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: 23 January 2012
E-mail: Democratic_Services@bathnes.gov.uk

To: All Members of the Corporate Audit Committee

Councillors: Andrew Furse (Chair), Gerry Curran, Will Sandry, Geoff Ward, Kate Simmons, Barry Macrae and Brian Simmons

Independent Member: John Barker

Chief Executive and other appropriate officers

Press and Public

Dear Member

Corporate Audit Committee: Tuesday, 7th February, 2012

You are invited to attend a meeting of the **Corporate Audit Committee**, to be held on **Tuesday, 7th February, 2012** at **4.30pm** in the **Brunswick Room - Guildhall, Bath.**

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, 7th February, 2012 at 4.30 pm in the Brunswick Room - Guildhall, Bath

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 6.

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: 6 DECEMBER 2011 (Pages 5 - 8)

9. TREASURY MANAGEMENT BRIEFING BY STERLING, ADVISORS

10. TREASURY MANAGEMENT MONITORING REPORT (Pages 9 - 20)

11. TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY 2012/13 (Pages 21 - 46)

12. ANNUAL GOVERNANCE REVIEW - UPDATE REPORT FOR 2010/11 AND 2011/12 (Pages 47 - 56)

13. EXTERNAL AUDITOR UPDATE REPORTS (Pages 57 - 164)

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

This page is intentionally left blank

BATH AND NORTH EAST SOMERSET COUNCIL

CORPORATE AUDIT COMMITTEE

Minutes of the Meeting held

Tuesday, 6th December, 2011, 5.30 pm

Councillors: Andrew Furse (Chair), Gerry Curran, Michael Evans (In place of Barry Macrae), Will Sandry, Brian Simmons, Kate Simmons and Geoff Ward
Independent Member: John Barker
Officers in attendance: Jeff Wring (Divisional Director - Risk and Assurance Services) and Andy Cox (Group Manager (Audit/Risk))
Guests in attendance: Chris Hackett (Audit Commission)

31 EMERGENCY EVACUATION PROCEDURE

The Democratic Services Officer read out the procedure.

32 ELECTION OF VICE-CHAIR

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

33 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

Apologies were received from Councillor Barry Macrae, for whom Councillor Michael Evans substituted.

RESOLVED to wish Councillor Macrae a speedy recovery and a happy Christmas.

34 DECLARATIONS OF INTEREST

There were none.

35 TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

There was none.

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

There were none.

37 ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

There were none.

38 MINUTES: 29 SEPTEMBER 2011

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

39 PRESENTATION ON INTERNAL AUDIT

The Group Manager (Audit/Risk) and the Divisional Director – Risk and Assurance Services made a presentation. A copy of the presentation slides is attached as Appendix 1 to these minutes.

Councillor Ward asked the meaning of the acronyms on the third slide. These were explained as follows:

CIPFA	Chartered Institute of Public Finance and Accountancy
IIA	Chartered Institute of Internal Auditors
MKI	Morgan Kai International

In reply to a question from Councillor Brian Simmons, the Divisional Director – Risk and Assurance Services said that Academies are no longer obliged to have internal audit services and almost all now have to carry out a 'responsible officer' function in relation to risk and control.

The Committee thanked the officers for their presentation.

40 INTERNAL AUDIT UPDATE REPORT

The Group Manager (Audit/Risk) presented the report. He said that 63% of the 2011/12 Annual Audit Plan had been completed and it was hoped that 95% would be completed by the end of the financial year, despite staffing issues during the year. 21 Audit Reviews and 28 Audit "Follow-Ups" had been completed. 22 of the "Follow-Ups" had identified that all the audit recommendations had been implemented by the time of the review. Of the 21 Audit Reviews, 74% were assessed at Assurance Level 3 or above (Adequate to Good Framework of Internal Control) with 5 assessed as Level 2 (Weak). In addition to the agreed audit plan, time had been spent on the five areas detailed in paragraph 4.8 of the report. He drew attention to the Performance Indicators for the Audit & Risk Team given in paragraph 4.14.

Councillor Ward asked why the work on Integrated Safeguarding had been cancelled despite having a "High" risk level. The Group Manager (Audit/Risk) replied that a number of reports had been produced in relation to this area, and that it was felt that adequate controls were now in place and that there would not be sufficient value in carrying out more work at this time. The Divisional Director – Risk and Assurance Services added that the controls were now assessed at level 3, though 18 months ago they were only at level 1 and concerns had been raised with Senior Management and the situation had been rectified very quickly.

In reply to a further question from Councillor Ward, the Group Manager (Audit/Risk) said that most of the planned audit reviews had been re-specified following budget reductions.

The Chair noted the audit review of Payroll was still in progress. He was also pleased to note that the completed reviews under the IT Management heading (all "High" risk") had achieved assurance levels of 3 or above.

RESOLVED to note the Internal Audit Update.

41 PRESENTATION ON ANTI-FRAUD AND CORRUPTION ARRANGEMENTS

The Group Manager (Audit/Risk) and the Divisional Director – Risk and Assurance Services gave a presentation to the Committee. A copy of the presentation slides is attached as Appendix 2 to these minutes.

The Chair informed Members that he had asked the Divisional Director – Risk and Assurance Services to check with the housing officers about safeguards against housing fraud, and suggested that this might be an agenda item for the Housing and Major Projects Policy Development and Scrutiny Panel. Councillor Curran noted that people still spoke about "council housing", so any fraud in relation to social housing could impact adversely on the Council's reputation. Councillor Brian Simmons noted that someone could be on 5 or 6 housing waiting lists and would be counted separately on each one.

The Committee thanked the officers for their presentation.

42 ANTI-FRAUD AND CORRUPTION REVIEW

The Divisional Director – Risk and Assurance Services presented the report.

Cllr Sandry noted that there was no reference to driving licence fraud. The Divisional Director – Risk and Assurance Services said that there had been no specific instances, though the issue was on the radar.

The Chair suggested that the poster about Whistleblowing could be improved; the present design was too crowded and lacked clarity. Cllr Sandry noted however that the poster was actually a good one based on ones he had seen and officers were requested to take on board these comments.

RESOLVED to confirm that the revised Anti-Fraud & Corruption & Whistleblowing Polices and the Anti-Money Laundering Policies remain appropriate.

43 ANNUAL AUDIT LETTER

Mr Hackett presented the report. He said that the Audit Commission required that a letter be sent each year to those bodies for which it provided external audit services setting out the audit opinion and key messages. The current letter summarised the findings of the 2010/11 audit. He reminded Members that the Governance Report, considered at the previous meeting, had commented on technical accounting issues.

He drew attention to the comments about the Council's organisational change programme given on page 9 of the letter.

He commended the Council for successfully implementing International Financial Reporting Standards, which had caused many local authorities difficulties, and for producing a very good set of accounts.

The Committee congratulated the finance officers for their excellent work.

44 EXTERNAL AUDIT UPDATE REPORT

Mr Hackett presented the report. He drew attention to the audit fee for 2011/12 of £273, 398 compared with the planned fee for 2010/11 of £303, 776 and the final fee for that year of £276, 913. The lower fee for 2011/12 reflected the abolition of the Comprehensive Area Assessment and efficiency savings made by the Audit Commission centrally.

The Chair referred to the list of key considerations at the end of the Audit Commission's update report and asked officers to comment on recommendation that the Committee satisfy itself that the Council had identified all potential income sources. The Divisional Director – Risk and Assurance Services assured him that every opportunity for increasing income had been considered during the budget preparation process and that work was ongoing or completed in all the other areas.

RESOLVED to note the update from the External Auditor and the findings from Appendix 1.

45 WORKPLAN

The Divisional Director – Risk and Assurance Services informed Members that the next meeting, to be held on 7th February 2012, would commence with an hour and a half-long presentation from Sterling Consultancy Services on treasury management. It was agreed that the meeting should commence at 4.30pm to allow time for this presentation. The usual start time for meetings would remain 5.30pm.

The meeting ended at 7.26 pm

Chair(person) ....

Date Confirmed and Signed ....

Prepared by Democratic Services

Bath & North East Somerset Council	
MEETING:	**Corporate Audit Committee**
MEETING DATE:	**7th February 2012**
TITLE:	**Treasury Management Monitoring Report to 31st December 2011**
WARD:	ALL
AN OPEN PUBLIC ITEM	
List of attachments to this report: **Appendix 1** – Performance Against Prudential Indicators **Appendix 2**– The Council's Investment Position at 31st December 2011**Appendix 3** – Average monthly rate of return for 1st 9months of 2011/12 **Appendix 4** – The Council's External Borrowing Position at 31st December 2011 **Appendix 5** – Sterling Consultant's Economic & Market Review Q3 of 2011/12**Appendix 6** – Interest & Capital Financing Budget Monitoring 2011/12	

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, which requires the Council to approve a Treasury Management Strategy before the start of each financial year, review performance during the year, and approve an annual report after the end of each financial year.

1.2 This report gives details of performance against the Council's Treasury Management Strategy and Annual Investment Plan 2011/12 for the first nine months of 2011/12.

RECOMMENDATION

The Corporate Audit Committee is asked to agree that:

1.3 the Treasury Management Report to 31st December 2011, prepared in accordance with the CIPFA Treasury Code of Practice, is noted

1.4 the Treasury Management Indicators to 31st December 2011 are noted.

FINANCIAL IMPLICATIONS

1.5 The financial implications are contained within the body of the report.

THE REPORT

Summary

1.6 The average rate of investment return for the first nine months of 2011/12 is 1.11%, which is 0.64% above the benchmark rate.

1.7 The Councils Prudential Indicators for 2011/12 were agreed by Council in February 2011 and performance against the key indicators is shown in **Appendix 1**. All indicators are within target levels.

Summary of Returns

1.8 The Council's investment position as at 31st December 2011 is given in **Appendix 2**. The balance of deposits as at 30thSeptember 2011& 31st December 2011 are also set out in the pie charts in this appendix.

1.9 Gross interest earned on investments for the first nine months totalled £888k. Net interest, after deduction of amounts due to West of England Growth Points, B&NES PCT and schools, is £723k. **Appendix3**details the investment performance, the average rate of interest earned over this period was 1.11%, which is 0.64% above the benchmark rate of average 7 day LIBID +0.05% (0.47%).

Summary of Borrowings

1.10 No new borrowing has taken place in the third quarter of 2011/12. The Council's total borrowing is currently £120 million. The Council's Capital Financing Requirement (CFR) as at 31st March 2011 was £112.7 million with a projected total of £151 million by the end of 2011/12 based on the capital programme approved at February 2011 Council.This represents the Council's need to borrow to finance capital expenditure, and demonstrates that the borrowing taken to date relates to funding historical capital spend.

1.11 Following Local Government Reorganisation in 1996, Avon County Council's residual debt is administered by Bristol City Council. All successor Unitary Authorities make an annual contribution to principal and interest repayment, for which there is a provision in the Council's revenue budget. The amount of residual debt outstanding as at 31st March 2011 apportioned to Bath & North East Somerset Council is £16.43m. Since this borrowing is managed by Bristol City Council and treated in the Council's Statement of Accounts as a deferred liability, it is not included in the borrowing figures referred to in paragraph 5.5.

1.12 The current borrowing portfolio is shown in **Appendix 4**.

Strategic & Tactical Decisions

1.13 As shown in the charts at **Appendix 2**, investments continue to be focussed on UK banks that have either already or are likely to receive support from the UK Government should they experience financial difficulties. As at 31st December 2011, £30.0m was been invested with other Local Authorities to increase diversification whilst maintaining strong counterparty rating. To increase diversification further, the Council has now started investing in AAA rated Money Market funds as authorised in the 2011/12 Treasury Management Strategy. The amount invested with the Debt Management Office continues to remain between 0-10% of total investments.

1.14 Due to concerns related to the current Eurozone debt situation, the Council does not currently hold any investments with banks in countries within the Eurozone. The Council's investment counterparty list does not include any banks from the countries most affected by the debt situation in the Eurozone (Portugal, Ireland, Greece, Spain and Italy).

1.15 As a result of the wider concerns relating to the Eurozone debt situation, ratings agencies are continually reviewing the ratings of all financial institutions. The recent downgrading of many UK banks places a considerable challenge for the delivery of the Council's Treasury Management & Investment Strategy, and will be reviewed for the February 2012 Council meeting.

Future Strategic & Tactical Issues

1.16 Our treasury management advisors economic andmarket review for the third quarter 2011/12 is included in **Appendix 5**.

1.17 The Bank of England base rate has remained constant at 0.50% since March 2009.

Budget Implications

1.18 A breakdown of the revenue budget for interest and capital financing and the forecast year end position based on the period April to December is included in **Appendix 6**. This is currently forecast to be £250,000 favourable by the end of 2011/12.

RISK MANAGEMENT

1.19 The Council's lending & borrowing list is 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.

1.20 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.

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

EQUALITIES

1.22 This report provides information about the financial performance of the Council and therefore no specific equalities impact assessment has been carried out on the report.

CONSULTATION

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

1.24 Consultation was carried out via e-mail.

ISSUES TO CONSIDER IN REACHING THE DECISION

1.25 This report deals with issues of a corporate nature.

ADVICE SOUGHT

1.26 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.ukJamie_Whittard@bathnes.gov.uk*
Sponsoring Cabinet Member	*Councillor David Bellotti*
Background papers	*2011/12 Treasury Management & Investment Strategy*
Please contact the report author if you need to access this report in an alternative format	

APPENDIX 1
Performance against Treasury Management Indicators agreed in Treasury Management Strategy Statement

1. 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.

	2011/12 Prudential Indicator	**2011/12 Actual as at 31st Dec. 2011**
	£'000	£'000
Borrowing	201,000	120,000
Other long term liabilities	3,000	0
Cumulative Total	**204,000**	**120,000**

2. 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.

	2011/12Prudential Indicator	**2011/12 Actual as at 31st Dec. 2011**
	£'000	£'000
Borrowing	150,000	120,000
Other long term liabilities	2,000	0
Cumulative Total	**152,000**	**120,000**

3. Upper limit for fixed interest rate exposure
This is the maximum amount of total borrowing which can be at fixed interest rate, less any investments for a period greater than 12 months which has a fixed interest rate.

	2011/12 Prudential Indicator	**2011/12 Actual as at 31st Dec. 2011**
	£'000	£'000
Fixed interest rate exposure	**204,000**	**100,000***

* The £20m of LOBO's are quoted as variable rate in this analysis as the Lender has the option to change the rate at 6 monthly intervals (the Council has the option to repay the loan should the rate increase)

4. Upper limit for variable interest rate exposure
While fixed rate borrowing contributes significantly to reducing uncertainty surrounding interest rate changes, the pursuit of optimum performance levels may justify keeping 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 (this includes any investments that have a fixed rate for less than 12 months).

	2011/12 Prudential Indicator	**2011/12 Actual as at 31st Dec. 2011**
	£'000	£'000
Variable interest rate exposure	**0**	**-65,000***

*This is the variable rate debt (LOBOs of £20m) less the £95m variable rate investments.

5. Upper limit for total principal sums invested for over 364 days
This is the maximum % of total investments which can be over 364 days.

	2011/12 Prudential Indicator	2011/12 Actual as at 31st Dec. 2011
	%	%
Investments over 364 days	**25**	**1**

6. Maturity Structure of new fixed rate borrowing during 2011/12

	Upper Limit	Lower Limit	2011/12 Actual as at 31st Dec.2011
	%	%	%
Under 12 months	50	Nil	0
12 months and within 24 months	50	Nil	0
24 months and within 5 years	50	Nil	0
5 years and within 10 years	50	Nil	0
10 years and above	100	Nil	100

APPENDIX 2

The Council's Investment position at 31st December 2011

	Balance at 31st December 2011
	£'000's
Notice (instant access funds)	9,000
Up to 1 month	21,000
1 month to 3 months	30,000
Over 3 months	35,000
Total	**95,000**

The investment figure of £95.0 million is made up as follows:

	Balance at31st December 2011
	£'000's
B&NES Council	73,726
B&NES PCT	7,068
West Of England Growth Points	4,861
Schools	9,345
Total	**95,000**

The Council had an average net positive balance of £94.8m (including Growth Points& B&NES PCT Funding) during the period April 2011to December 2011.

Chart 1: Investments as at 31st December 2011 (£95.0m)

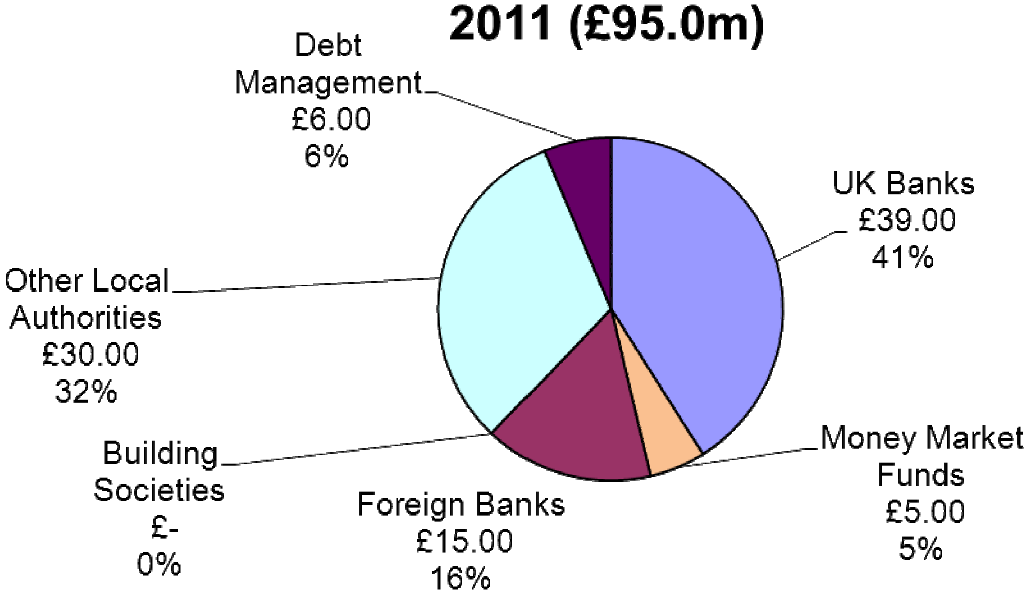


Chart 2: Investments as at 30th September 2011 (£109.4m)

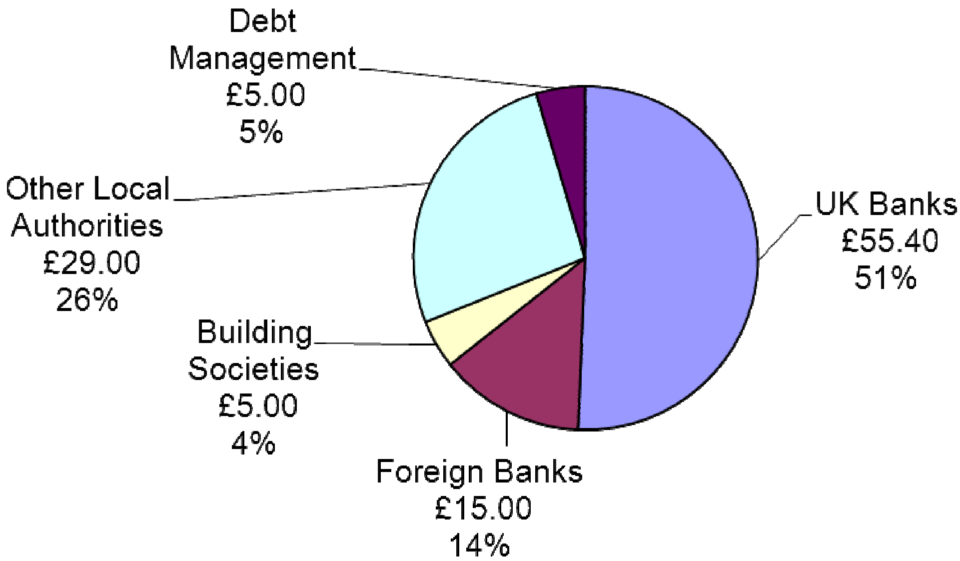


Chart 3: Investments per Lowest Equivalent Long-Term Credit Ratings (£95.0m) - 31st December 2011

