Bath & North East Somerset Council

Democratic Services
Riverside, Temple Street, Keynsham, Bristol BS31 1LA
Telephone: (01225) 477000 *main switchboard*
Direct Lines - Tel: 01225 395090 Fax: 01225 394439
Web-site - http://www.bathnes.gov.uk

Your ref:
Our ref:
Date: 17 January 2011
E-mail: Democratic_Services@bathnes.gov.uk

To: All Members of the Corporate Audit Committee

Councillors: Andrew Furse (Chair), Tim Ball, Colin Barrett, Armand Edwards, Bryan Organ, Brian Simmons and Brian Webber

Independent Member: John Barker

Chief Executive and other appropriate officers
Press and Public

Dear Member

Corporate Audit Committee: Tuesday, 1st February, 2011

You are invited to attend a meeting of the **Corporate Audit Committee**, to be held on **Tuesday, 1st February, 2011** at **5.00 pm** in the**. Kaposvar Room - Guildhall.**

The agenda is set out overleaf.

Yours sincerely

Sean O'Neill
for Chief Executive

If you need to access this agenda or any of the supporting reports in an alternative accessible format please contact Democratic Services or the relevant report author whose details are listed at the end of each report.

This Agenda and all accompanying reports are printed on recycled paper

NOTES:

1. **Inspection of Papers:** Any person wishing to inspect minutes, reports, or a list of the background papers relating to any item on this Agenda should contact Sean O'Neill who is available by telephoning Bath 01225 395090 or by calling at the Riverside Offices Keynsham (during normal office hours).

2. **Public Speaking at Meetings:** The Council has a scheme to encourage the public to make their views known at meetings. They may make a statement relevant to what the meeting has power to do. They may also present a petition or a deputation on behalf of a group. Advance notice is required not less than two full working days before the meeting (this means that for meetings held on Wednesdays notice must be received in Democratic Services by 4.30pm the previous Friday)

   The public may also ask a question to which a written answer will be given. Questions must be submitted in writing to Democratic Services at least two full working days in advance of the meeting (this means that for meetings held on Wednesdays, notice must be received in Democratic Services by 4.30pm the previous Friday). If an answer cannot be prepared in time for the meeting it will be sent out within five days afterwards. Further details of the scheme can be obtained by contacting Sean O'Neill as above.

3. **Details of Decisions taken at this meeting** can be found in the minutes which will be published as soon as possible after the meeting, and also circulated with the agenda for the next meeting. In the meantime details can be obtained by contacting Sean O'Neill as above.

   Appendices to reports are available for inspection as follows:-

   Public Access points - Riverside - Keynsham, Guildhall - Bath, Hollies - Midsomer Norton, and Bath Central, Keynsham and Midsomer Norton public libraries.

   For Councillors and Officers papers may be inspected via Political Group Research Assistants and Group Rooms/Members' Rooms.

4. **Attendance Register:** Members should sign the Register which will be circulated at the meeting.

5. THE APPENDED SUPPORTING DOCUMENTS ARE IDENTIFIED BY AGENDA ITEM NUMBER.

6. **Emergency Evacuation Procedure**

   When the continuous alarm sounds, you must evacuate the building by one of the designated exits and proceed to the named assembly point. The designated exits are sign-posted.

   Arrangements are in place for the safe evacuation of disabled people.

Corporate Audit Committee - Tuesday, 1st February, 2011

at 5.00 pm in the Kaposvar Room - Guildhall

A G E N D A

1. EMERGENCY EVACUATION PROCEDURE

   The Chair will draw attention to the emergency evacuation procedure as set out under Note 8.

2. ELECTION OF VICE-CHAIR

   To elect a Vice-Chair (if required) for this meeting.

3. APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

4. DECLARATIONS OF INTEREST

   To receive any declarations from Members/Officers of financial or other interests in respect of matters for consideration at this meeting, together with their statements on the nature of any such interests declared.

5. TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

   The Chair will announce any items of urgent business.

6. ITEMS FROM THE PUBLIC - TO RECEIVE DEPUTATIONS, STATEMENTS, PETITIONS OR QUESTIONS

7. ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

   To deal with any petitions, statements or questions from Councillors and, where appropriate, co-opted and added Members.

8. MINUTES: 7 DECEMBER 2010 (Pages 5 - 10)

9. TREASURY MANAGEMENT STRATEGY (Pages 11 - 34)

10. ANNUAL GOVERNANCE STATEMENT UPDATE (Pages 35 - 44)

11. INTERNAL AUDIT - FUTURE SERVICE DELIVERY OPTIONS (Pages 45 - 92)

12. EXTERNAL AUDIT REPORTS (Pages 93 - 132)

The Committee Administrator for this meeting is Sean O'Neill who can be contacted on 01225 395090.

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BATH AND NORTH EAST SOMERSET COUNCIL

CORPORATE AUDIT COMMITTEE

Minutes of the Meeting held

Tuesday, 7th December, 2010, 5.00 pm

Councillors: Tim Ball, Armand Edwards, Bryan Organ, Brian Simmons and Brian Webber
Independent Member: John Barker
Also in attendance: Andrew Pate (Strategic Director - Resources), Tim Richens (Divisional Director - Finance), Jeff Wring (Head of Audit, Risk and Information) and Andy Cox (Risk Manager)

15 EMERGENCY EVACUATION PROCEDURE

The Democratic Services Officer read out the procedure.

16 ELECTION OF VICE-CHAIR

RESOLVED that a Vice-Chair was not required on this occasion.

17 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

Apologies were received from Councillor Colin Barrett.

18 DECLARATIONS OF INTEREST

There were none.

19 TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

There was none.

20 ITEMS FROM THE PUBLIC - TO RECEIVE DEPUTATIONS, STATEMENTS, PETITIONS OR QUESTIONS

There were none.

21 ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

A Member asked about the future of Business Link West following the abolition of the Regional Development Agency and the replacement of the West of England Partnership by a Local Enterprise Partnership. The Chair said that he would seek information from the Divisional Director – Development and Regeneration and report back.

22 MINUTES: 30 SEPTEMBER 2010

These were approved as a correct record and signed by the Chair.

23 TREASURY MANAGEMENT SIX MONTHLY UPDATE REPORT

The Divisional Director – Finance presented the report. He said that as part of the Comprehensive Spending Review the Government had increased the interest rate charged by the Public Works Loans Board (PWLB) by 1% above UK Government Gilts. The Council had been fortunate in the timing of borrowing that had antedated this increase, but there would be an impact on future borrowing costs. Consideration was being given to the issue of corporate bonds by the Council, because this could be the cheapest form of borrowing.

A Member asked whether all borrowing had been risk-assessed and expressed concern about the risk of the Council being unable to repay the long-term loans of 30-50 years listed on page 19 of the Appendix. The Divisional Director – Finance said that borrowing only took place when interest rates were satisfactory, otherwise cash was used to finance the capital programme. The financing of the capital programme would be reviewed by the whole Council in February 2011 as part of the budget setting process. The length of loans depended on the life of the asset; buildings would have an expected life of 50-60 years.

A Member asked about the interest rates on long-term loans. The Divisional Director – Finance said that they were actually short-term rates. 4.75% was an extremely good rate – the lowest that could now be obtained following the PWLB change was 5.4%.

A Member asked about the impact of schools becoming Academies on the Council's budget. The Divisional Director – Finance explained that the Council would merely pass the funds provided by the Government to the Academies.

RESOLVED to note the Treasury Management Monitoring Report to 30th September 2010.

24 RISK MANAGEMENT ANNUAL UPDATE REPORT

The Head of Audit, Risk and Information drew attention to the information in paragraph 4.3 of the report that, following the Government's announcement about the future of the PCTs, it was no longer the intention to integrate the Council and PCT risk management strategies but to align them. The Council's risk management had had to be rewritten to reflect this and would be submitted for the decision of the Cabinet Member for Resources.

The Risk Manager summarised the progress report on the Risk Management Strategy attached as Appendix 1 to the main report. He then distributed copies of the Corporate Risk Register and commented on it, using several examples to explain how risk ratings could be changed or how it could be decided to remove particular risks from the Register altogether.

A Member asked about the success in engaging team leaders with the risk management strategy. The Risk Manager replied that there was a core staff competency relating to risk management and that it was an item on all staff induction courses, where emphasis was laid on the "golden thread" linking high-level Council objectives with individual staff objectives.

A Member asked about the risk management implications of Academies. Another Member noted that Academies acquired the ownership of the school's assets. The Divisional Director – Finance said that the Director of Children's Services would ensure that there was no major expenditure on schools that were likely to become Academies in the near future.

RESOLVED to note the report.

25 INTERNAL AUDIT SIX MONTHLY UPDATE REPORT

The Head of Audit, Risk and Information presented the report. He acknowledged that the performance of 80% of planned work completed was disappointing, but underlined there were several mitigating factors. He drew attention to the information given in paragraphs 4.11-4.15 about the Financial Management Standard in Schools following the Government's decision to abolish it.

A Member referred to the statement about the flexible working of the Internal Audit team and the reduced accommodation need arising from this. He wondered what assessments had been undertaken to ensure that the Council did not make wrong decisions about accommodation. The Head of Audit, Risk and Information replied that all services were seeking to reduce their accommodation. One of the reasons the new auditing software had been chosen was that it facilitated flexible working and so reduced accommodation requirements.

Mr Hackett asked about the prospects of completing the work plan by March. The Head of Audit, Risk and Information replied that in January and February priority had to be given to the Corporate Plan. The work plan was under review, and the need for follow-up action from previous audit work would be looked at very carefully. There were resources available for temporary staff.

A Member said that he had heard that a Council was considering discontinuing its anti fraud and corruption service because it did not recover its costs and asked about the future of the service in B&NES. The Head of Audit, Risk and Information said that consideration was being given to which functions were core and which could be outsourced, but that there was no chance of anti-fraud and corruption work being discontinued.

RESOLVED to note progress on the Internal Audit Plan 2010/11 and Internal Audit's performance within the CIPFA Benchmarking exercise.

26 CHANGES TO VFM OPINION AND OPINION AUDIT

The District Auditor distributed to Members copies of a set of slides on the new methodology for the 2010-2011 Value for Money (VfM) conclusion. A copy is attached to these minutes as an appendix. In future VfM would be assessed against the two criteria described in the slides and there would no longer be Key Lines of Enquiry. The Director of Resources and Support Services said that the Council was already doing a great deal to improve VfM. There was a Change Programme and a great many improvements were noted in the Annual Audit Letter. He was confident that Bath & North East Somerset was in a much stronger position to face the future than many other Councils. A Member asked what risk assessments had been taken carried out for the Change Programme. The Director of Resources and Support Services responded that there were risks associated with the programme, but he felt, whilst the Corporate Audit Committee did have a role in relation to them, most were service-specific and fell within the jurisdiction of the Overview and Scrutiny Panels. He would consider how the Corporate Audit Committee could be provided with an overview of the risks without duplicating the work of the O&S Panels. A Member suggested that the Chairs of the O&S Panels might make a joint report to the Committee. The District Auditor said that the Change Programme could necessitate changes to controls and that the Committee needed to be sure that an adequate risk management and governance framework was in place.

A Member asked what would be the main differences between the new VfM approach and the previous Comprehensive Performance Review, what form the assessment report would take, and whether the use of resources other than finance, e.g. staff would be taken into account. The District Auditor replied that under the new approach there would be no grading system that would allow direct comparisons between Councils; the aim was to understand how individual Councils operated. The external auditors would not provide full assurance, but would assess corporate arrangements on a pass or fail basis. The form of reports was still under development. Staffing would be assessed only from a financial point of view.

Mr Hackett explained the changes relating to the Opinion Audit. He explained that the professional accountancy bodies had agreed new International Standards on Auditing (ISA). These would affect the way the next audit would have to be carried out. The main changes would occur in Journals, Related Party Transactions, Accounting Entries and Reporting Deficiencies in Internal Control. Accounts inevitably included many estimates and auditors would in future have to more work on the basis for these estimates.

RESOLVED to note the changes proposed in relation to the VfM opinion for Local Authorities and the Opinion Audit in relation to the Annual Accounts.

27 COMPLIANCE WITH ISA'S - FRAUD AND CORRUPTION

The Head of Audit, Risk and Information presented this item. The Committee was requested to make a formal response to the Audit Commission about compliance with International Auditing Standards (ISA) in relation to fraud and corruption. He provided Members with a copy of a draft response. The Chair summarised and commented on the response.

The Divisional Director – Finance said that he would keep the Committee informed of if any changes were required to the Council’s implementation of ISA.

RESOLVED to approve the draft response to the Audit Commission letter.

28 ANNUAL AUDIT LETTER - AUDIT 2009/10

The District Auditor presented the report. He said that overall the letter reflected the improvements the Council had made over the past twelve months. He drew attention to the section on “current and future challenges” on page 3 of the letter and also to the comments about the implementation International Financial Reporting Standards (IFRS) on pages 4 and 5. He said that the challenge of implementing IFRS should not be underestimated. He noted that the Finance team had a project plan in place for implementation, but he advised Members that they should seek regular assurance that the plan was on target. He said the challenge presented by the abolition of the PCT was for the Council not to lose the benefits of the work already done on Council/PCT integration. The Council had been proactive in its work with the PCT and should strive to keep on top of issues during the transition period. He said that the Council was fortunate in having balances above the minimum level and had been proactive in planning for future funding cuts. However, the Council was also committed to significant structural changes and had to ensure that there was enough capacity to implement these and to work with external stakeholders.

A Member was concerned by the recent Government statement encouraging local authorities to use their reserves to address immediate financial challenges.

A Member asked about future audit fees. The District Auditor replied that 2010/2011 would be the last audit conducted under the old Audit Commission framework. He would be surprised if there were significant reductions in fees, because the Audit Commission was to be wound up and this would give rise to exceptional one-off costs. It was possible that the Commission would become an independent auditor, which, he believed, would result in a significant reduction in costs because of a reduction in overheads.

RESOLVED to note the Annual Audit Letter 2009/10.

29 AUDIT PLAN EXTERNAL 2010/11

The District Auditor presented the 2010/11 External Audit Plan.

RESOLVED to note the Audit Plan 2010/11.

The meeting ended at 7.09 pm

Chair(person) ....

Date Confirmed and Signed ....

Prepared by Democratic Services

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Bath & North East Somerset Council		
MEETING:	**Corporate Audit Committee**	
MEETING DATE:	**1st February 2011**	**AGENDA ITEM NUMBER**
TITLE:	**Treasury Management Strategy Statement and Annual Investment Strategy 2011/12**	
WARD:	All	
AN OPEN PUBLIC ITEM		
List of attachments to this report: **Appendix 1 –** Treasury Management Strategy 2011/12 **Appendix 2 –** Annual Investment Strategy 2011/12 **Appendix 3 –** Authorised Lending List		

1 THE ISSUE

1.1 In February 2010 the Council adopted the 2009 edition of the CIPFA Treasury Management in the Public Services: Code of Practice, appointing the Corporate Audit Committee as the required body to scrutinise a Treasury Management Strategy before the start of each financial year, a mid year report, and an annual report after the end of each financial year.

1.2 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.

1.3 The Act therefore requires the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy; this report sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

2 RECOMMENDATION

The Corporate Audit Committee is asked to agree that:

2.1 the actions proposed within the Treasury Management Strategy Statement (Appendix 1) have been scrutinised and are submitted to February Council for approval.

2.2 the Investment Strategy as detailed in Appendix 2 have been scrutinised and is submitted to February Council for approval.

2.3 the changes to the authorised lending lists detailed in Appendix 2 and highlighted in Appendix 3 have been scrutinised and are submitted to February Council for approval.

2.4 it is noted that at the Cabinet meeting on 2nd February 2011, it is recommended to delegate authority for updating the Prudential Indicators (detailed in Appendix 1), prior to approval at Full Council on 16th February 2010, to the Divisional Director - Finance and Cabinet Member for Resources, in light of any changes to the recommended budget as set out in the Budget Report also on the agenda for the Cabinet meeting.

FINANCIAL IMPLICATIONS

2.5 The financial implications are contained within the body of the report and appendices.

3 THE REPORT

Background

3.1 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.

3.2 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.

3.3 The suggested strategy for 2011/12 in respect of the following aspects of the treasury management function is based on the Treasury Officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor.

The strategy covers:

•	Treasury limits in force which will limit the treasury risk and activities of the Council;
•	Prudential Indicators;
•	The current treasury position;
•	The borrowing requirement;
•	Prospects for interest rates;
•	The borrowing strategy;
•	Debt rescheduling;
•	The investment strategy.

3.4 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from: -

1. increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
2. any increases in running costs from new capital projects , and
3. increases in the Minimum Revenue Provision for capital expenditure

are limited to a level which is affordable within the projected income of the Council for the foreseeable future

3.5 The revised CIPFA Treasury Management in Public services Code of Practice, adopted by Council in February 2010, requires the Treasury Management Strategy and policies to be scrutinised by an individual / group of individuals or committee. The Council recommended the Corporate Audit Committee to carry out this function.

2011/12 Treasury Management & Annual Investment Strategy

3.6 The Prudential Code was introduced for the first time in 2004/05. The Strategy Statement for 2010/11 set Prudential Indicators for 2010/11 – 2012/13, which included a total borrowing requirement at the end of 2010/11 of £105 million. At the end of December 2010, external borrowing was at £90 million, with no further borrowing planned in the 2010/11 financial year. There is a full provision for this borrowing within the Council's revenue budget.

3.7 The proposed Treasury Management Strategy is attached at Appendix 1 and includes the Prudential Indicators required by the Prudential Code. The Prudential Indicators contained within this report are currently draft and could be affected by changes made to the capital programme, following decisions on the budget report which is also on the agenda for this meeting. It is therefore requested that the Cabinet grant delegated authority to the Divisional Director - Finance and the Cabinet Member for Resources to agree any changes to the indicators prior to reporting for approval at Full Council on the 15th February 2011.

3.8 Although the Prudential Indicators provide for a maximum level of total borrowing, this should by no means be taken as a recommended level of borrowing as each year affordability needs to be taken into account together with other changes in circumstances, for example revenue pressures, levels and timing of capital receipts, changes to capital projects spend profiles, and levels of internal cash balances.

3.9 The budget report, which is also on the agenda, includes full provision for the revenue costs of proposed borrowing recognising the affordability of the capital programme including the significant efficiency savings which will be generated as a result.

3.10 Appendix 1 also details the Council's current portfolio position as at 31st December 2010, which shows after the netting off of the £76.1 million investments, the Council's net debt position was £13.9 million.

3.11 The potential generation of significant capital receipts of up to £100m over the next five years to invest in and implement the Public Realm & Movement Strategy and other necessary infrastructure for the future sustainable development of the area, as detailed in the Future Council report from the agenda of 3rd November 2010 Cabinet, could lead to a decrease in the future borrowing requirement of the Council as they are potentially applied to support planned capital projects.

3.12 The Annual Investment Strategy is attached at Appendix 2. This sets 'outer limits' for treasury management operations. While the strategy uses credit ratings in a "mechanistic" way to rule out counterparties, in operating within the policy Officers complement this with the use of other financial information when making investment decisions, for example Credit Default Swap (CDS) Prices, Individual Ratings, financial press. This has been the case in recent years, which protected the Council against losses of investment in Icelandic banks.

3.13 The Counterparty listing in Appendix 3 includes credit ratings from three agencies, as well as a sovereign rating for each country. Counterparties who now meet the minimum criteria as recommended in Appendix 2 as at 31st December 2010 are included in the listing in Appendix 3.

3.14 Interest rate forecasts from the Council's Treasury advisors are included in Appendix 1.

4 RISK MANAGEMENT

4.1 The Council's lending & borrowing list has been regularly reviewed during the financial year and credit ratings are monitored throughout the year. All lending/borrowing transactions are within approved limits and with approved institutions. Investment & Borrowing advice is provided by our Treasury Management consultants Sterling.

4.2 The 2009 edition of the CIPFA Treasury Management in the Public Services: Code of Practice requires the Council nominate a committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies. In May 2010, the Council's treasury advisors provided training to the Corporate Audit Committee to carry out this scrutiny.

4.3 In addition, the Council maintain a risk register for Treasury Management activities, which is regularly reviewed and updated where applicable during the year.

5 EQUALITIES

5.1 This report provides information about the Council's Treasury Management Strategy and therefore no specific equalities impact assessment was carried out.

6 CONSULTATION

6.1 Consultation has been carried out with the Deputy Leader of The Council & Cabinet Member for Resources, Section 151 Finance Officer, Chief Executive and Monitoring Officer prior to this report being presented to the 2nd February 2011 Cabinet meeting.

6.2 Consultation was carried out via e-mail.

7 ISSUES TO CONSIDER IN REACHING THE DECISION

7.1 This report deals with issues of a corporate nature.

8 ADVICE SOUGHT

8.1 The Council's Monitoring Officer (Council Solicitor) and Section 151 Officer (Divisional Director - Finance) have had the opportunity to input to this report and have cleared it for publication.

Contact person	*Tim Richens - 01225 477468 ; Jamie Whittard - 01225 477213* *Tim_Richens@bathnes.gov.uk* *Jamie_Whittard@bathnes.gov.uk*
Sponsoring Cabinet Member	*Councillor Malcolm Hanney*
Background papers	*2010/11 Treasury Management & Investment Strategy* *Q1 Treasury Performance Report (Single Member Decisions)*
Please contact the report author if you need to access this report in an alternative format	

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APPENDIX 1

TREASURY MANAGEMENT STRATEGY – 2011/2012

Treasury Limits for 2011/12 to 2013/14

It is a statutory duty under s.3 of the Local Government Act 2003, and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. This amount is termed the 'Affordable Borrowing Limit'.

The Council must have regard to the Prudential Code when setting the Affordable Borrowing Limit. The Code requires an authority to ensure that its total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax levels is 'acceptable'.

The Affordable Borrowing Limit must include all planned capital investment to be financed by external borrowing and any other forms of liability, such as credit arrangements. The Affordable Borrowing Limit is to be set on a rolling basis for the forthcoming year and two successive financial years.

Prudential Indicators for 2011/12 – 2013/14

The following prudential indicators are relevant for the purposes of setting an integrated treasury management strategy.

The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The revised code was formally adopted by Council in February 2010.

In addition, the Department for Communities and Local Government (CLG) issued revised guidance on Local Authority investments in March 2010, which require the Council to approve an investment strategy before the start of each financial year.

