds responsibility to maintain a set of statutory codes and rules which require councils to act prudently in their spending.

Standards and guidance

Chartered Institute of Public Finance Accountancy: issues guidance on the required content of local public bodies' financial statements.

Comptroller and Auditor General, National Audit Office: sets the standards for local public audit, through maintaining a Code of Audit Practice for audits of local public bodies and issuing guidance to auditors.

Preparing and auditing financial statements

Local bodies: local authorities and other public bodies are required to prepare and publish financial statements setting out their financial performance for the year.

Public Sector Audit Appointments Ltd: responsible for securing efficient and effective arrangements for the independent appointment of auditors on behalf of local bodies and setting fees.

External audit firms: responsible for reporting their opinion on whether local public bodies' financial statements give a true and fair view, and for concluding on whether the body has made proper arrangements for securing value for money.

Quality review

Financial Reporting Council: monitors the quality of major local audits in England, and recognises accountancy institutes as Recognised Supervisory Bodies with which audit firms must register before being appointed by local bodies.

Institute of Chartered Accountants in England & Wales: monitors the quality of other local audits in England.

Source National Audit Office: https://www.nao.org.uk/report/timeliness-of-local-auditor-reporting-on-local-government-in-england-2020/

9. Local audit has changed significantly since the abolition of the Audit Commission in 2015. The Local Audit and Accountability Act (2014) sets out the local audit arrangements from 1 April 2015 that currently apply to local government, local police and local fire bodies.

10. The introduction of the local audit framework under the 2014 Act spread roles and responsibilities for local audit across multiple organisations. Figure 1 sets out briefly the roles and responsibilities of the Comptroller and Auditor General (the head of the National Audit Office (NAO)), external audit firms, Public Sector Audit Appointments (PSAA), local public bodies and professional accounting institutions.

11. The Act also resulted in the establishment of Public Sector Audit Appointments Ltd (PSAA) a subsidiary company of the Local Government Association (LGA) to procure audits for councils across the country. Relevant local bodies have the choice on whether to opt into these arrangements and some 98% (all but 10) have done so for the period from 2018 to 2023. A proposal to opt in from 2023 onwards will be considered by the Audit Committee at its November meeting before going to full Council for decision.

12. In addition, the Accounts and Audit Regulations (2015) set out the publication requirements for local authority financial statements by specifying a date by which a local authority should publish its accounts. Where an authority is unable to publish its accounts including the auditor's opinion, it must also publish a notice to that effect including reasons for the delay. The publication deadline for the 2019/20 audited statement of accounts was moved from 31st July to 30th November, due to the effect of the COVID-19 pandemic and to reduce the burden on councils and audit firms, and an extended deadline (to the 30th September) will remain the case for the next two financial years.

Problems with the current local audit framework

13. A report from the House of Commons public accounts committee (PAC) published on the 14th July 2021 says "*if local authorities are to effectively recover from the pandemic, it is critical that citizens have the necessary assurances that their finances are in order and being managed in the correct manner. Delays and quality issues undermine the value and purpose of audit, reducing the assurance to taxpayers and elected representatives".* The report concludes that "…*without urgent action from government, the audit system for local authorities in England and Wales may soon reach breaking point."* (Source: **"***Local auditor reporting on local government* ")

https://publications.parliament.uk/pa/cm5802/cmselect/cmpubacc/171/17104.htm

14. The problems with the current local audit framework include:
- Late delivery of audit opinions
- The quality of audits undertaken
- The focus on issues that are not priorities for the public sector

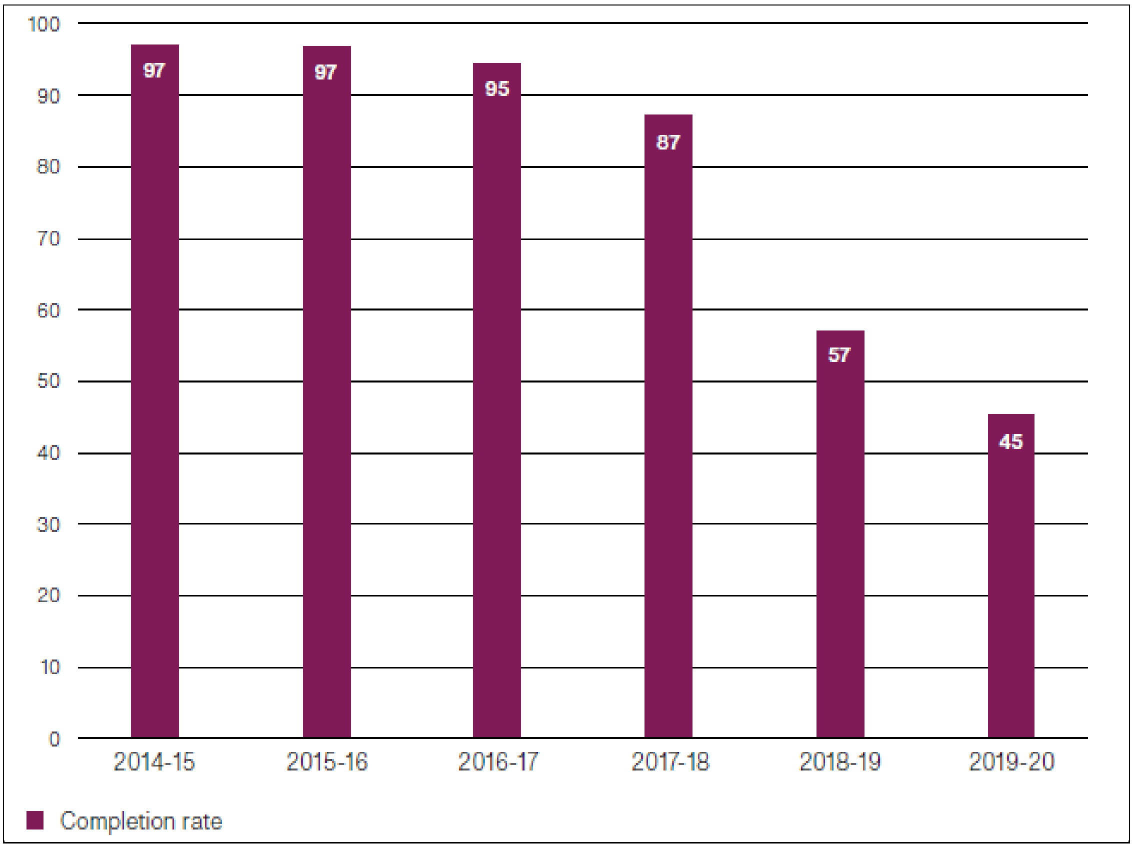
- The complexity of the Statement of Accounts
- The small number of firms able to service the needs of local public sector audits

Late delivery of audit opinions

15. Less than half of local bodies' 2019-20 audits were completed by the extended deadline of 30 November 2020. Figures compiled by Public Sector Audit Appointments Ltd (PSAA) show that 267 audit opinions (55%) were not issued by 30 November 2020. This was despite the then Ministry of Housing, Communities & Local Government (the Department) easing the deadline for the completion of the 2019-20 audits It continued a downward trend (Figure 2) which has accelerated since 2017-18.

16. SSDC did not publish the 2019/20 audited Statements on time (it was delayed by one month) and it will not be able to do so for 2020/21.

Figure 2: Proportion of opinions issued by the accounts publication deadline



Source: National Audit Office analysis of Public Sector Audit Appointments Ltd published data

17. The impact of late delivery of audit opinions include the following:

- This can delay timely management action to address any financial or performance issues identified by the auditors.

- Audited accounts provide confidence, assurance and transparency for the budget setting process. There have been recent cases where an audit had revealed information that affected the value of a local authority's reserves and which had knock-on effects on future budget.

- As local authorities commence their annual budget planning during the autumn of the preceding year, the late delivery can, particularly in a small finance team, take time away from medium term financial planning in order to respond promptly and efficiently to queries raised during the audit process.

- The late delivery of local audit opinions delay the audits for some government departments, impacting on the assurance Parliament receives over how taxpayers' money is used. For example, the 2019–20 audits of the Care Quality Commission and of the Department for Environment, Food & Rural Affairs, were delayed due to issues with the audit of the Local Government Pension Scheme. In addition, the 2019-2020 Whole of Government Accounts (WGA) was delayed by more than 15 months.

- Many of the audit firms employed on local audit work have several clients, with varying reporting deadlines. Audits of local NHS bodies usually happen before audits of local authorities, which happen before audits of the higher education sector. Delays in the audits of local authorities therefore affect the delivery of other audits and disrupt the audit firms' usual cycle of audit planning and delivery.

18. The National Audit Office in its publication "*Timeliness of Local Auditor Reporting on Local Government*" (2020), and after seeking the views of audit firms and stakeholder bodies, give the following underlying reasons for late delivery of audit opinions:

- Insufficient staff with the right qualifications, skills and experience in both local finance teams and firms serving the public audit sector and a net loss of staff from both.

- Serious shortfalls in the number of specialists which audit firms rely on to carry out audits of local authorities. To maintain accreditation, audit firms' key audit partners must have at least three years' oversight experience of auditing local authorities. Most key audit partners are over 50 years old and audit firms are likely to find it difficult to replace experienced staff when they retire. (Source: PAC **"***Local auditor reporting on local government* "(2021)).

- The requirements of International Financial Reporting Standards (IFRS), along with the increased expectations from the Financial Reporting Council (FRC) following the high-profile corporate failures such as Carillion, have combined to produce a significant increase in audit work, such as on asset and pensions valuations.

- Competing workload pressures, both within the finance function and elsewhere in local authorities, diverts staff resources from completing working papers and preparing accounts within the time available for submission to the external auditor.

- Complex technical issues have been a significant factor in delaying sign-off. This includes auditing local bodies' investments in commercial property and in 3rd party enterprises and subsidiaries requiring group accounts.

- Audit firms have told the Public Accounts Committee that they safeguard quality before deadlines and that they would not provide an opinion on an audit of a local authority to an "arbitrary deadline" or without sufficient evidence, at the appropriate quality, to support it.

- The COVID-19 pandemic has exacerbated problems which already existed within the local audit landscape. Staff sickness and staff isolating have reduced staffing levels. Working from home arrangements have also affected some access to records and some communications between finance staff and audit staff. This has been exacerbated by additional workload related to COVID-19, such as distributing COVID-19-related grants to local businesses and familiarisation with the guidance announced by government.