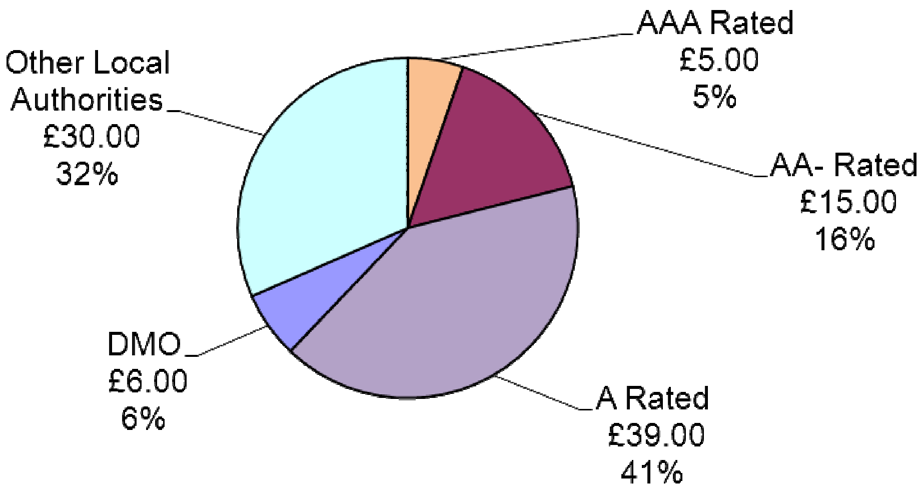
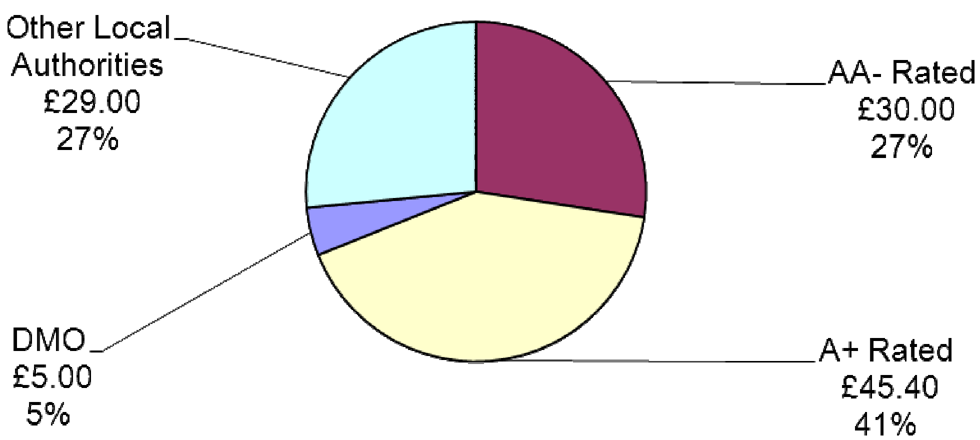


Chart 4: Investments per Lowest Equivalent Long-Term Credit Ratings (£109.4m) - 30th September 2011



APPENDIX 3

Average rate of return on investments for 2011/12

	April %	May %	June %	July %	August %	Sept. %
Average rate of interest earned	1.05%	1.13%	1.18%	1.10%	1.09%	1.14%
Benchmark = Average 7 Day LIBID rate +0.05% (source: Sterling)	0.50%	0.50%	0.50%	0.52%	0.49%	0.54%
Performance against Benchmark %	+0.55%	+0.63%	+0.68%	+0.58%	+0.60%	+0.60%

	Oct. %	Nov. %	Dec. %	Average for Period
Average rate of interest earned	1.11%	1.08%	1.11%	**1.11%**
Benchmark = Average 7 Day LIBID rate +0.05% (source: Sterling)	0.55%	0.55%	0.55%	**0.47%**
Performance against Benchmark %	+0.56%	+0.53%	+0.56%	**+0.64%**

APPENDIX 4
Councils External Borrowing at 31st December 2011

LONG TERM	Amount	Fixed Term	Interest Rate	Variable Term	Interest Rate
PWLB	10,000,000	30 yrs	4.75%	n/a	n/a
PWLB	20,000,000	48 yrs	4.10%	n/a	n/a
PWLB	10,000,000	46 yrs	4.25%	n/a	n/a
PWLB	10,000,000	50 yrs	3.85%	n/a	n/a
PWLB	10,000,000	47 yrs	4.25%	n/a	n/a
PWLB	5,000,000	25 yrs	4.55%	n/a	n/a
PWLB	5,000,000	50 yrs	4.53%	n/a	n/a
PWLB	5,000,000	20 yrs	4.86%	n/a	n/a
PWLB	10,000,000	18 yrs	4.80%	n/a	n/a
PWLB	15,000,000	50 yrs	4.96%	n/a	n/a
KBC Bank N.V*	5,000,000	2 yrs	3.15%	48 yrs	4.50%
KBC Bank N.V*	5,000,000	3 yrs	3.72%	47 yrs	4.50%
Eurohypo Bank*	10,000,000	3 yrs	3.49%	47 yrs	4.50%
TOTAL	**120,000,000**				

*All LOBO's (Lender Option / Borrower Option) have reached the end of their fixed interest period and have reverted to the variable rate of 4.50%. The lender has the option to change the interest rate at 6 monthly intervals, however at this point the borrower also has the option to repay the loan without penalty.

APPENDIX 5
Economic and market review for October 2011 to December 2011 (Sterling Consultancy Services)

Two stories dominated the last quarter of 2011; the weakening short-term economic outlook and further deterioration in the Eurozone sovereign debt crisis. By this point, the debt crisis had been an on-going problem for nearly 18 months, since Greece first ran into trouble in early 2010. Due to political dithering the situation had remained largely unsolved; various meetings caused plenty of disagreement, but little concrete and implementable policies. By the end of the summer, the situation markedly deteriorated – Greece appeared on the verge of default despite a previous bailout and investors appeared to have lost confidence in the larger economies of Italy and Spain. Spain would prove troublesome to save, but Italy may be simply too big, a fact not lost on investors, prompting Italian 10-year bond yields to approach the perceived danger-level of 7%.

The ECB resisted calls to step in and save sovereign countries, but central banks did respond to support the banking sector, which had come under intense funding pressure due to banks' exposure to sovereign debt. Reminiscent of the actions undertaken in the midst of the financial crisis in 2008, the Federal Reserve, in conjunction with the ECB, the Bank of England and the Swiss National Bank, enabled banks access to unlimited amounts of US dollar liquidity. The ECB backed this up with unlimited euro liquidity in regular short-term auctions and, just before Christmas, lent €480bn to Eurozone banks for a three-year term. Politicians hope that some of this cash will be lent to and indirectly reduce the funding pressure on sovereign governments.

By the end of the year, following unparalleled and sustained financial market volatility and panic, the governments of both Greece and Italy had been replaced, headed by unelected leaders, whose role was to control the public finances. The Greek PM resigned after prompting massive panic among investors and Eurozone leaders by appearing to renege on an agreement for a second bailout reached only the previous week. Italy's long-standing and controversial PM Silvio Berlusconi resigned after coming under massive market pressure, due to his inability and unwillingness to bring the Italian government finances under control. However, despite a move towards greater fiscal union in the Eurozone, the short-term problem of near-insolvent Eurozone governments remains unsolved.

The on-going crisis prompted a decline in global business and consumer confidence, particularly apparent in Q4. Allied to widespread fiscal consolidation, the reduction in confidence dampened economic growth, prompting significant downward revisions to global growth forecasts. In the UK, the Office for Budget Responsibility cut the UK's economic growth prospects to 0.9% for 2011 and 0.7% for 2012. Lower growth placed additional pressure on the UK government to meet its borrowing targets, and the Chancellor duly implemented new taxes and spending cuts. By this point, however, slower economic growth had already become widely evident in a range of economic indicators. With inflation expected to fall sharply in 2012, MPC policymakers at the Bank of England implemented another round of financial asset purchases, or quantitative easing, in October to boost economic activity and help the economy avoid a sharp recession.

APPENDIX 6
Interest & Capital Financing Costs – Budget Monitoring 2011/12 (April to December)

April to December 2011	YEAR END FORECAST Budgeted Spend or (Income) £'000	Forecast Spend or (Income) £'000	Forecast over or (under) spend £'000	ADV/FAV
Interest &Capital Financing				
- Debt Costs	4,840	4,840		
- Internal Repayment of Loan Charges	(3,188)	(3,188)		
- Ex Avon Debt Costs	1,491	1,491		
- Minimum Revenue Provision (MRP)	3,380	3,380		
- Interest of Balances	(460)	(710)	(250)	FAV
Sub Total - Capital Financing	**6,063**	**5,853**	**(250)**	

This page is intentionally left blank

Bath & North East Somerset Council	
MEETING:	**Corporate Audit Committee**
MEETING DATE:	**7th February 2012**
TITLE:	**Treasury Management Strategy Statement and Annual Investment Strategy 2012/13**
WARD:	All
AN OPEN PUBLIC ITEM	
List of attachments to this report: Appendix 1 - Treasury Management Strategy 2012/13 Appendix 2 -Annual Investment Strategy 2012/13 Appendix 3 - Authorised Lending List Appendix 4 - Treasury Management Policy Statement	

1 THE ISSUE

1.1 In February 2010, the Council adopted the revised CIPFA Treasury Management in Public services Code of Practice, which requires the Council to approve a Treasury Management Strategy before the start of each financial year and for this to be scrutinised by an individual / group of individuals or committee.

1.2 The Institute published a revised version of CIPFA Code in November 2011 in light of the additional financial freedoms available to local authorities in the Localism Act 2011. The Council is therefore asked to formally adopt the Treasury Management in the Public Services: Code of Practice 2011 Edition.

1.3 The new Code of Practice requires some amendments to the Council's Treasury Management Policy Statement (amendment to Treasury Indicators, and inclusion of a policy on derivatives), and the Council is asked to formally adopt the new policy statement in Appendix 4.

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

1.5 This report fulfils the Council's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the CLG Guidance.

1.6 This report is tabled to be scrutinised by the Corporate Audit Committee at the 7th February 2012 meeting, reported to Cabinet on 8th February 2012 and presented to February Council for approval.

2 RECOMMENDATION

The Corporate Audit Committee is asked toagree to:

2.1 recommend the actions proposed within the Treasury Management Strategy Statement (Appendix 1) to February Council for approval.

2.2 recommend the Investment Strategy as detailed in Appendix 2 to February Council for approval.

2.3 recommend the changes to the authorised lending lists detailed in Appendix 2 and highlighted in Appendix 3to February Council for approval.

2.4 recommend the adoption of CIPFA's revised Code of Practice on Treasury Management, as detailed in 5.5, to February Council for approval.

2.5 recommend the revised Treasury Management Policy Statement, as detailed in Appendix 4 to February Council for approval.

The Corporate Audit Committee is also asked to:

2.6 Note the Treasury Management Indicators detailed in Appendix 1 and note that Cabinet are recommended to delegate authority for updating the indicators prior to approval at Full Council on 14th February 2012to the Divisional Director - Finance and Cabinet Member for Community Resources, in light of any changes to the recommended budget as set out in the Budget Report elsewhere on the agenda at 8th February Cabinet.

3 FINANCIAL IMPLICATIONS

3.1 Included in the report and appendices.

5 THE REPORT

Background

4.1 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.

4.2 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.

4.3 The suggested strategy for 2012/13 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;
•	Treasury Management Indicators;
•	The current treasury position;
•	The borrowing requirement;
•	Prospects for interest rates;
•	The borrowing strategy;
•	The investment strategy.

4.4 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

4.5 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. This report is tabled to be scrutinised by the Corporate Audit Committee at the7th February 2012 meeting, following which any recommendations will be reported back verbally as an update to this report.

2012/13 Treasury Management & Annual Investment Strategy

4.6 The Prudential Code was introduced for the first time in 2004/05. The Strategy Statement for 2011/12 set Prudential Indicators for 2011/12 – 2013/14, which included a total borrowing requirement at the end of 2011/12 of £150million. At the end of December 2011, external borrowing was at £120million, with no further borrowing planned in the 2011/12 financial year. There is a full provision for this borrowing within the Council's revenue budget.

4.7 The proposed Treasury Management Strategy is attached as Appendix 1 and includes the Treasury Management Indicators required by the Treasury Management Code. The 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 on the agenda for 8th February Cabinet. It is requested that the Cabinet grant delegated authority to the Divisional Director - Finance and the Cabinet Member for Community Resourcesto agree any changes to the indicators prior to reporting for approval at Full Council on the 14th February 2012.

4.8 Although the 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.

4.9 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.

4.10 Appendix 1 also details the Council's current portfolio position as at 31st December 2011, which shows after the netting off of the £95 million investments, the Council's net debt position was £25 million.

4.11 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.

4.12 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 2011 are included in the listing in Appendix 3.

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

5 RISK MANAGEMENT

5.1 The report author and Lead Cabinet member have fully reviewed the risk assessment related to the issue and recommendations, in compliance with the Council's decision making risk management guidance.

5.2 The Council's lending & borrowing list has been regularly reviewed over the past 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 Advisers Sterling.

6 EQUALITIES

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

7 CONSULTATION

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

8 ISSUES TO CONSIDER IN REACHING THE DECISION

8.1 This report deals with issues of a corporate nature.

9 ADVICE SOUGHT

9.1 The Council's Monitoring Officer (Divisional Director – Legal & Democratic Services) and Section 151 Officer (Divisional Director – Finance) will 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.ukJamie_Whittard@bathnes.gov.uk*
Sponsoring Cabinet Member	*Cllr David Bellotti*
Background papers	*None*
Please contact the report author if you need to access this report in an alternative format	

This page is intentionally left blank

APPENDIX 1

TREASURY MANAGEMENT STRATEGY – 2012/2013

Introduction

In February 2010 the Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice Fully Revised Second Edition 2009 (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year.

The Institute published a revised version of CIPFA Code in November 2011 in light of the additional financial freedoms available to local authorities in the Localism Act 2011. The Council is therefore asked to formally adopt the Treasury Management in the Public Services: Code of Practice 2011 Edition. The new Code of Practice requires some amendments to the Council's Treasury Management Policy Statement, and the Council is asked to formally adopt the new policy statement in Appendix 4.

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

This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the CLG Guidance.

Treasury Borrowing Limits for 2012/13 to 2014/15

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.

Treasury Management Indicators for 2012/13 – 2014/15

The Council measures and manages its exposures to treasury management risks using the following indicators. The council is asked to approve the following indicators:.

Treasury Management Indicators for 2012/13 – 2014/15

Security: average credit rating
The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the weighted average credit rating of its investment portfolio.

	2012/13
Minimum Portfolio average credit rating	A+

Interest rate exposures
This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as an amount of net principal borrowed will be:

	2012/13	2013/14	2014/15
Upper limit on fixed interest rate exposures	£171m	£197m	£205m
Upper limit on variable interest rate exposures	£0m	£0m	£0m

The variable interest rate exposure limit is set at £0m to restrict the amount of variable rate debt up to the level of variable rate investments.

Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

Maturity structure of borrowing
This 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:

	Upper	Lower
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within five years	50%	0%
Five years and within 10 years	50%	0%
10 years and above	100%	0%

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.

Principal sums invested for periods longer than 364 days
The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the proportion of total principal sum invested to final maturities beyond the period end will be:

	2012/13	2013/14	2014/15
Limit on proportion of principal invested beyond year end	£30m	£30m	£30m

Gross and net debt
The upper limit on net debt indicator was introduced in 2011 and is intended to highlight where the Council borrowing in advance of need. Since net debt does not change when loans are borrowed and the proceeds re-invested, it is not yet clear how this indicator will work. CIPFA has not yet produced guidance on its use, and so the Council is being asked to set a deliberately high limit this year.

	2012/13	2013/14	2014/15
Upper limit on net debt *(as a proportion of gross debt)*	100%	100%	100%

Borrowing limits
The Authorised limits for external debt include current commitments and proposals in the budget report for capital expenditure, plus additional headroom over and above the operational limit for unusual cash movements.

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. This level also factors in the proposed approach to use internal borrowing backed by cashflow and capital receipts as the financing method for the Keynsham Town Centre Regeneration project, subject to approval.

	2012/13	2013/14	2014/15
Operational boundary – borrowing Operational boundary – other long-term liabilities Operational boundary – TOTAL	£161m £2m £163m	£167m £2m £169m	£170m £2m £172m
Authorised limit – borrowing Authorised limit – other long-term liabilities Authorised limit – TOTAL	£171m £2m £173m	£197m £2m £199m	£205m £2m £207m

Current Portfolio Position
The Council's treasury portfolio position at 31st December 2011 comprised:

	Principal	Ave. rate
	£m	%
Total Fixed rate funding	PWLB 100	4.45
Variable rate funding	Market 20	4.50*
Other long term liabilities	Nil	N/A
TOTAL DEBT	**120**	**4.46**
TOTAL INVESTMENTS**	**95.0**	**1.15**
NET DEBT	**25.0**	

* 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 B&NES 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

<u>Current position</u>
The global economy appears to be teetering on the edge of another slowdown, despite early optimism for a continued recovery from the 2008 financial crisis and recession. The combination of fiscal consolidation in developed economies, monetary tightening in developing economies, the Eurozone debt crisis and, in the UK, a fall in real household income, has severely damaged business and consumer confidence. As a result, household spending and business investment have weakened, with a consequent effect on the labour market.

<u>The outlook for 2012/13</u>

The short-term global outlook is relatively pessimistic. The effect of the debt crisis is likely to cause a shallow recession in the Eurozone, reducing demand for exported goods from trading partners, thus causing slower growth elsewhere. On the brighter side, the US consumer appears to be awakening from a long slumber, possibly helping the world's largest economy avoid a similar fate to the Eurozone. After engaging in monetary tightening throughout 2011, the Chinese government could reverse its stance in response to slowing global growth to try to boost domestic demand, essential to global rebalancing. Japan appears to have recovered from the March earthquake, but unlike China, will find stimulating domestic demand to offset ebbing foreign demand more difficult. The Eurozone will remain a drag on global growth in the short run, but other large economies should allow the global economy to tread water.

Once driven by the unrelenting appetite of consumers, the UK economy is currently more reliant on global demand as the combination of fiscal consolidation, the contraction in real household incomes and the resultant negative impact on sentiment dampens domestic demand. With foreign demand, particularly from one of the country's main trading partners, slowing, the economic outlook over the near term is somewhat weaker. In this low growth environment, there is little chance of inflation remaining at current high levels. As temporary factors fall out of the twelve-month comparison and more aggressive competition becomes commonplace, the CPI rate will fall back towards target.

While GDP growth may pick up from mid- to late-2012, the deteriorating outlook is likely to prompt further monetary easing in the next few months from the Bank of England, building on the extra £75bn of asset purchases it announced in October. Bank Rate will therefore remain unchanged in the short term, but faces upside risks from mid- to late-2012 as the economy gets back on track.

Businesses and households have deleveraged since 2008. The household savings rate also remains substantially above pre-crisis levels. While this implies that households remain cautious, confidence will return as the economy starts to recover and the pressure on incomes eases. Spending is therefore likely to rise, with a beneficial impact on employment. Following substantial injections of newly created money and recovering domestic demand, monetary policy will require tightening to keep inflation in check. MPC policymakers will attempt to stay ahead of the curve to avoid the prospect of demand-led inflation boosting wages and prices.

The main downside risk is a partial breakup of the Euro-area. No matter how well managed, such an exercise would create huge uncertainty and act as a severe drag on the global and UK economy for some time.

<u>SCS and Markets Interest Rate Forecasts</u>

Sterling Consultancy Services central interest rate forecast – November 2011

	Bank Rate	1 month LIBOR	3 month LIBOR	12 month LIBOR	25 year PWLB
Current	0.50	0.73	1.01	1.79	4.06
Q1 2012	0.50	0.70	1.00	1.75	4.20
Q2 2012	0.50	0.70	1.00	1.70	4.40
Q3 2012	0.50	0.75	1.00	1.80	4.50
Q4 2012	0.75	0.85	1.05	1.90	4.50
H1 2013	1.00	1.10	1.25	2.00	4.60
H2 2013	1.50	1.60	1.75	2.50	4.70
H1 2014	2.00	2.10	2.25	3.00	4.80
H2 2014	2.50	2.60	2.75	3.50	4.90

HM Treasury Survey of Forecasts – November 2011

	Average annual Bank Rate %			
	2012	2013	2014	2015
Highest	1.1	2.6	3.0	3.7
Average	0.6	0.9	1.7	2.7
Lowest	0.5	0.5	0.9	1.4

The Council has budgeted for interest rates at 1.0% for 2012/13, 2.0% for 2013/14 & 3.0% thereafter.