Treasury Management Prudential Indicators for 2011/12 – 2013/14

PRUDENTIAL INDICATOR	2009/10	2010/11	2011/12	2012/13	2013/14
Treasury Management Indicators	£'000	£'000	£'000	£'000	£'000
Authorised limit for external debt					
These limits include current commitments and proposals in the budget report for capital expenditure, plus additional headroom over & above the operational limit for unusual cash movements. The increase between 2010/11 and 2011/12 reflects the borrowing requirement of the 3 year Capital Programme, enabling the Council to have flexibility in using financial instruments to borrow in advance of need.					
borrowing	85,000	115,000	*201,000*	*201,000*	*207,000*
Other long term liabilities	2,000	3,000	*3,000*	*3,000*	*3,000*
Cumulative Total	**87,000**	**118,000**	***204,000***	***204,000***	***210,000***
Operational limit for external debt					
The operational boundary for external debt is based on the same estimates as the authorised limit but without the additional headroom for unusual cash movements and without the capacity for borrowing in advance of need.					
borrowing	80,000	105,000	*150,000*	*177,000*	*204,000*
other long term liabilities	2,000	2,000	*2,000*	*2,000*	*2,000*
Cumulative Total	**82,000**	**107,000**	***152,000***	***179,000***	***206,000***
Interest Rate Exposures					
These indicators are set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest exposures, expressed as the amount of net principle borrowed will be:					
Upper limit for fixed interest rate exposure					
This is the maximum amount of total net borrowing which can be at fixed interest rate.	£82m	£107m	*£204m*	*£204m*	*£206m*
Upper limit for variable interest rate exposure					
While fixed rate interest contributes significantly to reducing uncertainty surrounding interest rate changes, the pursuit of optimum performance levels may justify keeping a degree of flexibility through the use of variable interest rates.					
This is the maximum amount of total borrowing which can be at variable interest rates less any investments at variable interest rates (including fixed rate investments under 12 months).	£41m	£20m	*£0m*	*£0m*	*£0m*

Upper limit for total principal sums invested for over 364 days
The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The indicator sets an upper limit for longer term investments that represent its core cash balances that are unlikely to be needed for short term cash flow purposes.

	2009/10	2010/11	2011/12	2012/13	2013/14
The maximum % of total investments which can be over 364 days.	80%	25%	25%	25%	25%

Maturity structure of borrowing

The following indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

Maturity Structure of fixed rate borrowing	Upper limit	Lower limit
Under 12 months	50%	NIL
12 months and within 24 months	50%	NIL
24 months and within 5 years	50%	NIL
5 years and within 10 years	50%	NIL
10 years and above	100%	NIL

This indicator applies to the financial years 2011/12, 2012/13 and 2013/14. 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.

Current Portfolio Position

The Council's treasury portfolio position at 31st December 2010 comprised:

	Principal	**Ave. rate**
	£m	%
Total Fixed rate funding	PWLB 70	4.26
Variable rate funding	Market 20	4.50*
Other long term liabilities	Nil	N/A
TOTAL DEBT	**90**	**4.32**
TOTAL INVESTMENTS**	**76.1**	**1.09**
NET DEBT	**13.9**	**-**

* The market loans are 'lenders options' or LOBO's. These are fixed at a relatively low rate of interest for an initial period but then revert to a higher rate of 4.5%. When the initial period is over the loans are then classed as variable, as the lender has the option to change the interest rate at 6 monthly intervals, however at this point the borrower has the option to repay the loan without penalty.

** Total Investments includes Schools balances where schools have not opted for an external bank account and cash balances related to PCT Pooled budgets and West of England Growth Points funding.

Prospects for Interest Rates

The Council has appointed Sterling Treasury Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following section gives their commentary on the economic context and views on the prospects for future interest rates.

Economic Context

The strength of the UK economy's recovery from recession has surprised analysts and policymakers alike. A 2.0% increase in the six months to September left gross domestic product 2.8% higher than a year ago. Economic activity has been boosted by three main factors: the exceptionally loose stance of monetary policy, the lower value of sterling and the recovery in international trade. With exports cheaper because of the depreciation of sterling, the recovery in global trade has primarily benefited the manufacturing sector

Despite the recession, inflation has remained stubbornly high. The annual change in the consumer price index increased to 3.2% in October, and has been above the 2% target for 36 of the past 45 months. A number of factors have boosted consumer price inflation. The resumption of the 17.5% VAT rate, a rise in commodity prices and higher import prices due to the past depreciation of sterling have acted to offset the effect from weaker domestic demand.

The current factors boosting inflation are considered temporary by members of the Bank of England's Monetary Policy Committee (MPC) and not representative of the underlying demand and supply situation. Inflation is expected to remain above target throughout 2011, but fall below target in 2012 as the effect of these temporary factors wanes. This outlook is driven by the expectation that potential supply comfortably exceeds demand, and that this significant margin of spare capacity will bear down on pricing pressure. The continuing poor availability of credit and forthcoming fiscal tightening are expected to weigh on domestic demand throughout the forecast period.

The outlook suggests the MPC will look to maintain the current level of accommodative monetary policy to support demand in the face of considerable headwinds. Our central forecast therefore sees Bank Rate remaining at 0.5% for most of 2011, and although rising thereafter, remaining below "normal" levels until 2013. Longer-term interest rates are likely to rise slowly as the economic situation improves and government borrowing increases, but the rate of increase will be tempered by the coalition government's austerity measures and the safe haven status of UK government debt.

The high level of uncertainty surrounding the economic and geo-political outlook means there are substantial risks to both the up- and downside. The speed of monetary tightening depends on the recovery in domestic demand, which in turn depends on private sector confidence and the strength of the global economy. Long-term rates may rise more significantly if risk appetite increases due to faster economic growth or, if planned spending cuts undershoot expectations, the government loses investor confidence. Equally rates could fall in the event of a sovereign default or non-financial event, as long as the UK retains its safe haven status.

Sterling Consultancy Services central interest rate forecast – November 2010

	Bank Rate	1 month LIBOR	3 month LIBOR	12 month LIBOR	25 year PWLB
Current	0.50	0.57	0.74	1.47	5.26
Q1 2011	0.50	0.60	0.80	1.60	5.45
Q2 2011	0.50	0.60	0.90	2.00	5.55
Q3 2011	0.50	0.60	1.00	2.50	5.65
Q4 2011	1.00	1.10	1.50	2.75	5.75
H1 2012	2.00	2.10	2.50	3.50	5.85
H2 2012	3.00	3.10	3.50	4.25	5.95
H1 2013	4.00	4.10	4.50	5.00	6.05

HM Treasury Survey of Forecasts – November 2010

	Average annual Bank Rate %			
	2011	2012	2013	2014
Highest	1.8	3.1	3.6	4.5
Average	0.7	1.5	2.5	3.1
Lowest	0.5	0.5	0.6	1.2

Sterling's current interest rate view is that Bank Rate: -

- Will remain at 0.5% until the first half of 2011 when it will increase to 1% followed by further 1% increases during the second half of 2011, the first half of 2012 and again in the second half of 21012, taking the rate to 4%.

The Council has budgeted for interest rates at 1.0% for 2011/12, 2.0% for 2012/13 & 3.0% thereafter. This is broadly in line with Sterling's view of 1.13%, 2.02% & 2.97% based on 3 month LIBOR rates.

Borrowing Strategy

The Council currently holds £90 million of long-term loans. No further borrowing is anticipated during the remainder of 2010/11.
The Council's capital financing requirement (CFR, or underlying need to borrow) as at 31st March 2011 is expected to be £125 million, and is forecast to rise to £151 million by March 2012 as capital expenditure is incurred.

The maximum expected long-term borrowing requirement for 2011/12 is:

	£m
Not borrowed in previous years	35
Forecast increase in CFR	26
Loans maturing in 2011/12	0
TOTAL	61

Looking at available borrowing instruments may now be cost effective in light of changes to PWLB borrowing rate increases. However, depending on the pattern of interest rates during the year, it may be more beneficial to defer borrowing until later years, and to temporarily reduce the size of the Council's investment balance instead. The capital financing budget for borrowing in 2011/12 assumes borrowing of £35 million is taken during the year.

In addition, the Council may borrow for short periods of time (normally up to two weeks) to cover unexpected cash flow shortages.

<u>Sources of borrowing</u>
The approved sources of long-term and short-term borrowing will be:

- Public Works Loan Board
- any institution approved for investments as listed in the Authorised Counterparty List
- any other bank or building society on the Financial Services Authority list
- Public or Private Bond Placement

<u>Debt instruments</u>
Loans will be arranged by one of the following debt instruments:

- fixed term loans at fixed or variable rates of interest, subject to the Prudential Indicators above.
- lender's option borrower's option (LOBO) loans, subject to limits on variable rate borrowing set out in the Prudential Indicators above.
- bonds

As an alternative to borrowing loans, the Council may also finance capital expenditure and incur long-term liabilities by means of:

- leases
- Private Finance Initiative

<u>Borrowing strategy to be followed</u>

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 not borrow and reduce the level of investments held instead. However, with long-term rates forecast to rise in the coming years, any such short-term savings will need to be balanced against potential longer-term costs. Officers will keep the borrowing strategy under review during the year and take advice from our external advisers with reference to movements in the differential between short term and long term interest rates.

The Council has previously raised the majority of its long-term borrowing from the Public Works Loan Board. However, the government's recent decision to raise the interest rates on new PWLB loans by around 0.85% means that other sources of finance may now be more favourable. In light of this the Council will be exploring alternative methods of borrowing which may be more cost effective. One example would be a Bond Issue where indicative savings of 0.25% to 0.50% over PWLB rates may be achievable.

The Public Works Loan Board 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. The Council may take advantage of this and replace some higher rate loans with new loans at lower interest rates where this will lead to an overall saving or reduce risk.

All rescheduling will be reported in the next available Treasury Management Monitoring report following its action with all rescheduling detailed in the annual review report.

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APPENDIX 2

ANNUAL INVESTMENT STRATEGY

Investment Policy

The Council will have regard to the CLG's Guidance on Local Authority Investments and CIPFA's Treasury Management in Public Services Code of Practice. Both the CIPFA Code and the CLG Guidance require the Council to invest its funds prudently, and to have regard to the **security** and **liquidity** of its investment before seeking the highest rate of return, or **yield**.

The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

Investment instruments identified for use in the financial year are listed below under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

The strategy of this policy is to set outer limits for treasury management operations. In times of exceptional market uncertainty, Council Officers will operate in a more restrictive manner than the policy allows, as has been the case during the last three years.

Avon Pension Fund Investments

The Council's Treasury Management team also manage the Avon Pension Fund's internally held cash on behalf of the Fund. New regulations required that this cash is accounted for separately and needs to be invested separately from the Council's cash, and the split has been managed this way since 1 April 2010. The Fund's investment managers are responsible for the investment of cash held within their portfolios and this policy does not relate to their cash investments.
The cash balance held internally is a working balance to cover pension payments at any point in time and as a result the working balance will be c. £10 million. This working balance represents around 0.5% of the overall assets of the Fund. These investments will operate within the framework of this Annual Investment Strategy, but the maximum counterparty limit and investment term with any counterparty were set by the Avon Pension Fund Committee at its meeting on 18th December 2009. These limits are in addition to the Council's limits for counterparties as set out in Appendix 3.

Specified Investments

Specified investments are those expected to offer relatively high security and liquidity, and can be entered into with the minimum of formalities. The CLG Guidance defines specified investments as those:

- denominated in pounds sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local authority, parish council or community council, or
  - a body or investment scheme of "high credit quality".

The Council defines the following as being of "high credit quality" for making specified investments, subject to the monetary and time limits shown.

	Maximum Monetary limit	Time limit (or notice)
Banks and building societies holding long-term credit ratings no lower than A or equivalent, short-term credit ratings no lower than F1 or equivalent and Support Ratings no lower than 3 or equivalent	£20m each (highest limit) [1]	12 months
UK building societies not meeting the above criteria that have a minimum asset size of £4bn and a long-term rating of BBB or above and short-term credit rating of F2 or above.	£2m each	3 months
Money market funds[2] holding the highest possible credit ratings (AAA)	£5m each	1 week
UK Central Government (Including Debt Management Agency Deposit Facility)	no limit	12 months
UK Local Authorities[3]	£5m each	12 months

[1] banks within the same group ownership are treated as one bank for limit purposes; Within this category and in accordance with the Code, The Council has set additional criteria to set the time limit and amount of monies which will be invested. The countries from which banks the Council can invest are detailed in the paragraph "Foreign Countries" below
[2] as defined in the Local Authorities (Capital Finance and Accounting) Regulations 2003
[3] as defined in the Local Government Act 2003

The Council will continue its policy of using increased counterparty limits (£20m) in relation to investments with UK banks & Building Societies that have either already or are likely to receive support from the UK Government should they experience financial difficulties. These limits will only apply while the Fitch "Support" rating remains at the highest level (Level 1). This is restricted to the following banks and Building Societies:

Barclays Bank, HSBC Bank, Lloyds Banking Group (Lloyds TSB & Bank of Scotland), Royal Bank of Scotland Group (Nat West & Royal Bank of Scotland) and Nationwide Building Society.

Building Societies
UK building societies with lower credit ratings will be considered to be of "high credit quality", but subject to a lower cash limit and shorter time limit than rated societies. The Council takes additional comfort from the building societies' regulatory framework and insolvency regime where, in the unlikely event of a building society liquidation, the Council's deposits would be paid out in preference to retail depositors. Investments in lower rated and unrated building societies will be reviewed if the insolvency regime is amended in future.

However, no investments will be made with building societies that hold a short-term credit rating lower than F2 or equivalent or a long-term credit rating of BBB or equivalent due to the increased likelihood of default implied by this rating.

Money market funds
Money market funds are pooled investment vehicles consisting of instruments similar to those used by the Council. They have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager. Fees of between 0.10% and 0.20% per annum are deducted from the interest paid to the Council.

The highest quality funds currently hold AAA credit ratings, although the rating scales applicable to money market funds are currently under review. Should the rating system change, funds holding ratings deemed to be equivalent to AAA will still be considered to be of "high credit quality".

Non-Specified Investments

Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments in foreign currencies, nor any with low credit quality bodies, nor any that are defined as capital expenditure by legislation (such as company shares or corporate bonds).

Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement. The maximum duration of the investment will depend upon its lowest published long-term credit rating and whether it is a UK counterparty:

Long-term credit rating	Time limit (UK)	Time limit (Foreign)
AAA	5 years	5 years
AA+	2 years	2 years
AA	2 years	N/A
AA-	2 years	N/A

The time limit for long-term investments in UK Local Authorities will be five years.

Long-term investments will be limited to 50% of a banks total counterparty limit where it meets the above credit rating criteria (except the UK Government). The combined value of short-term and long-term investments with any organisation will not exceed the limits for specified investments highlighted above.

The total limit on long-term investments, and the total limit on non-specified investments is 25% of total investments.

Information on the security of investments

Full regard will be given to available information on the credit quality of banks and building societies, including credit default swap prices, financial statements and rating agency reports. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria set out above.

Use of Credit Ratings

The Council uses credit ratings from the three main rating agencies Fitch Ratings Ltd, Moody's Investors Service and Standard & Poor's to assess the risk of loss of investments. The lowest available credit rating will be used to determine credit quality.

In light of the experience of Government support to banks over the past year, and the likelihood this will continue, the Council will not be restricted on the "Individual" rating to assess counterparties, placing more reliance on the "Support" ratings to supplement long and short term ratings. Support Ratings are the Ratings Agencies assessment of a potential supporter's propensity to support a bank, and of its ability to support it. Support Ratings do not assess the intrinsic credit quality of a bank. Rather they communicate the agency's judgment on whether the bank would receive support should this become necessary. Although the Council will no longer be restricted by "Individual" ratings, they will still be considered as part of the overall investments decision making process. This move to no longer place such high reliance on "Individual" ratings has been suggested by our external adviser.

Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings on a daily basis as they occur, and the counterparty listing is updated immediately. Where an institution has its credit rating downgraded so that it fails to meet the above criteria then:

- no new investments will be made,
- any existing investments that can be recalled at no cost will be recalled, and
- full consideration will be given to the recall of any other existing investments

Where a credit rating agency announces that it is actively reviewing an organisation's credit ratings with a view to downgrading it so that it is likely to fall below the above criteria, no further investments will be made until the outcome of the review is announced.

If further counterparties are identified during the year that meet the minimum credit rating criteria and conform to the other criteria set out in the Treasury Management Practice Schedules, they can be added to the lending list following the agreement of the Section 151 Officer and the Cabinet Member for Resources.

Investment instruments

Investments may be made using any of the following instruments:

- interest paying bank accounts
- fixed term deposits
- call or notice deposits (where the Council can demand repayment)
- callable deposits (where the bank can make early repayment)
- certificates of deposit
- treasury bills and gilts issued by the UK Government
- bonds issued by multilateral development banks (*e.g. the EIB*)
- AAA money market funds

Investments may be made at either a fixed rate of interest, or at a variable rate linked to a market interest rate, such as LIBOR.

Foreign countries

Investments in foreign countries will be limited to those that hold a AAA or AA+ sovereign credit rating from all three major credit rating agencies, and to a maximum of £15 million per country. Banks that are domiciled in one country but are owned in another country will need to meet the rating criteria of and will count against the limit for both countries. There is no limit on investments in the UK.

Liquidity management

The Council regularly reviews and updates its cash flow forecasts to determine the maximum period for which funds may prudently be committed. Limits on long-term investments are set by reference to the Council's medium term financial plan, levels of reserves and cash flow forecast.

Planned investment strategy for 2011/12

Investments are made in three broad categories:

- Short-term – cash required to meet known cash outflows in the next month, plus a contingency to cover unexpected cash flows over the same period.

- Medium-term – cash required to manage the annual seasonal cash flow cycle, including amounts to cover forecast shortages, planned uses of reserves, and a longer-term contingency.
- Long-term – cash not required to meet cash flows, and used primarily to generate investment income.

Short-term funds are required to meet cash flows occurring in the next month or so, and the preservation of capital and liquidity is therefore of paramount importance. Generating investment returns is of limited concern here, although it should not be ignored. Bank deposit accounts will be the main methods used to manage short-term cash.

Medium-term funds which may be required in the next one to twelve months will be managed concentrating on security, with less importance attached to liquidity but a slightly higher emphasis on yield. The majority of investments in this period will be in the form of fixed term deposits with banks and building societies. Preference will continue to be given to investments with UK banks with high credit ratings, on the basis that they either had already or were likely to receive support from the UK Government should they experience financial difficulties. The higher counterparty limits assigned to these banks facilitates this approach.

Cash that is not required to meet any liquidity need can be invested for the longer term with a greater emphasis on achieving returns that will support spending on local authority services. Decisions on making longer term investments (i.e. over 1 year) will be considered during the year after taking account of the interest rate yield curve, levels of core cash and the amount of temporary internal borrowing related to funding of capital spend.

With short-term interest rates currently much lower than long-term rates, due consideration will also be given to using surplus funds to make early repayments of long-term borrowing. In addition to the savings on the interest rate differential, this strategy will also reduce the Council's exposure to credit risk and interest rate risk.

Review Reports

The revised CIPFA Code of Practice requires that both mid year and annual review reports on treasury activities are reported to Full Council.

Other Matters

The revised CLG Investment Guidance also requires the Council to note the following matters each year as part of the investment strategy:

Investment consultants

The Council contracts with Sterling Consultancy Services to provide advice and information relating to its investment and borrowing activities. However, responsibility for final decision making remains with the Council and its officers. The services received include:

- advice and guidance on relevant policies, strategies and reports,
- advice on investment decisions,
- notification of credit ratings and changes,
- other information on credit quality,
- advice on debt management decisions,
- accounting advice,
- reports on treasury performance,
- forecasts of interest rates, and
- training courses.

The quality of this service is monitored by officers on a regular basis, focusing on supply of relevant, accurate and timely information across the headings above.

Investment training

The needs of the Council's treasury management staff for training in investment management are assessed every year as part of the staff performance development review process, and additionally when the responsibilities of individual members of staff change. Staff regularly attend training courses, seminars and conferences provided by Sterling Consultancy Services and CIPFA.

Investment of money borrowed in advance of need

The Council may, from time to time, borrow in advance of spending need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £204 million. The maximum periods between borrowing and expenditure is expected to be two years, although the Council does not link particular loans with particular items of expenditure.