The quality of audits undertaken

19. The Financial Reporting Council (FRC) is the independent body responsible for monitoring the quality of major local audits in England. The Institute of Chartered Accountants in England and Wales (ICAEW) monitors the quality of the remaining local audits.

20. The FRC inspected 15 financial statement audits in 2019-20 across seven local audit firms. In its report "*Major local audits – audit quality inspection*" (October 2020) it described the overall results as concerning, with only 40% of audits judged good or requiring no more than limited improvement, down from 64% in 2018-19. The FRC said that urgent action was required from some of the firms, to take appropriate action to respond to the findings and ensure improvements were made in audit quality, given the deterioration in quality in the year.

21. Areas where improvements in audit quality were needed included:

- The valuation of property (including investment property)
- Sufficiency of audit procedures to confirm that all expenditure transactions occurred and were recorded appropriately
- The auditor's response to fraud risks
- Consideration of the risk that money owed to the authority might not be collectable in full (impairment of receivables)
- Valuation of assets supporting pension funds
- The effectiveness of the Engagement Quality Control review (an arrangement whereby a second audit engagement lead is used to ensure that key audit judgements are reviewed and challenged effectively).

The focus on issues that are not priorities for the public sector

22. In their 2019 report, the National Audit Office surveyed local authority finance directors (section 151 officers) for their views on external audit. (Source: Comptroller and Auditor General: *Local Authority Governance*, Session 2017–2019, National Audit Office, January 2019).

23. More than half of the section 151 officers from single tier and county councils responding to the survey indicated that they wanted changes to external audit. These included:
    - A greater focus on the value-for-money element of the audit (26%), and
    - Less of a focus on the valuation of capital assets within auditors' work on their financial statements (14%).

24. The Public Accounts Committee (July 2021) gave its view that "...*some areas of the audit to which the auditors give much attention are not proportionate to the risk to the overall financial stability and resilience of local authorities*". It notes that the additional work that audit firms are now required to do arise from the requirements of the Financial Reporting Council and that many believed this work "…*was not a high priority in the governance of local authorities*".

25. An example of this is asset valuations. For the private sector, the overstatement of the value of assets is a serious issue with such false accounting being used to obtain additional financing or inflate the share price. However, the movement in the value of an asset, be it up or down, does not impact on a council's financial position as there is a statutory override in place which means that the changes in value do not go into the revenue budget and have no impact on council tax.

26. Yet the valuation of assets is a key part of the audit and adds to its cost as asset valuations, particularly for commercial investment properties, which require significant input from the audit firms' specialist real-estate valuation teams.

27. The valuations are one of the big risks reported in the audit report which can mean that the gaze of those charged with governance is drawn to the changes in value rather than perhaps asking more pertinent questions? For example, and assuming these are investment properties: is the income being reported accurately? Is it sustainable? Do we understand the timing and impact of rent reviews? These are the factors that will impact on the long-term financial health of the authority, not annual fluctuations in value.

28. The audit focus on these areas means less attention is paid to perhaps more meaningful areas, such as financial resilience, outturn against budget, and performance outcomes.

The complexity of the Statement of Accounts

29. Local authorities' audited accounts are hard reading and are impenetrable to many stakeholders. The adoption of Internal Financial Reporting Standards

back in 2011 has meant, over the years, that there has been a growth in the length of statutory accounts and the required accompanying notes. Many councils have increasingly complex financial arrangements, for example in their borrowings, investments and financial instruments, often requiring complex group accounts to be prepared.

30. The Public Accounts Committee (July 2021) has concluded that "*unless local authority accounts are useful, relevant and understandable they will not aid accountability*".

The small number of firms able to service the needs of local public sector audits

31. Only eight audit firms have the specialist knowledge and accreditation needed to audit local authorities. Currently, the market is dominated by just two firms, (EY and Grant Thornton) which carry out around 70% of local authority audits.

32. The market therefore is not competitive and there is a significant risk of market collapse due to an over reliance on a small number of audit firms: for example KPMG stopped providing local government audits in 2017. Audit firms that have left the market no longer have the necessary specialist teams in place, if they ever considered re-entering the market.

33. New audit firms face considerable barriers in the time and costs involved in gaining entry to the market, such as developing a sufficient sized team of staff with the specialist skills, led by key audit partners, as part of gaining accreditation.

34. The Public Accounts Committee (July 2021) also notes that councils have become increasingly unattractive as clients and that audit fees in real terms have dropped significantly in recent years and now no longer reflect the work involved. This work has increased significantly, as noted elsewhere in the report: for example on pension and property valuations and the increasing regulatory requirements from the Financial Reporting Council.

Recommendations of the Redmond Review and the government's response

35. On 10 July 2019 the then Secretary of State for Housing, Communities and Local Government, James Brokenshire, announced a review into local audit. This was chaired by Sir Tony Redmond, a former Local Government Ombudsman and former president of the Chartered Institute of Public Finance and Accountancy (CIPFA).

36. The review was originally due to report in spring 2020, but finally reported in September 2020. The review made 23 recommendations, the key proposal being the creation of a new body, the Office of Local Audit and Regulation (OLAR) which would take over the local audit functions currently held by PSAA, ICAEW, the Financial Reporting Council, and the National Audit Office.

37. The report said: "…*none of the six entities with responsibility for the different elements of the framework has a statutory responsibility, either to act as a system leader or to make sure that the framework operates in a joined-up and coherent manner…As a result, the lack of co-ordination and the lack of a system leader is widely recognised as a weakness in the framework by most of the stakeholder groups".*

38. The Government published an interim response in December 2020. It rejected the central recommendation of a new body. Nevertheless, it also said: "*the department will commit to explore the full range of options as to how best to deliver Sir Tony's finding that a 'system leader' is required. This will include close consideration of whether existing bodies could take on this function*".

39. The Government's interim response also agreed to:

- Accept the recommendation to review the current fee structures in local audit, to provide greater flexibility to meet audit firms' costs. PSAA consulted on adjusting this system in November 2020, and the Government consultation closed on 1 June 2021. £15m of additional funding was allocated to local authorities in 2021-22.

- The Government has also recognised that this year will be particularly challenging as audit firms seek to catch-up after the significant Covid-19 delays last year and that trying to return to a 31st July deadline to audit the 2020/21 accounting period would be unrealistic. Hence, they have agreed moving the audit deadline to 30th September for local authorities for the next two years and to keep this under review, but without committing to a permanent change.

40. Introduce a requirement for local authorities to publish a simplified and standardised financial statement of service information to be produced to allow comparison with the annual budget and council tax and to enhance the transparency of financial information. This new statement will be prepared in addition to the statutory accounts and will be subject to audit.

41. A full Government response to the Redmond Review was published in May 2021.The Government stated in this document that it would create a new organisation, to replace the Financial Reporting Council to be the "system leader" for local audit. This organisation will be known as the Audit, Governance and Reporting Authority (ARGA) and its creation will require primary legislation.

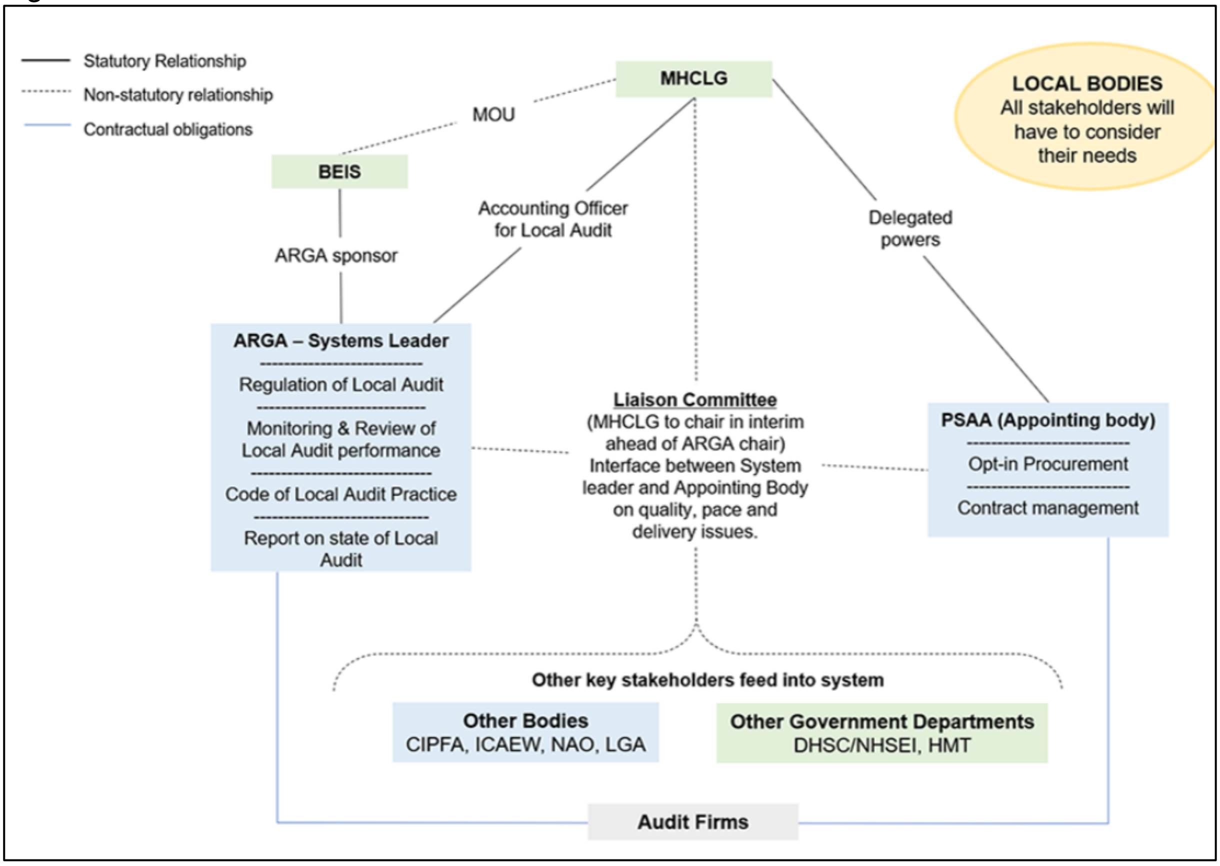
42. A subsequent Government technical consultation on implementation, was published on 28 July 2021 and ran up to 22 September. Government's response to the consultation responses are currently awaited.