Borrowing Strategy

The Council currently holds £120 million of long-term loans, and we will continue to monitor appropriate opportunities for borrowing in line with the overall Capital Financing Requirement.
The Council's capital financing requirement (CFR, or underlying need to borrow) as at 31st March 2012 is expected to be £142 million, and is forecast to rise to £170 million by March 2013 as capital expenditure is incurred.

The maximum expected long-term borrowing requirement for 2012/13 is:

	£m
Not borrowed in previous years	*22*
Forecast increase in CFR	*28*
Loans maturing in 2013/14	*0*
TOTAL	***50***

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 2012/13 assumes borrowing of £30 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.

Sources of borrowing
The approved sources of long-term and short-term borrowing will be:
- Public Works Loan Board
- any institution approved for investments that meets the investment criteria (this includes other local authorities)
- any other bank or building society on the Financial Services Authority list
- Public or Private Bond Placement
- Special purpose companies created to enable joint Local Authority bond issues.

Debt instruments
Loans will be arranged by one of the following debt instruments:
- fixed term loans at fixed or variable rates of interest.
- lender's option borrower's option (LOBO) loans.
- 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

Planned Borrowing strategy for 2012/13

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 decision in 2010 to raise the interest rates on new PWLB loans by around 0.85% means that other sources of finance may now be more favourable and will be kept under review.

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.

Policy on use of Financial Derivatives
Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans).

The Localism Bill 2011 includes a general power of competence that removes the uncertain legal position over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). The latest CIPFA Code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.

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

This page is intentionally left blank

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**.

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 a Fitch Support Rating (where given) no lower than 3.	£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)	£10m each	1 week
UK Central Government (Including Debt Management Agency Deposit Facility)	no limit	12 months
UK Local Authorities[3] (irrespective of ratings)	£5m each	12 months

[1] The matrix for limits on each rating is provided in Appendix 3. Banks within the same group ownership are treated as one bank for limit purposes. 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

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 lower than 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.

Funds that offer same-day liquidity and a constant net asset value will be used as an alternative to instant access call accounts, while funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

Not more than 50% of the Council's total investment portfolio shall be invested in Money Market Funds.

Collateralised investments

Where the Council makes an investment with an organisation that is secured on collateral in a third party (e.g. a reverse repo or a collateralised deposit), the time limit may be extended to match the limit given above for the third party. However, the investment will still count against the cash limit of the organisation receiving the funds.

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 which are:

- denominated in foreign currencies,
- nor any with low credit quality bodies,
- nor any that are defined as capital expenditure by legislation, such as company shares.

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.

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	10 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 counterparty's 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 £30m.

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 long-term credit ratings from the three main rating agencies Fitch Ratings Ltd, Moody's Investors Service Inc and Standard & Poor's Financial Services LLC to assess the risk of investment default. The lowest available credit rating will be used to determine credit quality.

Long-term ratings are expressed on a scale from AAA (the highest quality) through to D (indicating default). Ratings of BBB- and above are described as investment grade, while ratings of BB+ and below are described as speculative grade. The Council's credit rating criteria are set to ensure that it is unlikely that the Council will hold speculative grade investments, despite the possibility of repeated downgrades.

Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

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

Where a credit rating agency announces that a rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it is likely to fall below the above criteria, then no further investments will be made in that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks.

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.

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)
- collared deposits
- certificates of deposit
- treasury bills and gilts issued by the UK Government
- bonds issued by multilateral development banks
- corporate bonds
- 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 £20m per country for those rated AAA and £15 million per country for those rated AA+. 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.

Sovereign credit rating criteria and foreign country limits will not apply to investments in multilateral development banks (e.g. the European Investment Bank and the World Bank) or other supranational organisations (e.g. the European Union).

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 2012/13

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 and Money Market Funds 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:

<u>Investment consultants</u>
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 2012/13 authorised borrowing limit of £173 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.

This page is intentionally left blank

Proposed Counterparty List

2012/13

CRITERIA									
			FITCH RATINGS			Moody's Ratings		S&P Ratings	
			S/Term	L/Term	Support	S/Term	L/Term	S/Term	L/Term
	Duration	Council Limit (£m)	F1	A	3	P-1	A2	A-1	A
UK Banks	**Sovereign Rating**			**AAA**			**Aaa**		**AAA**
Barclays Bank	6 Months	10	F1	A	1	P-1	Aa3	A-1	A+
HSBC Bank plc	1 Year	20	F1+	AA	1	P-1	Aa2	A-1+	AA-
Lloyds Banking Group									
Lloyds TSB Bank	6 Months	10	F1	A	1	P-1	A1	A-1	A
Bank of Scotland	6 Months	10	F1	A	1	P-1	A1	A-1	A
RBS Group									
National Westminster Bank	6 Months	10	F1	A	1	P-1	A2	A-1	A
Royal Bank of Scotland	6 Months	10	F1	A	1	P-1	A2	A-1	A
Standard Chartered Bank	6 Months	10	F1+	AA-	3	P-1	A1	A-1	A+
UK Building Societies									
Nationwide	6 Months	10	F1	A+	1	P-1	A2	A-1	A+
Yorkshire	3 Months	2	F2	BBB+	5	P-2	Baa2	A-2	A-
Coventry	3 Months	2	F1	A	5	P-2	A3	-	-
Leeds	3 Months	2	F2	A-	5	P-2	A3	-	-
Foreign Banks									
Australia	**Sovereign Rating**			**AAA**			**Aaa**		**AAA**
Australia & New Zealand Banking Group	6 Months	10	F1+	AA-	1	P-1	Aa2	A-1+	AA-
Commonwealth Bank of Australia	6 Months	10	F1+	AA	1	P-1	Aa2	A-1+	AA-
National Australia Bank									
National Australia Bank	6 Months	10	F1+	AA	1	P-1	Aa2	A-1+	AA-
Westpac Banking Corporation	6 Months	10	F1+	AA	1	P-1	Aa2	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
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+
Royal Bank of Canada	6 Months	10	F1+	AA	1	P-1	Aa1	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	A2	A-1	A
France	**Sovereign Rating**			**AAA**			**Aaa**		**AAA**
BNP Paribas Group									
BNP Paribas	6 Months	5	F1+	A+	1	P-1	Aa3	A-1+	AA-
Fortis Bank	3 Months	5	F1	A	1	P-1	A1	A-1+	AA-
Credit Mutuel Centre Est Europe Group									
Banque Federative du Credit Mutuel	6 Months	5	F1+	A+	1	P-1	Aa3	A-1	A+
Credit Industriel et Commercial	3 Months	5	F1+	A+	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	5	F1+	A+	1	P-1	Aa3	A-1	A+
Credit Agricole Corp. & Investment Bank	6 Months	5	F1+	A+	1	P-1	Aa3	A-1	A+
Societe Generale	6 Months	5	F1+	A+	1	P-1	A1	A-1	A+

Proposed Counterparty List

2012/13

	Duration	Council Limit (£m)	FITCH RATINGS S/Term	FITCH L/Term	FITCH Support	Moody's Ratings S/Term	Moody's L/Term	S&P Ratings S/Term	S&P L/Term
CRITERIA			F1	A	3	P-1	A2	A-1	A
Germany	**Sovereign Rating**			**AAA**			**Aaa**		**AAA**
Commerzbank AG	3 Months	5	F1+	A+	1	P-1	A2	A-1	A
Deutsche Bank	6 Months	5	F1+	A+	1	P-1	Aa3	A-1	A+
DZ Bank	6 Months	5	F1+	A+	1	P-1	Aa3	A-1	AA-
Landesbank Hessen-Thuringen	3 Months	5	F1+	A+	1	P-1	A1	A-1	A
Netherlands	**Sovereign Rating**			**AAA**			**Aaa**		**AAA**
ING Bank NV	6 Months	5	F1+	A+	1	P-1	Aa3	A-1	A+
Rabobank Group	1 Year	10	F1+	AA	1	P-1	Aaa	A-1+	AA
Norway	**Sovereign Rating**			**AAA**			**Aaa**		**AAA**
DnB NOR Bank	6 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	6 Months	10	F1+	AA-	1	P-1	Aa1	A-1+	AA-
United Overseas Bank	6 Months	10	F1+	AA-	1	P-1	Aa1	A-1+	AA-
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	3 Months	5	F1	A	1	P-1	Aa1	A-1	A+
UBS AG	3 Months	5	F1	A	1	P-1	Aa3	A-1	A
USA	**Sovereign Rating**			**AAA**			**Aaa**		**AA+**
Bank of America Corporation									
Bank of America NA	3 Months	5	F1	A	1	P-1	A2	A-1	A
Bank of New York Mellon	6 Months	10	F1+	AA-	1	P-1	Aaa	A-1+	AA-
Citigroup									
Citibank NA	3 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	5	F1+	AA-	1	P-1	Aa1	A-1	A+
Wells Fargo & Co									
Wells Fargo Bank NA	6 Months	10	F1+	AA-	1	P-1	Aa3	A-1+	AA-

Credit Rating Matrix - UK Banks & Building Societies from 1st April 2012

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	A3	A-1	A-
£10M	6 Months	F1	A	3	P-1	A2	A-1	A
£10M	1 Year	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+	AA	1	P-1	Aa2	A-1+	AA
£20M	10 Years	F1+	AAA	1	P-1	Aaa	A-1+	AAA

Credit Rating Matrix - Foreign Banks from 1st April 2012

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

APPENDIX 4

Treasury Management Policy Statement

The Council's financial regulations require it to create and maintain a Treasury Management Policy Statement, stating the policies, objectives and approach to risk management of its treasury activities, as a cornerstone for effective treasury management.

Definition
The Council defines its treasury management activities as: the management of the Council's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

Risk management
The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

Value for money
The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

Borrowing policy
The Council greatly values revenue budget stability and will therefore borrow the majority of its long-term funding needs at long-term fixed rates of interest. Short-term and variable rate loans will only be borrowed to the extent that they either offset short-term and variable rate investments or can be shown to produce revenue savings.

The Council will set an affordable borrowing limit each year in compliance with the *Local Government Act 2003*, and will have regard to the *CIPFA Prudential Code for Capital Finance in Local Authorities* when setting that limit. It will also set limits on its exposure to changes in interest rates and limits on the maturity structure of its borrowing in the treasury management strategy report each year.

Investment policy
The Council's primary objectives for the investment of its surplus funds are to protect the principal sums invested from loss, and to ensure adequate liquidity so that funds are available for expenditure when needed. The generation of

investment income to support the provision of local authority services is an important, but secondary, objective.

The Council will have regard to the Communities and Local Government Guidance on Local Government Investments and will approve an investment strategy each year as part of the treasury management strategy. The strategy will set criteria to determine suitable organisations with which cash may be invested, limits on the maximum duration of such investments and limits on the amount of cash that may be invested with any one organisation.

Bath & North East Somerset Council		
MEETING:	Corporate Audit Committee	
MEETING DATE:	7thFebruary 2012	**AGENDA ITEM NUMBER**
TITLE:	**Annual Governance Review - Update Report for 2010/11& 2011/12**	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
List of attachments to this report: Appendix 1 - Annual Governance Review Process Appendix 2–Update on Actions from 2010/11Significant 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 2010/11 Annual Governance Review and progress on the 2011/12 review.

2. RECOMMENDATION

2.1 The Committee is asked to:

2.2 Noteaction taken to date in relation to the 'Significant Issues' recorded in the Annual Governance Statement 2010/11.

2.3 Note the process &timetable for the Annual Governance Review 2011/12.

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 year's statement.

4.5 **2010/11 Significant Issues Update**

4.6 The Annual Governance Statement 2010/11was considered by the Committee in June 2011 and the final statement included 2'Significant' issues:-

- Public Sector Funding
- Planning (Finding of Judicial Review)

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

4.7 In addition the Audit Committee recommended that progress against the issues identified with regard to Payroll – whilst not classed as 'significant' - should also be monitored by the Audit Committee. An update position will be presented to the meeting by the Head of Human Resources (lead client officer) as work is ongoing.

4.8 The committee is asked to consider this update and support an investment in resources to improve Client control and aid effective outcomes in relation to People Services.

4.9 **Annual Governance Review Process & Timetable 2011/12**

4.10 The Risk & Assurance Service will:-

- Manage the process, collating and analysing information from across the Council (Feb. to June'12).
- Consult Senior Officers / Members to identify issues to be recorded in AGS (Feb. to June '12).
- Report to Corporate Audit Committee / Cabinet (April& June'12).
- 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 '12).

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 external audit.

6 EQUALITIES

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

7 CONSULTATION

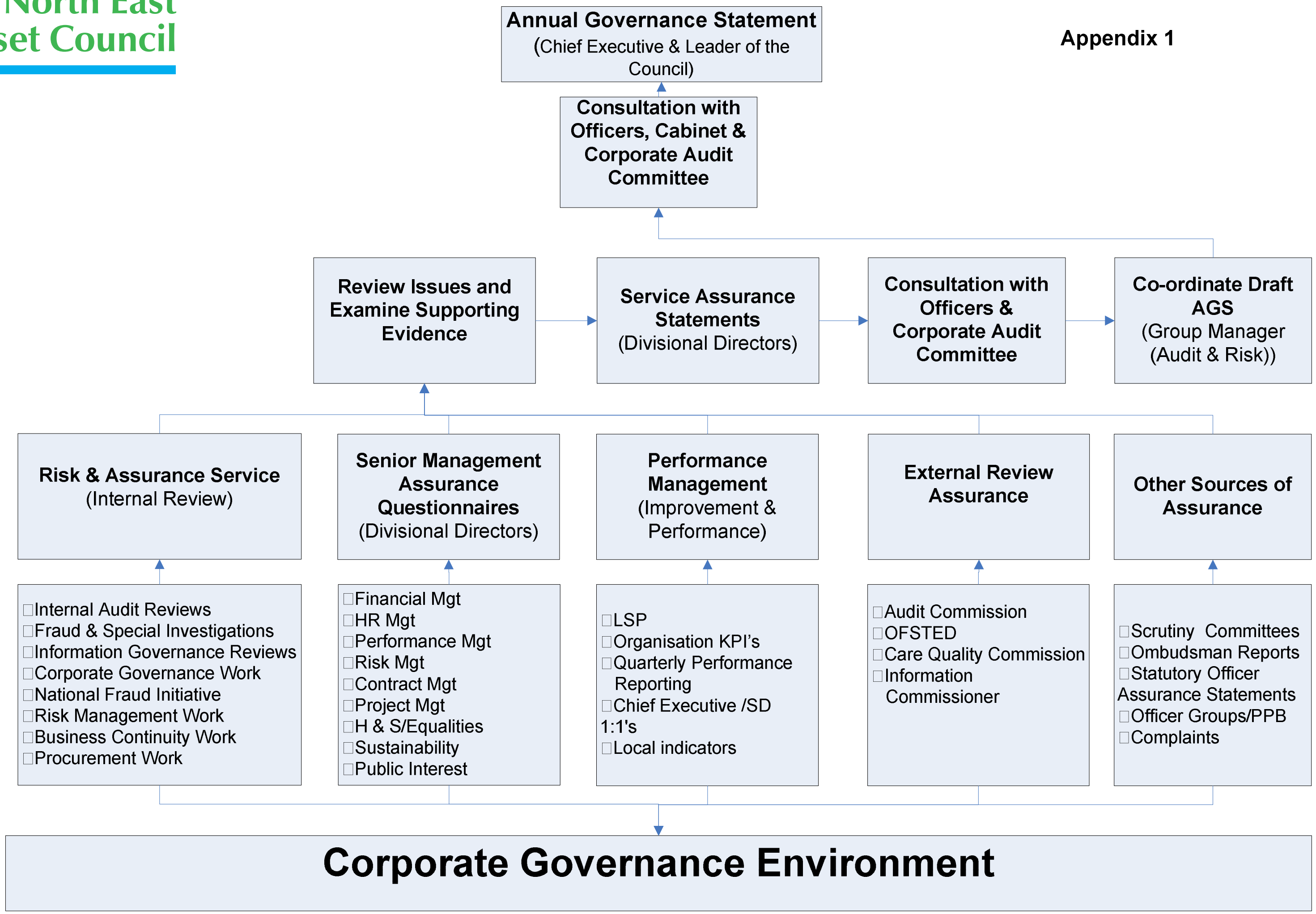
7.1 A copy of this report was distributedto the S151 Officer for consultation.

Contact person	*Andy Cox (01225 477316) Jeff Wring (01225 477323)*
Background papers	▪ Corporate Audit Committee Report, Annual Governance Statement 28th June 2011
Please contact the report author if you need to access this report in an alternative format	

This page is intentionally left blank

Bath & North East Somerset Council

Appendix 1



Everyone is a risk manager

Follow up of Significant Issues on AGS 2010/11

Ref	Issue	Agreed Actions on AGS	Current Position	RAG
AGS 1	**PUBLIC SECTOR FUNDING** The government's policy to reduce the national debt has led to significant cuts in public spending during 2011/12 and future years. This has resulted in B&NES Council having to manage additional in-year reductions of £1.8M in both revenue and capital expenditure. Whilst the required savings have been successfully achieved, these did include a reduction in staff, which in itself incurs costs and impacts on the ability of the Council to provide efficient and effective services.	1. **SDG & Cabinet** should continue to ensure there are robust budget setting and budget monitoring processes to minimise the impact on delivery of service. 2. **SDG & Cabinet** should continue to monitor and review Financial Planning targets and linked to this complete an Annual Review of the Medium Term Financial Plan. The review process will result in preparation of a Summarised Plan for Overview & Scrutiny (November 2011) and finalise the Plan for Council (February 2012). 3. **SDG & Cabinet** to continue to monitor the impact of the staff losses and related capacity issues through the Council's Performance and Risk Management processes.	The medium term service and resource plans along with individual service action plans have been reported to the relevant policy, development and scrutiny panels over the last three to four months and the budget report for 2012/13 is being prepared for full Council in February. Performance regarding the budget & staffing implications for 2011/12 has been subject to regular (monthly) scrutiny by SDG & Cabinet and is on-track. Corporate Risks are subject to ongoing review by SDG and Cabinet and the risk around financial challenge and resource capacity continues to rank as one of the organisations highest risks. Actions in relation to that risk as detailed above are on track.	**Green Status** **Actions on Target or Complete**

Ref	Issue	Agreed Actions on AGS	Current Position	RAG
AGS 2	**PLANNING** During the year (2010/11) the Council lost a judicial review of action taken by the Council's Planning Service. This was related to a planning enforcement case. The findings of the Court resulted in costs of £95,000 being awarded against the Council. In addition the Council had to incur the costs of defending the claim of £65,429.85.	1. **The Divisional Director – Planning & Transportation** to undertake a detailed review of policies and procedures based on the Court findings and implement any necessary changes. 2. **Strategic Director – Service Delivery** to review progress	Risk & related action plan being monitored through the Planning and Transportation Risk Register – risk that the Council does not take sufficient action following the outcome of legal challenge and Judicial Review. Actions recorded against this risk include: 1) Submission of a Development & Control Paper 2) Appointment of leading QC 3) Commence high level engagement with the planning applicant. Current Status of actions as at Qtr 3 2011/12 – 'Complete' or 'On-Target'.	**Green Status** **Actions on target or complete**

Appendix 2

This page is intentionally left blank

<table>
<tr><th colspan="3">Bath & North East Somerset Council</th></tr>
<tr><td>MEETING:</td><td colspan="2">Corporate Audit Committee</td></tr>
<tr><td>MEETING DATE:</td><td>7th February 2012</td><td>AGENDA ITEM NUMBER</td></tr>
<tr><td>TITLE:</td><td>External Audit Update Reports</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 – Audit Plan 2011/12 – Bath & North East Somerset Council
Appendix 2 – Audit Plan 2011/12 – Avon Pension Fund
Appendix 3 – Certification of Claims & Returns – External Audit Annual Report
Appendix 4 - External Audit Update Report for Audit Committee
Appendix 5 – Government Response to the future of local audit consultation</td></tr>
</table>

1 THE ISSUE

1.1 The External Auditor will update the Committee on a range of issues affecting the Councils audit work. This will include the Audit Plans for 2011/12 for the Council and Pension Fund, results of audit work of grant returns and a general update on emerging national issues.(Appendices 1 to 5).