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Proposed Counterparty List
2011/12

CRITERIA	Duration	Council Limit (£m)	FITCH RATINGS S/Term	FITCH RATINGS L/Term	FITCH RATINGS Support	Moody's Ratings S/Term	Moody's Ratings L/Term	S&P Ratings S/Term	S&P Ratings L/Term
			F1	A	3	P-1	A2	A-1	A
UK Banks	**Sovereign Rating**			**AAA**			**Aaa**		**AAA**
Barclays Bank	2 Years	20	F1+	AA-	1	P-1	Aa3	A-1+	AA-
HSBC Bank plc	2 Years	20	F1+	AA	1	P-1	Aa2	A-1+	AA
Lloyds Banking Group									
Lloyds TSB Bank	2 Years	20	F1+	AA-	1	P-1	Aa3	A-1	A+
Bank of Scotland	2 Years	20	F1+	AA-	1	P-1	Aa3	A-1	A+
RBS Group									
National Westminster Bank	2 Years	20	F1+	AA-	1	P-1	Aa3	A-1	A+
Royal Bank of Scotland	2 Years	20	F1+	AA-	1	P-1	Aa3	A-1	A+
Standard Chartered Bank	3 Months	5	F1+	AA-	3	P-1	A1	A-1	A+
UK Building Societies									
Nationwide	6 Months	20	F1+	AA-	1	P-1	Aa3	A-1	A+
Leeds	3 Months	5	F1	A	5	P-1	A2	-	-
Coventry	3 Months	2	F1	A	5	P-2	A3	-	-
Yorkshire	3 Months	2	F2	A-	5	P-2	Baa1	A-2	A-
Skipton	3 Months	2	F2	A-	5	P-2	Baa1	-	-
Principality	3 Months	2	F2	BBB+	5	P-2	Baa2	-	-
Norwich & Peterborough	3 Months	2	F2	BBB+	3	P-2	Baa2	-	-
Foreign Banks									
Australia	**Sovereign Rating**			**AA+**			**Aaa**		**AAA**
Australia & New Zealand Banking Group	6 Months	10	F1+	AA-	1	P-1	Aa1	A-1+	AA
Commonwealth Bank of Australia	1 Year	10	F1+	AA	1	P-1	Aa1	A-1+	AA
National Australia Bank									
Clydesdale Bank	6 Months	5	F1+	AA-	1	P-1	A1	A-1	A+
National Australia Bank	1 Year	10	F1+	AA	1	P-1	Aa1	A-1+	AA
Westpac Banking Corporation	6 Months	10	F1+	AA	1	P-1	Aa1	A-1+	AA
Austria	**Sovereign Rating**			**AAA**			**Aaa**		**AAA**
Raiffeisen Zentralbank Österreich AG	3 Months	5	F1	A	1	P-1	A1	A-1	A
Belgium	**Sovereign Rating**			**AA+**			**Aa1**		**AA+**
Dexia Bank									
Dexia Bank Belgium	3 Months	5	F1+	A+	1	P-1	A1	A-1	A
Dexia Banque Internationale a Luxembourg	3 Months	5	F1+	A+	1	P-1	A1	A-1	A
Dexia Credit Local	3 Months	5	F1+	A+	1	P-1	A1	A-1	A
KBC Bank									
KBC Bank	3 Months	5	F1+	A	1	P-1	Aa3	A-1	A
Canada	**Sovereign Rating**			**AAA**			**Aaa**		**AAA**
Bank of Montreal	6 Months	5	F1+	AA-	1	P-1	Aa2	A-1	A+
Bank of Nova Scotia	6 Months	10	F1+	AA-	1	P-1	Aa1	A-1+	AA-
Canadian Imperial Bank of Commerce	6 Months	5	F1+	AA-	1	P-1	Aa2	A-1	A+
National Bank of Canada	3 Months	5	F1	A+	2	P-1	Aa2	A-1	A
Royal Bank of Canada	6 Months	10	F1+	AA	1	P-1	Aaa	A-1+	AA-
Toronto-Dominion Bank	6 Months	10	F1+	AA-	1	P-1	Aaa	A-1+	AA-
Denmark	**Sovereign Rating**			**AAA**			**Aaa**		**AAA**
Danske Bank	3 Months	5	F1	A+	1	P-1	Aa3	A-1	A
France	**Sovereign Rating**			**AAA**			**Aaa**		**AAA**
BNP Paribas									
BNP Paribas	6 Months	10	F1+	AA-	1	P-1	Aa2	A-1+	AA
Fortis Bank	6 Months	5	F1+	A+	1	P-1	A1	A-1+	AA
Caisse Federative du Credit Mutuel									
Banque Federative du Credit Mutuel	6 Months	5	F1+	AA-	1	P-1	Aa3	A-1	A+
Credit Industriel et Commercial	6 Months	5	F1+	AA-	1	P-1	Aa3	A-1	A+
Group BPCE									
BPCE	6 Months	5	F1+	A+	1	P-1	Aa3	A-1	A+
Credit Foncier de France	3 Months	5	F1+	A+	1	P-1	Aa3	A-1	A
Group Credit Agricole									
Credit Agricole	6 Months	10	F1+	AA-	1	P-1	Aa1	A-1+	AA-
Credit Agricole Corp. & Investment Bank	6 Months	10	F1+	AA-	1	P-1	Aa3	A-1+	AA-
Societe Generale	6 Months	5	F1+	A+	1	P-1	Aa2	A-1	A+

Proposed Counterparty List
2011/12

CRITERIA	Duration	Council Limit (£m)	FITCH RATINGS S/Term	FITCH RATINGS L/Term	FITCH RATINGS Support	Moody's Ratings S/Term	Moody's Ratings L/Term	S&P Ratings S/Term	S&P Ratings L/Term
			F1	A	3	P-1	A2	A-1	A
Germany	**Sovereign Rating**			**AAA**			**Aaa**		**AAA**
Commerzbank Group									
Commerzbank AG	3 Months	5	F1+	A+	1	P-1	Aa3	A-1	A
Deutsche Bank	6 Months	5	F1+	AA-	1	P-1	Aa3	A-1	A+
DZ Bank	6 Months	5	F1+	A+	1	P-1	Aa3	A-1	A+
Landesbank Hessen-Thuringen	3 Months	5	F1+	A+	1	P-1	Aa2	A-1	A
Netherlands	**Sovereign Rating**			**AAA**			**Aaa**		**AAA**
ING Bank NV	3 Months	5	F1+	A+	1	P-1	Aa3	A-1	A+
Rabobank Group	2 Years	10	F1+	AA+	1	P-1	Aaa	A-1+	AAA
Norway	**Sovereign Rating**			**AAA**			**Aaa**		**AAA**
DnB NOR Bank	3 Months	5	F1	A+	1	P-1	Aa3	A-1	A+
Singapore	**Sovereign Rating**			**AAA**			**Aaa**		**AAA**
Development Bank of Singapore	6 Months	10	F1+	AA-	1	P-1	Aa1	A-1+	AA-
Oversea-Chinese Banking Corp	3 Months	5	F1+	AA-	1	P-1	Aa1	A-1	A+
United Overseas Bank	3 Months	5	F1+	AA-	1	P-1	Aa1	A-1	A+
Sweden	**Sovereign Rating**			**AAA**			**Aaa**		**AAA**
Nordea Group									
Nordea Bank AB	6 Months	10	F1+	AA-	1	P-1	Aa2	A-1+	AA-
Nordea Bank Finland plc	6 Months	10	F1+	AA-	1	P-1	Aa2	A-1+	AA-
Skandinaviska Enskilda Banken (SEB)	3 Months	5	F1	A+	1	P-1	A1	A-1	A
Svenska Handelsbanken	6 Months	10	F1+	AA-	1	P-1	Aa2	A-1+	AA-
Switzerland	**Sovereign Rating**			**AAA**			**Aaa**		**AAA**
Credit Suisse	6 Months	5	F1+	AA-	1	P-1	Aa1	A-1	A+
UBS AG	6 Months	5	F1+	A+	1	P-1	Aa3	A-1	A+
USA	**Sovereign Rating**			**AAA**			**Aaa**		**AAA**
Bank of America Corporation									
Bank of America NA	6 Months	5	F1+	A+	1	P-1	Aa3	A-1	A+
Bank of New York Mellon	6 Months	10	F1+	AA-	2	P-1	Aaa	A-1+	AA
Citigroup									
Citibank NA	6 Months	5	F1+	A+	1	P-1	A1	A-1	A+
Citibank International plc	3 Months	5	F1+	A+	1	P-1	A2	A-1	A+
J P Morgan Chase Bank NA	6 Months	10	F1+	AA-	1	P-1	Aa1	A-1+	AA-
Northern Trust Company	6 Months	10	F1+	AA-	3	P-1	Aa3	A-1+	AA
State Street Bank and Trust Co	6 Months	5	F1+	A+	1	P-1	Aa2	A-1+	AA-
Wells Fargo & Co									
Wells Fargo Bank NA	6 Months	10	F1+	AA-	1	P-1	Aa2	A-1+	AA

Credit Rating Matrix - UK Banks & Building Societies from 1st April 2011

Total Limit	Maximum Term	Short Term	Long Term	Support	Short Term	Long Term	Short Term	Long Term
£5M	3 months	F1	A	3	P-1	A2	A-1	A
£20M*	1 Year	F1	A+	1	P-1	A1	A-1	A+
£20M*	2 Years*	F1+	A+	1	P-1	A1	A-1	A+
£20M	2 Years	F1+	AA+	1	P-1	Aa1	A-1+	AA+
£20M	5 Years	F1+	AAA	1	P-1	Aaa	A-1+	AAA

* It is proposed that where taking the lowest of the Credit Rating Agencies, the Long Term Rating is A+ or equvilant, the maximum investment limit is raised from £10m to £20m and duration up to 2 years for UK Banks . This is to allow the proposed investment strategy of increased limits for UK banks and Building Societies with implicit or expected Government Support.

Credit Rating Matrix - Foreign Banks from 1st April 2011

Total Limit	Maximum Term	Short Term	Long Term	Support	Short Term	Long Term	Short Term	Long Term
£5M	3 months	F1	A	3	P-1	A2	A-1	A
£5M	6 Months	F1	A+	3	P-1	A1	A-1	A+
£10M	6 Months	F1	AA-	3	P-1	Aa3	A-1	AA-
£10M	1 Year	F1+	AA	2	P-1	Aa2	A-1+	AA
£10M	2 Years	F1+	AA+	2	P-1	Aa1	A-1+	AA+
£10M	5 Years	F1+	AAA	1	P-1	Aaa	A-1+	AAA

Bath & North East Somerset Council		
MEETING:	Corporate Audit Committee	
MEETING DATE:	1st February 2011	**AGENDA ITEM NUMBER**
TITLE:	**Annual Governance Review - Update Report for 2009/10 & 2010/11**	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
List of attachments to this report: Appendix 1 - Annual Governance Review Process Appendix 2 – Update on Actions from 2009/10 Significant Issues		

1 THE ISSUE

1.1 This report has been prepared to update the Corporate Audit Committee on the implementation of actions based on issues identified during the 2009/10 Annual Governance Review and progress on the 2010/11 review.

2 RECOMMENDATION

The Committee is asked to:

2.1 Note action taken to date in relation to the 'Significant Issues' recorded in the Annual Governance Statement 2009/10.

2.2 Note the process & timetable for the Annual Governance Review 2010/11.

3 FINANCIAL IMPLICATIONS

3.1 There are no direct financial implications relevant to this report.

4 THE REPORT

4.1 Background

4.2 In 2006 the Accounts and Audit Regulations were updated and in 2007 CIPFA / SOLACE published revised guidance 'Delivering Good Governance in Local Government'. This requires all Authority's to carry out an 'Annual Governance Review' and to publish an 'Annual Governance Statement' as part of the Council's Statutory Statement of Accounts. The process adopted by the Council for producing the statement is shown in **Appendix 1**.

4.3 The governance statement covers all significant corporate systems, processes and controls, spanning the whole range of a council's activities including in particular those designed to ensure the council is:

- implementing policies as it intends;
- delivering high-quality services, efficiently and effectively;
- meeting its values and ethical standards;
- complying with relevant laws and regulations;
- adhering to required processes e.g. risk management;
- publishing accurate and reliable financial statements and other performance information; and
- managing human, financial, environmental and other resources efficiently and effectively.

4.4 The Corporate Audit Committee is required to consider the Annual Governance Statement prior to final approval and monitor progress on the significant issues and actions identified in the previous years statement.

<u>2009/10 Significant Issues Update</u>

4.5 The Annual Governance Statement 2009/10 was considered by the Committee in May and June 2010 and the final statement included 4 'Significant' issues:-

- Economic Downturn & Financial Challenge to the Council
- Bath Transport Package
- Severe Weather
- Information Security

Appendix 2 provides an update on the Council's progress in implementing agreed actions.

<u>Annual Governance Review Process & Timetable 2010/11</u>

4.6 The Risk & Assurance Service will:-

- Manage the process, collating and analysing information from across the Council (Feb. to June'11).
- Consult Senior Officers / Members to identify issues to be recorded in AGS (Feb. to June '11).
- Report to Corporate Audit Committee / Cabinet (May & June'11).
- Obtain sign-off by Chief Executive and the Leader of the Council and make available for inclusion in the Council's Statutory Statement of Accounts (June '11).

5 RISK MANAGEMENT

5.1 A risk assessment related to the issue and recommendations has been undertaken, in compliance with the Council's decision making risk management guidance.

5.2 This report has been prepared to 'inform' the Committee in line with the Committee's adopted 'Terms of Reference'. Failure to report progress regarding the Annual Governance Statement would mean that the Committee is failing in its prescribed responsibility. This would also be identified through the Councils own governance review and the Audit Commissions Use of Resources assessment.

6 EQUALITIES

6.1 A proportionate equalities impact assessment has been carried out and there are no significant issues to report.

7 CONSULTATION

7.1 A copy of this report was distributed to the S151 Officer and Cabinet Member for Resources for comment.

Contact person	*Andy Cox (01225 477316) Jeff Wring (01225 477323)*
Background papers	▪ Corporate Audit Committee Report, Annual Governance Review Update 4th May 2010 ▪ Corporate Audit Committee Report, Annual Governance Statement 29th June 2010
Please contact the report author if you need to access this report in an alternative format	

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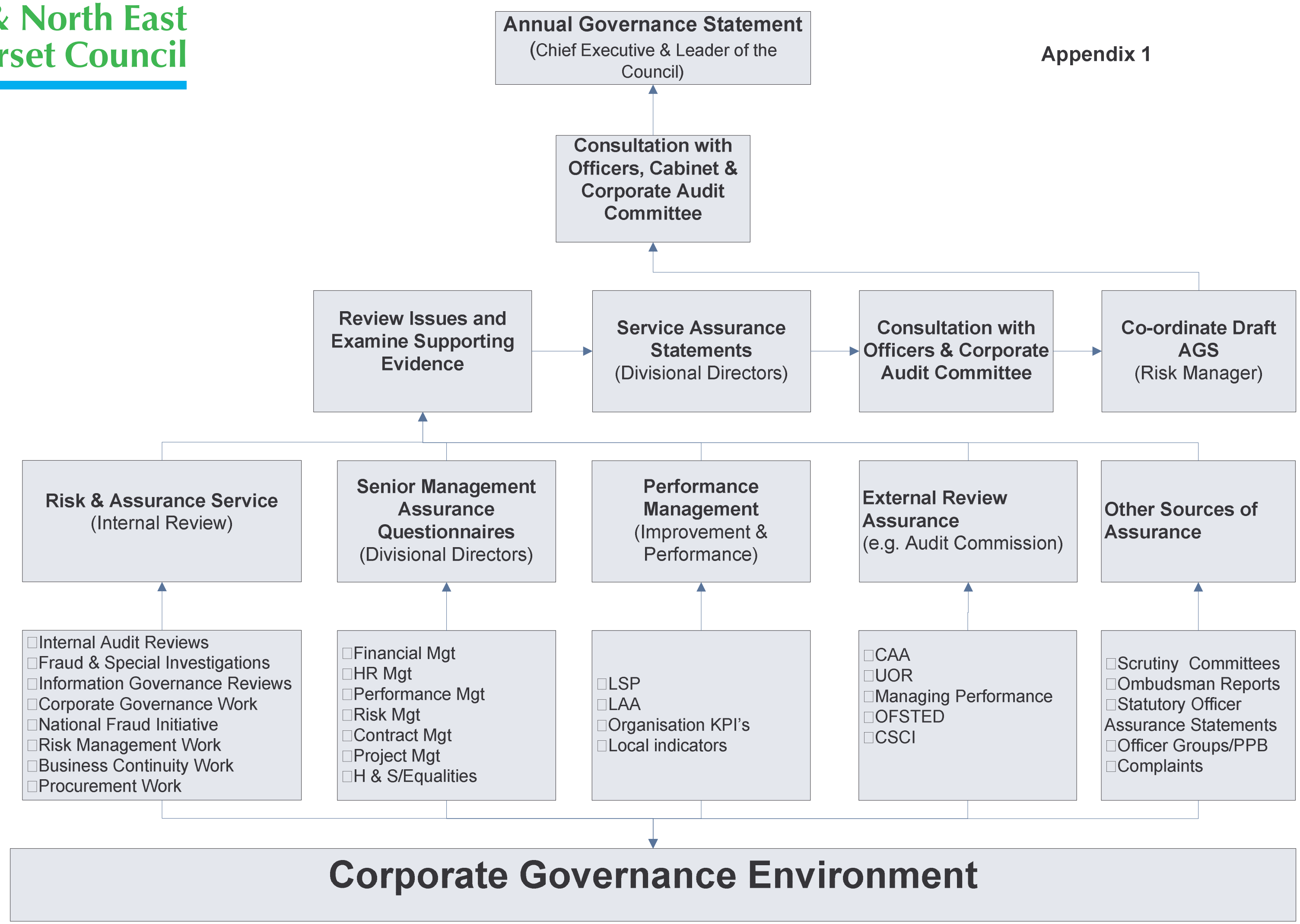
Bath & North East Somerset Council

Appendix 1



Everyone is a risk manager

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Follow up of Significant Issues on AGS 2009/10

Ref	Issue	Agreed Actions on AGS	Current Position	RAG
AGS 1	**Economic Downturn & Financial Challenge to the Council** The Economic Downturn issue was raised in the 2008/9 Annual Governance Statement and at that time the impact of the recession was only just being felt by Services and the Community. During 2009/10 the Council's Cabinet and Corporate Performance & Resources Overview & Scrutiny Panel received regular monitoring reports on the Council's pro-active efforts to reduce the impact on the Community through the use of its recession reserve. It remains too early to say whether the recession is fully behind us as recovery in the economy is still weak and there remains the risk of a 'double dip'. During the year, the demand for Council Services has changed and the Council has responded to the financial challenge of managing budgets in key areas within the Customer Services Directorate. The organisational change process was complex and required staffing issues to be managed. The 22nd June 2010 Emergency Budget announced a significant reduction in public sector spending and the savings required will impact on service provision.	In relation to support to the local economy the majority of actions were complete as at end of year when a full report on the use of Recession Reserve was made to Cabinet. The Financial Challenge to Council Services is being assessed in detail following the elections, the appointment of a Coalition government and the 22nd June Emergency Budget. The Council has made prudent assumptions of the likely impacts on its budget and services have started the Medium Term Resource and Service Plan exercise early. The assumptions will be updated when the impact of the Emergency Budget has been analysed and these will then be reviewed again following the Comprehensive Spending Review scheduled for the 20th October 2010.	Risks & related action plan being monitored through the Corporate Risk Register – Risks 15 & 16. Current Status of actions as at Qtr 3 2010/11 – "On Target"	

AGS 2	**Bath Transport Package** During 2009/10 the Bath Transport Package continued to progress, however it received 'significant public interest' which is a key criteria for consideration. Events during 2009/10 included: ▪ 20th May 2009 – 4 planning applications comprising the Bath Transport Package submitted to Development Control Committee. Three of the applications approved, the fourth (Newbridge Park & Ride and Bus Transit System) was deferred to obtain further technical detail. ▪ 6th Aug 2009 – Applications for Newbridge Park & Ride / BTS and A4 Eastern Park & Ride subject to consideration by Secretary of State. ▪ 8th October 2009 – Government announced two outstanding applications will not be subject to Public Enquiry. ▪ November 2009 – Decision Notices for Newbridge Park & Ride / BTS and A4 Eastern Park & Ride issued. ▪ February 2010 – Compulsory Purchase Orders – Council serve 'Statement of Case for Making the Order' for each CPO. Further developments: ▪ May 2010 – Public Inquiry date of 1st September to decide on compulsory purchase of parcels of land in Bath. ▪ June 2010 – Government announcement that the Public Inquiry is to be postponed. ▪ June 2010 – Emergency Budget and scheduling of the Capital Spending Review for 20th October 2010. There remain significant funding risks as the project proceeds and the situation will therefore need to be carefully monitored and managed.	1. Action taken & required to prepare for a Public Inquiry will be monitored through the Council's Built Environment Leadership Group & the Transport Board. 2. Government Funding plans will be monitored and reported to Cabinet. In the mean time, further expenditure will be minimised pending the outcome of the comprehensive spending review.	Risk & related action plan being monitored through the Corporate Risk Register – Risk 13. Current Status of actions as at Qtr 3 2010/11 – Action 4 - "On Target" Action 6 - "On Target"	

AGS 3 Page 43	**Severe Weather** Between the 5th and 15th January severe weather was experienced both locally and nationally resulting in heavy snow falls, severe ice and freezing temperatures within the B&NES region. The results of this weather impacted directly on the ability of all sectors of business and Council Services to continue to deliver their full range of services. In these situations this inevitably places significant strain on front-line and critical services where services have the biggest impact both on the community and vulnerable individuals. The situation was exacerbated in key areas such as refuse by a period of cold weather pre-Christmas and the impact of the Christmas holidays which meant delays to providing services were even longer than normal. An 'Outcomes of Severe Weather' report was submitted to the Council's Strategic Directors Group on 15th February 2010 recording achievements and issues. This reported that the emergency had been managed well. However as with all incidents of this nature, areas of improvement were identified.	A paper will be submitted to Strategic Directors Group in the late Summer of 2010 to verify that the Council is in an improved position if exceptional circumstances are experienced again during the Winter 2010/11.	Paper submitted to SDG 2nd August 2010. **Incident Command / Capabilities / Roles** Major Incident Plan progressing through consultation process. Workshop provided to Environmental Services Management Team 15th December 2010. **Highways** Completed Winter Maintenance Review during Summer / Autumn 2010. Additional grit stocks held – 1400 tonnes, Clutton; 1000 tonnes, Braisdown (Neighbourhood use – grit bins and car park clearance); 500 tonnes, Avonmouth. Priority Gritting routes increased and mapped on Council's webpages. **Council Comms (including Schools)** Server and internet pipe capacity increased. Load testing in November 2010 identified sever could manage up to 7,000 concurrent connections compared with 2,000 which caused loss of service for short time in Jan 2010. IT systems developed enabling Schools to directly input to Council webpages for direct public access and use by radio stations. **IT Systems** In addition to comms issues, resilence in relation to remote access through broadband and slvpn has been improved. **Note: A period of severe weather was experienced during December 2010 (coldest for over 100 years).**	

AGS 4	**Information Security** During 2009/10, three Internal Audit reviews relating to the management of key information management systems within the Council assessed the system of internal control as 'weak'. These included the ONE system in Children's Services, ParkMobile system in Parking Services and the ResourceLink system in Human Resources. Issues included – - Audit Trails deactivated - Lack of effective management and exception reports - Weaknesses in access and password management - Accessibility to personal information - Training of system administrators - Third Party access - Unnecessary Retention of Records - Separation of duties - Business Continuity Planning All of the issues / weaknesses identified were accepted by management and action plans are being monitored. Internal Audit will follow-up all these areas during 2010.	A proposal has been made to look at the options for centralising, simplifying and sharing the role of key system administrator tasks. The purpose of this proposal will be to reduce risk, simplify information security requirements and achieve efficiencies through economies of scale. This would tackle the vast majority of issues being raised. In addition, Internal Audit will carry out follow-up reviews on the relevant systems.	Discussions with Council Officers has established that there has been no progress on the proposed action to centralise System Administrator roles. Follow-up Internal Audit reviews for the ONE System, ParkMobile & ResourceLink Audits have been carried out during Quarter 4 2010/11. Generally good progress has been made with implementing agreed actions following the Internal Audit reports. Other IT Audits have been completed since the AGS 2009/10 Review: Comino (2), Radius (4), Pensions (4), Uniform (3), SIMS (4), Carefirst (3) Documentum (3). Levels – 1 (Poor), 2 (Weak), 3 (Adequate), 4 (Good), 5 (Excellent). As detailed above, the Comino Systems was concluded as a weak system of internal control. An audit follow-up has been completed and again good progress had been made in implementing recommended action.	

<table>
<tr><td colspan="3">Bath & North East Somerset Council</td></tr>
<tr><td>MEETING:</td><td colspan="2">Corporate Audit Committee</td></tr>
<tr><td>MEETING DATE:</td><td>1st February 2011</td><td>AGENDA ITEM NUMBER</td></tr>
<tr><td>TITLE:</td><td>INTERNAL AUDIT – FUTURE SERVICE DELIVERY OPTIONS</td><td>EXECUTIVE FORWARD PLAN REFERENCE:
E</td></tr>
<tr><td colspan="3">AN OPEN PUBLIC ITEM</td></tr>
<tr><td colspan="3">List of attachments to this report:
Appendix 1 – Final Report</td></tr>
</table>

1 THE ISSUE

1.1 The Committee has previously received updates over the last 12 months of a project to review future options for service delivery for Internal Audit in light of the very challenging picture for public sector funding.