43. The consultation included proposals for ARGA to take on the responsibility for the Code of Audit Practice and auditor guidance notes, currently produced by the National Audit Office.

44. The Code of Audit Practice has the status of secondary legislation and the Local Audit and Accountability Act 2014 requires it to be updated at least every five years, with the latest version of the Code published in April 2020. The updated code (currently being applied to the external audit of the 2020/21 accounts) includes enhanced value of money audit requirements including consideration of financial sustainability and governance arrangements.

45. The government's view is that the scope of local audit should reach further than for company audits, in recognition that unlike shareholders, taxpayers cannot divest from their local bodies. The Government is therefore proposing that ARGA, once it is established, undertake a post-implementation review to assess whether the new Code of Audit Practice has led to a more effective external audit consideration of financial resilience and value for money matters.

Figure 3: New Local Audit Framework



Source: MHCLG *Local Audit Framework: Technical Consultation* July 2021

46. It is also proposed that ARGA will establish a dedicated local audit unit, in order that it acquires the detailed expertise on the local audit sector, and this will be established in shadow form from April 2022. ARGA will be required to include a separate section on local audit in its statutory annual report to Parliament. The consultation asked for views on whether that should also include details of the results of audit, which was a statutory duty on PSAA up to 2017-18. Government are minded that ARGA's specific local audit responsibilities should be funded directly by MHCLG (now Department for Levelling Up, Housing & Communities).

47. A Liaison Committee is recommended to be established and whilst the exact membership of this will be subject to further consideration, Government envisage representation from organisations including CIPFA, PSAA, LGA, NAO, ICAEW, the Department for levelling Up, Housing & Communities,, the Department of Health and Social Care (DHSC), NHS England, BEIS and HM Treasury (HMT). The Liaison Committee will be the key forum for ensuring coordination across different parties, but also for acting on risks and issues as they emerge and considering responses to developments in local audit.

48. In addition to the above the consultation also sought views on local governance arrangements regarding external audit and consideration on whether these should be delivered through the production of an updated version of CIPFA's existing guidance, "*Audit Committees: Practical Guidance for Local Authorities and Police (2018 Edition)",* or through legislation:

- An annual report being submitted to Fill Council by the external auditor.
- The appointment of at least one independent member, suitably qualified, to the Audit Committee.
- Formalising the need for the CEO, Chief Finance Officer and Monitoring Officer to meet with the key Audit Partner at least annually.
- External audit to submit an annual report to the first full council meeting after 30th September each year, irrespective of whether the financial accounts have been certified.
- A change to the Audit Code of Practice to allow External Audit to liaise with the internal audit function and to use them more effectively.

Background Papers

The Local Audit and Accountability Act (2014)
https://www.legislation.gov.uk/ukpga/2014/2/schedule/12/paragraph/95

The Accounts and Audit Regulations (2015)
https://www.legislation.gov.uk/uksi/2015/234/regulation/12/made?view=plain

House of Commons Public Accounts Committee (PAC) **"***Local auditor reporting on local government"* (2021)
https://publications.parliament.uk/pa/cm5802/cmselect/cmpubacc/171/17104.htm

National Audit Office "*Timeliness of Local Auditor Reporting on Local Government*" (2020)
https://www.nao.org.uk/report/timeliness-of-local-auditor-reporting-on-local-government-in-england-2020/

Financial Reporting Council "*Major local audits – audit quality inspection*" (2020)
https://www.frc.org.uk/news/october-2020/frc-publishes-major-local-audit-inspection-results

National Audit Office, Comptroller and Auditor General: "*Local Authority Governance" (*2019).
https://www.nao.org.uk/wp-content/uploads/2019/01/Local-authority-governance.pdf

Ministry of Housing, Communities & Local Government "*Review of local authority financial reporting and external audit"* (2019)
https://www.gov.uk/government/news/audit-quality-of-councils-will-face-examination-in-new-independent-review

Ministry of Housing, Communities & Local Government "I*ndependent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting*" (2020)
https://www.gov.uk/government/publications/local-authority-financial-reporting-and-external-audit-independent-review

Ministry of Housing, Communities & Local Government "*Local authority financial reporting and external audit: government response to the Redmond review*" (2020)
https://www.gov.uk/government/publications/local-authority-financial-reporting-and-external-audit-government-response-to-the-redmond-review

Ministry of Housing, Communities & Local Government "*Local authority financial reporting and external audit: Spring update*" (2021)
https://www.gov.uk/government/publications/local-authority-financial-reporting-and-external-audit-spring-update

Department for Levelling Up, Housing & Communities "*Local audit framework: technical consultation*" (2021)
https://www.gov.uk/government/consultations/local-audit-framework-technical-consultation

South Somerset District Council

SWAP Internal Audit Progress Report 2021-22

SWAP CEO: Dave Hill – Chief Executive - SWAP
Lead Officer: Alastair Woodland – Assistant Director
Contact Details: Alastair.Woodland@SWAPAudit.co.uk

Purpose of the Report

To update members on the Internal Audit Plan 2021/22 progress and bring to their attention any significant findings identified through our work.

Public Interest

Audit committees are a key component of an authority's governance framework. Their function is to provide an independent and high-level resource to support good governance and strong public financial management.

The purpose of an audit committee is to provide to those charged with governance independent assurance on the adequacy of the risk management framework, the internal control environment and the integrity of the financial reporting and governance processes.

Recommendations

1. Members are asked to note progress made in delivery of the 2021/22 internal audit plan and the significant findings since the previous update.

Background

The Internal Audit function plays a central role in corporate governance by providing independent assurance to the Audit Committee over the effectiveness of internal controls, governance and risk management. The 2021/22 Annual Audit Plan was approved by the Audit Committee at its March 2021 meeting and is to provide independent and objective assurance on SSDC's Internal Control Environment and this work will support the Annual Governance Statement.

Report Detail

This report summarises the work of the Council's Internal Audit Service and provides:

- Details of any new significant weaknesses identified during internal audit work completed since the last report to the committee in July 2021.
- A schedule of audits completed during the period, detailing their respective assurance opinion rating, the number of recommendations and the respective priority rankings of these.

Please refer to the attached SWAP Progress Report 2021-22 for further details.

Financial Implications

There are no financial implications associated with these recommendations.

Council Plan Implications

Delivery of corporate objectives requires strong internal control. The attached report provides a summary of the audit work carried out to date this year by the Council's internal auditors, SWAP Internal Audit Services.

Carbon Emissions and Climate Change Implications

There are no implications arising from this report.
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Equality and Diversity Implications

There are no implications arising from this report.

Background Papers

- Internal Audit Plan and Charter 2021-22 March 2021
- Internal Audit Progress Report July 2021

South Somerset District Council

Report of Internal Audit Activity

2021-22 Progress Update Report October 2021

Internal Audit ▪ Risk ▪ Special Investigations ▪ Consultancy

Contents

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Internal Audit Plan Progress 2021-22

Our audit activity is split between:

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

Role of Internal Audit

The Internal Audit service for the South Somerset District Council is provided by South West Audit Partnership Limited (SWAP). SWAP is a Local Authority controlled Company. SWAP has adopted and works to the Standards of the Institute of Internal Auditors, further guided by interpretation provided by the Public Sector Internal Audit Standards (PSIAS), and also follows the CIPFA Code of Practice for Internal Audit. The Partnership is also guided by the Internal Audit Charter approved by the Audit and Governance Committee at its meeting in March 2021.

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

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

Internal Audit work is largely driven by an Annual Audit Plan. This is approved by the Section 151 Officer, following consultation with the Senior Management Team. This year's Audit Plan was reported to and approved by this Committee at its meeting in March 2021. Audit assignments are undertaken in accordance with this Plan to assess current levels of governance, control and risk.

Outturn to Date:

We rank our recommendations on a scale of 1 to 3, with 3 being minor or administrative concerns to 1 being areas of major concern requiring immediate corrective action.

Internal Audit Work Programme Update

The schedule provided at **Appendix B** contains a list of all audits as agreed in the Annual Audit Plan 2021/22. It is important that Members are aware of the status of all audits and that this information helps them place reliance on the work of Internal Audit and its ability to complete the plan as agreed.

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

The following table summarises Audits finalised since the last update in July 2021:

Audit Area	Opinion
Fraud Risk Assessment	Advisory
Yeovil Cemetery & Crematorium Annual Accounts	Advisory
New: Patch Management	Reasonable
Procurement	Reasonable
Homelessness Follow Up	Advisory

Internal Audit Plan Progress 2021-22

Significant Corporate Risks

Identified Significant Corporate Risks should be brought to the attention of the Audit Committee.
Completed Assignments:

Summary of work completed with a focus on the high priority issues that we believe should be brought to the attention of the Audit Committee.

- **Limited or No Assurance Opinions**
- **Follow-ups**

Significant Corporate Risks

We provide a definition of the 3 Risk Levels applied within audit reports and these are detailed in **Appendix A**. For those audits which have reached report stage through the year, I will report risks we have assessed as 'High'.

In this update there are no final reports included with significant corporate risks.

Summary of Work Completed – Limited or No Assurance Opinions

There are no limited or no assurance opinion pieces of work to bring to your attention.

Completed Assignments:

Summary of work completed with a focus on the high priority issues that we believe should be brought to the attention of the Audit Committee.

- **Limited or No Assurance Opinions**
- **Follow-ups**

Summary of Work Completed – Follow up Audits

Homelessness - Follow Up

The original audit of Homelessness was completed in October 2020 and received a Limited assurance opinion. The purpose of this follow up audit was to provide assurance that agreed actions to mitigate against risk exposure identified within the 2020/21 Limited opinion audit of Homelessness report have been implemented

Follow Up Progress Summary				
Priority	**Complete**	**In Progress**	**Not Started**	**Summary**
Priority 1	0	0	0	**0**
Priority 2	0	3	0	**3**
Priority 3	0	2	0	**2**
Total	**0**	**5**	**0**	**5**

All the actions have been started by the service. However, they are going to take longer to complete than originally agreed as they required more groundwork, therefore, new timescales have been agreed for all of the original findings.

Since the 2020-21 audit a new Lead Specialist Communities has been appointed and part of their umbrella of work includes homelessness. While the audit report and agreed actions formed the basis of the change, there is more work to complete before the audit actions can be resolved.