2 RECOMMENDATION

2.1 The Corporate Audit Committee is asked to –

a) Approve the External Audit Plan for the Council for 2011/12

b) Approve the External Audit Plan for the Avon Pension Fund for 2011/12

c) Note the findings from the External Audit Annual Report on Grant Claims

d) Note the emerging issues identified from the External Audit Update Report

3 FINANCIAL IMPLICATIONS

3.1 The financial implications as a result of this report are primarily related to the fees for the external audit of the Council and Pension Fund. In both cases the net fees are a reduction from last year's figure and can be contained within existing resources.

4 THE REPORT

4.1 The purpose of each of the reports attachedis as follows –

a) Appendix 1 – External Audit Report for the Council 2011/12 – This document sets out the work which the Audit Commission wish to carry out for the 2011/12 audit and which will cost the Council £273,398 before rebates. The Plan is compiled from a risk based approach to audit planning and the document sets out the key risks which may potentially impact on their work and key dates for the completion of its work. The Committee is asked to approve the plan.

b) Appendix 2 – External Audit Report for the Avon Pension Fund 2011/12 - This document sets out the work which the Audit Commission wish to carry out for the 2011/12 audit and which will cost the Avon Pension Fund £46,622. The Plan is compiled from a risk based approach to audit planning and the document sets out the key risks which may potentially impact on their work and key dates for the completion of its work. The Pension Fund Committee will also review the plan but the Audit Committee is charged with its governance and is asked to approve the plan.

c) Appendix 3 – External Audit Annual Report – Certification of Claims and Returns – This document summarises the outcomes of the Audit Commission work in certifying claims including a summary of recommendations and progress. The Committee is asked to note the report.

d) Appendix 4 – External Audit Update Report – This document seeks to highlight key emerging national issues and developments which may be of interest to members of the Corporate Audit Committee. The paper concludes by asking a number of questions which the Committee may wish to consider in order to assess whether it has received sufficient assurance on emerging issues. The Committee is asked to note the report.

5RISK 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.

7CONSULTATION

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

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	

This page is intentionally left blank

Audit plan

Bath and North East Somerset Council

Audit 2011/12

Contents

Introduction

This plan sets out the work for the 2011/12 audit. The plan is based on the Audit Commission's risk-based approach to audit planning.

Responsibilities

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 you.

The Statement summarises where the different responsibilities of auditors and of the audited body begin and end and I undertake my audit work to meet these responsibilities.

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

- the Audit Commission Act 1998; and
- the Code of Audit Practice for local government bodies.

My audit does not relieve management or the Corporate Audit Committee, as those charged with governance, of their responsibilities.

Accounting statements and Whole of Government Accounts

I will carry out the audit of the accounting statements in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board (APB). I am required to issue an audit report giving my opinion on whether the accounts give a true and fair view.

Materiality

I will apply the concept of materiality in planning and performing my audit, in evaluating the effect of any identified misstatements, and in forming my opinion.

Identifying audit risks

I need to understand the Council to identify any risk of material misstatement (whether due to fraud or error) in the accounting statements. I do this by:

- identifying the business risks facing the Council, including assessing your own risk management arrangements;
- considering the financial performance of the Council;
- 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 Council's information systems.

Identification of significant risks

Significant risks are defined in the auditing standards which govern my work. They are material risks that arise from changes in the accounting framework, operational changes at the authority or from changes in the overall economic conditions. I have considered the national and local context and identified additional risks that are relevant to the audit of the accounting statements. I have set these out below.

Table 1: **Significant risks**

Risk	Audit response
Financial spending pressures The level of savings public bodies are required to make is unprecedented. The Council needs to achieve savings of £23m in 2011/12 and 2012/13 with similar levels over the coming years. This along with other pressures arising from the economic downturn such as pressures on service provision and potential falling revenues puts pressure on the Council to achieve its financial plans. Whilst I have assessed the overall control environment as strong and the overall level of risk as low, the unprecedented level of savings increases the risk of financial misreporting in the accounting statements.	I will continue to assess and monitor the control environment including management's controls over the medium term financial plans and savings programmes. I will also focus on management controls over those areas of the accounting statements that are considered to present higher levels of risk for example: • Journals; • Accounting estimates • The allocation of expenditure between capital and revenue; and • Changes in accounting policy that may impact on the financial position. I will also consider the in-year financial performance of the Council against the year-end financial position to identify any unusual or unexpected transactions.
Transfer of social care provision to a community interest company The Council transferred its social care provider to a community interest company on 1 October 2011. At the same time the B&NES Primary Care Trust transferred it community health provider to the same company.	I will consider the controls operated by the Council during the year and undertake detailed tests on the cut off of transactions at 30 September 2011. I will test the full-year expenditure to ensure it is correctly classified as:

Risk	Audit response
Related expenditure in the Councils accounting statements will be reported as commissioned expenditure for the second half of the year. Supplier invoices and payroll costs will only be included on the Council's systems for the first half of the year. The Council undertook due diligence on the changes however, the system changes, the transfer of staff and the change in accounting part way through the year presents risks that expenditure may not be accounted for correctly..	■ direct costs for services provided by the Council until 30 September 2011; and ■ expenditure for commissioned services from 1 October 2011.
Heritage Assets The 2011/12 Accounts Code adopts the requirements of Financial Reporting Standard (FRS) 30, Heritage Assets. A heritage asset is a tangible asset with historical, artistic, scientific, technological, geophysical or environmental qualities that is held and maintained principally for its contribution to knowledge and culture. For B&NES this is likely to include your Roman Baths and a number of other assets in Bath. The valuation of heritage assets presents a number of challenges which will impact on the way they are reported in the accounts.	I will evaluate the management controls you have in place to recognise and value heritage assets. I will also undertake testing to check the Council has accounted for heritage assets in accordance with the requirements and the accounting statements are materially fairly stated.
Service organisation Cash collection and banking of monies from Council car parks and leisure sites was contracted to Bristol City Council in January 2011. Under this contract Bristol provide information for the Council's accounting systems. There is a risk that, Bristol City Council, the service organisation, does not provide the correct information for the Council's financial statements.	Review of contractual arrangements, including internal audit coverage, and management controls such as monthly review of financial performance. Review of management oversight of reconciliations between expected information from the service organisation and actuals, including exception reports. Tests of detail, including sample checking of items of account produced by the service organisation to source documentation.

Testing strategy

My audit involves:

- review and re-performance of work of your internal auditors;
- testing of the operation of controls;
- reliance on the work of experts; and
- substantive tests of detail of transactions and amounts.

I have sought to:

- maximise reliance, subject to review and re-performance, on the work of your internal auditors; and
- maximise the work that can be undertaken before you prepare your accounting statements.

The nature and timing of my proposed work is as follows.

Table 2: **Proposed work**

	Review of internal audit	Controls testing	Reliance on the work of other auditors	Reliance on work of experts	Substantive testing
Interim visit	Cash collection Accounts payable and accounts receivable and payroll	General Ledger	Assurances from KPMG on controls operated over payroll for schools which use the Wiltshire system. Assurances from Grant Thornton over controls operated in the cash collection team of Bristol City Council.		Testing of transactions covering the first nine months of the year.
Final visit			Pensions assets and liabilities – my work as the auditor to Avon Pension Fund	Pensions liabilities and assets – Mercer's and our own consulting actuary Valuation of property, plant and	All material accounts balances and amounts Year-end feeder system

	Review of internal audit	Controls testing	Reliance on the work of other auditors	Reliance on work of experts	Substantive testing
				equipment – in-house Valuers and our own national advice from Gerald Eve	reconciliations

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

Whole of Government Accounts

Alongside my work on the accounting statements, I will also review and report to the National Audit Office on your Whole of Government Accounts return. The extent of my review and the nature of my report are specified by the National Audit Office.

Value for money

I am required to reach a conclusion on the Council's arrangements to secure economy, efficiency and effectiveness.

My conclusion on the Council's arrangements is based on two criteria, specified by the Commission. These relate to the Council's 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 is prioritising its resources within tighter budgets and improving productivity and efficiency.

Identification of significant risks

I have considered the risks that are relevant to my value for money conclusion. I have identified the following significant risks that I will address through my work.

Table 3: **Significant risks**

Risk	Audit response	Reporting
Arrangements to support delivery of the change programme and savings plans The Council faces considerable financial and organisational challenges, including the transfer of schools to foundation status, the on-going rationalisation of offices, and severe financial	I will continue to monitor the arrangements for managing this programme, including the governance of the programme, the methodologies used to support specific reviews and the input of resources to maximise the outcomes. I will monitor the delivery of the Council's savings plans, and consider the level of recurrent vs non-recurrent savings being	To be reported with the annual governance report

Risk	Audit response	Reporting
pressures. In response the Council has an ambitious change programme that aims to achieve efficiencies and to release cost savings.	delivered and the impact this has on the financial resilience of the Council.	
Commissioning arrangements for social care Following the transfer of social care to a community interest company, the Council will need to develop its commissioning arrangements to ensure the on-going delivery and development of services under the new contract arrangements.	I will review the Council's arrangements for monitoring performance under the contract.	To be reported with the annual governance report

Key milestones and deadlines

The Council is required to prepare the accounting statements by 30th June 2012. I aim to complete my work and issue my opinion and value for money conclusion by 30 September 2012.

Table 4: **Proposed timetable and planned outputs**

Activity	Date	Output
Opinion: controls and early substantive testing	March 2012	Interim memorandum of matters arising if material issues identified
Opinion: receipt of accounts and supporting working papers	June 2012	
Opinion: substantive testing	August 2012	
Present Annual Governance Report at the Corporate Audit Committee	September 2012	Annual Governance Report
Issue opinion and value for money conclusion	By 30 September 2012	Auditor's report
Summarise overall messages from the audit	October 2012	Annual Audit Letter

The audit team

The key members of the audit team for the 2011/12 audit are as follows.

Table 5: **Audit team**

Name	Contact details	Responsibilities
Wayne Rickard District Auditor	w-rickard@audit-commission.gov.uk 0844 798 1208 0788 1832360	Responsible for the overall delivery of the audit including quality of reports, signing the auditor's report and liaison with the Chief Executive.
Chris Hackett Audit Manager	c-hackett@audit-commission.gov.uk 0844 798 8760 07760 1173187	Manages and coordinates the different elements of the audit work. Key point of contact for the Director of Financial Services.
Emma Wainwright Principal Auditor	e-wainwright@audit-commission.gov.uk 0844 798 8784 07875 677232	Responsible for delivery of details aspects of the audit.

Independence and quality

Independence

I comply with the ethical standards issued by the APB and with the Commission's additional requirements for independence and objectivity as summarised in appendix 1.

I am not aware of any relationships that may affect the independence and objectivity of the Audit Commission, the audit team or me, that I am required by auditing and ethical standards to report to you.

Quality of service

I aim to provide you with a fully satisfactory audit service. If, however, you are unable to deal with any difficulty through me and my team please contact Chris Westwood, Director – Standards & Technical, Audit Practice, Audit Commission, 1st Floor, Millbank Tower, Millbank, London SW1P 4HQ (c-westwood@audit-commission.gov.uk) who will look into any complaint promptly and to do what he can to resolve the position.

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).

Fees

The fee for the audit is £273,398. This was discussed at the meeting of the Corporate Audit Committee held in February 2011. The fee was confirmed in my letter of 5 April 2011.

The audit fee

The Audit Commission has set a scale audit fee of £273,398 which represents a ten per cent reduction on the planned audit fee for 2010/11 which was £303,776.

The scale fee covers:

- my audit of your accounting statements and reporting on the Whole of Government Accounts return; and
- my work on reviewing your arrangements for securing economy, efficiency and effectiveness in your use of resources.

The scale fee reflects:

- the Audit Commission's decision not to increase fees in line with inflation;
- a reduction resulting from the new approach to local VFM audit work; and
- a reduction following the one-off work associated with the first-time adoption of International Financing Reporting Standards (IFRS).

Variations from the scale fee only occur where my assessments of audit risk and complexity are significantly different from those reflected in the 2010/11 fee. I have not identified significant differences and have therefore set the fee equal to the scale fee.

Assumptions

In setting the fee, I have made the assumptions set out in appendix 2. Where these assumptions are not met, I may be required to undertake more work and therefore increase the audit fee. Where this is the case, I will discuss this first with the Director of Financial Services and I will issue a supplement to the plan to record any revisions to the risk and the impact on the fee.

Total fees payable

In addition to the fee for the audit, the Audit Commission will charges fees for:

- certification of claims and returns; and
- the agreed provision of non-audit services under the Audit Commission's advice and assistance powers.

Based on current plans the fees payable are as follows.

Table 6: **Fees**

	2011/12 proposed	2010/11 actual	Variance
Audit	273,398	303,776	10 per cent
Rebates to audit fee agreed nationally by the audit commission	21,872	26,863	19 per cent
Total net fee	**251,526**	**276,913**	**9 per cent**

* Work on the certification of claims for 2010/11 was on-going until December 2011. The final fee will be reported in February 2012. No additional non audit work was undertaken in 201/11 and none is currently planned for 2011/12.

Appendix 1 – Independence and objectivity

Auditors appointed by the Audit Commission must comply with the Commission's Code of Audit Practice and Standing Guidance for Auditors. When auditing the accounting statements, auditors must also comply with professional standards issued by the Auditing Practices Board (APB). These impose stringent rules to ensure the independence and objectivity of auditors. The Audit Practice puts in place robust arrangements to ensure compliance with these requirements, overseen by the Audit Practice's Director – Standards and Technical, who serves as the Audit Practice's Ethics Partner.

Table 7: **Independence and objectivity**

Area	Requirement	How we comply
Business, employment and personal relationships	Appointed auditors and their staff should avoid 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 appointed auditor and senior members of the audit team must not take part in political activity for 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.	All audit staff are required to declare all potential threats to independence. Details of declarations are made available to appointed auditors. Where appropriate, staff are excluded from engagements or safeguards put in place to reduce the threat to independence to an acceptably low level.

Area	Requirement	How we comply
Long association with audit clients	The appointed auditor responsible for the audit should, in all but the most exceptional circumstances, be changed at least once every seven years, with additional consideration of threats to independence after five years.	The Audit Practice maintains and monitors a central database of assignment of auditors and senior audit staff to ensure this requirement is met.
Gifts and hospitality	The appointed auditor and members of the audit team must abide by the Commission's policy on gifts, hospitality and entertainment.	All audit staff are required to declare any gifts or hospitality irrespective of whether or not they are accepted. Gifts and Hospitality may only be accepted with line manager approval.
Non-audit work	Appointed auditors should not perform additional work for an audited body (that is work above the minimum required to meet their statutory responsibilities) if it would compromise their independence or might result in a reasonable perception that their independence could be compromised. 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. Work over a specified value must only be undertaken with the prior approval of the Audit Commission's Director of Audit Policy and Regulation.	All proposed additional work is subject to review and approval by the appointed auditor and the Director – Standards and Technical, to ensure that independence is not compromised.

Code of Audit Practice, Audit Commission Standing Guidance and APB Ethical Standards

Appendix 2 – Basis for fee

In setting the fee, I have assumed the following.

- The risk in relation to the audit of the accounting statements is not significantly different to that identified for 2010/11. For example internal controls are operating effectively.
- The risk in relation to my value for money responsibilities is not significantly different to that identified for 2010/11.
- Internal Audit meets professional standards.
- Internal Audit undertakes sufficient appropriate work on all systems that provide material figures in the accounting on which I can rely.
- The Council provides:
  - good quality working papers and records to support the accounting statements and the text of the other information to be published with the statements by June 2012;
  - other information requested within agreed timescales;
  - prompt responses to draft reports; and
- there are no questions asked or objections made by local government electors.

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

Appendix 3 – Glossary

Accounting statements

The annual statement of accounts that the Council is required to prepare, which report the financial performance and financial position of the Authority in accordance with the Accounts and Audit (England) Regulations 2011 and the Code of Practice on Local Authority Accounting in the United Kingdom.

Annual Audit Letter

Report issued by the auditor to the Council after the completion of the audit that summarises the audit work carried out in the period and significant issues arising from auditors' work.

Annual Governance Report

The auditor's report on matters arising from the audit of the accounting statements presented to those charged with governance before the auditor issues their opinion and conclusion.

Annual Governance Statement

The annual report on the Council's system of internal control, it supports the achievement of the Council's policies, aims and objectives.

Audit of the accounts

The audit of the accounts of an audited body comprises all work carried out by an auditor under 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.

Auditing Practices Board (APB)

The body responsible in the UK for issuing auditing standards, ethical standards and associated 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 that contain basic principles and essential procedures with which auditors must 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 for local government bodies issued by the Audit Commission and approved by Parliament.

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 relating to independence, integrity and objectivity that apply to the conduct of audits and with which auditors must comply, except where otherwise stated in the standard concerned.

Internal control

This is the whole system of controls, financial and otherwise, that the Council establishes. The aim is to provide reasonable assurance of effective and efficient operations, internal financial control and compliance with laws and regulations.

Materiality

The APB defines this concept as ‘an expression of the relative significance or importance of a particular matter in the context of the accounting 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 accounting 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 to the accounting statements. Auditors appointed by the Commission have responsibilities and duties under statute, as well as their responsibility to give an opinion on the accounting statements, which do not necessarily affect their opinion on the accounting statements.

Significance

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 of the accounting statements. Significance has both qualitative and quantitative aspects.

Those charged with governance

Those entrusted with the supervision, control and direction of the Council. This term includes the members of the Council and its Corporate Audit Committee.

Whole of Government Accounts

A project leading to a set of consolidated accounts for the entire UK public sector on commercial accounting principles. The Council must submit a consolidation pack to the department for Communities and Local Government which is based on, but separate from, its accounting statements.

If you require a copy of this document in an alternative format or in a language other than English, please call:
0844 798 7070

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to non-executive directors, members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any director/member or officer in their individual capacity; or
- any third party.

www.audit-commission.gov.uk

January 2012

This page is intentionally left blank

Audit plan

Avon pension fund

Audit 2011/12

audit commission

Contents

Introduction

This plan sets out the work for the 2011/12 audit. The plan is based on the Audit Commission's risk-based approach to audit planning.

Responsibilities

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 you.

The Statement summarises where the different responsibilities of auditors and of the audited body begin and end and I undertake my audit work to meet these responsibilities.

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

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

My audit of the accounting statements does not relieve management or the Corporate Audit Committee, as those charged with governance, of their responsibilities.

Accounting statements and Pension Fund Annual Report

I will carry out the audit of the accounting statements included within the Authority's Statement of Accounts in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board (APB). I also report on the accounting statements included in the Pension Fund Annual Report. I am required to issue audit reports giving my opinion on whether the accounting statements give a true and fair.

Materiality

I will apply the concept of materiality in planning and performing my audit, in evaluating the effect of any identified misstatements, and in forming my opinion.

Identifying audit risks

I need to understand the Pension Fund to identify any risk of material misstatement (whether due to fraud or error) in the accounting statements. I do this by:

- identifying the business risks facing the Fund, including assessing your own risk management arrangements;
- considering the financial performance of the 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 Fund's information systems.

Identification of significant risks

I have considered the additional risks that are relevant to the audit of the accounting statements. I have identified one which I set out below.

Table 1: **Significant risks**

Risk	Audit response
Pooled investment vehicles Avon pension fund has some £1.8bn billion of units in pooled investment securities. A large portion of these investments is in unquoted securities. There is an inherent risk to the valuation of these investments 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 reports from the auditors of the fund managers responsible for these pooled investment vehicles. These reports confirm the effectiveness of internal control arrangements at fund mangers. 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. I will review how management has ensured the valuations for the unquoted investments were prepared in a suitable way. I will review the valuations in relation to accounting standards (IAS 39).

Testing strategy

My audit involves:

- review and re-performance of work of your internal auditors;
- testing of the operation of controls;
- reliance on the work of other auditors;
- reliance on the work of experts; and
- substantive tests of detail of transactions and amounts.

I have sought to:

- maximise reliance, subject to review and re-performance, on the work of your internal auditors; and
- maximise the work that can be undertaken before you prepare your accounting statements.

The nature and timing of my proposed work is as follows.

Table 2: **Testing**

	Review of internal audit	Reliance on the work of other auditors	Reliance on work of experts	Controls testing	Substantive testing
Interim visit	Pensions payroll	Reliance on auditors to admitted bodies over controls on pension contributions		General Ledger	Completeness and accuracy of information on pensions liabilities provided to the actuary.
Final visit		SAS70 reports/AAF01 - fund managers and custodians	Pensions liabilities – Mercers and my consulting actuary PWC.		All material accounts balances and amounts Year-end feeder system reconciliations Investments

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

Pension Fund Annual Report

I will also review and report on the accounting statements included in the Pension Fund's Annual Report prepared under Regulation 34 of the Local Government Pension Scheme (Administration) Regulations 2008.