1.2 This report sets out the final conclusions and recommendations of this project and asks the committee to endorse these for implementation.

2 RECOMMENDATION

2.1 The Corporate Audit Committee is asked to comment on the report and specifically the recommendations for future service delivery.

3 FINANCIAL IMPLICATIONS

3.1 Financial implications are detailed within the report, these involve savings proposals of 25% of the gross Internal Audit budget which would amount to approximately £105k delivered over 2 years.

4 THE REPORT

4.1 Appendix 1 details the full report which was drafted by the Project Manager to whom significant thanks must go for his support and direction throughout the course of the project. A summary of the report is detailed as follows:-

1. Introduction Background

1.1 Internal Audit is defined by the CIPFA Guideline as;

"…..*an independent appraisal function established by the management of an organisation for the review of the internal control system as a service to the organisation. It objectively examines, evaluates and reports on the adequacy of internal control as a contribution to the proper, economic, efficient and effective use of resources".*

1.2 Auditors in the public sector have a pivotal role to play in ensuring that public funds are administered properly, economically, efficiently and effectively, in the interests of the public and there is an expectation by the community that audit is protecting the public purse.

1.3 In Local Government, an internal audit service is a mandatory requirement; and all principal authorities in England and Wales are required by statute (under the Accounts and Audit Regulations and section 151 of the Local Government Act 1972, to have an adequate and effective internal audit function.

1.4 Since the last round of local government reorganisation in 1996, the Bath & North East Somerset Council Internal Audit has been delivered by an in-house team. The team currently stands at 9 FTE (7 F/T and 3 P/T staff) having been reduced from a staffing number of 14 in 1996.

In addition the team also carries out the Internal Audit of the Avon Pension Fund, all Schools (including the assessment of the Financial Management Standard in Schools) and works jointly with the audit and counter fraud service of B&NES PCT.

1.5 The gross expenditure budget for the service in 2010/11 is £434K with a net budget of £285K primarily as a result of a number of recharges which have been historically built into the budget since 1996.

1.6 In terms of benchmarking the service has, for the last ten years, participated in a national exercise co-ordinated by CIPFA (IPF).

In summary, in terms of cost, the team has consistently demonstrated a cost per day at approximately 5% - 10% lower than the Unitary average and in relation to quality, productivity and coverage it is at average levels.

1.7 During the end of 2009 the Council engaged consultancy support from PwC to carry out a Council wide diagnostic exercise to identify a range of potential solutions to its medium to long-term organisational planning. One of the areas identified for further work - amongst many others - was the Support Services block managed primarily by the Strategic Director for Resources.

1.8 Internal Audit is part of the Risk & Assurance service which is one of the smaller service blocks of the Support Services portfolio in terms of staff and budgets.

1.9 At the same time as the diagnostic exercise was being carried out, medium term service and resource plans were being prepared by each Divisional Director to indicate both priorities and objectives for the coming year and outline plans for future years.

1.10 When taking into account the indicative budget reductions being planned over the medium term at that time - at least 20% over 4 years - Internal Audit was identified as an area where further work was necessary in order to prepare itself properly to meet these tough challenges.

1.11 The key reasons identified at this time were:

a) Medium Term budget reductions would inevitably result in redundancies from 2011/12;

b) Without adequate service planning there would be a ‘tipping point’ at which the service could no longer deliver at a basic level;

c) Productivity and coverage of key risk was at average levels;

d) Skills gaps were evidenced (primarily in IT and Procurement);

e) Service Delivery was likely to be more complex in the future (less in-house provision).

f) Impacts of increasing numbers of schools becoming Academies and the potential for Adult Social Care and Health functions to form a Social Enterprise.

1.12 The independent nature of Internal Audit meant that whilst it is part of the Support Services ‘block’, options on its future, were not linked and therefore these would need to be considered separately.

1.13 It was therefore decided to carry out a specific project to review the medium term options for the future and a brief was prepared and presented to the Audit Committee in February 2010.

2. Objectives

2.1 To review a range of options for the delivery of Internal Audit services in the medium to long-term and recommend an option for implementation

2.2 **Options to be Assessed**:
- In-House Model (Restructure)
- Outsourced Model (100% of service outsourced
- Co-Sourced Model (At least 50% outsourced)
- Partnership Models (i.e. Existing or New Partnerships)

2.3 **Scope**:
To cover the whole range of Internal Audit Services for the Council:
- Risk Based Planning
- Core Systems/Risk Based Audit
- Grant Return Audit
- FMSiS Assessments for Schools
- Specialist Audit, i.e. Pensions, IT or Procurement Audit
- Fraud & Investigation Reviews
- Policy & Procedural Guidance
- Joint working with External Auditor & Inspectorates
- Joint working on Annual Governance Review
- Joint working with PCT Internal Audit & Counter-Fraud Services
- Joint working with Audit teams within the South West region
- Reporting to Corporate Audit Committee

3. Approach

3.1 A project team was formed and an external Project Manager appointed to manage the process and provide specific independent challenge. The individual appointed has specific experience of managing local government internal audit and of letting internal audit contracts.

3.2 Four key stages were identified
- Planning
- Research
- Options Appraisal
- Reporting

3.3 The key stage of options appraisal was based around assessing each of the models against the following key criteria which were grouped and weighted in terms of a score.

Standards & Quality – 30%

- Audit Methodology
- Quality Control
- Leadership
- Access to Specialist Skills

Staff & Skills – 20%

- Investment in People
- Use of Audit Automation
- Terms and Conditions

Organisational – 25%

- Strategic Fit
- Track Record
- Use of Resources
- Governance & Accountability

Financial/VFM – 25%

- Cost of Implementation
- Flexibility of Future Costs
- Cost of Service

4. Summary of Options Appraisal

The scores were assessed through a mix of objective and subjective data collected through the different phases of the project. These were then independently challenged by the Project Manager.

In general the partnership model of service delivery - where services are shared between local authorities - has been assessed as the most effective in the long term. A summary of each assessment is detailed below followed by the assessment table.

4.1 New CUBA Partnership Model

4.1.1 This model scored the highest and was assessed as being the most effective and sustainable form of service delivery in the long-term.

4.1.2 **Key strengths**:

- Partnership delivery with neighbouring local authorities fits strategically with the future model of the organisation as well as the expectations of the new government in finding more efficient methods of service delivery;
- Providing Internal Audit through an independent Partnership strengthens both its profile and independence and enables a pooling of skills and resources which cannot be achieved when delivery services to only one organisation;
- All four Authorities already work closely together and have accepted a joint partnership provides a strong long-term option;
- Bristol City Council have moved a step further to state that it is serious in working with B&NES to develop a partnership in the next 12 - 24 months;
- All four Authorities are currently part of the West of England Partnership and agreed to work within the new Local Enterprise Partnership thereby strengthening the strategic fit of this model;
- Overheads would be lower than buying into an existing partnership which is spread more geographically, i.e. SWAP Partnership works across all of Somerset, Dorset and parts of Devon;
- Geographically the relatively compact size of the CUBA area also enables a more efficient organisational set-up by hosting all staff in one place but enabling them to deliver services to all partners, rather than being fixed on only one authority;
- There is no significant loss of strategic control, influence or local knowledge as the number of partners is relatively low as opposed to the main existing partnership model (SWAP) which currently has 11;
- Integrating resources through partnership strengthens standards and improves opportunities for staff and career development and ultimately provides greater resilience for the future.

4.1.3 **Key Issues**:

- The partnership would be based on a 5 or 10 year legal agreement which can be approved without the need for any procurement exercise. However it has to be formed from scratch and so set-up costs and timescales to implement are relatively long, it is estimated it would take at least 12 – 24 months;
- At present only one Authority is in a position to work with B&NES (Bristol CC) to implement a partnership. This in itself is not particularly negative as it will speed up implementation and enable the other 2 authorities to join at a later stage much more easily;
- Rebasing of budgets before joining the partnership is critical. B&NES Internal Audit will be reducing costs by 25% before a partnership is formed so providing stability for the immediate future (3 - 5 years). Other partners must also reflect on their costs before entering the partnership and decide on their own client arrangements;
- The partnership would be based on one authority 'hosting' the partnership, a single head of partnership and having a single methodology and supporting systems and software and IT links to partners networks;
- All staff would transfer to the 'hosting' authority but would retain all other employment rights, i.e. local government terms and conditions and access to the pension scheme;
- The partnership would however have freedom to operate as a separate entity within this framework and would have its own 'branding' and operating name;
- The Head of Partnership would report to a Partnership or Management Board consisting of each partner. This board would sign off the budget, business plan and audit and resource plans for the partnership;
- Existing Audit Committees would remain as now for each partnership authority and the Head of Partnership would report direct to each committee on the performance of Internal Audit;
- There is a wider opportunity to link together in the long-term with the SWAP partnership and other regional delivery models to provide even greater efficiency and resilience including sharing contracts and resources;
- Initially the partnership would be for B&NES and Bristol CC to form but would be set-up to allow North Somerset, South Gloucestershire and potentially other local authorities or other public sector bodies to join in future years;
- It is recommended this option is seriously considered for the medium to long-term as part of a phased implementation and an optimum time for implementation would be the 2013/14 year.

4.2 In-House Re-Structure

4.2.1 This model was assessed as second and scores very highly in terms of the short term - at least 2 years - and is the easiest and most economical to implement.

Key Issues:

- Enabling an in-house team to continue to deliver Internal Audit when resources have been reduced by 25% is only viable if it is integrated with the Risk Management function;
- This effectively means creating a joint audit and risk team and replacing the redundant auditor posts resource from the risk management team, which would equate to an extra 200 audit days;
- The key advantages of integrating the functions are significant savings in time, cost and management capacity. The re-structure could be fully implemented in less than 3 months for no cost;
- The new team will give between 9% and 15% more audit coverage than the other proposed partnership models and be able to replace some of the skills gaps, i.e. procurement;
- There will be a stronger emphasis on risk based auditing and whilst there will be a reduction in risk management support to services, this can be mostly replaced through targeted audit coverage;
- As the authority will be going through a severe period of organisational change, risks of fraud and misuse of resources are much higher and so having full flexibility and control of audit resources throughout at least a 2 year period is assessed as being highly beneficial;
- The restructure would be based and operated on preparing for partnership by re-evaluating audit planning methodologies and re-prioritising investment in standards and training;
- It is therefore recommended that the in-house restructure is chosen as part of a phased approach to longer-term partnership by implementing it immediately for a period of at least 2 years.

4.3 SWAP (South West Audit Partnership) Model

4.3.1 This model scored third in the assessment and has broadly the same strengths and issues as a new CUBA partnership except for the following differences:

- The SWAP partnership is hosted from South Somerset District Council, has 11 partners including 2 Counties (Somerset and Dorset) and a number of District Councils all the way down to Weymouth and Portland;
- The partnership has been in existence for over 5 years and has an extensive set of governance and legal arrangements in place;
- Geographically the partnership is spread over a vast distance so organisationally existing teams primarily stay serving their original authority with some minimal flexibility outside of this, in terms of working for different partners;
- Whilst the strengths are primarily the same as a new CUBA partnership would be, its key advantage is that it is already in existence and is successful and therefore set-up and implementation is relatively short (3 - 6 months);
- However as a model it is not considered to be as strong as a new, more local partnership which would have lower overheads, a stronger strategic fit in terms of joint working and a more flexible operation by having a single ‘hosted’ team working on a variety of partners.
- Additionally there would be a substantial loss of strategic control and influence due to the number of partners within the partnership and in most cases those partners have yet to ‘downsize’ their audit budgets thereby creating additional risk in the medium term;
- As all local authorities will be going through a period of severe organisational turbulence and change it may be advisable to delay any decision on joining SWAP until the future is clearer and the impacts on the SWAP partnership are evidenced;
- It is recommended this option is retained as an alternative solution position for potential implementation in 2013/14 in case a new local CUBA partnership is not able to be implemented or delivered.

4.4 Co-Sourcing & Outsourcing

4.4.1 Co-Sourcing is effectively downsizing the team by approximately 50% and then letting out that part of the audit service to external providers, i.e. IT Audit or Core Systems Audit. Outsourcing is transferring the whole function to an external provider (i.e. PwC). These models scored fourth and fifth.

Key issues:

- In theory both these models should work well, with the ability to replace skills gaps and invest in areas of highest risk;
- Key advantages are an ability to flex costs, seek private sector expertise and enable standards to rise;
- However, research identified that the co-sourced model had been generally ineffective in relatively small audit functions with poor standards, inconsistent management and effectively two different sets of methodologies being employed;
- Additional compulsory redundancies would be required to further reduce the audit function by at least 25%. This reduction would be both costly (and unaffordable) and would not replace the skills being lost with anything that was discernibly different;
- In terms of outsourcing the market told us that they would prefer to use their own staff and not TUPE existing staff into their own organisation. The relative size of our service was not therefore attractive enough to make it a viable proposition;
- However in the short-term there could be cost advantages but these were countered by little in the way of any track record of positive service delivery and an uncertain future for staff transferred. Indeed there was no history of a sustainable and quality service being delivered by an external firm for a Unitary Authority;
- In addition, the loss of any real flexibility of the audit resource through a time of severe organisational change was not considered to be advantageous;
- Implementation would take at least six months and involve a significant amount of management capacity and the value of either exercise was not considered beneficial;
- It is recommended that neither option is chosen.

4.5 Assessment

Detailed on the next pages is the scoring assessment table, together with an analysis for each of the options, and the implications on audit coverage in terms of numbers of days and estimations of cost and timescales of implementing each option.

Overall Summary of Options		%	WEIGHTING	In House Restructure	Co-Source	Existing Partnership (i.e. SWAP)	New Partnership (i.e. CUBA)	Fully Outsourced
Standard & Quality	**TOTAL SCORE**	**29%**	**10**	**33**	**32**	**36**	**37**	**34**
Audit Methodology			3	9	9	9	9	9
Quality Control			3	12	9	9	12	9
Leadership			2	8	6	8	8	6
Access to specialist skills			2	4	8	10	8	10
Staff	**TOTAL SCORE**	**20%**	**7**	**22**	**22**	**28**	**25**	**19**
Investment in People			3	9	9	12	12	9
Use of audit automation			1	4	4	4	4	4
Terms and Conditions			3	9	9	12	9	6
Financial / VFM	**TOTAL SCORE**	**26%**	**9**	**36**	**21**	**27**	**27**	**21**
Cost of Implementation			3	15	6	9	3	6
Flexibility of Future Costs			3	6	9	9	12	9
Cost of Service			3	15	6	9	12	6
Organisational	**TOTAL SCORE**	**26%**	**9**	**33**	**30**	**32**	**37**	**27**
Strategic fit			3	9	12	12	15	9
Track Record			2	6	4	6	6	6
Use of resources			2	10	8	6	8	6
Governance and Accountability			2	8	6	8	8	6
	TOTAL SCORE	**100%**	**35**	**124**	**105**	**123**	**126**	**101**

Analysis of Top 3 Options	In House	Existing Partnership (i.e. SWAP)	New Partnership (i.e. CUBA)	Explanation of Scoring
Standard & Quality	**33**	**36**	**37**	
Audit Methodology	9	9	9	Equal score for each option
Quality Control	12	9	12	The SWAP model was assessed as having less direct management resource than could be provided in the future through an in-house restructure or new CUBA partnership. The potential implication of this would directly affect quality control.
Leadership	8	8	8	Equal score for each option
Access to specialist skills	4	10	8	SWAP currently have access to a broader range of specialist skills via a mix of internal skills but moreover, an external contractor. A new CUBA Partnership could mirror a similar arrangement, whilst the in-house option could not match either model.
Staff	**22**	**28**	**25**	
Investment in People	9	12	12	Economies of scale allow both SWAP and a new CUBA partnership to invest more in staff in terms of professional training and career development. This area is currently a particular strength of the SWAP model.
Use of audit automation	4	4	4	Equal score for each option
Terms and Conditions	9	12	9	Although not in every case, the SWAP model is able to offer the potential for improved pay for staff.
Financial / VFM	**36**	**27**	**27**	
Cost of Implementation	15	9	3	The In-house model would be almost cost neutral and achieved in a very short timescale. The SWAP Model would take longer but has the benefit of a tried and trusted approach with its existing partners, thereby saving time and cost. A new CUBA Partnership has to be built from scratch and will therefore take the longest to implement, although SWAP have offered to assist in the implementation process.
Flexibility of Future Costs	6	9	12	Very significant savings are being delivered upfront. Due to the very nature of the models, the in-house option then has very limited to no scope to deliver further savings in the next 3-5 years. Due to their size and scale, the partnership models have more opportunity to achieve efficiencies. The new CUBA model is considered to have the greatest long-term opportunity due to the way the model would be constructed.
Cost of Service	15	9	12	All the models deliver less audit days than currently. The in-house restructure delivers the most coverage in terms of audit days as it is replacing lost resource with new skilled staff from the risk management function. SWAP delivers a reasonable return on its cost per day but it was assessed that a new CUBA model could deliver approx 5% more coverage due to the way the model could be structured and potential for lower overheads.

Analysis of Top 3 Options	In House	Existing Partnership (i.e. SWAP)	New Partnership (i.e. CUBA)	Explanation of Scoring
Organisational	**33**	**32**	**37**	
Strategic fit	9	12	15	The partnership options score well but the new CUBA model provides a perfect fit in terms of the future council model and the direction of travel of support services in general through public/private sector partnership.
Track Record	6	6	6	Equal score for each option
Use of resources	10	6	8	An in-house service offers total (100%) control and flexibility over the audit resource which enables it to score highest. This flexibility is considered important in the short term (2 years) whilst the overall organisation is changing significantly. The new CUBA model scores slightly better than the SWAP model based on the way it was assessed that the resource would be set up and allocated.
Governance and Accountability	8	8	8	Equal score for each option
	124	**123**	**126**	

	2011/12			2012/13			2013/14			2014/15		
	In-house	SWAP	CUBA	In-house	SWAP	CUBA	In-house	SWAP	CUBA	In-house	SWAP	CUBA
Proposed Annual Savings (Cumulative in Brackets)	£45K	£45K	£45K	£60K (£105K)	£60K (£105K	£60K (£105K)	-	-	-	-	-	-
Proposed Savings as % of Gross/Net Expenditure	10% (Gross) 16% (Net)	-	-	15% (Gross) 25% (Net)	-	-	-	-	-	-	-	-
One-Off Set-up Costs	-	-	£10K	-	£15K	£10K	-	-	-	-	-	-
Set-up Timeframe	Implemented by April 2011	No Work in 11/12	All of 11/12 (12 Mths)	-	Oct – Mar (3 - 6 Mths)	All of 12/13 (Up to 12 Months)	-	-	-	-	-	-
Set-up Complexity	Implemented (V. Low)	-	High	-	Med	High	-	-	-	-	-	-
Estimated Audit Days (Currently 1609)	1423	-	-	1423	-	-	1423	1235	1310	1423	1235	1310
Transfer of Risk for Service Delivery	None	-	-	None	-	-	None	Yes	Yes	None	Yes	Yes

5. **Recommendations**

The following recommendations are made in relation to the future service delivery for Internal Audit based on the results of the above assessment above.

It is recommended that:

a) Planned redundancies and reductions in budget in Internal Audit are implemented to reduce costs by approximately 25%.

b) No further reductions or cuts proposed for internal audit for 5 years within this period and costs fixed at this new level.

c) The remaining in-house team is restructured and integrated with the risk management function with effect from the 1st of April 2011.

d) Service delivery to be maintained in-house for a period of at least 2 years pending the results of the work on the alternative partnership models.

e) Risk Management support to be reduced and replaced with a strengthened risk-based approach to audit coverage of service areas.

f) Development work with Bristol CC is sanctioned to start in 2011/12 to investigate the detailed model for a potential internal audit partnership to cover both authorities.

g) Any model should be flexible to take into account the client roles of the respective authorities and be able to add additional parties as required.

h) The model is based on a single shared service to be hosted by one authority with audit teams from both organisations fully integrated.

i) That a report to be received back to the respective audit committees by April 2012 on the full implications and detailed requirements of the new proposed partnership model.

j) Full implementation is to be proposed from April 2013 for at least a 5 year period with shadow arrangements to be in place during 2012/13.

k) It is agreed that the SWAP (South West Audit Partnership) is retained as an alternative solution if it is decided that a local partnership cannot be implemented or agreed upon by April 2012.

l) If this is the case approval for SWAP to deliver Internal Audit for B&NES should be taken by June 2012 to enable implementation by April 2013.

6. Staffing & Financial Implications

6.1 Budget

6.1.1 In order to implement any of the proposed options it is recommended that the audit service should plan effectively for a stable future and so the equivalent of a gross 25% reduction in resources is proposed. This will then enable the future team to have some sense of certainty in the medium term by fixing the budget for future years.

6.1.2 Financially this results in a total reduction of approximately £105K in audit resources over 2 years and equates to approximately 3 members of staff.

6.1.3 The cost of redundancies and any resulting strain on the fund will be repaid by the service in accordance with the corporate requirements agreed by the Strategic Directors Group and Cabinet.

6.1.4 The revised budget and costs for internal audit should be fixed for between 3 and 5 years with no further reductions or cuts proposed within this period.

6.2 Redundancies

6.2.1 During summer 2010, an exercise was carried out to identify those staff wishing to take voluntary redundancy within Internal Audit.

6.2.2 Two members of Internal Audit staff volunteered and have been accepted for redundancy, one of these left in November with the other leaving in March.

6.2.3 The integration of the risk management and internal audit teams places both posts of Audit Manager and Risk Manager at risk.

6.2.4 Following discussion, the Audit Manager has also volunteered for redundancy and early retirement during 2011/12.

6.2.5 The three volunteers therefore enable a saving of 25% of the gross budget.

6.3 Impact of Redundancies

6.3.1 The impact of losing staff through redundancy means that the existing Risk Manager will become the new Group Manager (Audit & Risk) with responsibility for both the provision of Internal Audit and Risk Management (including all Corporate Governance functions).

6.3.2 The Corporate Governance Manager will also move across to the wider audit and risk team and be structured into an Audit Team Leader post entitled Risk & Governance to simplify the structure.

6.3.3 The previous posts of Audit Manager and Risk Manager would be deleted.

6.3.4 All other staff will remain in their existing posts with the only effective change being a new manager of the two functions.

6.3.5 These changes are recommended to be implemented by the 1st of April 2011.

6.3.6 The current Audit Manager will remain until August 2011 to ensure a smooth transition, to be able to work on the development of the partnership with Bristol CC and complete a number of specific outstanding one-off projects.