Completed Assignments:

Summary of work completed with a focus on the high priority issues that we believe should be brought to the attention of the Audit Committee.

Summary of Work Completed – Follow up Audits Continued

In the original homelessness audit the collection of data and use of data to confirm statutory requirements were being met was the main theme for the limited assurance. The council have looked into getting a new system to manage the homelessness information, however the Unitary decision has now put this on hold, although other options are being explored.

To summarise the main findings (Priority 1 & 2 only) and progress as of September 2021:

Priority 2 finding - *The Key Performance Indicators (KPIs) in place for the homelessness team do not measure the service against the legislation in place.*

The service conducted a review into the work which is being completed and discovered that only the reactive case work was being captured in the data and only a small proportion of the reactive work was being reported as KPIs. This therefore did not represent the whole service and the work they were completing. As such they are now working out how they are able to capture the preventive work the service completes. This will give them more accurate data of the whole service. Once they have this data, they will then be able to come up with KPIs which are accurate and working to the service objectives and relevant legislation. Revised target date – 30 April 2022

Priority 2 finding - *There are no performance or quality standards in place for Case Officers to work to.*

A standards checklist was completed, however it was too long and did not work as part of the new ways of working the Lead Specialist Communities is installing. In addition, the checklist only covered the reactive work and was not looking at the preventative work. This linked into the previous action and along with the review of the KPIs this review also looked at how best to create a checklist for all the work. However, this checklist needs to have fewer more comprehensive steps and empower the officers. On top of this Covid-19 has had a huge impact on the service meaning this change to the way the service works is taking more time. Therefore, this action has had an agreed new timescale. Revised target date – 31 January 2022

Completed Assignments:

Summary of work completed with a focus on the high priority issues that we believe should be brought to the attention of the Audit Committee.

Summary of Work Completed – Follow up Audits Continued

Priority 2 finding - *The data the Council collects for homelessness is incomplete and does not allow for analysis to ensure the Council is meeting their objectives.*

A new officer has been put in place to have a look at all of the data which is being put into the system. This has helped with the KPIs and the quality review process. However, this is taking longer than expected because it is a system issue and not only an issue with inputting the data. Therefore, this is still in progress until they have the ability to capture all work which is undertaken. Revised target date – 31 January 2022

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

SWAP Performance

SWAP now provides the Internal Audit service for 24 public sector bodies. SWAP performance is subject to regular monitoring review by both the Board and the Member Meetings. The respective outturn performance results for South Somerset District Council for the 2021/22 (as of October 2021) were as follows:

Performance Target	Target Year End	Average Performance
Audit Plan – Percentage Progress Final, Draft and Discussion In progress Yet to complete	>90%	43% 26% 32%
Quality of Audit Work Customer Satisfaction Questionnaire	>95%	100%
Outcomes from Audit Work Value to the Organisation *(client view of whether our audit work met or exceeded expectations, in terms of value to their area)*	>95%	Reported Year End

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

Approved Changes to the Plan

We will regularly re-visit and adjust our rolling programme of audit work to ensure that it matches the changing risk profile of the organisation's operations, systems, and controls. Details of our current work areas are provided in **Appendix B**.

Unplanned work, special reviews or projects carried out on a responsive basis which are requested as new and emerging risk areas and which result in significant changes to the agreed plan will be reported to the Audit Committee.

The following table highlights changes to the plan since the July update report. There are also some required/requested timing changes of reviews which would be separately identified if considered to be significant.

Assignment	Amendment	Reason
Green Homes Grant	Added	Department for Business, Energy & Industrial Strategy requirement for Head of Audit to sign off grant expenditure.
Ongoing urgent confidential matter	Added	A number of reviews were required to be deferred/dropped to accommodate time for this review.
Health & Safety Framework Housing Benefits Incident management or Information Security (IS)	Deferred	Removed to cover the time needed for the ongoing urgent confidential matter.
Covid-19 Financial Impacts and Lessons learned	Removed	Removed to cover the time needed for the ongoing urgent confidential matter.
Income generation Follow up	Removed	Area put on hold due to Unitary. Management to circulate update on recommendations.

Internal Audit Definitions — Appendix A

Assurance Definitions

No	Immediate action is required to address fundamental gaps, weaknesses or non-compliance identified. The system of governance, risk management and control are inadequate to effectively manage risks to the achievement of objectives in the area audited.
Limited	Significant gaps, weaknesses or non-compliance were identified. Improvement is required to the system of governance, risk management and control to effectively manage risks to the achievement of objectives in the area audited.
Reasonable	There is a generally sound system of governance, risk management and control in place. Some issues, non-compliance or scope for improvement were identified which may put at risk the achievement of objectives in the area audited.
Substantial	A sound system of governance, risk management and control exist, with internal controls operating effectively and being consistently applied to support the achievement of objectives in the area audited.
Non-Opinion/Advisory	In addition to our opinion-based work we will provide consultancy services. The “advice” offered by Internal Audit in its consultancy role may include risk analysis and evaluation, developing potential solutions to problems and providing controls assurance.

Definition of Corporate Risks

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

Categorisation of Recommendations

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

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

Audit Type	Audit Area	Status	Opinion	No of Rec	1 = Major	↔	3 = Minor	Comments
					Recommendation			
					1	2	3	
Completed Work								
Governance Fraud & Corruption	Fraud Risk Assessment	Final	Advisory	0	0	0	0	
Fraud, Corruption and Governance	Boden Mill & Chard Regeneration Scheme Accounts Review	Final	Advisory	0	0	0	0	
Fraud, Corruption and Governance	**New:** Growth Deal Capital Expenditure Certification	Final	Advisory	0	0	0	0	
Fraud, Corruption and Governance	Yeovil Cemetery & Crematorium Annual Accounts	Final	Advisory	0	0	0	0	
ICT	**New:** Patch Management	Final	Reasonable	2	0	0	2	
Fraud, Corruption and Governance	Procurement	Final	Reasonable	4	0	1	3	
Follow Up	Homelessness Follow Up	Final	Advisory	5	0	3	2	Relates to outstanding recommendations raised in 2020-21
Reporting								
Confidential matter	**New:** Ongoing urgent confidential matter	Draft						Review includes separate controls assurance report.
Fraud, Corruption and Governance	Chard Regeneration Project	Drafting						
In Progress								
Grant Certification	**New:** Green Homes Grant	In Progress						

Audit Type	Audit Area	Status	Opinion	No of Rec	1 = Major	↔	3 = Minor	Comments
					Recommendation			
					1	2	3	
Fraud, Corruption and Governance	Covid-19 - External Recovery plan	In Progress						
Fraud, Corruption and Governance	Covid-19 Discretionary grants	In Progress						
Grant Certification	Covid-19 Grants – Post Payment Assurance Restart Grant	In Progress						
Follow Up	Project Governance Regeneration Projects Follow Up	In Progress						
Not Started								
ICT	User Access Management arrangements	Not Started						
Key Control	Council Tax & NNDR	Not Started						
Key Control	Debtors	Not Started						
Fraud, Corruption and Governance	Opium arrangements	Not Started						
Fraud, Corruption and Governance	Commercial investments	Not Started						
Follow Up	**NEW**: S106 Follow up Audit	Not Started						
Deferred (moved to rolling schedule of Audits) **or Removed** (no longer risk/area to audit)								
Fraud, Corruption and Governance	Complaint Procedures	Deferred	Reported to Audit Committee July 2021					
ICT	Incident management or Information Security (IS)	Deferred	Reported to Audit Committee October 2021					

Audit Type	Audit Area	Status	Opinion	No of Rec	1 = Major	↔	3 = Minor	Comments
					Recommendation			
					1	2	3	
Follow Up	Income Generation Follow up	Removed	Separate update on recommendations to be provided from management					
Operational	Health & Safety Framework	Deferred	Reported to Audit Committee October 2021					
Key Control	Housing Benefit	Deferred	Reported to Audit Committee October 2021					
Fraud, Corruption and Governance	Covid-19 - Financial Impacts and Lessons learned	Removed	Reported to Audit Committee October 2021					
Fraud, Corruption and Governance	Restart Grants – Bank Account Check	Removed	Reported to Audit Committee July 2021					
Fraud, Corruption and Governance	Planning policy Change - Phosphate	Deferred	Reported to Audit Committee July 2021					
Fraud, Corruption and Governance	Decarbonisation Grant	Deferred	Reported to Audit Committee July 2021					

South Somerset District Council

2021/22 Treasury Management Mid-Year Performance Report and Strategy Update

Executive Portfolio Holder:	Peter Seib, Finance and Legal Services
SLT Lead:	Karen Watling, Chief Finance Officer
Lead Officers:	Paul Matravers, Lead Specialist – Finance Cheryl Summers, Specialist Finance

Purpose of the Report

1. To present the Council's 2021/22 mid-year treasury performance report as required by CIPFA's Treasury Management Code.

Recommendations

2. The Audit Committee is asked to note the actual and forecast treasury performance and recommend the updated Treasury Management Strategy Statement and Investment Strategy to Council.

Introduction and Background

3. The Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management in the Public Services Code of Practice requires the Council to approve an annual Treasury Management Strategy and, report treasury performance mid-year and at the year end.

4. The Council has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk is therefore central to the Treasury Management Strategy.

5. This report provides information on the performance of the Council's Treasury Investments for the first six months of the 2021/22 financial year. The performance of the Council's Commercial Investments, which are part of the Commercial Strategy, are reported separately through 6-monthly update reports therefore that detail is not included in this report. On this basis, it is worth noting that whilst the treasury income and cost implications of commercial investment acquisitions are included within this report, the investment property income is not.

6. CIPFA has defined Treasury Management as "the management of the organisation's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

7. The Council has delegated responsibility for the oversight and monitoring of its treasury management policies and practices to Audit Committee, and for the execution and administration of treasury management decisions to the S151 Officer who will act in accordance with the organisation's policy statement and Treasury Management Practices (TMPs), and CIPFA's standard of Professional Practice on Treasury Management.

8. The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Specific risks are identified in the Council's approved Treasury Management Practices. The risks include:

- Liquidity Risk (Adequate cash resources)
- Interest Rate Risk (Fluctuations in the value of investments and borrowing).
- Inflation Risks (Exposure to inflation)
- Fraud, Error and Corruption, and Contingency Management (Exposure to loss through fraud, error or other eventualities)
- Refinancing Risks (Impact of debt maturing in future years).
- Legal & Regulatory Risk (Compliance with statutory and regulatory requirements).