Key milestones and deadlines

The Pension Fund is required to prepare the accounting statements by 30 June 2012. I aim to complete my work and issue my opinions on the accounting statements included in the Statement of Accounts and the Pension Fund Annual Report by 30 September 2012.

Table 3: **Proposed timetable and planned outputs**

Activity	Date	Output
Opinion: controls and early substantive testing	March 2012	Interim memorandum if required
Opinion: receipt of accounts and supporting working papers	June 2012	
Opinion: substantive testing	August 2012	
Present Annual Governance Report at the Corporate Audit Committee	25 September 2012	Annual Governance Report
Issue opinion on accounting statements included in the Statement of Accounts	By 30 September 2012	Auditor's report
Issue opinion on accounting statements included in the Pension Fund Annual Report	By 30 September 2012	Auditor's report
Summarise overall messages from the audit	October 2012	Annual Audit Letter to B&NES Council

The audit team

The key members of the audit team for the 2011/12 audit are as follows.

Table 4: **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 quality of reports, signing the opinion and liaison with the 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 Financial Services.

Independence and quality

Independence

I comply with the ethical standards issued by the APB and with the Commission's additional requirements for independence and objectivity as summarised in appendix 1.

I am not aware of any relationships that may affect the independence and objectivity of the Audit Commission, the audit team or me, that I am required by auditing and ethical standards to report to you.

Quality of service

I aim to provide you with a fully satisfactory audit service. If, however, you are unable to deal with any difficulty through me and my team please contact Chris Westwood, Director – Standards & Technical, Audit Practice, Audit Commission, 1st Floor, Millbank Tower, Millbank, London SW1P 4HQ (c-westwood@audit-commission.gov.uk) who will look into any complaint promptly and do what he can to resolve the position.

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).

Fees

The fee for the audit is £46,622, as set out in my letter of 5th April 2011.

The audit fee

The Audit Commission has set a scale audit fee of £46,622. The audit fee for 2010/11 was £47,000. The scale fee reflects the Audit Commission's decision not to increase fees in line with inflation.

Variations from the scale fee only occur where my assessments of audit risk and complexity are significantly different from those reflected in the 2010/11 fee. I have not identified significant differences and have therefore set the fee equal to the scale fee.

The Audit Commission can provide discretionary non-audit services under the Audit Commission's advice and assistance powers. No work is planned presently.

Assumptions

In setting the fee, I have made the assumptions set out in appendix 2. Where these assumptions are not met, I may be required to undertake more work and therefore increase the audit fee. Where this is the case, I will discuss this first with the Director of Financial Services and I will issue a supplement to the plan to record any revisions to the risk and the impact on the fee.

Appendix 1 – Independence and objectivity

Auditors appointed by the Audit Commission must comply with the Commission's Code of Audit Practice and Standing Guidance for Auditors. When auditing the accounting statements, auditors must also comply with professional standards issued by the Auditing Practices Board (APB). These impose stringent rules to ensure the independence and objectivity of auditors. The Audit Practice puts in place robust arrangements to ensure compliance with these requirements, overseen by the Audit Practice's Director – Standards and Technical, who serves as the Audit Practice's Ethics Partner.

Table 5: **Independence and objectivity**

Area	Requirement	How we comply
Business, employment and personal relationships	Appointed auditors and their staff should avoid 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 appointed auditor and senior members of the audit team must not take part in political activity for 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.	All audit staff are required to declare all potential threats to independence. Details of declarations are made available to appointed auditors. Where appropriate, staff are excluded from engagements or safeguards put in place to reduce the threat to independence to an acceptably low level.

Area	Requirement	How we comply
Long association with audit clients	The appointed auditor responsible for the audit should, in all but the most exceptional circumstances, be changed at least once every seven years, with additional consideration of threats to independence after five years.	The Audit Practice maintains and monitors a central database of assignment of auditors and senior audit staff to ensure this requirement is met.
Gifts and hospitality	The appointed auditor and members of the audit team must abide by the Commission's policy on gifts, hospitality and entertainment.	All audit staff are required to declare any gifts or hospitality irrespective of whether or not they are accepted. Gifts and Hospitality may only be accepted with line manager approval.
Non-audit work	Appointed auditors should not perform additional work for an audited body (that is work above the minimum required to meet their statutory responsibilities) if it would compromise their independence or might result in a reasonable perception that their independence could be compromised. 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. Work over a specified value must only be undertaken with the prior approval of the Audit Commission's Director of Audit Policy and Regulation.	All proposed additional work is subject to review and approval by the appointed auditor and the Director – Standards and Technical, to ensure that independence is not compromised.

Code of Audit Practice, Audit Commission Standing Guidance and APB Ethical Standards

Appendix 2 – Basis for fee

Assumptions

In setting the fee, I have assumed the following.

- The risk in relation to the audit of the accounting statements is not significantly different to that identified for 2010/11. For example:
  - internal controls are operating effectively;
  - I secure the co-operation of other auditors;
- Internal Audit meets professional standards.
- Internal Audit undertakes sufficient appropriate work on systems that provide material figures in the accounts on which I can rely.
- The Authority provides:
  - good quality working papers and records to support the accounting statements and the text of the other information to be published with the statements by 30 June 2012;
  - the full text of the Pension Fund Annual Report by early September 2012;
  - other information requested within agreed timescales; and
  - prompt responses to draft reports.

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

Appendix 3 – Glossary

Accounting statements

The Pension Fund accounts included within the annual statement of accounts that the Authority is required to prepare, which report the financial performance and financial position of the Fund in accordance with the Accounts and Audit (England) Regulations 2011 and the Code of Practice on Local Authority Accounting in the United Kingdom.

AAF01 reports

These are industry standard reports on the effectiveness of internal control arrangements at fund mangers. They are normally issued by the auditors to the fund managers. (Auditors also sometimes issue standard letters on internal controls referred to as SAS70 letters.)

Annual Governance Statement

The annual report on the Fund's systems of internal control that supports the achievement of the Fund's policies aims and objectives.

Annual Governance Report

The auditor's report on matters arising from the audit of the accounting statements presented to the Corporate Audit Committee before the auditor issues their opinion.

Audit of the accounts

The audit of the accounts of an audited body comprises all work carried out by an auditor under 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.

Auditing Practices Board (APB)

The body responsible in the UK for issuing auditing standards, ethical standards and associated 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 that contain basic principles and essential procedures with which auditors must 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 issued by the Audit Commission and approved by Parliament.

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 relating to independence, integrity and objectivity that apply to the conduct of audits and with which auditors must comply, except where otherwise stated in the standard concerned.

Internal control

The whole system of controls, financial and otherwise, that the Pension Fund establishes to provide reasonable assurance of effective and efficient operations, internal financial control and compliance with laws and regulations.

Materiality

The APB defines this concept as ‘an expression of the relative significance or importance of a particular matter in the context of the accounting 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 accounting 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 to the accounting statements. Auditors appointed by the Commission have responsibilities and duties under statute, (as well as their responsibility to give an opinion on the accounting statements), which do not necessarily affect their opinion on the accounting statements.

Pension Fund Annual Report

The annual report, including accounting statements, that the Pension Fund must publish under Regulation 34 of the Local Government Pension Scheme (Administration) Regulations 2008.

Those charged with governance

Those entrusted with the supervision, control and direction of the Pension Fund. This term includes the members of the Authority, the Corporate Audit Committee and the Pension Fund Committee.

If you require a copy of this document in an alternative format or in a language other than English, please call:
0844 798 7070

The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to non-executive directors, members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any director/member or officer in their individual capacity; or
- any third party.

www.audit-commission.gov.uk

December 2011

Certification of claims and returns - annual report

Bath & North East Somerset Council

Audit 2010/11

Contents

Introduction

Local authorities claim large sums of public money in grants and subsidies from central government and other grant-paying bodies and are required to complete returns providing financial information to government departments. My certification work provides assurance to grant-paying bodies that claims for grants and subsidies are made properly or that information in financial returns is reliable. This report summarises the outcomes of my certification work on your 2010/11 claims and returns.

Under section 28 of the Audit Commission Act 1998, the Audit Commission may, at the request of authorities, make arrangements for certifying claims and returns because scheme terms and conditions include a certification requirement. Where such arrangements are made, certification instructions issued by the Audit Commission to its auditors set out the work auditors must do before they give their certificate. The work required varies according to the value of the claim or return and the requirements of the government department or grant-paying body, but in broad terms:

- for claims and returns below £125,000 the Commission does not make certification arrangements and I was not required to undertake work;
- for claims and returns between £125,000 and £500,000, I undertook limited tests to agree form entries to underlying records, but did not undertake any testing of eligibility of expenditure; and
- for claims and returns over £500,000 I planned and performed my work in accordance with the certification instruction. I assessed the control environment for preparing the claim or return to decide whether to place reliance on it. Depending on the outcome of that assessment, I undertook testing as appropriate to agree form entries to underlying records and test the eligibility of expenditure or data.

Claims and returns may be amended where I agree with your officers that this is necessary. My certificate may also refer to a qualification letter where there is disagreement or uncertainty, or you have not complied with scheme terms and conditions.

Summary of my 2010/11 certification work

The Council has performed well in preparing claims and returns.

My work gave rise to minor amendment of three of the five claims and returns submitted for the year ended 31 March 2011. For two claims and returns I issued a qualification letter accompanying my certificate. The qualification letters were for relatively minor issues.

Table 1: **Summary of 2010/11 certification work**

Number of claims and returns certified	
Total value of claims and returns certified	£128,032,895
Number of claims and returns amended due to errors	3
Number of claims and returns where I issued a qualification letter because there was disagreement or uncertainty over the content of the claim or return or scheme terms and conditions had not been complied with	2
Total cost of certification work	£37,824

Results of 2010/11 certification work

This section summarises the results of my 2010/11 certification work and highlights the significant issues arising from that work.

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 working papers. They respond to requests for information in a timely and positive manner. These good arrangements ensured the net impact of the audit amendments were low in value.

Table 2: **Claims and returns above £500,000**

Claim or return	Value of claim or return presented for certification (£’000)	Was reliance placed on the control environment?	Value of any amendments made (£’000)	Was a qualification letter issued?
Housing and council tax benefit scheme	57,615	Limited Assurance	2	Yes (see below)
National non-domestic rates return	52,913	Limited Assurance	0	No
Teachers’ pensions return	10,771	No	0 (amendment made but no impact on value claimed)	Yes (see below)

Claim or return	Value of claim or return presented for certification (£'000)	Was reliance placed on the control environment?	Value of any amendments made (£'000)	Was a qualification letter issued?
Sure start, early years and childcare grant and aiming high for disabled children grant	6,312	Yes	6	No

Housing and Council Tax Benefit Subsidy Claim

I assessed the control environment as effective. The grant paying department, however, still requires that I undertake detailed testing of this claim because of its complexity and value.

My testing of samples of benefits transactions identified several cases where benefits assessors had recorded information from the supporting evidence on to the Benefits system incorrectly. I tested more transactions to enable us to quantify extrapolated errors on the claim.

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

I raised a qualification letter, which reported some relatively minor uncertainties arising from incorrect calculation of rent allowance and council tax benefits.

Teachers Pensions (TP) Return

I was not able to place reliance on the control environment around the return. This was because of errors noted on the previous year's returns. I therefore undertook full audit testing in line with the requirements of the relevant certification instruction.

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.

The draft claim was sent to TP and to audit by the deadline of 30 June 2011. I recognise significant improvements in preparing the claim, but as in previous years there remains no evidence of review by the 'client side, Human Resources, before presenting the claim to the Chief Financial Officer.

In 2009/10 I agreed the Council's management would liaise with their Internal Audit team to ensure that they undertook a suitable programme of testing for 2010/11 to gain assurance over the completeness and accuracy of individual deductions, in respect of schools that have outsourced their payroll from the Authority.

Internal audit identified additional contributions being made using incorrect rates of deduction since 2006 and possibly longer. These were for small amounts. I reported the matter in a qualification letter as I was unable to quantify the error within the audit timescale.

Claims between £125,000 and £500,000

Claim or return	Value of claim or return presented for certification (£'000)	Value of any amendments made	Qualification letter
Disabled facilities	422	0	No

Summary of progress on previous recommendations

This section considers the progress made in implementing recommendations I have previously made arising from certification work.

In 2009/10 I raised two recommendations. The Council has made good progress in implementing these recommendations.

Table 3: **Summary of progress made on recommendations arising from certification work undertaken in earlier years**

Agreed action	Priority	Date for implementation	Responsible officer	Current status	Comments
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.	M	2010/11 Claims	Tony Bartlett	Implemented	All 2010/11 claims submitted in accordance with deadlines.
Finance officers should monitor to ensure Mouchel and Human Resources take adequate action to address the issues set out in our action plan in relation to the Teachers Pensions Return.	M	January 2011	Tony Bartlett	Partially Implemented	Recognise significant improvements in preparing the 2010/11 return. Scope to improve further, specifically on the 'client' side.

Summary of recommendations

This section highlights the recommendations arising from my certification work and the actions agreed for implementation.

Table 4: **Summary of recommendations arising from 2010/11 certification work**

Recommendation	Priority	Agreed action	Date for implementation	Responsible officer
Continue to take action to address the issues raised in the 2009/10 action plan in relation to the Teachers Pensions Return.	M		Ongoing	William Harding

Summary of certification fees

This section summarises the fees arising from my 2010/11 certification work.

Table 5: **Summary of certification fees**

Claim or return	2010/11 fee	2009/10 fee	Comment
Housing and council tax benefit scheme	26,854	40,231	Decrease in fee reflects the grade mix used in carrying out the work and joint working with the Authority.
National non-domestic rates return	5,012	3,973	
Teachers' pensions return	4,648	4,416	
Sure start, early years and childcare grant and aiming high for disabled children grant	686	1,870	Reduction in fee reflects reliance placed on control environment in 2010/11 resulting in less work being carried out in accordance with certification instructions.
Disabled facilities	624	603	
Total	37,824	51,093	

The Statement of responsibilities of grant-paying bodies, authorities, the Audit Commission and appointed auditors in relation to claims and returns issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body.

audit commission

www.audit-commission.gov.uk

January 2012

This page is intentionally left blank

Corporate Audit Committee Update

Bath and North East Somerset Council

Audit 2011/12

The Audit Commission is a public corporation set up in 1983 to protect the public purse.

The Commission appoints auditors to councils, NHS bodies (excluding NHS Foundation trusts), police authorities and other local public services in England, and oversees their work. The auditors we appoint are either Audit Commission employees (our in-house Audit Practice) or one of the private audit firms. Our Audit Practice also audits NHS foundation trusts under separate arrangements.

We also help public bodies manage the financial challenges they face by providing authoritative, unbiased, evidence-based analysis and advice.

Introduction

1 The purpose of this paper is to provide the Corporate Audit Committee with a report on progress in delivering our responsibilities as your external auditors.

2 This paper also seeks to highlight key emerging national issues and developments which may be of interest to members of the Corporate Audit Committee. The paper concludes by asking a number of questions which the Committee may wish to consider when assessing whether it has received sufficient assurance on emerging issues.

3 If you require any additional information regarding the issues included within this briefing, please feel free to contact me or your Audit Manager using the contact details at the end of this update.

4 Finally, please also remember to visit our website (www.audit-commission.gov.uk) which now enables you to sign-up to be notified of any new content that is relevant to your type of organisation.

Wayne Rickard

District Auditor

January 2012

5 The following table sets out a commentary against the key audit milestones for your audit in the coming year.

Area of work	Date report is due	Comments
2011/12 audit		
Audit fees letters	April 2011	Discussed with the Corporate Audit Committee and agreed with the Director of Financial Services.
Audit plan	January 2012	Presented to the February meeting of the Corporate Audit Committee. Two plans are presented, one for the audit of the Council and one for the audit of Avon Pension Fund.
Interim Audit	April 2012	Interim Memorandum to be issued as required. Our interim audit of financial systems and arrangements is underway.
VFM conclusion	September 2012	Main findings will be reported in the Annual governance report.
Annual governance report	September 2012	There will be two annual governance reports, one for the Council and one covering the Avon Pension Fund.
Auditor's report giving the opinion on the financial statements and the value for money conclusion	September 2012	There will be a separate auditor's report giving the opinion on the Pension Fund accounts and a report giving the opinion on the Council's accounts.
Annual audit letter	October 2012	Overall summary of the audit.

Other Matters of Interest

2011/12 Final Accounts Workshops

6 We invited your finance staff to a workshop that will help them to prepare your financial statements for 2011/12.

7 The closest events were at Westward House in Bristol on 24 January and 22 February 2012. Members of your accounts team attended these events.

Dealing with the economic downturn

8 On 17 November 2011 the Audit Commission published 'Tough Times - Councils' responses to a challenging financial climate'.

9 The report draws heavily on the expertise of the external auditors of each council and also includes new analysis of councils' budget data.

10 The key findings in the report are:

- Most councils are managing well in the face of unprecedented reductions to their income, but services have been affected and a small number of councils may struggle to balance their books;
- Although councils face a real terms loss of total income of £4.7 billion (7.5 per cent) in 2011/12, auditors felt nine out of ten councils are well prepared for this and are on track to deliver their budgets;
- To meet the future challenge of cuts in government funding, some elements of councils' cost-reducing strategies will have to change and many councils will face difficult decisions about how to meet their funding shortfall in the next few years; and
- Councils are not planning to make significant withdrawals from their reserves this year - some even plan to increase them.

11 The report recommends that councils use the Audit Commission's Value for Money profiles to see how their council compares to the national picture set out in this report, identify councils facing similar challenges, and learn from others' approaches.

Procurement Fraud in the Public Sector

12 The National Fraud Agency has recently issued a report on public sector procurement fraud which examines new approaches to reduce fraud risk and make processes both quicker and simpler.

13 The report acknowledges that procurement fraud is a complex problem. It covers a wide range of illegal activities from bid rigging during the pre-contract award phase through to false invoicing in the post-contract award phase. It can be perpetrated by those inside and outside an organisation.

14 The report includes a number of case studies and details a number of actions that can be taken both immediately and in the medium term.

Protecting the Public Purse 2011

15 In November 2011 the Audit Commission published 'Protecting the Public Purse 2011 - Fighting Fraud against Local Government.'

16 This report is based on the Audit Commission's annual fraud survey - which is still the sole source of evidence about the levels of detected fraud in Local Government and related bodies.

17 The report reveals that England's councils have succeeded in detecting £185 million worth of fraud, an improvement of 37 per cent on last year's figure of £135 million. This is equivalent to a year's funding for around 700 libraries or the wages of up to 11,000 care workers.

18 The key areas where fraud was detected are:

- housing benefits and council tax benefits fraud, which accounted for more than half of the total fraud losses detected by councils;
- false claims for student and single person council tax discounts - £22million; and
- procurement fraud, with 145 cases amounting to £14.6 million.

19 We have therefore developed a single person discount comparator tool that allows local authorities to compare their levels of council tax single person discount with their predicted levels, based on a national average and this can be found on our website.

20 The report found that counter-fraud professionals increasingly recognise abuse of personal budgets in adult social care as a fraud risk for councils and, in addition to the above, the National Fraud Authority estimates that housing tenancy fraud could cost up to £900 million each year.

21 The report concludes with a checklist that organisations may find helpful to self-assess against. Covering a wide range of issues from procurement to recruitment, it will help provide Audit Committees with assurance over the arrangements in place.

22 In addition to the core report, there are separate briefings to specifically aid governors in schools and councillors in parish and town councils.

For information: Police Reform and Social Responsibility Act 2011

23 The Police Reform and Social Responsibility Act received Royal Assent on 15 September 2011.

24 This Act will abolish police authorities in England and Wales and replace them with directly elected police and crime commissioners.

25 The Act requires the police and crime commissioner for a policing area to hold the chief constable to account, while also safeguarding the chief constable's operational independence. A police and crime panel, established by the local authorities in a police area, will provide independent scrutiny of the police and crime commissioner.

26 The first elections of police and crime commissioners will take place on 15 November 2012 and police authorities will be abolished within a week of these elections. All staff and assets will transfer in the first instance to the office of the police and crime commissioner.

Localism Act 2011

27 On 15 November 2011 the Localism Bill received Royal Assent.

28 The Department for Communities and Local Government (DCLG) has published an updated plain English guide to the Localism Act to reflect the final legislation and this may be of interest to members of the Corporate Audit Committee.