6.3.7 The wider impact of deleting the post of Risk Manager will mean the Business Continuity & Emergency Planning Manager reporting direct to the Divisional Director and a minor restructure required in the Information Governance team to ensure a reporting line direct to the Divisional Director.

5 RISK MANAGEMENT

5.1 A proportionate risk assessment has been carried out in relation to the Councils risk management guidance.

6. EQUALITIES

6.1 A proportionate equalities impact assessment has been carried out using corporate guidelines, no significant issues to report.

7 CONSULTATION

7.1 Consultation has been carried out with the Section 151 Finance Officer, Cabinet Member for Resources and Chief Executive.

8 ADVICE SOUGHT

8.1 The Council's Section 151 Officer has had the opportunity to input to this report and have cleared it for publication.

Contact person	Jeff Wring (01225 47323)
Background papers	Feb 2010 Audit Committee - Project Brief – Internal Audit Options for Future Service Delivery
Please contact the report author if you need to access this report in an alternative format	

Strictly Private and Confidential

Internal Report

Options Appraisal for the Future Delivery of Bath and North East Somerset Internal Audit Service

Report Status:	FINAL	Report No:	MMB&NES1

Distribution List	
Name	**Job Title**
Jeff Wring	Divisional Director, Risk and Assurance Services

Staff involved in this review

The Author would like to thank all staff involved in this review for their valued assistance and co-operation

Internal Report

Options for the future delivery of Internal Audit Services

This report may refer to certain findings that relate to personal data as defined by the Data Protection Act 1998, therefore its contents should be treated as strictly confidential.

Parts of this report may also be exempt from disclosure under the Freedom of Information Act 2000 Sections 40 & 44

Author: Martin Millman **Date:** December 2010

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1. Introduction & Background

1.1 Internal Audit is defined by the CIPFA Guideline as;

"*…..an independent appraisal function established by the management of an organisation for the review of the internal control system as a service to the organisation. It objectively examines, evaluates and reports on the adequacy of internal control as a contribution to the proper, economic, efficient and effective use of resources".*

1.2 Auditors in the public sector have a pivotal role to play in ensuring that public funds are administered properly, economically, efficiently and effectively, in the interests of the public and there is an expectation by the community that audit is protecting the public purse.

1.3 In Local Government, an internal audit service is a mandatory requirement; and all principal authorities in England and Wales are required by statute (under the Accounts and Audit Regulations and section 151 of the Local Government Act 1972, to have an adequate and effective internal audit function.

1.4 Since the last round of local government reorganisation in 1996, Bath & North East Somerset Council Internal Audit has been delivered by an in-house team. The team currently stands at 9 FTE (7 F/T and 3 P/T staff) having been reduced from a staffing number of 14 in 1996.

In addition the team also carries out the Internal Audit of the Avon Pension Fund, all Schools (including the assessment of the Financial Management Standard in Schools) and works jointly with the audit and counter fraud service of B&NES PCT.

1.5 The gross expenditure budget for the service in 2010/11 is £434K with a net budget of £285K primarily as a result of a number of recharges which have been historically built into the budget since 1996.

1.6 In terms of benchmarking the service has, for the last ten years, participated in a national exercise co-ordinated by CIPFA (IPF).

In summary, in terms of cost, the team has consistently demonstrated a cost per day at approximately 5% - 10% lower than the Unitary average and in relation to quality, productivity and coverage it is at average levels.

1.7 During the end of 2009 the Council engaged consultancy support from PwC to carry out a Council wide diagnostic exercise to identify a range of potential solutions to its medium to long-term organisational planning. One of the areas identified for further work - amongst many others - was the Support Services block managed primarily by the Strategic Director for Resources.

1.8 Internal Audit is part of the Risk & Assurance service which is one of the smaller service blocks of the Support Services portfolio in terms of staff and budgets.

1.9 At the same time as the diagnostic exercise was being carried out, medium term service and resource plans were being prepared by each Divisional Director to indicate both priorities and objectives for the coming year and outline plans for future years.

1.10 When taking into account the indicative budget reductions being planned over the medium term at that time - at least 20% over 4 years - Internal Audit was identified as an area where further work was necessary in order to prepare itself properly to meet these tough challenges.

1.11 The key reasons identified at this time were:

a) Medium Term budget reductions would inevitably result in redundancies from 2011/12;
b) Without adequate service planning there would be a 'tipping point' at which the service could no longer deliver at a basic level;
c) Productivity and coverage of key risk was at average levels;
d) Skills gaps were evidenced (primarily in IT and Procurement);
e) Service Delivery was likely to be more complex in the future (less in-house provision).
f) Impacts of increasing numbers of schools becoming Academies and the potential for Adult Social Care and Health functions to form a Social Enterprise.

1.12 The independent nature of Internal Audit meant that whilst it is part of the Support Services 'block', options on its future, were not linked and therefore would need to be considered separately.

1.13 In the circumstances, the Divisional Director Risk and Assurance Services initiated an options appraisal review to identify an appropriate model for the future delivery of the Internal Audit Service with the intention of producing a business case to support the chosen option and a brief was prepared and presented to the Audit Committee in February 2010.

1.14 There is potential for a review of this nature to be open to a wide and varied number of models, however, five key delivery options were identified for detailed analysis - the options include;

- In-house restructuring to achieve smarter working,
- Partnership with other Local Authorities in the South West region,
- Partnership with neighbouring CUBA authorities,
- Co-sourcing with an external provider, or,
- Fully outsourcing and externalisation of the service to an external provider.

This report represents the output of work to identify the options considered.

2. Staff involvement

Throughout the project a process of dialogue and available update, led by the Divisional Director Risk and Assurance Services has been provided to both internal audit staff through Team Meetings and the Audit Committee through Committee meetings.

At Stage One of the exercise a structured team-day workshop, was held with the internal audit staff in order to fully include and engage them in discussing the current service provision and the options for future delivery.

The outcome of the day, feedback and their views were gathered in order that they could be taken into account during the options appraisal process.

In addition, a questionnaire was forwarded to all Senior Managers to canvass their views on the current and future service delivery. These were also taken into consideration.

Meetings were also held with the following significant stakeholders to obtain their views on the options reviewed and to consider their opinions in the options appraisal.

- Chief Executive Officer,
- Audit Committee Independent Member,
- Strategic Director/Cabinet Member
- External Auditor,
- O&S Scrutiny Panel.

This report outlines the findings of the review.

3. Objectives of the review

3.1 To review a range of options for the future delivery of Internal Audit services in the medium to long-term and recommend a timescale for implementation based on the chosen option.

The timescale for implementation will be dependent upon consideration of all relevant factors, including cost savings to be made, impact on the service medium to long term and the affect on staffing and resources.

The timeframe for implementation could therefore be anytime over a 2 year period between April 2011 and April 2013.

3.2 Options to be Assessed:

- In-House Model (Restructure)
- Outsourced Model (100% of service outsourced
- Co-Sourced Model (At least 50% outsourced)
- Partnership Models (i.e. Existing or New Partnerships)

3.3 Scope:

To cover the whole range of Internal Audit Services for the Council –

- Risk Based Planning
- Core Systems/Risk Based Audit
- Grant Return Audit
- FMSiS Assessments for Schools
- Specialist Audit, i.e. Pensions, IT or Procurement Audit
- Fraud & Investigation Reviews
- Policy & Procedural Guidance
- Joint working with External Auditor & Inspectorates
- Joint working on Annual Governance Review
- Joint working with PCT Internal Audit & Counter-Fraud Services
- Joint working with Audit teams within the South West region
- Reporting to Corporate Audit Committee

4. Approach and Methodology

A project team was formed and an external Project Manager appointed to manage the process and provide specific independent challenge. The individual appointed has specific experience of managing local government internal audit and of letting internal audit contracts.

4.1 Key Stages of the Review

4.1.1 Stage 1 and 2 - Planning and Research

- Agreement of project brief, identification of project resources and detailed project planning.

  The gathering of stakeholder perceptions identified in Section 3 of this report through a series of meetings, an assessment of existing in-house services current performance, a combination of an assessment of existing resources through a gap and skills analysis, benchmarking data and the involvement of internal audit staff.
- Research was also carried out on the existing external market options available through meetings with key responsible officers of interested parties, other providers and potential partnership models, including neighbouring Local Authority representatives in the case of a new local CUBA partnership proposal,
- As previously stated, there is potential for a review of this nature to be open to a wide and varied number of models, however, a brief description of the five key delivery options identified for detailed analysis are as follows;

  (a) **In-House Model**
  Delivery of service retained 100% by B&NES, i.e. limited change to existing arrangements i.e. an internal re-structure and amalgamation of similar functions;

  (b) **Partnership Model – (**Existing , i.e. **S**outh **W**est **A**udit **P**artnership**)**
  Delivery of the service to be provided through a collaboration of audit resource from neighbouring authorities in the South West region, i.e. potential transfer of staff to a separate partnership entity or one single authority;

  (c) **Partnership Model – (New, i.e. CUBA** Authorities consortia)
  Delivery of service provided through a collaboration of audit resource from CUBA neighbouring authorities.

  (d) **Co-sourced Model**
  Co-sourcing means the Council is still involved in provision of service, with transfer or allocation of a number of audit days to an external partner, i.e. 30% whereas it differentiates transfer from fully outsourced which would be 100%. i.e. Core Service reduced and remainder of provision bought in with no transfer of staff;

  (e) **Fully Outsourced Model**
  Delivery of service provided 100% by an external partner, i.e. transfer of all staff to an alternative provider; with any approach to externalisation, the local authority maintains a client role. Service delivery becomes the responsibility of an external organisation

4.1.2 Stage 3 - Options Appraisal

The results of the research fed into the development of a set of evaluation criteria for the options appraisal to identify a preferred option; these options were considered without detailed financial information, so were initially scored on a comparative basis according to their ability to meet the criteria selected.

The selected criteria are detailed in Section 7.2 of this report.

4.1.3 Stage 4 - Reporting

A summary of the detailed work carried out and the recommendation of a preferred option, to include a risk assessment of implementing the preferred option along with any impacts on staff.

4.2 Key Stages of Options Appraisal

The key stage of options appraisal was based around assessing each of the models against the following key criteria which were grouped and weighted in terms of a score.

Standards & Quality – 30%

- Audit Methodology
- Quality Control
- Leadership
- Access to Specialist Skills

Staff & Skills – 20%

- Investment in People
- Use of Audit Automation
- Terms and Conditions

Organisational – 25%

- Strategic Fit
- Track Record
- Use of Resources
- Governance & Accountability

Financial/VFM – 25%

- Cost of Implementation
- Flexibility of Future Costs
- Cost of Service

5. Conclusions

5.1 This review provides a balanced opinion of the reviewing Officer based on the information gathered, supporting documentation, interviews with staff and using an options appraisal scorecard.

All matters arising have been discussed with the Divisional Director Risk and Assurance along with suitable recommendations.

5.2 The information gathered has been collated and following conclusions formed:

- There are potential net benefits from each of the 5 options; but specifically 3 options – Both Partnership Models & the In-House Restructure - present the most sustainable and effective solution;
- Significant savings can be delivered with all 3 top options and as the savings are being front-loaded the Internal Audit budget should be protected for a sufficient period of between 3 – 5 years;
- Solutions should be phased in to maximise the advantages of any model and allow appropriate opportunity to further test existing assumptions;
- There are benefits of re-structuring the in-house service first in order to progress medium term to a potential partnership model, with Bristol City Council as an initial potential partner;
- North Somerset & South Gloucestershire Council have expressed interest but are not in a position to progress at the moment so the development work with Bristol should ensure that they could join easily within a relatively short timescale;
- Existing partnerships such as SWAP also present a strong option, however allowing a period of testing and development with a more localised partnership with Bristol will provide further opportunity of testing the assumptions made around partnership models;
- The SWAP model may therefore present an effective solution if a local partnership cannot be agreed or developed successfully in the next 12 – 24 months;
- There are significant risks of moving directly towards a fully outsourced or co-sourced arrangement and these models are not recommended.

6. Recommendations

The following recommendations are made in respect of the future service delivery for Internal Audit based on the results of this exercise and assessment.

It is recommended that the Divisional Director Risk and Assurance Services should consider the content of this report and supporting working papers with a view to the future delivery of the internal audit service for Bath and North East Somerset.

6.1 In-House Restructure

Re-structure and re-base the internal audit service by the amalgamation and integration of existing staff with internal audit experience from the risk and assurance service to provide a suitable level of assurance;

<u>In order to achieve this, the re-structure should:</u>

a) Implement the planned redundancies and reduce the internal audit budget based on required savings; of approximately 25% immediately.

b) Fix the revised budget and costs for internal audit for 5 years with no further reductions or cuts proposed within this period.

c) Continue in-house with remaining current staff; with the integration and amalgamation of the risk management team into one composite Internal Audit and Risk Management team; the current risk management team includes 3 FTE members of staff with previous audit experience which would readily fit into a new structure and would compensate for the loss of staff through redundancies and savings;

d) This will in effect be a cost neutral exercise and will replace the Audit Manager role and, in part, the 2 Auditor roles through existing risk management staff;

e) The proposed restructure to be finalised bringing in audit qualified staff within the division with an anticipated full implementation date of 1st April 2011.

f) Risk Management support to be reduced and replaced with a strengthened risk-based approach to audit coverage of service areas.

g) Service delivery to be maintained in-house for a period of at least 2 years pending the results of the work on the alternative partnership models.

h) Performance of the new restructured in-house team would expect to be improved by at least 10% in order to strengthen the status and performance of the team through the amalgamation of the risk assurance service; and to satisfy the external audit requirements;

i) In order to increase performance there is a need to identify new and smarter ways of working, such as, prioritising reviews to ensure adequate coverage and assurance; and; ensure that all reviews are completed within the number of days allocated (subject to issues arising which require further work);

j) Investment in staff development and the implementation of a service improvement programme which is focused on creating a quality delivery environment and culture of an Excellent Council;

k) If budget permits, potential to work in partnership with an external provider to support the in-house improvement programme in the short to medium term and to provide specialist skills or expertise to add value in the longer term ensuring service improvement is sustained;

l) Consider the growth opportunities within Academies and Social Enterprise Partnership.

6.2 New Partnership (i.e. CUBA)

6.2.1 Commence formal dialogue with Bristol City Council, as a potential partner, in carrying out joint working on specific reviews and establishing governance and management of those reviews;

- Development work with Bristol CC to be sanctioned to start in 2011/12 to investigate the detailed model for a potential internal audit partnership to cover both authorities.
- Any model should be flexible to take into account the client roles – if considered necessary - of the respective authorities and be able to add additional parties as required.
- The model is based on a single shared service to be hosted by one authority with audit teams from both organisations fully integrated.

6.2.2 A report on the full implications and detailed requirements of the new proposed partnership model to be presented to the respective audit committees by 2012/13.

6.2.3 Full implementation of the partnership model to be proposed from April 2013 for at least a 5 year period with shadow arrangements to be in place during 2012/13.

6.2.4 Continue dialogue with the other neighbouring authorities in order to establish their potential commitment and ambition to join or form a new CUBA partnership in the future to deliver an internal audit service;

6.2.5 The proposed option for a new CUBA partnership is considered to be the best option for B&NES. It is considered that it would deliver all the required outcomes at the same cost.

6.3 Existing Local Authority Partnership (i.e. SWAP)

It is recommended that the SWAP (South West Audit Partnership) should be retained as an alternative solution in the event that the decision is made that a local partnership cannot be implemented or agreed upon by April 2012.

If this is the case approval for SWAP to deliver Internal Audit for B&NES should be taken by June 2012 to enable implementation by April 2013.

An in-house restructure will build on service improvement to move towards confidence in future internal audit service delivery.

In principal there are advantages to be gained in sharing specialist skills and management, although consortia are vulnerable to the changing requirements and priorities of their members.

6.4 Co-sourced and Fully Outsourced

As a result of the evaluation it is recommended that the following options are ruled out at this stage;

- fully outsourced; and;
- co-sourced.

6.5 Staffing & Financial Implications

6.5.1 Budget

a) In order to implement any of the proposed options it is recommended that the audit service should plan effectively for a stable future and so the equivalent of a gross 25% reduction in resources is proposed. This will then enable the future team to have some sense of certainty in the medium term by fixing the budget for future years.

b) Financially this results in a total reduction of approximately £105K in audit resources over 2 years and equates to approximately 3 members of staff.

c) The cost of redundancies and any resulting strain on the fund will be repaid by the service in accordance with the corporate requirements agreed by the Strategic Directors Group and Cabinet.

d) The revised budget and costs for internal audit should be fixed for between 3 and 5 years with no further reductions or cuts proposed within this period.

6.5.2 Redundancies

During summer 2010, an exercise was carried out to identify those staff wishing to take voluntary redundancy within Internal Audit. Two members of Internal Audit staff volunteered and have been accepted for redundancy, one of these left in November with the other leaving in March.

The integration of the risk management and internal audit teams places both posts of Audit Manager and Risk Manager at risk. Following discussion, the Audit Manager has also volunteered for redundancy and early retirement during 2011/12.

The three volunteers therefore enable a saving of 25% of the gross budget.

6.5.3 Impact of Redundancies

a) The impact of losing staff through redundancy means that the existing Risk Manager will become the new Group Manager (Audit & Risk) with responsibility for both the provision of Internal Audit and Risk Management (including all Corporate Governance functions).

b) The Corporate Governance Manager will also move across to the wider audit and risk team and be structured into an Audit Team Leader post entitled Risk & Governance to simplify the structure.

c) The previous posts of Audit Manager and Risk Manager would be deleted.

d) All other staff will remain in their existing posts with the only effective change being a new manager of the two functions.

e) The current Audit Manager will remain until August 2011 to ensure a smooth transition, to be able to work on the development of the partnership with Bristol CC and complete a number of specific outstanding one-off projects.

f) The wider impact of deleting the post of Risk Manager will mean the Business Continuity & Emergency Planning Manager reporting direct to the Divisional Director and a minor restructure required in the Information Governance team to ensure a reporting line direct to the Divisional Director.

7. Findings:

7.1 Stage 1 and 2: Planning and Research

7.1.1 In-House Model

7.1.1.1 Delivery of the service retained 100% by B&NES, i.e. limited change to existing arrangements by way of an internal re-structure or amalgamation of similar functions.

7.1.1.2 An improved in-house option is likely to follow from evidence that:

- The in-house team is already delivering economy, efficiency, and effectiveness at levels that match both local needs and external comparators;
- The in-house team has the capacity and capability to make the improvements necessary to meet ***and sustain*** performance at levels that will meet the Council's future targets; (enabling it to continue to deliver Internal Audit when resources have been reduced by 25% is only viable if it is integrated with the Risk Management function);
- The risk of failure, or the impact of failure, is so high that the Council has to maintain a high level of control over the activity. Risks are managed better within the authority;
- The activity is so central, or core, to the purpose of the Council that any other option would seriously question the Council's ability to function as an organisation;
- The potential economies of scale, scope, or for investment, offered by other options are outweighed by the transaction and process costs of implementing those options;
- The Council has, or can generate, sufficient funds to meet future investment requirements;

7.1.1.3 Additionally, the (improved) in-house approach may be seen as a temporary solution while the Council prepares for the introduction of an alternative approach such as a partnership working with local neighbouring authorities.

7.1.1.4 The strongest argument against maintaining (or developing) an in-house provision is that there is another option that can deliver services and meet the authorities objectives more economically, efficiently, and effectively.

7.1.1.5 <u>Current Performance</u>

The review exercise drew on the results of the CIPFA benchmarking exercise and an analysis of a data gathered in relation to the service in order to develop a reasonable understanding of the services offered by the Internal Audit Service; in terms of;

a) the main tasks or additional offers that the Internal Audit Service provides;
b) a collation of basic summary financial and resource information;
c) a collation of more detailed data regarding the service offers that are managed and the associated demand;
d) a skills analysis; and;
e) a workshop with the Internal Audit staff to discuss items (a) to (d).

7.1.1.6 Stakeholder perceptions

This was accomplished by way of interviews with key stakeholders identified in Section 2, and feedback from Directors and Heads of Service via a questionnaire.

7.1.1.7 Current State Assessment

The current performance and service delivery of the in-house Internal Audit Service established that, in general, service delivery meets the needs of clients and the external auditors.

7.1.1.8 Opportunities for improvement were identified as:

- In order to realise the savings identified by the Council and to have a neutral or reduced cost of provision consideration should be given to the amalgamation of the risk management team into the Internal Audit Service;

  This effectively means the creation of a joint audit and risk team and replacing the redundant auditor posts resource from the risk management team, which would equate to an extra 200 audit days;
- Improve the ability of the service to deliver the audit plan and react to ad-hoc unplanned work by streamlining the audit resource planning process and by the reduction of non-productive days;
- A stronger emphasis on risk based auditing. Whilst there will be a reduction in risk management support to services, this is envisaged to be replaced through targeted audit coverage;
- Introduce stronger management practices to control contingency items to demonstrate appropriate areas of coverage;
- As the authority will be going through a severe period of organisational change, risks of fraud and misuse of resources are much higher and so having full flexibility and control of audit resources throughout at least a 2 year period is assessed as being highly beneficial;
- The new team will give between 9% and 15% more audit coverage than the other proposed partnership models and be able to replace some of the skills gaps, i.e. procurement;
- Re-structure and formation of service teams;
- Identify skills gaps and invest in staff training;
- It may also be appropriate for internal secondments to be arranged from within the organisation on a project basis or longer term, dependant upon the nature of the review;
- The restructure would be based and operated on preparing for partnership by re-evaluating audit planning methodologies and re-prioritising investment in standards and training;
- It is therefore recommended that the in-house restructure is chosen as part of a phased approach to longer-term partnership by implementing it immediately for a period of at least 2 years.

Table 1 - Summary risk assessment of the advantages and disadvantages of this option.