9. The Local Government Act 2003 requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy; this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

10. When the strategy for 2021/22 was written it took into account the Council's current treasury position and drew upon the forecasts for interest rates provided by the Council's treasury advisors, Arlingclose, leading to the proposed Prudential Indicators included. This has been updated with the most recent forecast as at September 2021.

Revisions to CIPFA Codes

11. In February 2021 CIPFA launched two consultations on changes to its Prudential Code and Treasury Management Code of Practice. These followed the Public Accounts Committee's recommendation that the prudential framework should be further tightened following continued borrowing by some authorities for investment purposes. In June, CIPFA provided feedback from this consultation.

12. In September CIPFA issued the revised Codes and Guidance Notes in draft form and opened the latest consultation process on their proposed changes.

The changes include:

- Clarification that:
  - local authorities must not borrow to invest primarily for financial return
  - it is not prudent for authorities to make any investment or spending decision that will increase the Capital Financing Requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority
- Categorising investments as those:
  - for treasury management purposes
  - service purposes
  - for commercial purposes
- Defining acceptable reasons to borrow money:
  - financing capital expenditure primarily related to delivering a local authority's functions
  - temporary management of cash flow within the context of a balanced budget
  - securing affordability by removing exposure to future interest rate rises
  - refinancing current borrowing, including replacing internal borrowing
- For service and commercial investments, in addition to assessments of affordability and prudence, an assessment of proportionality in respect of the authority's overall financial capacity (i.e. whether plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services).
- Prudential Indicators:
  - New indicator for net income from commercial and service investments to the budgeted net revenue stream.
  - Inclusion of the liability benchmark as a mandatory treasury management prudential indicator. CIPFA recommends this is presented as a chart of four balances – existing loan debt outstanding; loans CFR, net loans requirement, liability benchmark – over at least 10 years and ideally cover the authority's full debt maturity profile.
  - Excluding investment income from the definition of financing costs.
- Incorporating ESG issues as a consideration within TMP 1 Risk Management.
- Additional focus on the knowledge and skills of officers and elected members involved in decision making.

South Somerset District Council

13. In addition the Department for Levelling Up, Housing and Communities (DLUHC) published a brief policy paper in July outlining the ways it feels that the current Capital Finance Framework framework is failing and potential changes that could be made.

14. The paper found that "while many authorities are compliant with the framework, there remain some authorities that continue to engage in practices that push the bounds of compliance and expose themselves to excessive risk". The actions announced include:

    - greater scrutiny of local authorities and particularly those engaged in commercial practices
    - an assessment of governance and training
    - a consideration of statutory caps on borrowing
    - further regulations around Minimum Revenue Provision (MRP)
    - ensuring that the DLUHC regulations enforce guidance from CIPFA and the new PWLB lending arrangements.

15. The consultation period ends on 16 November 2021, the Chief Finance Officer will provide a response to both consultations and an update on the outcome and the implications for the Council will be reported to the committee.

Treasury Management Strategy Statement and Investment Strategy

16. The updated 2021/22 Treasury Management Strategy is attached at Appendix A. There are no amendments to the borrowing strategy, treasury investment strategy, approved counterparties or investment limits.

17. The updated strategy includes a revision to the capital financing requirement figures, with amendments made to reflect the actual capital financing requirement at 31/3/2021 and the revised estimates for the subsequent three years. Please refer to table 1: Balance Sheet Summary and Forecast within Appendix A.

18. The remainder the report provides information on:

    - Treasury Management Position
    - Current Borrowing
    - Treasury Investment Activity
    - Pooled Fund Investments
    - Non Treasury Investments

Treasury Management Position - Summary

19. The treasury management position as at 30 September 2021 and the change during the year is shown in the Table 1.

Table 1: Treasury Management Position – Summary

	31/03/2021 Balance £000's	Net Movement £000's	30/09/2021 Balance £000's
Long-term borrowing	-	-	-
Short-term borrowing	(98,000)	10,000	(88,000)
Total Borrowing	**(98,000)**	**10,000**	**(88,000)**
Long-term Investments	2,000	(1,000)	1,000
Short-term Investments	-	-	-
Cash and Cash Equivalents	23,980	2,340	26,320
Total Investment	**25,980**	**1,340**	**27,320**
Net Position	**(72,020)**	**11,340**	**(60,680)**

External Borrowing

20. External borrowing has decreased during the first six months of the year due to a significant element of the loan portfolio maturing in this period. Improved cash flow has meant that not all of the matured borrowing needed replacing. In addition, during this period there has been no investment property acquisitions as part of the Commercial Strategy (although some acquisitions are anticipated by the end of this financial year). These acquisitions are financed by external borrowing. In line with Arlingclose advice, and as reported in the MTFP Refresh report to District Executive in October 2021, the Council continues to utilise short term borrowing, which is flexible and keeps our borrowing costs low.

21. The projected value of long term borrowing as at 31 March 2022 was reported to Audit Committee in February 2021 in the Annual Treasury Management Strategy report. The external borrowing requirement at the end of the 2021/22 financial year was anticipated to be £159m.

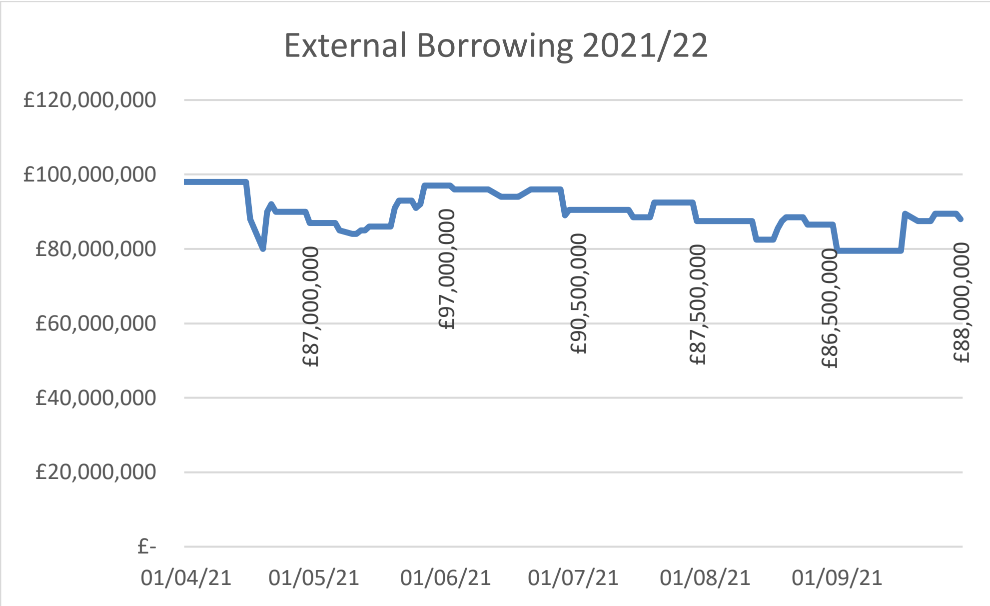
22. The amount of external borrowing is dependent on purchases of commercial property and the projects included in the capital programme progressing as planned, particularly those projects in the Regeneration Programme, and the Council's cash flow position. If project timescales slip and no commercial property purchases are made in the remaining part of the financial year the external borrowing amount will be significantly lower than the figure anticipated in the 2021/22 Annual Treasury Management Strategy.

23. The Council's finance team continually review the council's cash flow position and borrowing options in order to keep the cost of borrowing to a minimum. With

interest rates remaining low it remains advantageous to continue to meet the financing requirement using short term rather than long term borrowing, however this is kept under review to strike the appropriate balance between costs and cost certainty. This strategy is also pursued in order to give the maximum flexibility to the new successor council when it comes into being in April 2023.

24. The graph shows the movement in the external borrowing position for 2021/22. It provides the amount of external borrowing on the first day of each month for the April to September period and the value of borrowing at 30 September 2021 (£88m).

Graph 1: External Borrowing 2021/22



25. Table 2 summarises the external borrowing position as at 30 September 2021. It includes the opening position in respect of external loans, loans repaid, new loans and the average interest rate.

Table 2: External Borrowing Summary

	Amount £'000	Average Interest Rate %
External Loans as at 1 April 2021	**98,000**	**0.86**
New Loans	157,500	0.31
Loans Repaid	(167,500)	0.17
Total External Loans as at 30 September 2021	**88,000**	**0.08**

26. The £88m of external borrowing as at 30 September 2021 is detailed in Table 3. The table shows that we have prioritised the inter-authority lending market, with the short-term loan interest rates ranging from 0.02% to 0.45%.

Table 3: External borrowing as at 30 September 2021

Lender	Date Borrowed	Maturity Date	No. of Days	Interest Rate %	Amount £
London Borough of Wandsworth	19/03/21	19/01/22	306	0.45	10,000,000
Nottingham City Council	22/04/21	27/01/22	280	0.14	4,000,000
City & County of Swansea	20/04/21	20/10/21	183	0.05	5,000,000
Northern Ireland Housing Executive	19/04/21	14/04/22	360	0.10	4,000,000
Northern Ireland Housing Executive	20/04/21	14/04/22	359	0.10	5,000,000
East Suffolk Council	20/04/21	20/04/22	365	0.14	3,000,000
Vale of Glamorgan Council	21/04/21	21/10/21	183	0.08	3,000,000
Middlesbrough Borough Council	25/08/21	24/05/22	272	0.07	5,000,000
University of Teeside	25/08/21	25/05/22	273	0.08	4,000,000
Greater Manchester Combined Authority	25/08/21	27/01/22	155	0.03	3,000,000
Greater Manchester Combined Authority	25/08/21	23/12/21	120	0.03	5,000,000
West Suffolk Council	18/08/21	10/01/22	145	0.02	1,000,000
Hampshire Police and Crime Commissioner	18/08/21	18/10/21	61	0.02	2,000,000
Hampshire County Council	19/08/21	18/10/21	60	0.02	2,000,000
Greater Manchester Combined Authority	25/08/21	25/11/21	92	0.02	8,000,000
Wigan Metropolitan Borough Council	25/08/21	25/05/22	273	0.07	5,000,000
Middlesbrough Borough Council	17/09/21	07/04/22	202	0.04	10,000,000
South Lanarkshire Council	20/09/21	20/05/22	242	0.05	2,000,000
South Lanarkshire Council	24/09/21	24/05/22	242	0.05	2,000,000
Tendring District Council	29/09/21	11/04/22	194	0.04	5,000,000
				Total	**88,000,000**

27. The above information shows that the current strategy of utilising short-term inter-authority lending for the Council's treasury borrowing requirement means interest rates and costs are relatively low.