29 Subject to commencement, key measures of the Act include:

- introducing a new general power of competence, giving councils freedom to work together to improve services and drive down costs. Councils are now free to do anything - provided they do not break other laws;
- giving communities the right to approve or veto - by way of a referendum - Council Tax increases higher than a limit determined by the Government.
- opening the door for the transfer of power to major cities to develop their areas, improve local services, and boost their local economies;
- abolishing the Standards Board;
- clarifying the rules on predetermination in order to free up councillors to express their opinions on issues of local importance without the fear of legal challenge;
- enabling councils to return to the committee system of governance, if they wish, regardless of their size;
- giving councils greater control over business rates. Councils will have the power to offer business rate discounts, which could help attract firms, investment and jobs; and
- promoting openness regarding the pay of senior officers.

30 Many of the measures in the Localism Act are expected to be in place by April 2012.

Openness and Accountability in Local Pay

31 The Localism Act referred to earlier requires local authority pay policies to be openly approved by democratically elected councillors.

32 On 17 November 2011 the Department for Communities and Local Government published guidance which sets out the requirements for councils to publish their remuneration arrangements and approve larger salary packages in an open session of the full council.

33 Pay policy statements must be in place by 31 March 2012 and Ministers explicitly say in the guidance that the pay vote ceiling should be set at £100,000.

34 There will be a requirement to publicly justify any big bonuses, above inflation annual pay rises, or hiring a person already in receipt of retirement or severance money and organisations should state in their pay policy statement whether or not they permit such practices.

DCLG publishes consultation response

35 DCLG published the government's response to the 'Future of Local Audit' consultation on 4 January 2012. This outlines the new arrangements for the audit of local public bodies once the Commission is abolished. The Commission has welcomed the government's response but believes there is still further work to do in a number of areas. These have been highlighted in a statement the Audit Commission has published on its website.

36 DCLG's way forward with the new framework is to:

- hold further discussions with local authorities, other local public bodies and the audit sector to flesh out the underlying detail of the framework, and how it might be implemented; and
- publish a draft Bill for pre-legislative scrutiny in Spring 2012, which allows for examination and amendments to be made before formal introduction to Parliament; and in advance of introduction of an Audit Bill as soon as Parliamentary time allows.

Key Considerations

37 The Corporate Audit Committee may wish to consider the following questions in respect of the issues highlighted in this briefing paper.

- Has the Council considered the Tough Times report and made appropriate use of the Audit Commission's VFM profiles?
- Has the Council used the single person discount comparator tool to compare its levels of council tax single person discount with the predicted level?
- Has the Council* completed the fraud prevention checklist and, where appropriate, developed an action plan to address any weaknesses?
- Has the Council circulated the fraud briefing to all school governors?
- Has the Council circulated the DCLG's plain English guide to the Localism Act to all members?
- Has the Council reviewed DCLG's Government response to the future of local audit consultation ?

Contact Details

38 If you would like further information on any items in this briefing, please feel free to contact either your District Auditor or Audit Manager.

39 Alternatively, all Audit Commission reports - and a wealth of other material - can be found on our website: www.audit-commission.gov.uk.

Wayne Rickard

District Auditor

0844 798 1208

07780

w-rickard@audit-commission.gov.uk

Chris Hackett

Audit Manager

0844 798 8760

07760 173187

c-hackett@audit-commission.gov.uk

This page is intentionally left blank

Communities and Local Government

Government response to the future of local audit consultation

This document/publication is also available on our website at www.communities.gov.uk

Any enquiries regarding this document/publication should be sent to us at:

Department for Communities and Local Government
Eland House
Bressenden Place
London
SW1E 5DU
Telephone: 030 3444 0000

January 2012

ISBN: 978-1-4098- 3282- 9

Contents

Executive Summary

1. Following the announcement of its decision to abolish the Audit Commission in August 2010, the Government consulted on its proposals for a new local public audit framework from 31 March to 30 June 2011. Those proposals were designed to deliver the Government's objective for a new local public audit framework that places responsibility firmly in the hands of local bodies, giving them the freedom to appoint their own auditors, with appropriate safeguards for auditor independence, from an open and competitive market for local public audit services. They were also designed with the fundamental principle of accountability in mind – providing a system of local public audit that allows local bodies to be held to account for the public money at their disposal, locally to residents and service users, and also as part of a framework of accountability that provides assurance to Parliament about the public money it votes to Government departments and which is in turn devolved to the local level.

2. This document (the Government response) sets out the key themes and views which were raised during the consultation and what the Government now proposes for the new arrangements for audit of principal public bodies. The response provides little detail on the audit arrangements for local health bodies. The Department of Health is working through the implications of Monitor's changing role and the proposed establishment of the Clinical Commissioning Groups, and will specify the detailed arrangements for audit of local health bodies, under the new framework, in due course.

Key elements of the new local public audit framework

3. The design principles of the new framework for local public audit are that it should be localist and transparent, achieve a reduction in the overall cost of audit, and uphold high standards of auditing, ensuring that there is effective and transparent regulation of public audit, and conformity to the principles of public audit. The key elements are:

Regulation

- There should be a consistent regulatory regime for audit, covering the private sector and the local public bodies (paragraph 24).
- The **National Audit Office** is best placed to produce the Code of Practice and supporting guidance for audit of local public bodies, subject to Parliamentary approval. The National Audit Office will be required to consult key partners in developing the Code (paragraph 26).
- The **Financial Reporting Council** will be the overall regulator, mirroring its role under the Companies Act 2006. The Financial Reporting Council

will be responsible for recognition and supervision of **Recognised Supervisory Bodies** (professional accountancy bodies responsible for supervising the work of auditors, and for putting rules and arrangements in place which their members must fulfil before they can be registered auditors) and for **Recognised Qualifying Bodies** (professional accountancy bodies responsible for awarding audit qualifications) (paragraphs 31-32).

AUDITOR REGISTRATION

- Mirroring the Companies Act 2006, Recognised Supervisory Bodies will:
  - have the roles of registration, monitoring and discipline for local public audit
  - put in place rules and practices covering eligibility of firms to undertake local public audit; and
  - keep a register of firms eligible to undertake local public audit (paragraphs 33-34).

MONITORING AND ENFORCEMENT

- As under the Companies Act 2006, Recognised Supervisory Bodies will monitor the quality of audits undertaken by their member firms, and investigate complaints, disciplinary cases and issues identified during the monitoring of firms on the register of local public auditors (paragraph 43).
- The Accountancy and Actuarial Disciplinary Board (part of the Financial Reporting council) investigates significant public interest disciplinary cases and can impose sanctions on those auditors found guilty of misconduct in both the companies and public sectors. We consider that the Accountancy and Actuarial Disciplinary Board should continue to have these powers for local public audit (paragraph 45).
- There will be additional oversight and monitoring of the audits of significant local public bodies (referred to as “Bodies of Significant Public Interest”) - the Financial Reporting Council (through its Audit Inspection Unit, or as appropriate through delegation to a Recognised Supervisory Body) will monitor the quality of the audits of these bodies, mirroring the arrangements for Public Interest Entities under the Companies Act (paragraph 47).

Commissioning local public audit services

AUDITOR APPOINTMENT

- Local public bodies will have a duty to appoint an auditor from the register of local public auditors, on the advice of an Independent Auditor Appointment Panel (paragraph 60).
- The Independent Audit Appointment Panel will have an independent chair and a majority of independent members (paragraph 60).

- We intend to frame requirements in a way that will allow local public bodies to share appointment panels (and therefore independent members) to ease admin burdens and reduce costs (paragraph 61).
- The Police and Crime Commissioner will make appointments for police bodies; (paragraph 73).
- The appointment process will be transparent. Local public bodies will be required to publish details of the auditor appointment on their website within 28 days of making the appointment, together with the Independent Audit Appointment Panel's advice and, if they did not follow that advice, a statement explaining why (paragraph 63).
- Where the local public body is not an elected body, the auditor appointment will usually be made directly by the Independent Audit Appointment Panel or its equivalent (paragraph 75).

ROLE OF INDEPENDENT AUDITOR APPOINTMENT PANELS

- Government intends to prescribe specific functions to the Independent Audit Appointment Panel limited to the external audit, including advising on auditor appointment, independence, removal and resignation, and in relation to public interest reports (paragraph 67).
- The arrangements will allow local public bodies to share Independent Audit Appointment Panels, and to expand on the remit of their Panel if they wish, choosing a model which best suits their circumstances (paragraph 67).

FAILURE TO APPOINT AN AUDITOR

- Local public bodies will be required to appoint an auditor by 31 December in the year preceding the financial year to be audited, and notify the Secretary of State if they have not done so. The Secretary of State will be able to direct the local public body to appoint an auditor or make the auditor appointment directly. In addition to meeting the cost of the appointment the local public body could be subject to a sanction for failing to make the appointment (paragraphs 79-80).

ROTATION OF AUDIT FIRMS AND AUDIT STAFF

- Local public bodies will be required to run a procurement competition for its audit services at least every five years (paragraph 86).
- Auditors will have to comply with the standards and rules set by the regulator. Applying the current standards means the audit engagement partner will be able to undertake audit for a local public body for an initial five years and be reappointed for a further two years. The audit manager will be able to be appointed for a maximum of ten years. After these periods, these key audit staff will not be able to work with the local public body for a further five years (paragraph 85).

RESIGNATION OR REMOVAL OF AN AUDITOR

- There will be rigorous, transparent processes for auditor resignation or removal, designed to protect auditor independence, quality of audit, and accountability to the electorate. These broadly mirror those in the Companies Act, but are adapted to reflect the principles of public audit (paragraphs 90-91).

AUDITOR LIABILITY

- Auditor liability should be an issue to be dealt with in the contractual negotiations between the auditor and audited body (paragraph 96).

SCOPE OF LOCAL PUBLIC AUDIT AND AUDITORS' WORK

- The scope of local public audit will remain broadly similar. As now, auditors of local public bodies will be required to satisfy themselves that the accounts have been prepared in accordance with the necessary directions; proper practices have been observed in the compilation of the accounts; and the body has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources (paragraph 99).
- The detail of how auditors should fulfil these requirements will, as now, be set out in a code of audit practice. The value for money component should be more risk based and proportionate, with auditors basing their assessment of risk on evidence of the local public body's arrangements for securing value for money provided by the local public body (paragraph 100).
- *Public Interest Reporting:* The duty for auditors of local public bodies to undertake Public Interest Reporting will be retained, as will their ability to charge audited bodies for reasonable work. The duty on audited bodies to consider Public Interest Reports at a meeting within one month of the report and to publish the details of the meeting will be retained. A new duty will be placed on audited bodies to publish the Public Interest Report (paragraphs 105-107).
- *Non-audit services*: Auditors will be permitted to provide non-audit services to the audited body, subject to adhering to the Auditing Practices Board's ethical standards and the Independent Auditor Appointment Panel's approval (paragraph 110).
- *Public interest disclosure*: The local public auditor and the Independent Auditor Appointment Panel will be defined as designated persons under the Public Interest Disclosure Act, to enable individuals to make disclosures under the Act (paragraph 112).
- *Transparency:* The new framework will retain the rights of local electors to make formal objections to the accounts, but give auditors greater discretion regarding whether to pursue an objection (paragraph 115).

- *Freedom of Information:* The auditor's public office holder functions will not be brought within the remit of the Freedom of Information Act (paragraph 118).

NON AUDIT FUNCTIONS OF AUDIT COMMISSION

- *Proposed arrangements for Grant Certification:* following the Audit Commission's closure, Government considers that for new grants, the grant paying bodies should agree certification arrangements with grant recipients and auditors (paragraph 122).
- *National Fraud Initiative:* Government proposes to continue the National Fraud Initiative, and is discussing with partners and the local public sector about how best to achieve this (paragraph 126).
- *VFM studies regarding the local public sector*: The Government considers that there is scope for rationalisation in the number of these value for money studies compared to the number previously undertaken and would like to see a coherent and complementary programme of offerings across all providers.

Implementation and next steps

4. Chapter 4 sets outs the next steps. In summary these are to:

- do some further work with smaller bodies and their representatives on regarding audit arrangements for smaller bodies, to explore options for these bodies before firming up proposals, and setting out our preferred approach in Spring 2012;
- hold further discussions with local authorities, other local public bodies and the audit sector to flesh out the underlying detail of the framework, and how it might be implemented;
- publish a draft Bill for pre-legislative scrutiny in Spring 2012, which allows for examination and amendments to be made before formal introduction to Parliament; and in advance of introduction of an Audit Bill as soon as Parliamentary time allows.

5. The Audit Commission is currently in the process of outsourcing all the audit work of its in-house practice The outsource contracts that the Commission will put in place will start from 2012-13 and are expected to run for three or five years giving local councils and other public bodies the time to plan for appointing own auditors. Once the audits have been outsourced the Commission will be radically reduced in size to become a small residuary body responsible for overseeing the contracts and making any necessary changes to the individual audit appointments during the life of the contracts.

CHAPTER 1
Background

6. On 13 August 2010, the Secretary of State for Communities and Local Government announced plans to disband the Audit Commission, transfer the work of the Audit Commission's in-house practice into the private sector and put in place a new local audit framework. Local authorities would be free to appoint their own independent external auditors and there would be a new audit framework for local health bodies. A new decentralised audit regime would be established and local public bodies would still be subject to robust auditing.

7. In March 2011, the Government published the Future of Local Public Audit consultation paper seeking views on proposals for how the new local audit framework could work following the disbandment of the Audit Commission. These proposals were developed by the Department for Communities and Local Government following discussion with a wide range of partners and bodies that would be affected by the changes. These included the Audit Commission, the National Audit Office, the Financial Reporting Council, accountancy professional bodies, local government, other local public bodies and Government departments with an interest.

8. The consultation paper set these proposals within the context that the current arrangements for local public audit, whereby a single organisation is the regulator, commissioner and provider of local audit services is unnecessarily centralised, and that there is a lack of transparency and clarity as well as potential conflicts between the role.

9. The proposals in the consultation paper built on the statutory arrangements and professional ethical and technical standards that currently apply in the companies sector with adaptations to ensure that the principles of public sector audit are maintained.

About the consultation

10. In total, 453 responses were received to the consultation. The majority of these responses were from local government: parish and town councils, district councils, county and unitary local authorities and their representative bodies. Responses were also received from professional accountancy and regulatory bodies, auditing firms and other audited public bodies and members of the public. The majority of the members of the public who responded identified that they had auditing/accounting experience or were involved directly with the financial reporting for a council. A breakdown of the total responses can be seen below:

Type of respondent	Number of responses
Upper tier local authorities	91
Lower tier local authorities	117
Parish and town councils	134
Individual members of the public	30 (including 4 councillors)
Audit and accountancy firms	14
Professional auditing and accountancy bodies	5 (including Audit Commission)
Other audited public bodies	
Fire authorities	21
Police authorities	12
National Park Authorities	4
Probation Authorities	4
Pension authorities	2
Others	5
Non-categorised responses	14
Total	**453**

11. A summary of the responses to the consultation is available at: www.communities.gov.uk/publications/localgovernment/localauditsummaryresponses

Format of the Government response

12. Chapter 2 contains the Government response to the consultation. It is organised into sections following the order in the original consultation document. We have set out the proposals which the Government made, summarised the key themes and views submitted in consultation responses, and presented the Government's response to these.

13. Chapter 3 covers other functions of the Audit Commission that were not dealt with in the consultation. Chapter 4 covers next steps and implementation.

CHAPTER 2

Consultation questions and government response

Design principles

14. The consultation proposed that the new local public audit framework should be based on the principles of localism and decentralisation, transparency, continuing to ensure high standards of auditing, while opening up the market and securing lower audit fees. Our aim is also to ensure the quality of audit by having regard to the principles of local public audit:

- the independence of public sector auditors
- the wide scope of public audit
- good reporting arrangements to democratically elected representatives.

15. The vast majority of respondents agreed that the consultation document had identified the correct design principles of:

- localism and decentralisation
- transparency
- lower audit fees; and
- high standards of auditing.

Some respondents (including some professional auditing and accountancy bodies), commented that they did not believe that the decentralised approach outlined in the consultation document would achieve lower audit fees. Local authorities exhibited less concern.

The Government's response

16. The responses received to the consultation support the Government's proposed design principles. The proposals that are set out in this response and on which we intend to legislate are all vital elements of a new local public audit framework which is localist and transparent, and upholds high standards of auditing, where audit remains independent, robust and efficient.

17. The Government is also committed to developing a new local public audit framework where audit fees remain competitive, stripped of the need to cover the central costs and overheads of the Audit Commission. Having a single body that is regulator, commissioner and provider of local audit services provides a unique monopoly position and weak incentives to drive down costs. The key drivers of audit fees in the new local public audit framework (aside from commercial and market considerations) will be the scope of audit (i.e. what auditors are actually required to do) and regulation of the work of auditors. We are working with our partners to ensure that these elements of the new

framework do not add unnecessary cost into the new system. The streamlining the Commission has done since the Government's decision to abolish the Commission is already resulting in lower audit fees for local bodies, with the smaller overheads of the Commission enabling it to propose a 10% reduction in fee scales for 2012-13[1] for the first year of audits done under outsourcing.

PROBATION TRUSTS

18. As the financial results of probation trusts are consolidated into the National Offender Management Service accounts, which are audited by the Comptroller & Auditor General, the consultation proposed that in future probation trusts should be audited by the Comptroller & Auditor General. The audit of probation trusts would therefore not fall under the new local public audit framework.

19. The majority of those who answered this question (local authorities) agreed that the audit of probation trusts should fall within the Comptroller & Auditor General's regime. The four probation trusts that responded were evenly split as to whether they should be included in the Comptroller & Auditor General's regime or not.

The Government's Response

20. The Government considers that it would be appropriate for the audit of probation trusts to fall within the Comptroller & Auditor General's regime. We intend to lay an order before Parliament under the Government Resources and Accounts Act 2000 which – if approved by Parliament – would add an amendment to Schedule 1 to the Offender Management Act 2007 and transfer responsibility for the audit of probation trusts to the Comptroller and Auditor General from April 2012.

HEALTH BODIES

21. It is currently envisaged that the new local public audit framework outlined in this Government Response will apply to Clinical Commissioning Groups. These are new health bodies proposed in the Health and Social Care Bill. The precise audit requirements for Clinical Commissioning Groups have not yet been finalised and will depend on the passage of the Health and Social Care Bill. The application of the new local public audit framework for Clinical Commissioning Groups will be specified in due course.

22. The audit arrangements for Foundation Trusts were not included in the consultation because they do not currently fall under the Audit Commission regime. Under the current arrangements, a Foundation Trust's board of governors appoints their own auditor, on advice from an audit committee. Monitor currently regulates the audits, including providing the Code of Audit Practice and guidance. The audits include an opinion on the financial statements and a conclusion on value for money. We intend that the audit arrangements for Foundation Trusts will remain broadly the same, but some changes will be necessary to reflect Monitor's changing role.

---

[1] See http://www.audit-commission.gov.uk/audit-regime/audit-fees/201213/Pages/default.aspx

Regulation of local public audit

23. The Government considers that having a new and separate regulator for local public audit would be inefficient and risks duplication. This would also have an impact on fees. We therefore consider that, to the extent possible, there should be a consistent regulatory regime for audit, covering the private sector and the local government and health sectors. The same arrangements for regulation would apply for all local health bodies.

24. The consultation proposed that the National Audit Office would be responsible for developing and maintaining the audit codes of practice which set out the approach to audit that auditors must follow when auditing local public bodies. Before preparing or altering a code applicable to any accounts, the National Audit Office will be required to consult appropriate local public bodies and professional accountancy bodies. The National Audit Office would also be responsible for producing any supporting guidance. 93% of respondents agreed that the National Audit Office is best placed to produce the Code of Audit Practice and the supporting guidance.

The Government's response

25. The Government considers that, subject to Parliament's agreement, the National Audit Office is best placed to produce the Code of Practice which auditors will be required to follow when auditing local public bodies. We have also discussed with the National Audit Office how it might support auditors in fulfilling their responsibilities under the Code. The National Audit Office recognises the need for annual and in-year guidance to promote consistency in audit approach and is in principle committed to providing support to auditors which is:

- principles-based not prescriptive;
- addresses key themes/issues (not every query);
- informed by technical forum of local auditors (led by the National Audit Office); and
- leaves discretion for an auditor to agree local audit approach based on their risk assessment.