Risk Assessment – In House	
Advantages ☑	**Disadvantages** ☒
The key advantages of integrating the functions are significant savings in time, cost and management capacity.	
Statutory effective internal audit coverage provided since 1996; Infrastructure already in place and adaptable.	Age profile of staff could result in potential loss of expertise and knowledge due to retirements;
Understanding of Council Services and operations and functions; Extensive Local Government experience.	Lack of training due to limited budget;
Retain relationships, rapport and goodwill with Directorates; Strong internal networks. Team has considerable experience at BANES. The team know the organisation and have knowledge of people.	Potential lack of independence Uncertainty of government Education agenda and Schools opting out of FMSiS or becoming Academy status; and the externalisation of other services may result in reduced areas of audit coverage;
Mixed skills base. Experience in certain areas; Able to offer advice to all areas of the Council; Less impact to staff and service.	Skills gap · IT, · Contracts and Procurement, · Pensions Need to train staff up in skills gap areas.
Flexible to the needs of clients; Greater control over internal audit plan, contingency and allocation of resources. The restructured team will provide sound audit coverage and can replace potential skills gaps, i.e. procurement.	Budget cuts, redundancies, cuts to all services or a reduction in Income streams could have a knock on affect to service delivery and customer perception;
Good quality service; Likelihood that staff will have faced problems before and have strategies for moving forward.	Limited expertise in certain areas;
Low cost; good value for money. The re-structure could be fully implemented in less than 3 months for no cost.	
Committed staff; · Availability, · Responsiveness, · Reliability of staff, · High integrity.	Budget cuts during 2010/11 resulting in cuts in staffing numbers and/or service provision

7.1.2 Partnership Model - Existing Consortium e.g. SWAP

7.1.2.1 Delivery of the service would be provided through a collaboration of audit resource from neighbouring authorities in the South West region, i.e. transfer of staff to a separate partnership entity or one single authority

7.1.2.2 The main types of evidence to support a move towards collaborative or partnership working are:

- Willing partners;
- Spare capacity in the potential partners;
- Benefits from pooling budgets and other resources that would not be realised if the authority was to continue acting independently;
- Shortages of specialist staff or other resources;
- Comparing evidence of the benefits of joint working for service delivery, service commissioning, or hybrid approaches.
- Shared, or similar, values and culture;
- Ground rules (agreement on the partners roles and responsibilities) from an early stage (by way of a formal contract);
- All partners must gain something from the partnership;
- All partners must contribute to the partnership;
- Achievable objectives.

7.1.2.3 ***Existing Provider – South West Audit Partnership Model (SWAP)***

The South West Audit Partnership (SWAP) is hosted from South Somerset District Council and operates in the South West region, from the boundaries of Somerset to Weymouth and Portland.

The partnership has been in existence for over 5 years and has an extensive set of governance and legal arrangements in place.

It comprises of 11 partners consisting of 9 District Councils and the County Councils of Dorset and Somerset, in addition, Dorset are currently in a 50/50 contract with Deloitte's, which has also been taken on by SWAP.

Geographically the partnership is spread over a vast distance so organisationally existing teams primarily stay serving their original authority with some minimal flexibility outside of this, in terms of working for different partners;

Such a model could be considered feasible where the Council considers that it cannot finance its own internal audit service to deliver a comprehensive range of reviews and provide adequate assurance, choosing not to fully outsource or co-source all the service.

Meetings were held with the Head of the South West Audit Partnership (SWAP) to discuss the options and benefits available to B&NES in joining the partnership.

The SWAP contract has recently been renewed with its partners and is currently in a new 5-year term. Any new partner would 'buy-in' at the time of joining for the remainder of the period. Each partner has their own 'trading agreement' to specify what is included, giving flexibility around terms of the contract.

Most service risks are transferred, including capacity and staffing issues which should lead to consistency in management and assignments. SWAP is also compliant with all CIPFA Code of Practice standards.

Each partner has an equal seat on the Partnership board - one partner one vote.

Staff from B&NES would transfer (TUPE) to the employment of the 'host' authority, (South Somerset District Council) and would be subject to TUPE arrangements and will have similar terms and conditions to B&NES.

SWAP also negotiates with each individual partner authority for the provision of free accommodation, which includes a separate broadband connection through their network.

For Bath and North East Somerset Council the partnership approach would mean that audit skills otherwise unavailable can be brought into the frame.

Experience shows that the concept has worked well in the NHS, where consortium arrangements have enabled the NHS bodies with inadequate audit resources and skills to develop effective audit regimes.

The concept is also considered to have worked well in the first 5 years of the South West Audit Partnership (SWAP).

It allows the Service to make an immediate overall cost saving and presents a level of security and certainty for staff.

7.1.2.4 Readiness/ Capability Assessment

Whilst the strengths are primarily the same as a new CUBA partnership would be, its key advantage is that it is already in existence and is successful and therefore set-up and implementation is potentially relatively short (3 - 6 months);

The existing SWAP partnership are in a good position of readiness as they have experience, a standard procedure and legal documentation in place to be able to ensure the smooth transition into the partnership.

However as a model it is not considered to be as strong as a new, more local partnership which would have lower overheads, a stronger strategic fit in terms of joint working and a more flexible operation by having a single 'hosted' team working on a variety of partners.

Additionally there would be a loss of strategic control and influence due to the number of partners within the partnership and in most cases those partners have yet to 'downsize' their audit budgets thereby creating additional risk in the medium term.

As all local authorities will be going through a period of severe organisational turbulence and change it may be advisable to delay any decision on joining SWAP until the future is clearer and the impacts on the SWAP partnership are evidenced.

It is recommended this option is kept as an alternative solution position for potential implementation in 2013/14 in case a new local CUBA partnership is not able to be implemented or delivered.

Table 2 - Summary risk assessment of the advantages and disadvantages of this option.

Risk Assessment - Existing Consortium with other Local Authorities	
Advantages ☑	**Disadvantages** ☒
Retain an in-direct control of the service; A more sustainable service; where previous absences or involvement in special investigations reduced or affected the annual audit plan or resulted in additional costs when providing adequate cover.	An unequal partnership may mean that control of resource is biased i.e. equity and delivery of service; Quality of service may deteriorate over time without fresh input.
Continuity and locally based staff; however; Audit would be seen as an independent service by Directorate staff.	Loyalties may be divided;
Costs are restricted to the direct costs of service provision (no profit element)	Lack of flexibility – usually a more formal arrangement
Cost - in terms of economies of scale	Inflexible pricing once budgets have been agreed;
Shared Knowledge – opportunities to learn from elsewhere and do cross-cutting reviews Opportunity to share costs and buy in specialist skills not otherwise available or share skills from other partner authorities such as IT or contracts.	Ancillary services (e.g. VAT, Pensions, IT) may still need to be bought in; Greater demand from all partners for a particular service i.e. computer audit or contract audit.
Efficiencies can be achieved by carrying out ‘parallel’ reviews at more than one partner site at a time. Themed reviews are a way to add value to all Partners;	Resource – if resources are a problem for all partners, it may just become a bigger problem;
Introduce increased flexibility through a greater number of staff able to work across all partner sites or locations; i.e. greater resilience within the partnership;	Potential lack of flexibility during very busy/quiet periods;
A good cultural fit;	Terms & Conditions – need to address disparities in pay and conditions between the partners.
Slimmer management structure;	Potential for management to be too few and managers’ roles may be spread too thin.
Client role can be focused on quality;	
Access to better career development opportunities and training, gaining experience in working with other authorities should provide greater opportunities for progression.	

7.1.3 New Partnership Model - CUBA Neighbouring Authorities

7.1.3.1 Delivery of service provided through a collaboration of audit resource from neighbouring local CUBA authorities.

7.1.3.2 Evidence to support a move towards a CUBA partnership consortia working are:

- Commitment from willing partners;
- Benefits from pooling budgets and other resources that would not be realised if the authority was to continue acting independently;
- Shortages of specialist staff or other resources;
- Shared or similar, values and culture;
- Ground rules (agreement on the partners roles and responsibilities) from an early stage (by way of a formal contract);
- All partners must gain something from the partnership;
- All partners must contribute to the partnership;
- Achievable objectives.

Providing Internal Audit through an independent Partnership strengthens both its profile and independence and enables a pooling of skills and resources which cannot be achieved when delivery services to only one organisation.

7.1.3.3 ***Proposed formation of a "CUBA" Partnership consortia***

Recent discussions were held individually with the Heads of Internal Audit of the neighbouring Unitary Authorities formed on the dissolution of the former Avon County Council (Bristol City Council, North Somerset Council and South Gloucestershire Council).

The meetings sought to establish their current position, the potential benefits and pitfalls of such an arrangement and their potential future appetite in considering a collaborative working partnership to deliver an internal audit service to the former Avon County geographic area.

All four Authorities are currently part of the West of England Partnership and have experience of collaborative joint working in the areas of Waste and Transport. They also agreed to work within the new Local Enterprise Partnership thereby strengthening the strategic fit of this model.

All four Authorities already work closely together and have accepted a joint partnership provides a strong long-term option.

The Heads of Internal Audit regularly meet to discuss local topics and consider the possibility of collaborative working on joint reviews.

Whilst feedback from the recent meetings indicated a lack of immediate interest in a local area consortium for internal audit from some authorities (due to the fact that budgetary pressures for savings were not as pressing in their service area), interest was expressed for a potential future arrangement with a champion for the partnership within each of the potential partner organisations.

Bristol City Council has however indicated that it is serious in working with B&NES to develop a partnership in the next 12 - 24 months.

Geographically the relatively compact size of the area also enables a more efficient organisational set-up by hosting all staff in one place but enabling them to deliver services to all partners, rather than being fixed on only one authority;

Overheads would be lower than buying into an existing partnership which is spread more geographically, i.e. SWAP Partnership works across all of Somerset, Dorset and parts of Devon.

There is no significant loss of strategic control, influence or local knowledge as the number of partners is relatively low as opposed to the main existing partnership - SWAP - which has 11.

This option, would present a suitable level of security and certainty for staff.

7.1.3.4 **Readiness/ Capability Assessment**

This option potentially represents the best alternative,

However, not all four Authorities are either ready or capable of delivering this change at the present time. Therefore, the assessment is based on the potential future delivery of the option and how B&NES and the other Authorities would move towards this as a real opportunity for all.

An initial commitment would be required from each potential partner in order to escalate the proposal forward into a solid business case with clear intentions.

At present only one Authority is in a position to work with B&NES (Bristol CC) to implement a partnership. This in itself is not particularly negative as it will speed up implementation and enable the other 2 authorities to join at a later stage much more easily.

Initially the partnership would be for B&NES and Bristol CC to form but would be set-up to allow North Somerset, South Gloucestershire and potentially other local authorities or other public sector bodies to join in future years;

The partnership would be based on a 5 or 10 year legal agreement which can be approved without the need for any procurement exercise. However it has to be formed from scratch and so set-up costs and timescales to implement are relatively long, and it is estimated it would take at least 12 – 24 months;

The rebasing of budgets before joining the partnership is critical.

B&NES Internal Audit will be reducing costs by 25% before a partnership is formed thereby providing stability for the immediate future (3 - 5 years). Other partners must also reflect on their costs before entering the partnership and decide on their own client arrangements.

In the case of B&NES this would start with the re-structure of the internal audit service to ensure that it continues to provide a suitable level of assurance to the Council in the medium term.

It would be beneficial for all participating authorities to commit to joint reviews and cross working on specific common areas to ‘pilot’ the potential for a partnership.

This would need to consider the type of governance; infrastructure and systems that could feasibly fit into a future partnership delivering an internal audit service on behalf of all the authorities.

It is recognised that such a major change programme will be delivered over the medium to long term. It would therefore be important to maintain momentum and establish an effective process to participate and commit to pre-determined timescales.

This option provides the best opportunity to maximise the use of joint reviews and to identify and possibly streamline processes and not be seen as a lack of ambition for this opportunity.

In order for this proposed option to succeed it is very important that participating Authorities express an early formal commitment and joint ambition to proceed and nominate a “champion’ to promote and drive the programme, and transition process.

The scale and cost of any new infrastructure and change will be dependent on which Councils decide to proceed, but it will require significant initial investment to fund new Infrastructure and systems, and re-source the process.

Prior to proceeding and in order to minimise misinformation, it is essential that this option is fully communicated and consulted upon with all stakeholders to dispel fears and allow discussion at an early stage.

There is a wider opportunity to link together in the long-term with the SWAP partnership and other regional delivery models to provide even greater efficiency and resilience including sharing contracts and resources;

It is recommended this option is seriously considered for the medium to long-term as part of a phased implementation and an optimum time for implementation would be the 2013/14 year.

Key Issues:

People

- Need for timely harmonisation planning;
- Head of Partnership would be appointed 6 months in advance to plan change.
- All staff would transfer to the ‘hosting’ authority but would retain all other employment rights, i.e. local government terms and conditions and access to the pension scheme;

Process

- Focus on best practice & harmonisation of processes, single methodology and need for flexible working to be in place;

Systems

- Need for single software system to be used and IT links to partners networks.

Governance

- The partnership would be based on one authority ‘hosting’ the partnership, a single Head of Partnership and having a single methodology and supporting systems and software;
- The partnership would however have freedom to operate as a separate entity within this framework and would have its own ‘branding’ and operating name;
- The Head of Partnership would report to a Partnership or Management Board consisting of each partner. This board would sign off the budget, business plan and audit and resource plans for the partnership;
- Existing Audit Committees would remain as now for each partnership authority and the Head of Partnership would report direct to each committee on the performance of Internal Audit.

Table 3 - Summary risk assessment of the advantages and disadvantages of this option.

Risk Assessment - Proposed partnership with Neighbouring Authorities	
Advantages ☑	**Disadvantages** ☒
A good cultural fit; Fits strategically with the future model of the organisation and expectations of the new government in finding more efficient methods of service delivery.	Lack of immediate interest in an area-wide consortium for internal audit; There may potentially be a loss of reputation for the audit teams involved, and, in the event of the project failing or no agreement being reached, the wider reputation of the Council.
More localised, as fewer partners, therefore a greater degree of control; the relatively compact size of the geographic area also enables a more efficient organisational set-up by hosting all staff in one place but enabling them to deliver services to all partners, rather than being fixed on only one authority.	At present only one Authority is in a position to work with B&NES to implement a partnership. This in itself is not a negative factor as it will speed up implementation and enable other authorities to join more easily at a later stage.
Continuity and locally based staff. Staff already familiar with each other and, in general, are based locally.	There is risk in the work involved in establishing a new consortium, including dealing with staffing issues and establishing a new identity and aligning working methods. A lack of availability of current staff wanting to work in locations at the other partner sites.
Experience of working closer together in collaboration on the same topics, such as the West of England partnership Waste and Transport reviews; Best practice in many service areas in will be feedback and circulated by the auditor involved.	Alignment of working methods; The partnership would be based on one authority 'hosting' the partnership, and having a single methodology and supporting systems and software.
No procurement regime to go through as this can be done under the Local Government Act 1972.	Timeframe to deliver; there is significant work involved in establishing a new consortium; it is estimated it would take at least 12 - 24 months; The project could fall behind (not introduced to the proposed deadline) or partners may fail to agree on the detail of the audit approach or other dispute causing the project to fail.
Transfer of all in-house staff to the new partnership 'hosting' authority under TUPE arrangements, strengthening both its profile and independence. All staff would retain employment rights, i.e. local government terms and conditions and access to the pension scheme.	Terms & Conditions - need to address disparities in pay and conditions between the partners.

Risk Assessment - Proposed partnership with Neighbouring Authorities	
Advantages ☑	**Disadvantages ☒**
Fixed term agreement; and integrated audit plan with local variations based on existing internal audit resources and partner requirements.	Failure to deliver the current level of audit coverage to the partner Councils involved and at the same time not achieving any efficiency gains.
Local Internal Audit Manager could be responsible for more than one team; and reports to Audit Committee.	Insufficient Management structure resulting in the Manager role being spread too thin.
Clear identification of the efficiency gains for each partner. Cost reductions through common areas of spend, such as CIPFA, periodicals, training etc.	
Overheads would be lower than buying into an existing partnership which is spread more geographically, i.e. SWAP Partnership works across all of Somerset, Dorset and parts of Devon.	
Pooling of skills and resources. Integrating resources through partnership strengthens standards and improves opportunities for staff and career development and ultimately provides greater resilience for the future.	
Wider long-term opportunity to link with the SWAP partnership and other regional delivery models to provide even greater efficiency and resilience including sharing contracts and resources.	

7.1.4 Co-sourced Model

In theory both the co-sourced and outsource models should work well, with the ability to replace skills gaps and invest in areas of highest risk.

7.1.4.1 Discussions were held with external providers to gain an understanding of the options available by way of a co-sourced arrangement.

7.1.4.2 Evidence to support a move towards a co-sourced option is:

- Where the current internal arrangements and shortages of specialist staff or other resources are considered to be inadequate in terms of ability to deliver a range of services;
- Commitment from Senior Management to provide financial capacity to procure additional resources to assist the in-house service;
- Spare capacity in the potential provider;
- Achievable objectives.

7.1.4.3 *Option – Co-sourced*

Co-sourcing is the procurement of core or additional specialist skills as a fixed term contract, secondment or as an ad-hoc arrangement, and is an attempt to address and rectify issues experienced such as short term resource problems e.g. sickness, unplanned work or difficulty in recruiting.

Co-sourcing involves an external provider working alongside the in-house function to provide valuable skilled support when required with an agreement on roles and responsibilities by way of a formal contract;

The extent to which co-sourcing is required depends on the specific audit or review being carried out, but access to the relevant specialists enhances the level of internal audit provision.

Occasional secondment of specialists to enhance the in-house role can be particularly useful for reviews of;

- Information Technology;
- Contracts and procurement;
- Taxation;
- Pensions.

This may be particularly relevant for contract or Information Technology audit reviews and will almost certainly be a cheaper option than external specialists. However, independence could possibly be compromised.

Delivery of the audit plan is shared between the chosen provider and the Council. It is common practice for the external provider to complete reviews that may be considered ‘specialist’ or are more cost effective to outsource. This eliminates the need for the Council to recruit expertise that is difficult and sometimes relatively expensive to retain and maintain.

The major disadvantage of co-sourcing is the cost of procuring specialists and it is recommended that an assessment of risk and value for money is carried out before proceeding with this option.

Whenever services are bought in, experience shows that it is essential that the contractual conditions are unambiguous and understandable to both parties.

The co-sourcing option does not allow the Council to make an overall cost saving as funding for the arrangement is from existing budget or increased savings.

Additional compulsory redundancies would be required to further reduce the audit function by at least 25%. This reduction would be both costly (and unaffordable) and would not replace the skills being lost with anything that was discernibly different.

The option presents a high level of security and certainty for staff that have been retained.

Implementation would take at least six months and involve a significant amount of management capacity. The value of this exercise was not considered beneficial.

7.1.4.4 **Readiness/ Capability Assessment**

The co-sourcing option does not allow the Council to make an overall cost saving as funding for the arrangement is from existing budget or increased savings.

It is estimated that if this option was chosen the process would take between 1 and 6 months to implement dependent upon the value of the contract and compliance to the Council’s Financial Standing Orders and procurement process.

The option presents a high level of security and certainty for retained staff.

Table 4 - Summary risk assessment of advantages and disadvantages.

Risk Assessment - Co-sourced arrangement	
Advantages ☑	**Disadvantages** ☒
Independence from the organisation.	Quality of delivery - the reliability of management information is vital to assess the quality.
No staff administration and training requirements and costs and Council can potentially have access to private sector training opportunities.	Potential loss of control of quality of staff provision.
Cross-fertilisation of ideas gained from other sources/sectors.	Cultural fit – differences in culture and approach can potentially lead to problems and staff may not have the detailed knowledge of the Authority.
Flexible resources and availability – can specify term and level of provision.	Staff may not always be available on site. Continuity of staff may be less certain. In addition, the loss of any real flexibility of the audit resource through a time of severe organisational change is not considered advantageous.
	Potential damage to in-house reputation; Research identified that the co-sourced model has, in general, been ineffective in relatively small audit functions in terms of standards, management and having different methodologies employed.
Full access to technical expertise, specialist resource and ancillary services.	Cost of procuring specialists may be high at a premium.
A flexible contract – the Council can specify term and level of provision and only pays for what is provided.	Contract restraints - you only get what is specified and agreed to pay for in your contract. Unforeseen changes to plan may incur extra cost.
Ability for provider to 'second' a member of staff to the in-house team.	If a secondment is considered, care must be taken to manage any potential conflict of interest, confidentiality or compromise the independence of internal audit.
In the short-term there could be cost advantages.	Costs - the private sector supplier will have significantly higher daily rates
Penalty clauses can be written into the contract to deal with delays in delivering the Annual Audit Plan.	Potential financial exposure if the co-sourcing fails. This could be of particular concern where the Council may have established in in-house resources on delivering and achieving all of the outputs.

7.1.5 Fully Outsourced Model

7.1.5.1 There is a well developed market for local authority internal audit services.

Delivery of service is provided 100% by an external provider. i.e. transfer of all staff to an outsourced external provider to deliver an annual risk-focused internal audit plan. A designated contact acts as a liaison reporting to the in-house responsible client officer and the Audit Committee.

7.1.5.2 Evidence to support a move towards a fully outsourced are:

- the organisation is too small to justify an in-house team,
- the organisation is unable to attract and retain suitably qualified internal auditors, or;
- requirement for specialist skills which are not available within the in-house internal audit team and;
- a benefit may be gained from a 'leading edge methodology' and wider experience of best practice.

7.1.5.3 <u>External Providers</u>

Discussions were held with external providers to gain an understanding of the options available for a fully outsourced arrangement.

The engagement of an external provider would assist or replace the in-house team and the Council would benefit from the greater independence and flexibility afforded by an external resource.

However, external providers are increasingly reluctant to take on local authority staff under TUPE transfer and would prefer to work in partnership or as a co-sourced arrangement.

In this respect this option would be likely to limit the market response, presenting a high risk that the procurement process will not deliver best value for money.

This option presents significant uncertainty for staff.

<u>*Option – Fully outsource*</u>

Immediate, short and long terms cost savings, with an internal audit service sufficiently staffed and up to date with the relevant skills or experience to consistently deliver a service.

7.1.5.4 Readiness/ Capability Assessment

It is estimated that if this option was chosen the process would take between 6 and 9 months to implement dependent upon the value of the contract and compliance to the Council's Financial Standing Orders and procurement process. The OJEU procurement timetable takes a minimum of 6 months. Procurement via competitive tendering carries related advertising and staff costs.

External providers are in a position of readiness to take on an internal audit service as they too have experience, procedures and legal documentation already in place to be able to ensure the smooth transition into the agreement.

Existing staff would transfer to the external provider under TUPE arrangements.

However, external providers are increasingly reluctant to take on local authority staff under TUPE transfer and would prefer to work in partnership or as a co-sourced arrangement.

The market advised that they would prefer to use their own staff and not TUPE existing staff into their own organisation. The relative size of the service was not therefore attractive enough to make it a viable proposition.

In this respect this option would be likely to limit the market response, presenting a high risk that the procurement process will not deliver best value for money.

In the short-term there could be cost advantages but these were countered by little in the way of any track record of positive service delivery and an uncertain future for staff transferred. Indeed there was no history of a sustainable and quality service being delivered by an external firm for a Unitary Authority

If the Council were to enter into a fully outsourced arrangement, operational risk may increase as there is potential for the arrangement to be terminated suddenly, if this happens, the Council should have a contingency plan to mitigate any significant gap in audit coverage, particularly for high-risk areas.

In its planning, the Council should consider possible alternatives to determine what it will do if an auditor with specialised knowledge or skills is unable to complete reviews of high risk areas, or if an outsourcing arrangement is terminated.