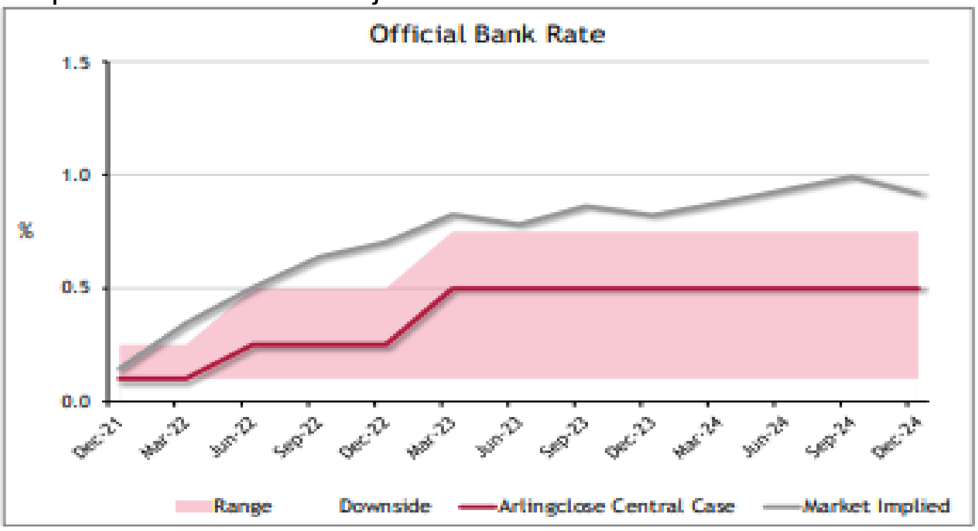
28. The tables demonstrate that rates have significantly reduced in the April to September period and short term borrowing for a 6 month period can now be sourced in the region of 0.01% - 0.05%. Borrowing for short periods takes advantage of the low rates on offer, and accepts an element of interest rate risk at the point of re-financing.

Interest Rates and Inflation

29. The October 2021 economic and interest forecast data provided by the Council's treasury advisors anticipates that inflation is likely to rise to over 4% in the near term (3.2% in August), the continuing increase in inflation has meant that the expectations around a rise in interest rates has also increased.

30. The graph below details the Arlingclose interest rate projection for the period to December 2024.

Graph 2: Interest Rate Projection



31. Arlingclose expects the Bank Rate to rise in Quarter 2 of 2022, with a further rise in March 2023 and rates remaining at 0.50% for the period to December 2024. This assumption is driven as much by the Bank's desire to move from emergency levels as by fears of inflationary pressure.

32. Investors have priced in multiple rises in Bank Rate to 1% by 2024. While there is a belief than the Bank Rate will rise, the Arlingclose assumption is that the rate rise will be to a lesser extent than expected by markets.

Borrowing Options and alternative funding streams

33. Given changes to PWLB lending terms and intended changes to CIPFA's Prudential Code, Arlingclose, the Council's Treasury Management adviser, was asked earlier this year by the Chief Finance Officer to review the Council's potential borrowing options given that SSDC is, at least for this financial year, actively seeking to undertake further "investment purely for yield" commercial activity and the changes mentioned above would restrict this activity.

34. Arlingclose analysed a range of potential borrowing options including the use of: PWLB (Public Works Loans Board), local authority to local authority short term lending, borrowing from Financial Institutions (e.g. Pension Funds, banks), a Bonds issue (either separately or using the Municipal Bonds Agency), Forward Starting Loans, Interest Rates swaps, and income strip deals (wrapper leases).

35. The Chief Finance Officer will be proposing to February 2022 Council (in the Treasury Management Strategy) that we keep to our current approach to borrowing namely: to (a) only borrow externally when cash flow requires this and to (b) only borrow short term from other councils. Obviously we will continue to review this approach with Arlingclose in light of any changes in market/economic conditions but the intention is that for the next two financial years SSDC will not enter into any long term borrowing arrangements.

36. The rationale for proposing this approach can be given as follows:
    - Short term borrowing from other councils is currently by far the cheapest option and is readily available and quick to administer.
    - Whilst there is a risk to SSDC if interest rates rise, this is assessed as a low risk by Arlingclose and other economic forecasters.
    - Other options, e.g. bond issues, interest rate swaps, will take officer time and cost to implement.
    - Income strip deals (wrapper leases) are intrinsically risky.
    - HM Treasury have recently clarified their new PWLB lending terms and have confirmed that PWLB lending is available to finance existing debt arising from past "investment purely for yield" commercial activity and to finance the council's capital programme the year after it ceases such commercial activity, if the Council so wishes.
    - The Chief Finance Officer advises that it would be wrong to fetter the future flexibility of the successor unitary authority in this matter if there is no immediate need for SSDC to enter into long term borrowing arrangements.

Treasury Investment Activity

37. The Council holds significant invested funds, representing income received in advance of expenditure plus cash balances and reserves held. In the first six months of the financial year, the Council's investment balance has ranged between £24.5 million and £29.5 million.

Table 4: Breakdown of Investments as at 30 September 2021

	Date Invested	Maturity Date	Interest Rate %	Nominal Amount £
Corporate Bonds				
National Australia Bank *Covered*	10/11/16	10/11/21	1.10	1,000,000
Business Reserve Accounts				
Santander Business Reserve	Various	Not fixed	0.04	2,820,000
Property & Pooled Funds				
Schroders Income Maximiser (UK Equity)	Various	Not fixed	5.97	6,250,000
CCLA Property Fund	Various	Not fixed	4.91	6,000,000
Fidelity Global enhanced income (Global Equity)	Various	Not fixed	4.74	250,000
Ninety One Diversified Income	Various	Not fixed	4.15	5,000,000
Columbia Threadneedle Strategic Bond	Various	Not fixed	2.25	5,000,000
Royal London Enhanced Cash Plus Fund	Various	Not fixed	0.75	1,000,000
			Total	27,320,000

38. The Council has maintained its strategic fund investments at £23.5m and it is estimated that the level of strategic investments as at 31 March 2022 will remain in the region of £23.5m. The long term strategy is to invest up to £30m in strategic investments if cashflow permits.

Pooled Fund Investment - Values

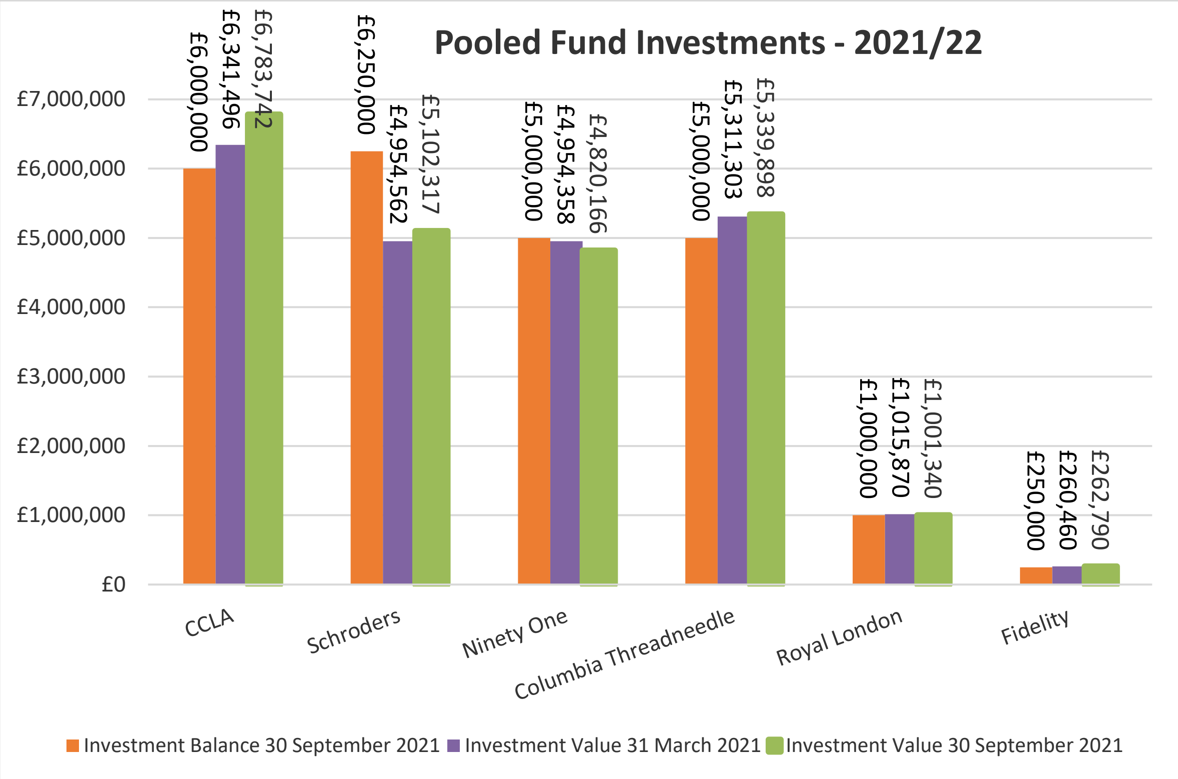
39. The Council's pooled fund investments are held in externally managed funds where short-term security and liquidity are lesser considerations, and the objectives instead are regular revenue income and long-term price stability. This fits with the objectives of the Council's overall Financial Strategy.

40. The Council has investments in bond, equity, multi-asset and property funds. The improved market sentiment in the past 6 months is reflected in equity, property and multi-asset fund valuations and, in turn, in the overall increase in capital values of the Council's pooled fund investments.

41. 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 medium to long term investment objectives are regularly reviewed. Strategic fund investments are made in the knowledge that capital values will move both up and down on months, quarters and even years; but with the confidence that over a three- to five-year period total returns will exceed cash interest rates.

42. The investment balance as at 30 September 2021 and the value of each investment as at 1 April and 30 September are detailed in the chart below.

Graph 3: Pooled Fund Investments 2021/22



Note: Pooled fund investments are revalued to reflect the fair value of the investment, the second and third bars in the graph signifies this value at 1 April and 30 September. The first bar represents the nominal investment balance in each fund at 30 September.