REGISTRATION OF AUDITORS

26. Under the Companies Act 2006 the Professional Oversight Board, part of the Financial Reporting Council, has statutory powers delegated to it for the recognition and supervision of those professional accountancy bodies responsible for supervising the work of auditors, Recognised Supervisory Bodies, or offering an audit qualification, Recognised Qualifying Bodies. Recognised Supervisory Bodies are responsible for putting rules and arrangements in place which their members must fulfil before they can be registered auditors. People with responsibility for company audit work must also hold a recognised qualification, awarded by a Recognised Qualifying Bodies.

27. The consultation proposed that the Financial Reporting Council would oversee the regulatory regime for local public audit, as it does for the statutory audit of companies under the Companies Act 2006. The Financial Reporting Council would share responsibility for registering statutory local public auditors and monitoring the quality of their audits with Recognised Supervisory Bodies.

28. 88% of responses were in agreement that the Companies Act 2006 should be replicated for local public audit. Some of the professional bodies responded that there would need to be some adaptation for the system to work for public bodies.

29. Overall, respondents indicated preferences for one of the existing regulatory bodies to take on the role for maintaining and reviewing the register of statutory local public auditors.

The Government's response

30. It is our intention that, as under the Companies Act 2006, the Financial Reporting Council will be the overall regulator[2]. We are therefore proposing that the Secretary of State will have powers which will allow him to authorise professional accountancy bodies to act as Recognised Supervisory Bodies for local public audit. In practice, the Secretary of State will delegate these powers to the Financial Reporting Council/Professional Oversight Board. This mirrors the arrangements under the Companies Act 2006.

31. The effect of this is that the Financial Reporting Council will be able to::

    - authorise existing Recognised Supervisory Bodies to have statutory responsibilities in respect of local public audit, in addition to their responsibilities for statutory audits of companies;

---

[2]. It should be noted that the Department for Business Innovation and Skills (BIS) and the Financial Reporting Council (FRC) are currently consulting jointly on reforms to the FRC's governance and structure. The consultation can be accessed at www.frc.org.uk/about/frcreform.cfm and is due to close on 10 January 2012. Both BIS and the FRC are working with DCLG to ensure the FRC has a proportionate role in the regulation and oversight of local public audits, as envisaged under the local public audit framework, in any revised structure for the FRC which results from the consultation.

- o authorise additional professional bodies to be Recognised Supervisory Bodies with statutory responsibilities in respect of local public audit.

32. As under the Companies Act 2006, the Recognised Supervisory Bodies will have the roles of registration, monitoring and discipline for local public audit, and will be given delegated authority to put in place rules and practices covering:

- The eligibility of firms to be appointed as local public auditors (subject to the Financial Reporting Council's oversight, which might include guidance produced by the Council); and
- The qualifications, experience and other criteria individuals must reach before being permitted to carry out a local public audit and sign off an audit report.

33. In line with the register of those eligible for appointment as auditor under Part 42 of the Companies Act 2006, all eligible local public auditors will be placed on a register, which will be kept by the Recognised Supervisory Bodies. This register will list:

- the audit firms that are able to undertake the audit of local public bodies;
- those individuals linked to each firm that are eligible to sign an audit report on behalf of that firm and able to take responsibility for local public audit work (though the names of individuals will not appear on the published register).

ELIGIBILITY FOR REGISTRATION

34. The consultation document asked how the right balance could be struck between requiring audit firms eligible for statutory local public audit to have the right level of experience, while allowing new firms to enter the market. The majority of responses suggested that firms should be required to demonstrate their track record in public sector audit and/or their ability to source the appropriate expertise. Other responses included the need to set proper high-level criteria, including the correct skills and qualifications for firms and individuals, but in a way that would not preclude new firms entering the market.

The Government's response

35. The Government considers that while it is important not to preclude new entrants to the local public audit market, it is also vital that any firm able to be appointed as a local public auditor has a number of suitable individuals with the necessary qualifications and experience to undertake local public audit work. Once enacted, legislation will provide that Recognised Supervisory Bodies (subject to the Financial Reporting Council's oversight, and in line with any guidance which the Council produce) will be responsible for determining the level of expertise and experience necessary for any firm to be eligible to be appointed as a local public auditor. We are confident that building on the rules and arrangements these bodies already have in place under the Companies Act 2006, but tailored appropriately to meet the specific requirements of local public auditors, will provide the right balance to ensure that an appropriate level of

experience and expertise is maintained in the system, while not precluding new firms from entering the market.

36. In order to ensure that individuals within firms are suitably qualified and have the necessary levels of skills and experience, the Government considers that each individual eligible to sign an audit report on behalf of the firm will need to:-

- hold an audit qualification ("appropriate qualification" in accordance with the Companies Act 2006 [Section 1219]); or
- hold a corresponding qualification to audit accounts under the law of another European Economic Area state; or
- hold a qualification from a body of accountants recognised by the Financial Reporting Council as an appropriate qualification for local public audit;

  and

- be approved under the rules of the Recognised Supervisory Body to take on that role. In practice, we envisage that the Recognised Supervisory Body will only approve someone where it judges that the individual has the necessary level of skills and experience to take on the role.

37. The Financial Reporting Council will need arrangements to monitor the continued appropriateness of qualifications that it recognises as appropriate for local public audit.

MONITORING AND ENFORCEMENT

38. The consultation proposed that the appropriate professional accountancy bodies should act as Recognised Supervisory Bodies and have responsibility for monitoring the quality of audits undertaken by their members, as they do in the private sector; and investigate complaints or disciplinary cases, as well as issues identified during their monitoring process. They would also be able to stop a firm being eligible for appointment as a statutory local public auditor, by removing them from the register of eligible local public auditors.

39. The consultation said that the Government was considering whether the overall regulator should have a direct role in assuring the quality and undertaking independent investigation of the audits of some specified local public bodies, i.e. those that might be considered analogous to Public Interest Entities under the Companies Act 2006.

40. The consultation also asked for views on the proposal that the overall regulator would have powers to investigate and discipline in these cases. About a third of respondents to the relevant question considered that all principal local authorities should be considered as equivalent to public interest entities, with a smaller number suggesting that all of the bodies currently audited by the Audit Commission should be viewed as equivalent to public interest entities. Nearly half of respondents suggested that regulation and monitoring arrangements should be the same for audits of all local public bodies, with no specially defined group to be subject to additional arrangements. The majority of respondents considered that the role of the regulator in relation to disciplinary cases should be the same for local public audit framework as it is under the Companies Act 2006.

The Government's response

41. We propose that, as under the Companies Act 2006, Recognised Supervisory Bodies will have responsibility for monitoring the quality of audits undertaken by their member firms. This work will fall under the monitoring units of these bodies, and will include:

- reviews of individual audit engagements
- reviews of the policies, procedures and internal controls of those firms licensed to carry out the public sector audits
- reporting on the quality of audit to the registration body
- investigating complaints or disciplinary cases, as well as issues identified during their monitoring process
- removing a firm from the register of eligible local public auditors.

42. The Recognised Supervisory Bodies will investigate complaints or disciplinary cases, as well as issues identified during the monitoring of firms on the register. Similarly, the Recognised Supervisory Bodies will be able to refer cases for investigation to the relevant arm of the Financial Reporting Council (the Accountancy and Actuarial Disciplinary Board).

43. The Accountancy and Actuarial Disciplinary Board investigates significant public interest disciplinary cases and can impose sanctions on those auditors found guilty of misconduct in both the companies and public sectors. The Government considers that the Accountancy and Actuarial Disciplinary Board should continue to have these powers for local public audit.

44. Under the Companies Act 2006 the overall regulator, through its Audit Inspection Unit, is responsible for monitoring the quality of the statutory audit of "major audits" which includes the audits of public interest entities. The Professional Oversight Board is responsible for determining which audited entities fall within the "major public interest" category (over and above those prescribed in statute), and therefore within the scope of the Audit Inspection Unit, and for approving the Audit Inspection Unit's work programme. The criteria the Professional Oversight Board applies and a list of inspections are published annually by the Board, following consultation with the professional accountancy

bodies. This additional level of monitoring reflects both the size of the company and the importance of that company to the public.

45. As under Companies Act 2006 audits, there will be an additional level of oversight and monitoring for audits of significant local public bodies given the very large level of taxpayers' money at their disposal. We therefore intend to give the Financial Reporting Council responsibility for monitoring (through the Audit Inspection Unit or as appropriate through delegation to a Recognised Supervisory Body) the quality of audits of these bodies (which we are referring to as "Bodies of Significant Public Interest").

46. We propose to include in legislation criteria to define which bodies will be considered Bodies of Significant Public Interest and hence within the scope of the Audit Inspection Unit. We propose that the Financial Reporting Council/Professional Oversight Board will then, each year, decide after consultation with relevant Government Departments whether any local public bodies which are not Bodies of Significant Public Interest should also fall within the scope of the Audit Inspection Unit, over and above those prescribed in legislation. The Financial Reporting Council /Professional Oversight Board will then decide which audits the Audit Inspection Unit will monitor. This is in line with the process under the Companies Act 2006 for determining which audited entities fall within the "major public interest" category, and therefore within the scope of the Audit Inspection Unit.

47. As set out in paragraph 46 above, audits of bodies which do not fall within the Audit Inspection Unit's scope will be monitored by the relevant Recognised Supervisory Body.

Commissioning local public audit services

DUTY TO APPOINT AN AUDITOR

48. The consultation proposed that all larger local public bodies (those with income/expenditure over £6.5m) would be under a duty to appoint an auditor. The auditor would need to be on the register of local public statutory auditors, which should help to ensure that the quality of auditors is maintained. Independence would be maintained in part through a new requirement for local public bodies to put in place independent audit committees. The consultation set out proposals for how such committees could be structured and proposals as to how independence would be defined.

49. The consultation sought to set out proposals which would enable local public bodies to co-operate to procure an external auditor.

50. Nearly three quarters of the responses agreed that the arrangements for audit committees were flexible enough to allow joint appointments. Generally, audited bodies, local authorities in particular, were against the idea of a majority independent audit committee. Those from other sectors, such as audit and accountancy firms and the professional bodies, were generally in favour of the proposals.

51. About a third of respondents agreed that our proposals for audit committees provide the necessary safeguards for the independence of the auditor

appointment. With regard to the make up of the audit committee, of those who indicated a preference, a minimum number of independent members was favoured by a small majority. Other notable comments that arose were that the makeup of the independent audit committee should be a local decision for each audited body and that these arrangements were not suitable for the way police authorities were structured.

52. The majority of respondents agreed that the correct criteria had been identified in the consultation document to ensure the quality of independent members. However, a sizeable minority disagreed. The main cause for disagreement was that the criteria listed appeared more focussed on ensuring the independence of members rather than their quality and capability. Local authorities thought that having the overall necessary skills to perform the audit committee function was important. Auditing and accountancy firms were more clearly in agreement with the criteria identified in the consultation.

53. About half of the respondents considered that financial awareness or experience was desirable, but not essential, for the independent members of an audit committee. Many felt that if the overall skills of the audit committee as a whole were appropriate for the tasks they had to perform, the financial expertise did not have to rest with the independent members.

54. About half of those who responded indicated that they thought it would be difficult to source independent members of a suitable calibre. Most respondents agreed that remuneration would be necessary for the independent members but responses were split with regard to what level, the most popular responses being that the level should be locally determined and that only ‘reasonable’ expenses should be paid (similar to other committees).

The Government’s response

55. Local public bodies are already responsible for procuring large volumes of goods and services in order to discharge their wider functions, e.g. local government’s procurement totals around £50bn per annum according to the Local Government Association. The Government considers there to be no barriers in terms of expertise that would prevent local public bodies appointing their external auditors, subject to appropriate safeguards to ensure independence in the appointment process.

56. The Government has confirmed on several occasions its commitment to maintaining auditor independence in the new local public audit framework. The regulatory regime set out in the preceding chapter ensures the quality of audit work is monitored effectively. We consider that requiring the appointment of an auditor to be undertaken by the full council (or equivalent for non-local government bodies) on the advice of an independent audit committee is the most practical and effective way of ensuring independence of appointment. Transparency in the appointment process will also be an important part of ensuring auditor independence.

57. In reaching this conclusion we have listened to the comments made by some local public bodies about the constitution of their existing audit committees, and that it might be difficult to find enough suitable independent members to ensure a majority of independent members. In order to distinguish between the existing

traditional audit committees and the role we propose for such a committee in the appointment process, we intend that the advice on the procurement and appointment of the auditor will be made by an independent audit appointment panel.

58. The Government therefore intends to legislate for a system of local appointment under which all local public bodies with income/expenditure over a threshold (currently £6.5m) will be under a duty to appoint an auditor who must be on the register of local public auditors. Responsibility for the final selection of the auditor and engagement of the auditor on a contractual basis will rest with the local public body. However, that appointment must be made by the full council (or its equivalent) on the advice of an Independent Audit Appointment Panel, independently chaired, with a majority of independent members. Where the body already has an independent audit committee, they may wish to use that committee to meet this requirement.

59. Local public bodies have signalled to us that they are interested in undertaking joint procurement exercises and sharing Independent Audit Appointment Panels or independent members. We want to ensure the arrangements that we put in place facilitate that. We intend to frame requirements in a way that will allow local public bodies to share appointment panels (and therefore independent members) to ease administration burdens and reduce costs. Local public bodies will be able to choose the model which suits their circumstances, and will have the flexibility to work with other bodies to jointly procure an auditor and reduce the costs of meeting this requirement.

60. We intend to work closely with the sector, as we finalise the detail of these proposals, so they are as administratively straightforward and practical as possible.

61. To aid transparency in the appointment process the local public body will be required to publish details of the auditor appointment on their website within 28 days of making that appointment, alongside the advice of the Independent Audit Appointment Panel, subject to considerations of commercial confidentiality. If the local public body did not follow the advice of the Independent Audit Appointment Panel in making its appointment, it will be required to publish on its website a statement setting out the reasons why it had chosen not to follow that advice.

ROLE OF THE INDEPENDENT AUDIT APPOINTMENT PANEL

62. The consultation proposed that the Independent Audit Appointment Panel would have a key role in the selection of the auditor engaged by the audited body, and monitoring the independence, quality and performance of the external audit. It proposed options for specifying in legislation some responsibilities that the Panel should have in relation to the engagement of an auditor, and monitoring the independence and quality of the external audit:-

- Only specify one mandatory duty for the local public body's Independent Audit Appointment Panel, i.e. to provide advice to the local public body on the engagement of the auditor and the resignation or removal of an auditor.

- Specify a more detailed role for the Independent Audit Appointment Panel. This would provide more assurance about the independence of the relationship between the audited body and its auditor, and would also ensure that the Panel had a wider role in reviewing the financial arrangements of the local public body.

63. The majority of respondents indicated a preference for the appointment of the auditor as the only mandatory duty for the Independent Audit Appointment Panel, and any other roles or responsibilities would be a local decision. However, a significant number of responses felt that a more detailed mandatory role for the Panel was preferable.

64. The majority of respondents felt that the process for the appointment of an auditor should not be set out in legislation. Guidance was preferable to a statutory code of practice with the National Audit Office indicated as the preferred provider.

The Government's response

65. The approach that the Government intends to take is to provide for a limited set of functions on the Independent Audit Appointment Panel in legislation, around advising on auditor appointment, independence, removal and resignation, and in relation to public interest reports. We believe that such an approach will provide flexibility for local public bodies to mould this requirement to suit their own circumstances, and facilitate joint working and joint commissioning between local public bodies.

66. We also recognise that in circumstances where a local public body will have both an audit committee (exercising the traditional functions of such a committee) and an Independent Audit Appointment Panel (whether shared or not) there may well be issues about the demarcation of responsibilities between both groups. We intend to work with the sector to produce guidance which would set out how the responsibilities of the Independent Audit Appointment Panel could be exercised (and how those responsibilities might interface with those of a more traditional audit committee). We would welcome a discussion and views on the detailed issues raised by this approach to help shape and inform the requirements and any future guidance issued.

INVOLVEMENT OF THE PUBLIC IN THE APPOINTMENT OF AN AUDITOR

67. The consultation said the Government was considering how local people could make representations about the specification designed by the audit committee for the procurement of an auditor. The options we considered were:

- Pre-appointment - The public could make representations to the audited body's audit committee about any expressions of interest from audit firms for the audit contract; or

- Post appointment – The public would be able to make representations at any time to the local public body's audit committee about issues relating to the auditor.

68. About equal numbers of respondents agreed as disagreed that this was a proportionate approach to public involvement. Some respondents suggested that public involvement be restricted to any undisclosed conflicts of interest on the part of the auditor.

The Government's response

69. The Government considers that its proposals to require – in the case of local authorities – the appointment to be made by a full council meeting on the advice of an independent auditor appointment panel; the requirement for that advice to be published (and any departure from it publicly justified); and the other measures we are proposing around transparency of the auditor appointment, secure the necessary level of transparency for the public in the appointment process.

APPLICABILITY TO OTHER SECTORS

70. The consultation recognised that the commissioning approach proposed for local authorities might need to be tailored for other local public bodies. Nearly all respondents indicated that the approach should be tailored as appropriate for different local public bodies.

The Government's response

71. The Government intends that in the case of police bodies that appointment would be made by the Police and Crime Commissioner.

72. The table at Annex A details the different types of local public bodies to which the new local public audit framework will apply and sets out the Government's proposals for how the auditor appointment will be made.

73. Where the local public body is not an elected body, then in most circumstances that appointment should be made directly by the Independent Auditor Appointment Panel (or its equivalent). There may be circumstances where it is appropriate for a local public body's board to make that appointment on the advice of the Panel. However, where this is the case transparency (i.e. publication of that advice) will be an important part of the appointment process.

FAILURE TO APPOINT AN AUDITOR

74. The consultation proposed that the audited body would be under a duty to appoint an auditor. However, it also recognised that there could be some instances under the new system where a body does not fulfil this duty. In these circumstances we proposed that the Secretary of State would be able to direct the local public body to appoint an auditor. Alternatively, where a local public body does not fulfil its duty to appoint an auditor the Secretary of State could be provided with the power to make the auditor appointment. In addition to meeting the cost of the appointment the local public body could be subject to a sanction for failing to make the appointment.

75. The majority of the responses favoured the Secretary of State having a power to make the auditor appointment. Most groups of respondents also suggested a staged approach, i.e. where the Secretary of State would direct the public body

to appoint an auditor and, should that fail, the Secretary of State would appoint the auditor.

76. A small majority preferred that a local public body should only be required to inform the Secretary of State in the case where it had failed to appoint an auditor, rather than when they had made the appointment. Other responses suggested that neither scenario warranted informing the Secretary of State as this would go against the principle of localism.

The Government's response

77. The Government considers it important, given the range of functions and legal responsibilities of a local public auditor, that local public bodies are required to appoint an auditor by a specified date in the financial cycle. We consider that requiring an auditor to be appointed by 31 December in the year preceding the financial year for which that auditor is to be appointed would fit with the annual financial and accounting cycle.

78. We also consider that any local public body should be under a requirement to notify the Secretary of State if they have not been able to make an appointment by that date. We are proposing that the Secretary of State would then have powers to either direct the local public body to make an appointment or make that appointment directly himself. In addition to meeting the cost of the appointment the local public body could be subject to a sanction for failing to make the appointment.

ROTATION OF AUDIT FIRMS AND AUDIT STAFF

79. The consultation proposed that the rotation of staff within the audit firm would need to be in line with the current ethical standards, but the audited body would also be required to undertake a competitive appointment process within five years. The audited body would be able to re-appoint the same firm for a (maximum) second five year period, following competition.

80. The majority of respondents were in favour of the proposal to limit a firm's term of appointment to ten years. However, some felt that there should be no limit on the length of a firm's appointment, e.g. it would be a barrier to new entrants.

81. The vast majority of responses agreed that the current ethical standards were sufficient safeguard for rotation of audit staff.

The Government's response

82. The Government considers that there is a balance to be struck between providing enough incentive for audit firms to invest in medium term relationships with local public bodies which would enable them to gain a thorough understanding of that body's operations, and ensuring that those undertaking the audit maintain an appropriate degree of independence and objectivity from the body being audited.