This option presents significant uncertainty for staff.

Implementation would take at least six months and involve a significant amount of management capacity. The value of this exercise was not considered beneficial.

Table 5 - Summary of the advantages and disadvantages of buying in the service.

Risk Assessment – Fully Outsourced arrangement	
Advantages ☑	**Disadvantages** ☒
Independence from the organisation. Audit would be seen as an independent service by Directorate staff.	Continuity of staff may be less certain. Significant uncertainty for current B&NES staff. Providers prefer to use their own staff and not TUPE existing staff into their organisation.
No staff administration and training costs. Large external provider is more likely to invest significantly in training, development and best practice techniques. Council can potentially have access to private sector training opportunities.	Staff may not always be available on site.
Client role can be focused on quality. Staff recruitment and retention issues no longer a problem	Potential loss of control of quality of staff provision.
Cross-fertilisation of ideas gained from other sources/sectors.	
Flexible resources and availability – can specify term and level of provision.	Cost - the external provider will potentially higher daily rates

Risk Assessment – Fully Outsourced arrangement	
Advantages ☑	**Disadvantages ☒**
In the short-term there could be cost advantages.	Long term costs - the external provider will potentially higher daily rates
Full access to technical expertise, specialist resource and ancillary services.	
A flexible contract – the Council only pays for what is provided.	Contract restraints – you only get what you have specified in the contract and agreed to pay for.
All service risks transferred to external provider, including capacity and staffing issues – resulting in consistency in management and assignments	Cultural fit – differences in culture and approach can potentially lead to problems Private sector staff won't have the detailed knowledge of the Authority
The outsourced provider works jointly with the internal audit manager in reporting significant findings to the audit committee.	Would be difficult to reverse the decision at a later date if the service were to be brought back in-house

7.2 Stage 3 and 4: Option Development

7.2.1 The feedback from the interviews held and results of the questionnaire fed into the development of a set of evaluation criteria for the options appraisal under a number of main headings;

These options were grouped and weighted in terms of scoring and were considered without detailed financial information, being scored on a comparative basis according to their ability to meet the criteria selected.

7.2.2 The following criteria were subsequently confirmed (not in any priority order):

a) **Standard and Quality - 30%** - Ability to develop audit strategy and risk-based plan consistent with the Council's corporate vision, strategy and priorities

- Quality Control - Ability to deliver core audit requirements – including compliance with CIPFA code of practice and satisfying the External Auditor's requirements,
- Leadership - Ability to deliver significant and sustainable improvements in the quality and productivity of the internal audit service – consistent with an excellent rating,
- Access to specialist skills - Ability to contribute to broader work including upstream advice on new developments, best value, efficiency, performance improvement and modernisation.

b) **Staff & Skills - 20%** - Delivering improved value for money within existing cost parameters - comparable with or better than other similar local authorities.

- Investment in People - Improving profile and standing of internal audit within the organisation, so that the function commands the confidence of the organisation and is perceived as adding real value.
- Use of Automation - Impact on staff – providing a quick resolution to current uncertainty, improve morale and provide a more satisfying working experience for existing internal audit staff
- Terms and Conditions - Track record and cultural readiness for change

c) **Financial / VFM – 25%**

- Cost of Implementation issues: ability to deliver benefits quickly & risks to authority
- Flexibility on future costs – ability to control number of days procured.
- Cost of service – in comparison to alternative options, specialists, day rate, ad-hoc.

d) **Organisational – 25%**

- Strategic Fit - Consistent with Council's vision, mission, values & strategic aims and corporate objectives and supports the organisation
- Track record – financial stability and quality of service.
- Use of resources – adaptability to change.
- Governance and accountability – Strategic role of Head of Audit; outcomes, accountability and responsibilities are properly discharged.

7.3 Required Financial Savings: Option Development

A savings target of 20% - 25% of gross spend (approx £105k) of the total Internal Audit Service budget was the parameter over the next 4 years.

Savings of £105,257 have been identified, and will be realised, as a result of voluntary in-house redundancies of 3 members of staff. (Equivalent to 29.4% of staff budget, 24.3% of overall gross budget, 36% of net budget)

The effect of these redundancies is to reduce the gross number of audit days to 1,423 which include a number of days as a contingency allowance for unplanned project and investigation work.

Whilst it is possible to achieve these savings it also means that delivery of the Internal Audit Service in its present structure will be difficult to sustain.

Overall Summary of Options		%	WEIGHTING	In House Restructure	Co-Source	Existing Partnership (i.e. SWAP)	New Partnership (i.e. CUBA)	Fully Outsourced
Standard & Quality	**TOTAL SCORE**	**29%**	**10**	**33**	**32**	**36**	**37**	**34**
Audit Methodology			3	9	9	9	9	9
Quality Control			3	12	9	9	12	9
Leadership			2	8	6	8	8	6
Access to specialist skills			2	4	8	10	8	10
Staff	**TOTAL SCORE**	**20%**	**7**	**22**	**22**	**28**	**25**	**19**
Investment in People			3	9	9	12	12	9
Use of audit automation			1	4	4	4	4	4
Terms and Conditions			3	9	9	12	9	6
Financial / VFM	**TOTAL SCORE**	**26%**	**9**	**36**	**21**	**27**	**27**	**21**
Cost of Implementation			3	15	6	9	3	6
Flexibility of Future Costs			3	6	9	9	12	9
Cost of Service			3	15	6	9	12	6
Organisational	**TOTAL SCORE**	**26%**	**9**	**33**	**30**	**32**	**37**	**27**
Strategic fit			3	9	12	12	15	9
Track Record			2	6	4	6	6	6
Use of resources			2	10	8	6	8	6
Governance and Accountability			2	8	6	8	8	6
	TOTAL SCORE	**100%**	**35**	**124**	**105**	**123**	**126**	**101**

Analysis of Top 3 Options	In House	Existing Partnership (i.e. SWAP)	New Partnership (i.e. CUBA)	Explanation of Scoring
Standard & Quality	**33**	**36**	**37**	
Audit Methodology	9	9	9	Equal score for each option
Quality Control	12	9	12	The SWAP model was assessed as having less direct management resource than could be provided in the future through an in-house restructure or new CUBA partnership. The potential implication of this would directly affect quality control.
Leadership	8	8	8	Equal score for each option
Access to specialist skills	4	10	8	SWAP currently have access to a broader range of specialist skills via a mix of internal skills but moreover, an external contractor. A new CUBA Partnership could mirror a similar arrangement, whilst the in-house option could not match either model.
Staff	**22**	**28**	**25**	
Investment in People	9	12	12	Economies of scale allow both SWAP and a new CUBA partnership to invest more in staff in terms of professional training and career development. This area is currently a particular strength of the SWAP model.
Use of audit automation	4	4	4	Equal score for each option
Terms and Conditions	9	12	9	Although not in every case, the SWAP model is able to offer the potential for improved pay for staff.
Financial / VFM	**36**	**27**	**27**	
Cost of Implementation	15	9	3	The In-house model would be almost cost neutral and achieved in a very short timescale. The SWAP Model would take longer but has the benefit of a tried and trusted approach with its existing partners, thereby saving time and cost. A new CUBA Partnership has to be built from scratch and will therefore take the longest to implement, although SWAP have offered to assist in the implementation process.
Flexibility of Future Costs	6	9	12	Very significant savings are being delivered upfront. Due to the very nature of the models, the in-house option then has very limited to no scope to deliver further savings in the next 3-5 years. Due to their size and scale, the partnership models have more opportunity to achieve efficiencies. The new CUBA model is considered to have the greatest long-term opportunity due to the way the model would be constructed.
Cost of Service	15	9	12	All the models deliver less audit days than currently. The in-house restructure delivers the most coverage in terms of audit days as it is replacing lost resource with new skilled staff from the risk management function. SWAP delivers a reasonable return on its cost per day but it was assessed that a new CUBA model could deliver approx 5% more coverage due to the way the model could be structured and potential for lower overheads.

Analysis of Top 3 Options	In House	Existing Partnership (i.e. SWAP)	New Partnership (i.e. CUBA)	Explanation of Scoring
Organisational	**33**	**32**	**37**	
Strategic fit	9	12	15	The partnership options score well but the new CUBA model provides a perfect fit in terms of the future council model and the direction of travel of support services in general through public/private sector partnership.
Track Record	6	6	6	Equal score for each option
Use of resources	10	6	8	An in-house service offers total (100%) control and flexibility over the audit resource which enables it to score highest. This flexibility is considered important in the short term (2 years) whilst the overall organisation is changing significantly. The new CUBA model scores slightly better than the SWAP model based on the way it was assessed that the resource would be set up and allocated.
Governance and Accountability	8	8	8	Equal score for each option
	124	**123**	**126**	

	2011/12			2012/13			2013/14			2014/15		
	In-house	**SWAP**	**CUBA**	**In-house**	**SWAP**	**CUBA**	**In-house**	**SWAP**	**CUBA**	**In-house**	**SWAP**	**CUBA**
Proposed Annual Savings (Cumulative in Brackets)	£45K	£45K	£45K	£60K (£105K)	£60K (£105K	£60K (£105K)	-	-	-	-	-	-
Proposed Savings as % of Gross/Net Expenditure	10% (Gross) 16% (Net)	-	-	15% (Gross) 25% (Net)	-	-	-	-	-	-	-	-
One-Off Set-up Costs	-	-	£10K	-	£15K	£10K	-	-	-	-	-	-
Set-up Timeframe	Implemented by April 2011	No Work in 11/12	All of 11/12 (12 Mths)	-	Oct – Mar (3 - 6 Mths)	All of 12/13 (Up to 12 Months)	-	-	-	-	-	-
Set-up Complexity	Implemented (V. Low)	-	High	-	Med	High	-	-	-	-	-	-
Estimated Audit Days (Currently 1609)	1423	-	-	1423	-	-	1423	1235	1310	1423	1235	1310
Transfer of Risk for Service Delivery	None	-	-	None	-	-	None	Yes	Yes	None	Yes	Yes

Suggested Timetable and Implementation Plan

APPENDIX B

New Partnership (CUBA)		2010 -2011		2011- 2012				2012 - 2013				2013-14
		Dec	Jan - Mar	Apr – Jun	Jul – Sept	Oct – Dec	Jan - Mar	Apr – Jun	Jul – Sept	Oct – Dec	Jan - Mar	Apr – Jun
New (CUBA) Partnership Option	Options Appraisal Report											
	In-House restructure											
	Dialogue with potential CUBA partner											
	Pilot collaborative audit work planning											
	Pilot collaborative working											
	Progress report on pilot collaborative working											
	If decision is to proceed with New (CUBA) partnership											
	CUBA implementation process											
	Detailed scope of partnership											
	Go 'live' implementation of new partnership											
SWAP Option	If decision is NOT to proceed with CUBA partnership											
	Formal decision to join SWAP											
	SWAP Implementation process											
	Go 'live' implementation of SWAP partnership											
SWAP Partnership		2010 -2011		2011- 2012				2012 - 2013				2013-14
		Dec	Jan - Mar	Apr – Jun	Jul – Sept	Oct – Dec	Jan - Mar	Apr – Jun	Jul – Sept	Oct – Dec	Jan - Mar	Apr – Jun

In House Training Needs Analysis
In House Invest in training to address skills gap
In House Restructure teams
In House Smarter Working Initiatives
- Audit Planning Process
- Improve time management of reviews (by Auditor and Manager)
- Management reporting
- Performance reporting

In House Dialogue with potential partner to address
- Joint working on specific reviews
- Establish governance and management of reviews
- Consistent approach to audit automation

Bath & North East Somerset Council		
MEETING:	**Corporate Audit Committee**	
MEETING DATE:	**1st February 2011**	**AGENDA ITEM NUMBER**
TITLE:	**External Audit Reports**	EXECUTIVE FORWARD PLAN REFERENCE: E
AN OPEN PUBLIC ITEM		
List of attachments to this report: **Appendix 1 – Audit Opinion Plan Pension Fund** **Appendix 2 – Certification of Claims & Returns – Annual Report** **Appendix 3 – Addendum to the Audit Plan** **Appendix 4 – Audit Fee Update**		

1 THE ISSUE

1.1 The appendices to this report present an update of various issues affecting the Councils audit work by the External Auditor.

2 RECOMMENDATION

2.1 The Corporate Audit Committee is asked to note each of the Appendices.

3 FINANCIAL IMPLICATIONS

3.1 There are no direct financial implications as a result of this report.

4 THE REPORT

4.1 The reports attached at Appendices 1 – 4 detail various updates of issues affecting the Councils audit work by the External Auditor.

4.2 The first is a draft audit plan for the Avon Pension Fund, this has not yet been considered by the Avon Pension Fund Committee (planned date 13th March 2011). The second is an annual report of work carried out on the certification of grant claims and returns. The third is a brief addendum to the Council Audit Plan in relation to the VFM Opinion and the final report details the latest position with regard to the Councils Audit fees.

4.3 A verbal update will be made at the Committee by the External Auditor against each of the items identified.

5 RISK MANAGEMENT

5.1 A proportionate risk assessment has been carried out in relation to the Councils risk management guidance. There are no new significant risks or issues to report to the Committee as a result of this report.

6. EQUALITIES

6.1 A proportionate equalities impact assessment has been carried out using corporate guidelines, no significant issues to report.

7 CONSULTATION

7.1 Consultation has been carried out with the Section 151 Finance Officer.

8 ADVICE SOUGHT

8.1The Council's Section 151 Officer has had the opportunity to input to this report and have cleared it for publication.

Contact person	Jeff Wring (01225 47323)
Background papers	None
Please contact the report author if you need to access this report in an alternative format	

Audit opinion plan

Avon Pension Fund

Audit 2010/11

The Audit Commission is an independent watchdog, driving economy, efficiency and effectiveness in local public services to deliver better outcomes for everyone.

Our work across local government, health, housing, community safety and fire and rescue services means that we have a unique perspective. We promote value for money for taxpayers, auditing the £200 billion spent by 11,000 local public bodies.

As a force for improvement, we work in partnership to assess local public services and make practical recommendations for promoting a better quality of life for local people.

Contents

Summary

1 This plan sets out the audit work I propose to undertake in relation to the audit of financial statements 2010/11 for Avon Pension Fund. The plan is based on the Audit Commission's risk-based approach to audit planning, which assesses:

- current national risks relevant to your local circumstances; and
- your local risks and improvement priorities.

2 I will discuss this plan, and any reports arising from the audit, with the Pension Fund Committee. The pension fund accounts remain part of the financial statements of Bath & North East Somerset Council as a whole. The Corporate Audit Committee will retain ultimate responsibility for receiving, considering and agreeing the audit plans, as well as receiving and considering any reports arising from the audit.

3 The audit planning process for 2010/11, including the risk assessment, will continue as the year progresses and I will keep the information and fees in this plan under review and update as necessary.

Responsibilities

4 The Audit Commission's Statement of Responsibilities of Auditors and of Audited Bodies sets out the respective responsibilities of the auditor and the audited body. The Audit Commission has issued a copy of the Statement to every audited body.

5 The Statement summarises where the different responsibilities of auditors and of the audited body begin and end and I undertake the audit work in the context of these responsibilities.

6 I comply with the statutory requirements governing our audit work, in particular:

- the Audit Commission Act 1998; and
- the Code of Audit Practice.

7 Specifically, the Auditing Practices Board practice note 15 on the audit of pension fund accounts defines the work of auditors on pension fund accounts.

8 I am required to complete the 2010/11 audit in accordance with up-dated auditing standards. The new clarified standards require that I set a lower level of materiality and undertake tests of detail on all material items in the accounts.

Fee for the audit of financial statements

9 The Audit Commission's work programme and fee scales for 2010/11, sets out the details of the structure of scale fees. Scale fees are based on several variables, including the type, size and location of the audited body.

10 The fee for the 2010/11 audit is £47,000, as reported in my letter of 15 June 2010.

11 In setting the fee, I have assumed the level of risk on the audit of the pension fund accounts is consistent with that for 2009/10.

12 Where this assumption is not met, extra work will be required, which is likely to result in an increased audit fee. Where this is the case, I will discuss this firstly with the Director of Resources. I will issue supplements to the plan to record any revisions to the risk and the impact on the fee.

13 Appendix 1 sets out more information on the basis for the fee.

14 The Audit Commission requires its auditors to inform audited bodies of specific actions it could take to reduce its audit fees. As in previous years, I will work with staff to identify any specific actions the Pension Fund could take to reduce its fee.

Auditors report on the financial statements

15 I will carry out the audit of the financial statements in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board (APB).

16 I am required to issue an audit report giving my opinion on whether the pension fund accounts give a true and fair view of the financial position of the Authority as at 30 September 2011.

17 I am also required to review the pension fund annual report according to the LGPS regulations 1997.

Identifying opinion audit risks

18 As part of my audit risk identification process I need to understand the audited body to identify any risk of material misstatement (whether due to fraud or error) in the financial statements. I do this by:

- identifying the business risks facing the Pension Fund, including assessing your own risk management arrangements;
- considering the financial performance of the Pension Fund;
- assessing internal control - including reviewing the control environment, the IT control environment and Internal Audit; and
- assessing the risk of material misstatement arising from the activities and controls within the Pension Fund information systems.

Identification of specific risks

19 I have considered the additional risks that are appropriate to the current opinion audit and have set these out below.

Table 1: **Specific risks**

Specific opinion risks identified

Risk area	Audit response
Avon pension fund has £1.8bn billion of units in unquoted pooled investment securities. There is an inherent risk of material misstatement because there is no direct market to independently check the valuation of these units, although we understand the underlying securities are quoted.	I will review and place reliance on AAF01 reports from auditors of fund managers. AAF01 reports are industry standard reports on the effectiveness of internal control arrangements at fund mangers. Appendix 3 provides a glossary of terms. I will substantively test the value of all material investment balances to fund manager's reports and custodian reports. Where possible I will agree the units held by Avon Pension Fund in pooled investments back to the underlying quoted securities.
Actuarial Valuation – politically sensitive disclosures.	I will check the disclosures on the actuarial valuation as at 31 March 2010 to supporting evidence from the Actuary.

Testing strategy

20 Based on the risks identified above I will produce a testing strategy that will consist of testing key controls and substantive tests of transaction streams and material account balances at year-end.

21 I will carry out our testing both before and after the draft financial statements are produced (pre- and post-statement testing).

22 Wherever possible, I will complete some substantive testing earlier in the year before the financial statements are available for audit. I have identified that I could carry out early substantive testing in the following areas.

- Review of accounting policies.
- Bank reconciliation.
- Contributions.
- Investments – ownership.
- Year-end feeder system reconciliations.

Where I identify other early testing as being possible I will discuss with officers.

23 Wherever possible I seek to rely on the work of Internal Audit to help meet our responsibilities.

Key milestones and deadlines

24 The Pension Fund is required to prepare the financial statements by 30 June 2011. I am required to complete our audit and issue our opinion by 30 September 2011. Table 2 shows the key stages in producing and auditing the financial statements.

25 I will agree with you a schedule of working papers required to support the entries in the financial statements.

26 Every week during the detailed testing in the summer, my team will meet with the key contact and review the status of all queries. If appropriate, they will meet at a different frequency depending on the need and the number of issues arising.

Table 2: **Proposed timetable**

Task	Deadline
Control and early substantive testing	28 February 2011
Receipt of accounts	30 June 2011
Sending audit working papers to the auditor	30 June 2011
Start of detailed testing	1 August 2011
Progress meetings	Weekly
Present report to those charged with governance at the Audit committee	September 2011
Issue opinion	30 September 2011

The audit team

27 The table below shows the key members of the audit team for the 2010/11 audit.

Table 3: **Audit team**

Name	Contact details	Responsibilities
Wayne Rickard District Auditor	w-rickard@audit-commission.gov.uk 0844 798 1208	Responsible for the overall delivery of the audit including the quality of outputs, signing the opinion and conclusion, and liaison with B&NES Chief Executive.
Chris Hackett Audit Manager	c-hackett@audit-commission.gov.uk 0844 798 8760	Manages and coordinates the different elements of the audit work. Key point of contact for the Director of Finance and the Head of Pensions.

Independence and objectivity

28 I am not aware of any relationships that may affect the independence and objectivity of the District Auditor and the audit staff, which auditing and ethical standards require me to communicate to you.

29 I comply with the ethical standards issued by the APB and with the Commission's requirements of independence and objectivity as summarised in Appendix 2.

Meetings

30 The audit team will maintain knowledge of your issues to inform our risk-based audit through regular liaison with key officers. Appendix 3 sets out our proposals.

Quality of service

1 I commit to providing you with a high-quality service. If you are in any way dissatisfied, or would like to discuss how to improve the service, please contact me. Alternatively you may wish to contact Chris Westwood, Director of Professional Practice at the Audit Commission (c-westwood@audit-commission.gov.uk). He will look into any complaint quickly and do what he can to resolve the problem.

2 . If you are still not satisfied you may of course take up the matter with the Audit Commission's Complaints Investigation Officer (The Audit Commission, Westward House, Lime Kiln Close, Stoke Gifford, Bristol BS34 8SR).

Planned outputs

3 Before issuing reports to Committee, I will discuss and agree reports with the appropriate officers.

Table 4: **Planned outputs**

Planned output	Indicative date
Audit plan	31 December 2010
Annual governance report	30 September 2011
Auditor's report giving an opinion on the financial statements	30 September 2011
Final accounts memorandum	30 October 2011

Appendix 1 Basis for fee

The Audit Commission is committed to targeting its work where it will have the greatest effect, based on assessments of risk and performance. This means planning work to address areas of risk relevant to our audit responsibilities and reflecting this in the audit fees.

The risk assessment process starts with identifying the significant financial and operational risks applying to the Pension Fund based on:

- our cumulative knowledge of the Council and pension fund;
- planning guidance issued by the Audit Commission;
- the specific results of previous and ongoing audit work;
- interviews with Council officers; and
- liaison with Internal Audit.

Assumptions

In setting the fee, I have assumed that:

- the level of risk on the audit of the financial statements is not significantly different from that identified for 2009/10;
- you will inform us of significant developments impacting on the audit;
- Internal Audit meets the appropriate professional standards;
- you will provide good quality working papers and records to support the financial statements by 30 June 2011;
- you will provide requested information within agreed timescales;
- you will provide prompt responses to draft reports; and
- additional work will not be required to address questions or objections raised by local government electors.

Where these assumptions are not met, I will be required to undertake additional work which is likely to result in an increased audit fee.

Appendix 2 Independence and objectivity

Auditors appointed by the Audit Commission are required to comply with the Commission's Code of Audit Practice and Standing Guidance for Auditors, which defines the terms of the appointment. When auditing the financial statements, auditors are also required to comply with auditing standards and ethical standards issued by the Auditing Practices Board (APB).