43. Table 5 below includes the opening and closing investment balances for each pooled fund investment. The investment fair value signifies the individual value of the investments after the year-end and mid-year valuation. The table shows that the ‘fair value’ of the portfolio has increased by £472k, which is an increase of 2.07% between 1 April and 30 September, reflecting volatility in market value. The strategy works on the basis that investment values will go up and down but annual income return remains positive, and the Council would not plan to redeem the investment when its value is below the nominal balance unless this would be a prudent course of action.

Table 5: Pooled Fund Investments as at 30 September 2021

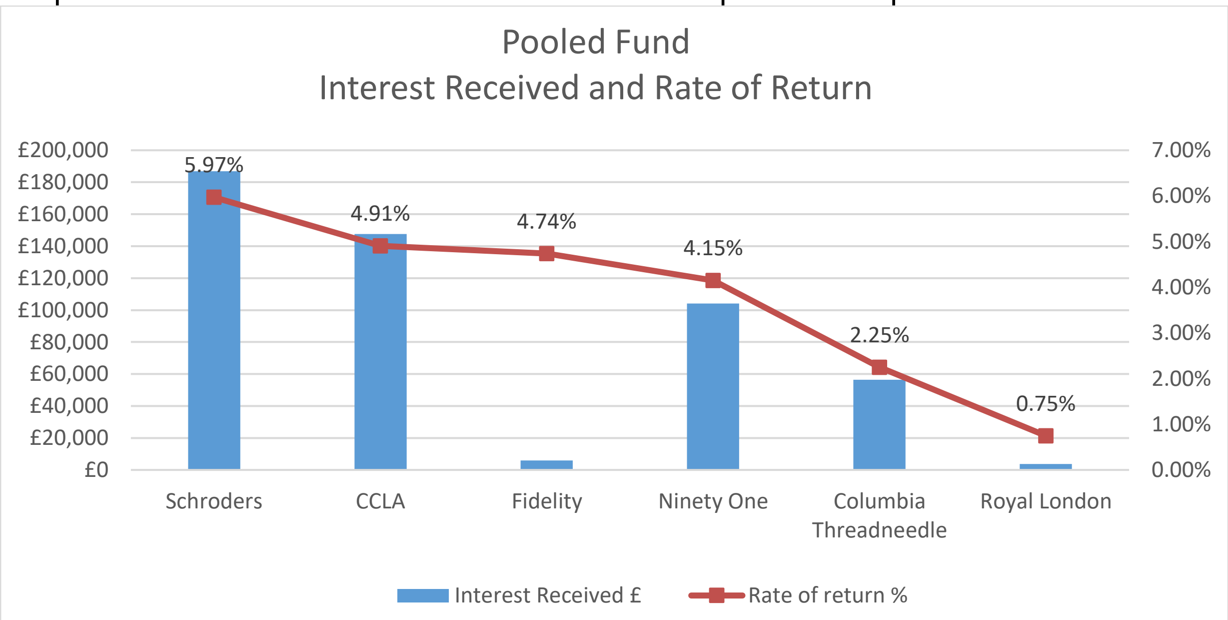
Investment	Investment Balance 30/09/2021 £	Investment Value 01/04/2021 £	Investment Fair Value 30/09/2021 £
CCLA	6,000,000	6,341,496	6,783,742
Schroders	6,250,000	4,954,562	5,102,317
Ninety One	5,000,000	4,954,358	4,820,166
Columbia Threadneedle	5,000,000	5,311,303	5,339,898
Royal London	1,000,000	1,015,870	1,001,340
Fidelity	250,000	260,460	262,790
Total	**23,500,000**	**22,838,049**	**23,310,253**

Pooled Fund Investment – Income Return

44. The income generated from pooled fund investments for the first six months of 2021/22 and the rate of return is detailed in the following Graph 4 and Table 6. This demonstrates that the investment in the Schroder Income Maximiser, Ninety One and CCLA Funds have performed well in terms of income and rate of return on investment.

45. Overall, the return on pooled funds has positively averaged 3% during the first six months of the financial year.

Graph 4: Interest Received and Rate of Return 1 April to 30 September



South Somerset District Council

Table 6: Pooled Fund Investment Interest at 30 September 2021

Fund	Interest Received £	Rate of return %
Schroders	186,974	5.97
CCLA	147,630	4.91
Fidelity	5,943	4.74
Ninety One	104,057	4.15
Columbia Threadneedle	56,400	2.25
Royal London	3,756	0.75
Total	**504,760**	

Non-Treasury Investments

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

47. In addition to its treasury investments, the Council also holds £36.23m in other investments in the form of loans to third parties. The loans values are detailed below:

    - Loan to Community Organisation - £0.14m
    - Loan to Trading Company - £0.08m
    - Loan to Local Authority Partnership - £4.36m
    - Loan for Commercial Activities - £31.55m

48. The detail of the Council's total investment in commercial investment property is reported separately. As part of its Commercial Strategy, investment in property has increased significantly in the past three years. The value of investment properties held on the balance sheet as at 31 March 2021 (including some properties held for a substantial period of time) was £79.8m. This has increased by £2.6m during this year, to £82.4m as at 30 September 2021 (not including the loan shown in the previous paragraph).

Financial Implications

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

Background Papers

- Treasury Management Strategy 2021/22 (Full Council February 2021)

Treasury Management Strategy 2021/22

(Updated October 2021)

Introduction

Treasury management is the management of the Council's cash flows, borrowing and investments and the associated risks. The Council has borrowed and invested substantial sums of money and is, therefore, exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of finical risk are, therefore, central to the Council's prudent financial management.

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.

Investments held for service purposes and for commercial income generation are considered in the Investment Strategy above.

External Context

The treasury strategy appropriately considers the wider economic picture. The Council's treasury advisor – Arlingclose – has provided a summary commentary on this wider context in Appendix B.

The Council's balance sheet summary and forecast for the current and future financial years is included in Table 1

Table 1: Balance Sheet Summary and Forecast

	1/4/2020 Actual £000's	31/3/2021 Actual £000's	31/3/2022 Revised Estimate £000's	31/3/2023 Revised Estimate £000's	31/3/2024 Revised Estimate £000's
Capital Financing Requirement	95,582	130,777	163,258	174,707	180,507
Less: External Borrowing	(79,500)	(98,000)	(132,276)	(146,724)	(155,524)
Less: Other debt liabilities (leases)	(51)	(20)	(20)	(20)	(20)
Internal Borrowing	**(16,031)**	**(32,757)**	**(30,962)**	**(28,413)**	**(25,063)**
Less: Usable reserves	48,550	69,447	57,743	57,743	57,743
Less: Working capital surplus/ deficit (-)	2,800	2,800	2,800	2,800	2,800
Treasury Investments / New Borrowing (-)	**35,319**	**39,490**	**29,581**	**32,130**	**35,480**

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investments. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

The Council has an increasing CFR due to the planned spending within the capital programme including significant expenditure on regeneration schemes. The trend of increased expenditure indicates it will be required to borrow up to £156m over the forecast period.

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 over the medium term.

Liability benchmark:

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 the table above, but that cash and investment balances are kept to a minimum level of £30m at each year-end to maintain sufficient liquidity but minimise credit risk.

Table 2: Liability benchmark

	1/4/2020 Actual £000's	31/3/2021 Actual £000's	31/3/2022 Revised Estimate £000's	31/3/2023 Revised Estimate £000's	31/3/2024 Revised Estimate £000's
Total CFR	95,582	130,777	163,258	174,707	180,507
Less: Usable reserves	(48,550)	(69,447)	(57,743)	(57,743)	(57,743)
Less: Working capital	(2,800)	(2,800)	(2,800)	(2,800)	(2,800)
Plus: Minimum investments	30,000	30,000	30,000	30,000	30,000
Liability benchmark	**14,232**	**28,530**	**72,715**	**84,164**	**89,964**

Borrowing Strategy

The Council currently holds £88.00m of loans (as at 30 September 2021), compared to £79.50m on 1 April 2020, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Council expects to borrow up to £133m in 2021/22. The Council may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £205m.

The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

Given the significant cuts to public expenditure and in particular local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short term to either use internal resources, or to borrow short term loans instead.

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 2021/22 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

Alternatively, the Council may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period (although forward loan interest rates will usually factor in an allowance for interest rate risk during the intervening period).

Additionally, the Council may borrow further short term loans to cover unplanned cash flow shortages.

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

- HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
- Any institution approved for investments (see below)
- Any other bank or building society authorised to operate in the UK
- Any other UK public sector body
- UK public and private pension funds (except Somerset County Pension Fund)
- Capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

Other sources of debt finance: In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- Leasing
- Hire purchase
- Private finance initiative
- Sale and leaseback

Municipal Bonds Agency: UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It issues bonds on the capital markets and lend the proceeds to local authorities. This is a more complicated source of finance than the PWLB for two reasons:

- borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason

- there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to full Council.

Short-term and variable rate loans: These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below. Financial derivatives may be used to manage this interest rate risk (see section below).

Debt rescheduling: The HM Treasury's PWLB lending facility 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.

Treasury Investment Strategy

The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's investment balance has ranged between £26m and £46m, and similar levels are expected to be maintained in the forthcoming year.

The CIPFA Code requires the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

The COVID-19 pandemic has increased the risk 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. Since investments cannot pay negative income, negative rates will be applied by reducing the value of investments. 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.

Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to continue to diversify into more secure and/or higher yielding asset classes during 2021/22. The Council has maintained its strategic fund investments at £23.5m and it is estimated that the level of strategic investments as at 31 March 2022 will remain at this level. The COVID-19 pandemic has resulted in uncertainty in cashflow and therefore the increase in strategic investments to the level planned (£27.50m) has not been possible. This diversification will represent a continuation of the strategy adopted in earlier years.

The Council will continue to monitor the risk and returns on its strategic (long-term) investments and will work closely with its treasury advisors ensuring that strategic investments continue to be an appropriate option for the Council.

A proportion of the Council's surplus cash is currently invested in short-term unsecured bank deposits, money market funds and other local authorities.

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

Approved Counterparties

The Council may invest its surplus funds with any of the counterparty types in table 3 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 3: Approved investment counterparties and limits

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

This table must be read in conjunction with the notes below

Credit rating: Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

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.

Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment or to a maximum of £2m per company as part of a diversified pool in order to spread the risk widely.

Registered providers (unsecured): 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 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.

Money market funds: Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Council will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

Strategic pooled funds: Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short term. These allow the Authority 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.

Real estate investment trusts: Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties. Investments in REIT shares cannot be withdrawn but can be sold on the stock market to another investor.

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 below £200,000 per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

Risk assessment and credit ratings: Credit ratings are obtained and monitored by the Council’s treasury advisers, who will notify changes in ratings as they occur. The credit rating agencies in current use are listed in the Treasury Management Practices document. 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 credit rating is on review for possible downgrade (also known as “rating watch negative” or “credit watch negative”) so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other information on the security of investments: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, 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 investment returns to fall but will protect the principal sum invested.

Investment Limits

The Council's revenue reserves available to cover investment losses are forecast to be £4m on 31 March 2022. In order that no more than 20% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £10m. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 4: Investment limits

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

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

The Council will spread its liquid cash over at least three providers (e.g. bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

Treasury Management Indicators

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

Security

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

Credit risk indicator	Target	Actual
Portfolio average credit rating	5.0	

Liquidity

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

Liquidity risk indicator	Target	Actual 30/09/21
Total cash available within 3 months	£10m	£21.3m

Interest Rate Exposures

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

Interest rate risk indicator	Limit	Actual 30/09/21
Upper limit on one-year revenue impact of a 1% rise in interest rates	£200,000	
Upper limit on one-year revenue impact of a 1% fall in interest rates	£150,000	

Maturity Structure of Borrowing

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

Refinancing rate risk indicator	Actual 30/09/21	Upper limit	Lower limit
Under 12 months	100%	100%	100%
12 months and within 24 months	0%	100%	100%
24 months and within 5 years	0%	100%	100%
5 years and within 10 years	0%	100%	100%
10 years and above	0%	100%	100%

Principal Sums Invested For Periods Longer Than a Year

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

Price risk indicator	2021/22	2022/23	2023/24
Limit on principal invested beyond year end	£30m	£25m	£25m

Related Matters

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

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.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria, assessed using the appropriate credit rating for derivative exposures. An allowance for credit risk calculated using the methodology in the Treasury Management Practices document will count against the counterparty credit limit and the relevant foreign country limit.

In line with the CIPFA Code, the Council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.

Markets in Financial Instruments Directive: The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the S151 Officer believes this to be the most appropriate status.

Financial Implications

The budget for investment income and debt interest in 2021/22 is summarised as follows:

Table 5: Interest Income and Costs Budget Estimates

	2021/22 Investment Income £k	**2021/22 Average Interest Rate %**	**2021/22 Interest Costs £k**	**2021/22 Average Interest Rate %**	**2021/22 Net Income or Costs £k**
Total	-1,946	2.10%	1,436	1.00%	-510

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

24 Other Options Considered

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

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

APPENDIX B – Additional commentary from Arlingclose

External Context

Economic background: Economic resurgence from coronavirus pandemic continued to dominate the first quarter of the financial year. In the biggest inoculation programme the country has ever undertaken, over 44 million people in the UK had received their first dose of a COVID-19 vaccine with 32 million also having a second dose.

The Bank of England (BoE) held Bank Rate at 0.1% throughout the period and maintained its Quantitative Easing programme at £895 billion, unchanged since the November 2020 meeting. In its June 2021 policy announcement, the BoE expected the economy to experience a temporary period of strong GDP growth and above-target CPI inflation, after which growth and inflation is expected to fall back. There were, however, two-sided risks around this central path, and it is possible that near-term upward pressure on prices could prove somewhat larger than expected. The Bank's Monetary Policy Committee does not intend to tighten monetary policy at least until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% inflation target sustainably.

Government initiatives continued to support the economy over the quarter, following the range of measures announced by the Chancellor in the 2021 Budget, which included extending the furlough (Coronavirus Job Retention) scheme until September 2021.

The latest labour market data showed that in the three months to April 2021 the unemployment rate fell to 4.7%, although it is likely that labour market slack has remained higher than implied by this measure. Some individuals stopped looking for work during the pandemic and were therefore recorded as inactive. There is uncertainty around how many of these individuals will resume their search for a job, and when. Latest data showed growth in average total pay (including bonuses) and regular pay (excluding bonuses) among employees was 5.6% for the three months February to April 2021. The seemingly high growth partly reflected a base effect from a decline in average pay in the spring of last year, associated with the reduced pay of employees on the furlough scheme.

Annual CPI inflation rose to 2.1% in May on the back of base effects in spring 2020 and partly due to higher energy and commodity prices and supply-side bottlenecks. The BoE expects inflation to exceed 3% for a temporary period. The ONS' preferred measure of CPIH which includes owner-occupied housing was also 2.1% year/year, marginally higher than expectations.

The reimposition of restrictions on activity in the first quarter of calendar 2021 year resulted in GDP falling 1.6% in Q1. GDP growth was strong in April at 2.3% with the partial easing of restrictions on non-essential retail and outdoor hospitality. Housing market activity remained strong, aided by the extension of the stamp duty threshold and an increase in mortgage approvals for house purchases.

The US economy rebounded by 4.3% in Q4 2020 (Oct-Dec) and then an even stronger 6.4% in Q1 as the recovery continued to be fuelled by $5 trillion worth of pandemic stimulus packages. The Federal Reserve maintained its main interest rate at between 0% and 0.25% over the period.

The European Central Bank maintained its base rate at 0%, deposit rate at -0.5%, and asset purchase scheme at €1.85 trillion.

Financial markets: Ongoing monetary and fiscal stimulus together with improving economic growth prospects and successful vaccine rollout programmes continued to boost equity markets over the period. The Dow Jones reached a record high during the period while the UK-focused FTSE 250 index was back above pre-pandemic levels and the more internationally focused FTSE 100 had recouped around three-quarters of 2020 losses.

Inflation worries continued during the period but declines in bond yields between April and June suggest bond markets may be expecting any general price increases to be less severe, or more transitory, that was previously thought.

The 5-year UK benchmark gilt yield began the financial year at 0.36% before declining to 0.32% by the end of June 2021. Over the same period the 10-year gilt yield fell from 0.80% to 0.71%, despite jumping to 0.90% in May. The 20-year yield declined from 1.31% to 1.21%.

The Sterling Overnight Rate (SONIA) averaged 0.05% over the quarter.

Credit review: Credit default swap spreads were relatively flat over the period and remain only slightly above their pre-pandemic levels. The gap in spreads between UK ringfenced and non-ringfenced entities remained, and Santander UK remained an outlier compared to the other ringfenced/retail banks. At the end of June, Santander UK was trading the highest at 52bps and Standard Chartered the lowest at 31bps. The other ringfenced banks were trading between 32 and 34bps while Nationwide Building Society was 38bps.

There were only a small number of credit rating actions over the period. Fitch revised a number of Singaporean and Australian banks as well as Close Brothers to stable, and also upgraded Coventry Building Society to ‘A’ (from ‘A-‘). Towards the end of the period Fitch revised the United Kingdom’s outlook to stable from negative.

S&P also revised some Australian banks to stable, as well as Transport for London, which a week or so later received a £1.08 billion bailout from the UK government. S&P also downgraded the long- and short-term ratings of DZ Bank (Germany) to A+ and A-1 from AA- and A-1+ respectively. In late June S&P took further rating actions, upwardly revising the outlooks for a number of UK and European banks from negative to stable, or in the case of Barclays and Nationwide from stable to positive.

The successful vaccine rollout programme is credit positive for the financial services sector in general, but there remains much uncertainty around the extent of the losses banks and building societies will suffer due to the economic slowdown which has resulted due to pandemic-related lockdowns and restrictions. The institutions and durations on the Authority’s counterparty list recommended by treasury management advisors Arlingclose remain under constant review, but at the end of the period no changes had been made to the names on the list or the recommended maximum duration of 35 days.

South Somerset District Council

Audit Committee Forward Plan

SLT Lead: Karen Watling, Chief Finance Officer
Lead Officer: Michelle Mainwaring, Case Officer (Strategy & Commissioning)
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Purpose of the Report

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

Recommendations

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

Audit Committee Forward Plan

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

Items marked *in italics* are not yet confirmed.

Background Papers

None.

South Somerset District Council

Audit Committee Forward Plan

Meeting Date	Item	Responsible Officer
25th November 2021 – Venue to be confirmed	1. Annual External Auditors' Report	Beth Garner - Manager (Grant Thornton)
	2. Approval of audited Statement of Accounts for 2020/21	Chief Finance Officer and Lead Specialist – Finance (Deputy S151 Officer)
	3. Counter Fraud Programme Update	Monitoring Officer and David Warren, Principal Investigation Officer, (SWAP)
	4. Proposal to opt into the National Scheme for external auditor appointments (to go onto Council)	Chief Finance Officer
	5. Financial Information requested by Audit Committee regarding SSDC Opium Ltd (Restricted Enclosure)	Chief Finance Officer and Lead Specialist – Finance (Deputy S151 Officer)
27th January 2022 – moving to 9th February 2022	1. Internal Audit Plan Progress Update Report	Alastair Woodland, Assistant Director, (SWAP)
	2. Treasury Management Strategy (to go on to Full Council)	Lead Finance Officer/Deputy S151 Officer
	3. Update on Somerset Reorganisation and any impact on the progression and financing of current council projects	Jill Byron - Monitoring Officer
	4. ToR Working Group Update	Alistair Woodland, Assistant Director (SWAP)
24th March 2022	1. External Audit Progress Report	Beth Garner, Manager - Grant Thornton
	2. Audit Plan 2022-2023 and Charter	Alistair Woodland, Assistant Director (SWAP)

TBC	*Annual review of Treasury Management Practices - CIPFA are currently updating the Treasury Management Code and consultation will finish early November 2021. This report will therefore go to Audit Committee when the Code changes are known*	*Lead Specialist – Finance (Deputy S151 Officer)*
	Risk Management Update	*Lead Specialist – Strategic Planning*
	Certificate of Claims Report	*Lead Specialist (Finance) & Deputy S151 Officer*
	Annual Health & Safety Update	*Lead Specialist – Strategic Planning*
	Annual Civil Contingencies and Whistle Blowing Update	*Lead Specialist – Strategic Planning*
	Update on S106 process following recent internal audit report	*TBC*
	Monitoring the recommendations of SWAP following audits.	*TBC*