Summarised below are the main requirements of the Code of Audit Practice, Standing Guidance for Auditors and the standards.

International Standard on Auditing (UK and Ireland) 260 (Communication of audit matters with those charged with governance) requires the appointed auditor:

- discloses in writing all relationships that may bear on the auditor's objectivity and independence, the related safeguards put in place to protect against these threats and the total amount of fee the auditor has charged the client; and
- confirms in writing the APB's ethical standards are complied with and that, in the auditor's professional judgement, they are independent and their objectivity is not compromised

The standard defines 'those charged with governance' as 'those persons entrusted with the supervision, control and direction of an entity'. In your case, the appropriate addressee of communications from the auditor to those charged with governance is the Corporate Audit Committee. The auditor reserves the right, however, to communicate directly with the Council on matters considered to be of enough importance.

The Commission's Code of Audit Practice has an overriding general requirement that appointed auditors carry out their work independently and objectively. To ensure that they do not act in any way that might give rise to, or could reasonably be perceived to give rise to, a conflict of interest. In particular, appointed auditors and their staff should avoid entering into any official, professional or personal relationships which may, or could reasonably be perceived to, cause them inappropriately or unjustifiably to limit the scope, extent or rigour of their work or impair the objectivity of their judgement.

The Standing Guidance for Auditors includes a number of specific rules. The key rules relevant to this audit appointment are as follows.

- Appointed auditors should not perform additional work for an audited body (ie work over and above the minimum required to meet their statutory responsibilities) if it would compromise their independence or might give rise to a reasonable perception that their independence could be compromised. Where the audited body invites the auditor to carry out risk-based work in a particular area that cannot otherwise be justified as necessary to support the auditor's opinion and conclusions, it should be clearly differentiated within the Audit Plan as 'additional work'. This work will be charged separate from the normal audit fee.

- Auditors should not accept engagements that involve commenting on the performance of other auditors appointed by the Commission on Commission work without first consulting the Commission.
- The District Auditor responsible for the audit should, in all but the most exceptional circumstances, change at least once every five years.
- The District Auditor and senior members of the audit team are prevented from taking part in political activity on behalf of a political party, or special interest group, whose activities relate directly to the functions of local government or NHS bodies in general, or to a particular local government or NHS body.
- The District Auditor and members of the audit team must abide by the Commission's policy on gifts, hospitality and entertainment.

Appendix 3 Working together

Meetings

4 The audit team will maintain knowledge of your issues to inform our risk-based audit through regular liaison with key officers.

5 Our proposal for meetings is as follows.

Table 5: **Proposed meetings with officers**

Council officers	Audit Commission staff	Timing	Purpose
Director of Financial Services	Audit Manager (AM) and Team Leader (TL)	March, July, September	General update plus: March - audit plan July - accounts progress September - annual governance report
Head of Pensions	AM and Team Leader (TL)	Quarterly	Update on audit issues
Pension Fund Committee	DA and AM, with TL as appropriate	As determined by the Committee	Formal reporting of: Audit Plan Annual governance report Other issues as appropriate

Sustainability

6 The Audit Commission is committed to promoting sustainability in our working practices and I will actively consider opportunities to reduce its impact on the environment. This will include:

- reducing paper flow by encouraging you to submit documentation and working papers electronically;
- use of video and telephone conferencing for meetings as appropriate; and
- reducing travel.

Appendix 4 Glossary

Audit of the accounts

The audit of the accounts of an audited body comprises all work carried out by auditors in accordance with the Code to meet their statutory responsibilities under the Audit Commission Act 1998.

Audited body

A body to which the Audit Commission is responsible for appointing the external auditor, comprising both the members of the body and its management (the senior officers of the body). Those charged with governance are the members of the audited body. (See also 'Members' and 'Those charged with governance'.)

Auditing Practices Board (APB)

The body responsible in the UK for issuing auditing standards, ethical standards and other guidance to auditors. Its objectives are to establish high standards of auditing that meet the developing needs of users of financial information and to ensure public confidence in the auditing process.

Auditing standards

Pronouncements of the APB, which contain basic principles and essential procedures with which auditors are required to comply, except where otherwise stated in the auditing standard concerned.

Auditor(s)

Auditors appointed by the Audit Commission.

Code (the)

The Code of Audit Practice.

Commission (the)

The Audit Commission for Local Authorities and the National Health Service in England.

Ethical Standards

Pronouncements of the APB that contain basic principles that apply to the conduct of audits and with which auditors are required to comply, except where otherwise stated in the standard concerned.

Financial statements

The annual statement of accounts or accounting statements that audited bodies are required to prepare, which summarise the accounts of the audited body, in accordance with regulations and proper practices in relation to accounts.

Internal control

The whole system of controls, financial and otherwise, that is established in order to provide reasonable assurance of effective and efficient operations, internal financial control and compliance with laws and regulations.

Materiality (and significance)

The APB defines this concept as 'an expression of the relative significance or importance of a particular matter in the context of the financial statements as a whole. A matter is material if its omission would reasonably influence the decisions of an addressee of the auditor's report; likewise a misstatement is material if it would have a similar influence. Materiality may also be considered in the context of any individual primary statement within the financial statements or of individual items included in them. Materiality is not capable of general mathematical definition, as it has both qualitative and quantitative aspects'.

The term 'materiality' applies only in relation to the financial statements. Auditors appointed by the Commission have responsibilities and duties under statute, in addition to their responsibility to give an opinion on the financial statements, which do not necessarily affect their opinion on the financial statements.

The concept of 'significance' applies to these wider responsibilities and auditors adopt a level of significance that may differ from the materiality level applied to their audit in relation to the financial statements. Significance has both qualitative and quantitative aspects.

Those charged with governance

Those charged with governance are defined in auditing standards as 'those persons entrusted with the supervision, control and direction of an entity'.

In councils, those charged with governance, for the purpose of complying with auditing standards, are the full council, audit committee (where established) or any other committee with delegated responsibility for approval of the financial statements;

Certification of claims and returns - annual report

Bath and North East Somerset Council

Audit 2009/10

The Audit Commission is an independent watchdog, driving economy, efficiency and effectiveness in local public services to deliver better outcomes for everyone.

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As a force for improvement, we work in partnership to assess local public services and make practical recommendations for promoting a better quality of life for local people.

Contents

Summary

Funding from government grant-paying departments is an important income stream for the Council. The Council needs to manage claiming this income carefully. It needs to prove to the auditors that it has met the conditions that attach to these grants. This report summarises the findings from the certification of 2009/10 claims. It includes the messages arising from our assessment of your arrangements for preparing claims and returns and information on claims that we amended or qualified.

Certification of claims

1 Bath & North East Somerset Council receives more than £195 million funding from various grant paying departments. The grant paying departments attach conditions to these grants. The Council must meet these conditions. If the Council cannot evidence this, the funding can be at risk. It is therefore important that the Council manages certification work properly and can prove to us, as auditors, that it has met the relevant conditions.

2 The audit commission agrees audit arrangements for some of the claims. Where this is the case they issue a certification instruction setting out the work we are required to do. In 2009/10, the audit team certified five claims with a total value of £117 million. Of these, we carried out a limited review of one claim and a full review of the remaining four claims. (Paragraph 14 explains the difference.)

Significant findings

3 There remains scope for the Council to improve its arrangements for preparing and certifying claims and returns.

4 Three of the five claims due for certification were presented for audit after the departmental deadline for submission to us, although two were within one week of the submission deadline. One claim was not certified within the deadline for audit certification. A delay of a few days arose due to the need to agree audit amendments.

5 We found that the working papers supporting claims were generally of a good standard.

6 Officers have introduced a pre-certification checklist to be completed by the officer preparing the claim, before submission for certification by the Chief Financial Officer. This new process had a notable impact when finance officers identified that the draft Teachers Pension Return was inadequately prepared, and working papers subsequently found to be inadequate. Senior finance officers assigned extra resources from the Finance department to undertake a detailed reworking of the claim and its supporting working papers.

7 Of the five claims we audited, minor amendments were made to three. We issued qualification letters to the grant-paying body for three claims where we identified non-compliance with the requirements set by the grant paying bodies. Appendix 1 sets out a summary.

Certification fees

8 The fees charged for grant certification work in 2009/10 were £50,497. The fees are based on the time taken to complete the work rather than a preset annual amount.

Actions

9 Appendix two summarises our recommendations. These include recommendations for general grant claims arrangements across the Council, and a summary of those detailed recommendations for individual claims. The relevant officers of the Council have already agreed these recommendations.

Background and audit approach

10 The Council claims more than £195 million for specific activities from grant paying departments. As this is significant to the Council's income it is important that the Council effectively manages the preparation of its grant claims. In particular this means:

- an adequate control environment over each claim and return; and
- ensuring that the Council can evidence that it has met the conditions attached to each claim.

11 We are required by section 28 of the Audit Commission Act 1998 to certify some claims and returns for grants or subsidies paid by the government departments and public bodies to Bath & North East Somerset Council. We charge a fee to cover the full cost of certifying claims. The fee depends on the work required to certify each claim or return.

12 The Council is responsible for compiling grant claims and returns in line with the requirements and timescale set by the grant paying departments.

13 The key features of the current arrangements are as follows.

- For grant claims below £100,000 the Commission does not make certification arrangements.
- For grant claims between £100,000 and £500,000, auditors undertake limited tests to agree the claim to underlying records, but do not undertake any testing of eligibility of expenditure.
- For claims over £500,000 auditors assess the control environment for preparing the claim or return to decide whether they can place reliance on it. Where we are able to place reliance on the control environment, we undertake limited tests to agree form entries to underlying records but do not undertake any testing of the eligibility of expenditure or data. Where we cannot place reliance on the control environment, we undertake detailed tests using the assessment of the control environment to inform the extent of the testing required. This means we can reduce the audit fees for certification work if the control environment is strong.
- For claims spanning more than one year, the financial limits above apply to the amount claimed over the entire life of the claim and we apply testing accordingly. The approach impacts on the grants work we carry out, placing more emphasis on high value claims.

Findings

Control environment

14 The officers completing the Council's grant claims and returns are experienced, have a detailed knowledge of the claim and generally produce a good standard of supporting working papers. They responded to requests for information in a timely and positive manner.

15 For some claims (notably the NNDR return) there is clear evidence of review of the draft claim by the line manager of the officer completing the claim.

16 Officers have introduced a pre-certification checklist, completed by the officer preparing the claim, before submission for certification by the Chief Financial Officer.

17 The only claim where we consider the Control Environment to be weak is in relation to the preparation of the Teachers Pensions Return.

Main conclusions

18 The net impact of the audit amendments raised in the year was low in value.

19 Officers presented three of the five claims due for certification for audit past the departmental deadline for submission, although two were within 1 week of the submission deadline. One claim was not certified within the deadline for audit certification. A delay of a few days arose because of the need to agree audit amendments. Table one summarises performance compared to previous years.

Table 1: **Summary analysis of grant claims performance**

Performance is similar to previous years

	2007/08	2007/08	2008/09	2008/09	2009/10	2009/10
	No.	%	No.	%	No.	%
Claims submitted for audit	6	-	5	-	5	-
Claims not submitted for audit within deadline	5	83	4	80	3	60
Claims not certified within deadline	1	17	1	20	1	20
Claims amended at	3	50	3	66	3	66

	2007/08	2007/08	2008/09	2008/09	2009/10	2009/10
	No.	%	No.	%	No.	%
audit						
Claims with Qualification letter raised	2	33	3	66	3	66

20 Other than for the NNDR return, there is still a lack of evidence of review of the draft claim and working papers by line managers before submission for certification by senior officers. This suggests that Council officers are largely relying on the external audit of the claim to identify errors.

21 Officers have introduced a pre-certification checklist to be completed by the officer preparing the claim, before submission for certification by the Chief Financial Officer. This new process had a notable impact when the draft Teachers Pension Return was identified as inadequately prepared, and working papers subsequently found to be inadequate. Senior officers assigned extra resources from the Finance department to undertake a detailed re-working of the claim and its supporting working papers.

Recommendation

R1 Officers should present all grant claims for audit by the deadline set by the government department. Managers of those responsible for submitting grant claims should monitor progress to ensure claims are adequately prepared.

22 We have reported detailed issues arising from the audit of each grant claim to officers responsible for the individual claims, and agreed action plans to improve arrangements in future years. The key issues are summarised below.

Specific claims

23 This section details the issues arising on each claim subject to audit.

National Non-Domestic Rates return

24 We were able to place limited reliance on the control environment. This is due to an issue noted in the previous year about up-dating applications for small business rate relief. Analytical review also highlighted significant variances in the claim over the previous year. We undertook detailed testing.

25 We identified the authorisation of write offs was not sufficiently evidenced in one case. This led to a qualification of the return. Our initial sample testing of five write-offs found one item (value £22,911) where there was no evidenced approval for the write off by management. We extended our audit sample by a further five cases and found no further instances of unapproved write-offs.

26 The Council has since reviewed all write-offs made during the year and satisfied itself that this was an isolated case.

27 We reported this issue in a qualification letter.

Sure Start, Early Years, and Childcare grant

28 We undertook detailed testing of this claim to confirm that we were able to continue to place reliance on the Control Environment around this claim.

29 We noted only minor issues during the audit, leading to a low value amendment of the claim.

Housing and Council Tax Benefit subsidy claim

30 We assessed that the control environment was largely effective. The grant paying department, however, still requires that we undertake detailed testing of this claim because of its complexity and value.

31 Our testing of samples of benefits transactions identified a small number of cases where benefits assessors had incorrectly recorded information from the supporting evidence on to the Benefits system. We tested additional transactions to enable us to quantify extrapolated errors on the claim. We made minor amendments to the claim.

32 We quantified and agreed an audit amendment relating to the assessment of eligible rent for Non-HRA rent rebates.

33 We raised a qualification letter detailing uncertainties arising from our testing in respect of single adult occupiers for Council tax benefits.

Teachers Pensions (TP) Return

34 We were not able to place reliance on the control environment around the return. This was because of the errors noted on the previous year's returns (2007/08 and 2008/09), and the lack of monitoring or review of the return before its submission. We therefore undertook full audit testing in line with the requirements of the relevant certification instruction.

35 While the Council holds overall responsibility for the return, responsibility for preparing the return lies with the payroll provider, Mouchel. This is monitored by the 'client' department, Human Resources.

36 As in previous years the return was prepared with little supervision or review by line management within Mouchel. Similarly, there was no evidence of review of the draft claim and its supporting working papers by the 'client side', Human Resources, before presenting the draft claim for certification by the Chief Financial Officer.

37 The Chief Financial Officer identified that the draft claim was incomplete and was not evidenced as agreed to underlying working papers. Extra resources from the Finance department were assigned to undertake a detailed reworking of the claim and its supporting working papers.

38 The draft return was sent to TP and to audit by the deadline of 30 June 2010. However, the claim was subject to major amendments by the Council following the extra work undertaken by Finance staff. This was done after submission to TP and audit. We had to record these as audit amendments.

39 Schools have not provided information necessary for the return, to Mouchel, on a timely basis. As Mouchel arguably have little authority over the schools, there is a need for the Council's Finance department to write to schools requiring schools to provide the information requested by Mouchel on a timely basis.

40 It is disappointing to note that Council officers and Mouchel had not addressed the issues raised in our previous year's action plan regarding this claim. There remains a danger that Teachers Pensions could take action against the Council if these issues are not addressed for future audits.

41 The Council has incurred the cost of Finance staff recompiling the return, when Mouchel should provide this service under its contract as payroll provider. The Council needs to ensure there is clear agreement over the responsibilities of the contractor (Mouchel) in completing the return, and the client side in reviewing the return and supporting working papers.

42 We are seeking to agree a further action plan, which will ensure that the Council assigns clearer responsibility between the payroll provider and client side for preparing the claim.

Recommendation

R2 Finance officers should monitor to ensure that Mouchel and Human Resources take adequate action to address the issues set out in our

Recommendation
action plan in relation to the Teachers Pensions Return.

Disabled Facilities grant

43 This grant was between the £100,000 and £500,000 thresholds, and therefore we only undertook limited testing of this claim

44 No significant issues arose during the audit of the claim.

Audit fees

45 The total amount billed to the Council for the audit of grant claims in 2009/10 was £50,497. This is analysed below.

Table 2: **Analysis of audit fees**

Performance is similar to previous years

Claim	2008/09 fee	2009/10 fee
	£	£
National non-domestic rates return	4,967	4,078
Sure start early years and childcare grant	2,928	1,768
Housing and Council tax benefit subsidy claim	38,052	39,655
Teacher's pensions return	3,894	4,393
Disabled facilities grant	1,842	603
Total	51,683	50,497

46 The fees charged to the Council are based on the actual time taken by auditors to complete the audits. Therefore it is in the Council's interest to minimise the audit work required to certify the claims, by presenting the claims for audit by their due date, presenting self-explanatory working papers to support the entries and the claims, and ensuring that the requirements of the grant paying body and the certification instruction are complied with.

The way forward

47 We attach an action plan in appendix two that sets out our recommendations for preparing grant claims in future years.

Appendix 1 Summary of 2009/10 certified claims

Claims and returns above £500,000

Service	Claim	Value £	Adequate control environment	Amended	Qualification letter
Revenues & benefits	NNDR return	48,252,425	Limited assurance	No	Yes
Children's Services finance	Sure Start, Early Years and Childcare	4,981,392	Yes	Yes	No
Revenues & Benefits/ Central services finance	Housing & Council Tax benefit subsidy	52,368,255	Limited assurance	Yes	Yes
Mouchel/ Human Resources	Teachers Pensions return	11,069,765	No	Yes	Yes

Claims between £100,000 and £500,000

Service	Claim	Value £	Amended	Qualification letter
Social services finance	Disabled Facilities Grant	405,000	No	No

Appendix 2 Action plan

Recommendations	
Recommendation 1	
Officers should present all grant claims for audit by the deadline set by the government department. Managers of those responsible for submitting grant claims should monitor progress to ensure claims are adequately prepared.	
Responsibility	Tony Bartlett
Priority	Medium
Date	2010/11 claims
Comments	
Recommendation 2	
Finance officers should monitor to ensure that Mouchel and Human Resources take adequate action to address the issues set out in our action plan in relation to the Teachers Pensions Return.	
Responsibility	Tony Bartlett
Priority	Medium
Date	January 2011
Comments	

Summary of recommendations per detailed action plans to officers

Claim	Priority 1 = Low	Priority 2 = medium	Priority 3 = High
NNDR return	2	1	0
Sure Start	0	0	0
Housing & Council Tax Benefit subsidy	3	1	0
Teachers Pensions Return	0	7	3
Disabled facilities	0	0	0

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Addendum to the Audit Plan

Bath and North East Somerset Council 2010/11

Value for Money (VFM) Audit

Introduction

1 I am required to give a statutory VFM conclusion on the Council's arrangements to secure economy efficiency and effectiveness. The audit plan for 2010/11 presented to the December meeting of the Corporate Audit Committee said that I would update my risk assessment and communicate to you my planned work. This addendum sets out my planned work.

Scope

2 The VFM conclusion is based on two criteria, specified by the Commission, related to your arrangements for:

- Securing financial resilience – focusing on whether the Council is managing its financial risks to secure a stable financial position for the foreseeable future; and
- Challenging how the Council secures economy, efficiency and effectiveness – focusing on whether the Council is prioritising its resources within tighter budgets and improving productivity and efficiency.

3 The conclusion covers the financial year 2010/11.

Planned work

4 My work is based on my assessment of risk taking account of material issues and is required to focus on corporate arrangements. I plan to do the following work:

- Review the Council's approach to developing and managing its change programme;
- Monitoring the development of the Council's medium term financial plans and the achievement of efficiencies and cost savings;
- Reviewing the development of plans for the provision of social care and joint working with the primary care trust.

Reporting

5 I will report my findings in my annual governance report to be issued in September 2011.

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Bath and North East Somerset Council – Update on audit fees

Fee consultation issued on 10 December 2010 – closing date for responses 7 January 2011.

Summary

The announcement made on 13 August 2010 proposing the Commission's abolition implies (although it has still to be confirmed) that 2011/12 may be the Commission's final year in its current form. If so, this will be the last time it will publish a work programme and set scales of audit fees.

There will be significant transitional costs associated with the abolition of the Commission. However, the Department for Communities and Local Government has now agreed that these costs should not fall on audit fees. Therefore, the 2011/12 scales of audit fees is based only on what the Commission needs in order to recover the costs of audits and its other activities in 2011/12.

The combined financial effect of the proposals would be to reduce audit and inspection fees in 2011/12 by £11.8 million or 9 per cent for local government and health bodies.

The Audit Commission Board has also decided to return some of the audit fees already collected for work carried out this year (2010/11) on Use of Resources. This work was suspended immediately the government announced in May 2010 that it would abolish Comprehensive Area Assessment (CAA).

Rebates will be sent to audited and inspected bodies shortly.

- A 3.5 per cent rebate of the 2010/11 scale fee for single tier and county councils.

The Commission has also decided not to charge any inspection fees for work on the Managing Performance part of the assessment of organisational effectiveness, as there was no value to this once CAA ended.

What this means for Bath and North East Somerset Council 2010/11 Audit Fee.

	£	£
2010/11 Audit Fee		303,776
2010/11 Assessment & inspection fee		16,630
Total fee payable (excluding certification of grants)		**320,406**
(Note: 2010/11 scale fee for the audit is £288,204)		
Reductions in 2010/11 fee		
6% rebate of scale fee for IFRS	16,776	
Assessment & inspection not invoiced	16,630	
3.5% rebate of scale fee for UoR	10,087	**43,493**
Total fee payable for 2010/11 (excluding certification of grants)		***276,913***
(13.5% reduction in the audit fee)		

2011/ 12 Fee proposal

The 2011/12 fee proposals are:

- no inflationary increase in 2011/12 for audit and inspection scales of fees and the hourly rates for certifying claims and returns;
- a reduction in scale fees resulting from our new approach to local VFM audit work of 2 to 20 per cent; and
- a reduction in scale audit fees of 3 per cent for local authorities, police and fire and rescue authorities, reflecting lower ongoing audit costs after implementing IFRS.

The Commission is proposing to set an audit fee (excluding certification of grants) of **£273,398** for Bath and North East Somerset Council for 2011/12.

(10% reduction against the original 2010/11 audit fee of £303,776).

Fee for Avon Pension Fund

The Commission has specified a formula for determining the 2011/12 audit fees for pension funds. Applying this formula indicates a scale fee for Avon Pension fund of £46,822. This compares to the audit fee for 2010/11 of £47,000.

The relatively small reduction reflects the formula. The formula works by applying a percentage to the pension fund net assets which have increased significantly from £1.8 billion in April 2009 to £2.5 billion in April 2010. The Commission intends to keep the fees for pension fund audits under review.

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