83. Paragraph 64 set out the government's intention to require Independent Audit Appointment Panels, to provide advice on the appointment of the auditor and to have a key role in ensuring auditor independence. Taking this into account, the Government considers that the ethical standards of the Auditing Practices Board

around the rotation of key audit staff provide enough safeguards without the need for mandatory rotation of firms. The ethical standards provide that the audit engagement partner would be able to perform audit work in respect of a local public body for an initial period of five years and then can only be reappointed for a further two years. The audit manager can only be appointed for a maximum of ten years. After these respective periods have elapsed, these key audit staff would not be able to work with the local public body concerned until a further period of five years had elapsed.

84. However, the Government is also convinced of the need to ensure local public bodies are achieving value for money in procuring audit services. It therefore intends to require that a local public body must run a procurement competition every five years for its audit services. The Independent Audit Appointment Panel would be required to provide advice before any appointment. There would, however, be no bar on the incumbent supplier being reappointed as a result of this competition.

RESIGNATION OR REMOVAL OF AN AUDITOR

85. The consultation envisaged that a body might wish to remove its auditor, or an auditor might wish to resign, only in exceptional circumstances, for example, an auditor being in breach of the ethical standards, or a complete breakdown in the relationship between the auditor and audited body. It recognised the importance of having stringent safeguards in place for the resignation and removal of an auditor to protect the independence of the auditor and the quality of the audit. It proposed safeguards that would broadly mirror those in the Companies Act 2006, but would be adapted to reflect the principles of public audit. The process would be designed to ensure that auditors are not removed, or do not resign, without serious consideration and through a process transparent to the public.

86. The majority of responses received to this question agreed that these proposals provide sufficient safeguard against the removal or resignation of the auditor.

The Government's response

87. The Government considers that it is important that there is a fully transparent process in place to deal with issues of auditor resignation or removal. We consider that in the first instance it is vital that auditors and audited bodies try as far as possible to resolve any difficulties or concerns (including through using the mediation and conciliation services of the professional accountancy bodies if appropriate).

88. However, if such differences become irreconcilable, in the case of auditor resignation, we intend to:-

- Require the auditor to give 28 days written notice of his intention to resign to the audited body and its Independent Audit Appointment Panel;
- Require the audited body to make a written response to the auditor's written notice, which it will be required to send with the auditor's written notice, to its members and the Independent Audit Appointment Panel;
- Require the auditor to then deposit a statement at the main office of the audited body, and with the Independent Audit Appointment Panel, setting out

the circumstances connected with the resignation of the office that are relevant to the business of the audited body;

- Require the audited body to publish the auditor's statement on its website;
- Require the Independent Audit Appointment Panel to investigate the circumstances that led to the resignation and consider whether any action is required; and
- Require the auditor to notify the appropriate regulatory monitoring body of his decision.

89. In the circumstance where a local public body wished to remove its auditor, the process would be similar. We intend to:-

- Require the audited body to give 28 days written notification of its wish to terminate the contract, to the auditor and its Independent Audit Appointment Panel;
- Provide that the auditor will have the right to make a written response to the notice, which the audited body will be required to send to its members and the Independent Audit Appointment Panel;
- Require the Panel to provide advice to the local public body within that 28 days notice period, having regard to any written response made by the auditor;
- Require the local public body to have regard to the advice of the Independent Audit Appointment Panel before making a decision whether to remove its auditor;
- Following the 28 days notice period, require the audited body to put to a full council meeting (or its equivalent) a resolution to remove the auditor (at which both the auditor and a representative of the Independent Audit Appointment Panel could speak if they wished);
- Require that, if the audited body still wished to remove its auditor, it should publish a statement of its decision on its website within 28 days of the decision of the full council. If the local public body did not follow the advice of the Independent Audit Appointment Panel, it will be required to explain in its statement what that advice had been, and the reasons why it had chosen not to follow that advice, subject to considerations of commercial confidentiality; and
- Require the audited body to notify the appropriate regulatory monitoring body of its decision.

AUDITOR LIABILITY

90. In the private sector auditors are concerned about the consequences of the risks of litigation. Auditors have sought to caveat their opinions by explicitly limiting their duty of care and limit their liability. The Companies Act provides that general provisions that protect auditors from liability are void, but:

- does not prevent a company from indemnifying an auditor against any costs incurred by him in defending proceedings in which judgment is given in his favour or in the granting of relief by the court in the case of honest and reasonable conduct; and

- allows for a "liability limitation agreement" to be put in place if it is authorised by the members of the company, provided it complies with the content permitted in the Companies Act.

91. The consultation recognised that in the absence of a central body providing indemnity to audit firms, it could be possible for audited bodies and auditors to deal with auditor liability as part of their contractual negotiations. A legislative framework, similar to that in the companies sector, could set out the process for setting and agreeing liability limitation agreements. The majority of respondents agreed with the proposals in the consultation document.

The Government's response

92. The Audit Commission currently indemnifies auditors for the costs they incur where they are engaged in litigation. In practice, calls on the indemnity are infrequent. The Audit Commission informed the Communities and Local Government Select Committee inquiry on the Audit and Inspection of Local Authorities that, in the five years to 2010, it had been called upon only once.

93. Auditors from the Commission's in-house audit practice have also faced litigation over the same five-year period. There have been three cases, all of which the in-house auditor won. The costs of in-house auditors not recovered from the other side are met by the Commission, and are also passed on to audited bodies in audit fees, so in effect the indemnity is extended to the Commission's own auditors.

94. Without a liability agreement, audit firms may increase their fees to match the increased risk they face in undertaking the work. Therefore, the Government considers that auditor liability should be an issue to be dealt with in the contractual negotiations between the auditor and audited body. The Government will also consider the feasibility and necessity of a supporting statutory framework which could set out the process for agreeing liability limitation agreements.

Scope of audit and the work of auditors

SCOPE OF LOCAL PUBLIC AUDIT

95. The consultation asked for views on four options regarding the scope of future audits for local public bodies. The narrowest option would comprise an opinion on whether the financial statements give a true and fair view of the audited body's financial position and income and expenditure and a review of other information included with financial statements. Wider options suggested included an auditor's conclusion on regularity and propriety, financial resilience and value for money; and a further option of the auditor providing reasonable assurance on an annual report prepared by the local body setting out its arrangements for securing value for money, whether they had achieved

economy, efficiency and effectiveness, regularity and propriety and financial resilience.

96. The responses to the consultation were split between the options but indicated a slight preference for leaving the overall scope of audit unchanged.

The Government's response

97. The Government has considered the wide range of views expressed in the consultation and intends to retain the current broad scope as set out in the Audit Commission Act 1998 so that auditors of local public bodies will continue to be required to satisfy themselves that:-

- the accounts have been prepared in accordance with the necessary directions or regulations and comply with relevant statutory requirements;
- proper practices have been observed in the compilation of the accounts; and
- the body has made proper arrangements for securing economy efficiency and effectiveness (value for money) in its use of resources.

98. The latter element is commonly referred to as the Value for Money component of the audit, which is a key difference between the scope of local public audit and statutory audit for private sector companies. The Government considers that the value for money component of the audit could be delivered in a more risk based and proportionate way. This has the potential for a consequent decrease or increase on the level of audit work some local public bodies might see as a result, but we would not expect this in itself to result in an overall increase in the total costs of audit.

99. The auditors will need to base their assessment of risk on evidence around the local public bodies' arrangements for securing value for money. We want to put the responsibility for providing the evidence firmly in the hands of the local public body, without introducing additional burdens by requiring the production of additional reports or documents. The majority of respondents to the consultation were not in favour of local public bodies being required to set out performance and plans in an annual report. One option would be to ask local public bodies to build on the information they already make available on their arrangements for securing value for money - for example, through the Annual Governance Statement. This would be consistent with the design principles of the new framework, by enhancing transparency and delivering a localist approach which shifts responsibility firmly onto local public bodies.

100. We will need input from a range of stakeholders to develop the value for money element of audit fully before implementation. These would include: the National Audit Office (given their envisaged role, subject to Parliament's agreement, in producing the Code of Audit Practice and associated guidance); the Chartered Institute of Public Finance and Accountancy, Local Authority (Scotland) Accounts Advisory Committee and the Society of Local Authorities Chief Executives as the respective authors of the Code of Practice on Local Authority Accounting and the Local Authority Governance Framework, and local public bodies themselves.

PUBLIC INTEREST REPORTING

101. The consultation proposed to retain existing duties for auditors around Public Interest Reporting and asked whether the new processes for resignation and removal of auditors would mitigate the risk that the introduction of local auditor appointment would impact on the auditor's ability or willingness to publish Public Interest Reports.

102. The vast majority of responses agreed that the safeguards outlined in the consultation document would allow the auditor to issue a public interest report, but some had concerns that the safeguards may not work in practice.

The Government's response

103. Government intends to retain the duty for auditors of all local public bodies to undertake Public Interest Reporting under the new framework. As is the case currently audited bodies will be charged for reasonable work involved in undertaking a Public Interest Report. The new framework will also retain the duty on audited bodies to consider Public Interest Reports at a meeting within one month of the report and to publish the details of the meeting.

104. In addition, in order to improve transparency we intend to introduce a new requirement for audited bodies to publish the Public Interest Report, as well as the existing requirement to publish a notice of and agenda for the meeting at which it will be discussed, but local bodies will in future be able to choose the mode for publishing these.

105. However, we recognise the concerns expressed around the need for further safeguards for Public Interest Reporting. We will work with partners to finalise the details of these, in particular the role of the Independent Auditor Appointment Panel, and arrangements for protecting auditors in undertaking and receiving payment for Public Interest Reports, and how the publication of Public Interest Reports may help to increase transparency and engage local people.

PROVISION OF NON-AUDIT SERVICES

106. The consultation proposed that auditors would be able to provide non-audit services to the audited body, with safeguards in the system to prevent any actual or perceived threats to the auditor's independence. It also proposed that auditors should continue to adhere to the ethical standards produced by the overall statutory regulator and permission should be sought from the audit committee who would provide advice to the body on whether non-audit work should be undertaken as well as continuing to monitor the relationship between the auditor and the audited body.

107. The majority of respondents favoured the auditor being able to provide non-audit services to the local public body in line with the regulator's current ethical guidelines and agreed that we had identified the correct balance between safeguarding auditor independence and increasing competition.

The Government's response

108. Auditors of local public bodies will be required to continue to comply with ethical standards and other applicable independence rules set by the regulator. [3] The Government considers that the current ethical standards provide sufficient safeguards for auditor independence. We therefore propose to enable auditors to provide non-audit services to the audited body, subject to adhering to the ethical standards produced by the Auditing Practices Board and gaining approval to undertake the work from the Independent Auditor Appointment Panel.

PUBLIC INTEREST DISCLOSURE

109. The consultation proposed that the Audit Commission's role in receiving, acknowledging receipt of and forwarding the facts of disclosure should be broadly transferred to the audit committee of the local public body. It also envisaged that the statutory auditor and the audit committee of the local public body would continue to be prescribed persons under the Public Interest Disclosure Act and would continue with their role with no change from the current system. The majority of responses agreed that was appropriate.

The Government's response

110. The Government considers it important that suitable mechanisms are in place to enable individuals to make disclosures under the Public Interest Disclosure Act. Having considered the responses received, we consider that it makes sense for the auditor and the Independent Auditor Appointment Panel to be designated persons under that Act and we intend to legislate accordingly.

TRANSPARENCY

111. The consultation proposed that the new framework for local audit would modernise the way in which local electors' objections would be considered. It proposed that electors would retain the right to make representations and raise issues and questions with the auditor (this does not apply to health bodies). It also proposed to introduce discretion for the auditor to decide which representations to follow up.

112. The overwhelming majority of respondents agreed that we should modernise the way objections to the accounts are handled. However, whilst respondents accepted that the auditor should have discretion as to whether to pursue particular objections, it was also suggested that standard criteria should be developed to help an auditor determine if he should investigate an individual representation.

The Government's response

113. The Government considers that the right of an elector to make an objection to accounts is a long-established and beneficial principle. However, we note that there are many more mechanisms now by which the electorate can hold local public bodies to account than when the right to object to the accounts was

[3] Those most applicable to provision of non audit services are http://www.frc.org.uk/images/uploaded/documents/ES5vprint.pdf

introduced more than 150 years ago. Also the costs of auditors investigating objections can be disproportionate to the sums involved in the complaint or to the normal audit costs of the local public body. Auditors currently have little discretion to refuse to investigate objections and the costs of investigating objections are recovered from the local public body. We therefore intend to legislate to provide a power to give the auditor discretion to reject vexatious, repeated or frivolous objections. We would welcome a discussion on whether guidance should be produced to help the auditor exercise that discretion.

FREEDOM OF INFORMATION

114. The consultation proposed that auditors of local public bodies should be brought within the remit of the Freedom of Information Act to the extent that they are carrying out their functions as public office holders, although recognised the potential impact on audit fees and relationship between the auditor and audited body.

115. Some respondents thought that this would be unnecessary as the information would already be available under the Freedom of Information Act from the audited body. All respondents thought that audit fees would increase, and there were mixed views about the impact on working relationships.

The Government’s response

116. The Government does not see a compelling case to bring the auditor’s public office holder functions within the remit of the Freedom of Information Act. The information held by appointed auditors currently is not subject to the Freedom of Information Act because appointed auditors are not currently 'public authorities' for the purposes of the Freedom of Information Act. We consider that the audited bodies being covered by the Freedom of Information Act and the requirements around publication of the accounts, the auditor’s report and Public Interest Report, provide sufficient and transparent access to key material for the public. The inclusion of local public auditors within the remit of the Freedom of Information Act would therefore add little, and has the potential to increase audit fees.

CHAPTER 3

Other functions of the Commission

117. There are a number of functions that are currently exercised by the Audit Commission under the Audit Commission Act 1998, the future operation of which were not covered in the consultation on the Future of Local Audit. Government's current thinking in relation to these functions is set out below.

Grant certification

118. The Audit Commission Act gives power to the Commission to make arrangements for the certification of audited bodies' claims for grants and subsidies from government departments, and charge authorities the full cost of certification. Certification helps grant-paying bodies satisfy themselves that a scheme is operating as intended. It is not an audit but is designed to provide reasonable assurance to grant-paying bodies about an authority's entitlement to grant or subsidy, or about the information provided in a return. Specific instructions or 'Certification Instructions' are developed for each scheme and different levels of assurance arrangements are applied to different thresholds of grant.

119. In 2010-11, certification arrangements were made for 20 schemes, and this has reduced to 16 schemes in 2011-12. Government is reducing the number of ringfenced grant programmes which will lead to a further reduction in the number of grant schemes for the Commission to certify. However, it is expected that a number of grant schemes will be live when the Audit Commission closes – so new certification arrangements are required for these and any new grant programmes.

120. The future arrangements for grant certification were not included in the consultation. Following the Audit Commission's closure, grant paying bodies for new grants will need to develop separate arrangements, either in the form of free-standing tripartite agreements (between the grant paying body, the payee and its auditor) or self-certification. Free-standing tripartite agreements would require the grant paying body to define the assurance requirements and certification instructions, and the local body to procure the necessary certification from its auditor. Some grant programmes may use self-certification to provide assurance: this relies on the internal governance and controls of the grant recipient and requires the Chief Executive or Section 151 Officer to certify the claim, usually through a standardised declaration. These arrangements will be supported by Treasury guidance, to ensure consistency of approach across Government grant programmes. For existing grant programmes currently certified by the Audit Commission, we are working with grant paying bodies to develop transitional arrangements that provide the assurance required.

1.

The National Fraud Initiative

121. The National Fraud Initiative is a secure, fully accredited, data matching service operated by the Audit Commission under statutory data matching powers now provided for in the Audit Commission Act 1998 with the purpose of protecting the public purse from fraud. It is run by a small team of 8 data matching specialists within the Commission.

122. The Commission's data matching powers mandate those bodies that are audited by the Commission to submit data for matching purposes. These include local authorities, health bodies - including Primary Care Trusts, Health Authorities, Foundation Trusts and Strategic Health Authorities - Housing Associations, Police, Fire, and Civil defence and ambulance services, Passenger Transport Executives and others.

123. The Commission currently runs a data-matching exercise every two years (although it is working on proposals to develop the National Fraud Initiative into a real-time data matching service). In 2008-09, it processed some 8,000 datasets from 1,300 organisations (including 100 voluntarily provided from the private sector) and identified fraud, errors and overpayments with a value of £215m. This brought the total value of detected fraud etc. since its inception in 1996 to £664m.

124. The Government is committed to the continuation of the National Fraud Initiative and the Department for Communities and Local Government has been considering the best way of securing that outcome. This has included talking to other parts of Government – the Department for Work and Pensions and the National Fraud Authority (an executive agency of the Home Office) – that are interested in taking on operational ownership of the National Fraud Initiative once the Commission is disbanded. We will be discussing these options further with the local public bodies who submit data and use the National Fraud Initiative.

Value for money studies

125. Section 33 of the Audit Commission Act 1998 gives the Audit Commission a duty to promote or undertake comparative or other studies in local authorities (including police authorities and fire and rescue authorities) so that they can make recommendations to improve the economy, efficiency and effectiveness of local public services, and the financial management of local public bodies. Only the financial management element applies in relation to the health sector. The Commission also has a duty to report on the effect of central government regulation, legislation, and directions on the ability of local authorities to achieve the 3Es (section 34). There is no equivalent power in relation to health. Before undertaking or promoting any value for money study, the Commission has a statutory requirement to consult with a range of parties as appropriate. It has typically consulted both on its forward programme and on a study-by-study basis.

126. The Commission has a long history of publishing recommendations from its national studies. Early reports looked at specific local government services, for example seeking to drive improvement in subjects as diverse as vehicle maintenance and social services for the elderly. The research was also used to provide audit guides that were applied through the appointed auditors in relevant local authorities. More recently, with local public bodies working together across sectors and with a wide range of partners in the public, private and voluntary sectors, the Audit Commission have examined how well that collaboration has delivered efficient and effective outcomes.

127. The Government announced in August 2010 that the Commission's research activities would stop and final reports remain to be published. We consider that there is scope for rationalisation in the number of value for money studies published relating to the local public sector compared to the number previously undertaken. We would like to see a coherent and complementary programme of offerings across providers including the National Audit Office, central Government and the Local Government Association. This was a view supported by the Communities and Local Government Select Committee inquiry into the audit and inspection of local authorities.

CHAPTER 4

Implementation and next steps

128. The preceding paras of this document set out the future proposals for principal local public bodies, currently defined as those with gross revenue expenditure over £6.5m. Under the Audit Commission regime there are different arrangements for the audit of smaller bodies, with a more proportionate form of scrutiny than a full audit (limited assurance audit), with the level of examination based on the income or expenditure of the body. The consultation document proposed different arrangements for smaller bodies would also apply in future. It also recognised the burden on smaller bodies of the local auditor appointment models and outlined different options for auditor appointment. We propose to do some further work with the sector to explore and build consensus around options for these bodies before firming up proposals and setting out our preferred approach in Spring 2012.

129. Having set out the key elements of the arrangements for principal bodies, we plan to hold further discussions with local authorities and other local public bodies, as well as audit firms, to flesh out the underlying detail of the framework, and how it might be implemented. We will also be working with key partners and the Audit Commission to develop appropriate transitional arrangements.

130. The Government will bring forward legislation to close down the Audit Commission and to put in place a new framework in line with the proposals set out in this response as soon as Parliamentary time allows. We intend to publish a draft Bill for pre-legislative scrutiny in Spring 2012, which allows for examination and amendments to be made before formal introduction to Parliament.

131. The Audit Commission is currently in the process of outsourcing all the audit work of its in-house practice The outsource contracts that the Commission will put in place will start from 2012-13 and are expected to run for three or five years giving local councils and other public bodies the time to plan for appointing own auditors. Once the audits have been outsourced the Commission will be radically reduced in size to become a small residuary body responsible for overseeing the contracts and making any necessary changes to the individual audit appointments during the life of the contracts.

ANNEX A

How different types of local public bodies will appoint their auditors

Body	Directly elected/ non-elected	Who Appoints
A local authority (meaning a county council, district council, London borough council).	Elected	Full Council
A Joint authority (meaning an authority established by Part 4 of the Local Government Act 1985).	Non-elected	IAAP
The Greater London Authority	Elected	Mayor and London Assembly
Mayor's Office for Policing and Crime	Elected	Mayor and London Assembly
Mayoral Development Corporation	Non-elected	IAAP
A functional body (meaning Transport for London, the London Development Agency, and the London Fire and Emergency Planning Authority)	Non-elected	IAAP
The London Pensions Fund Authority	Non-elected	IAAP
The London Waste and Recycling Board	Non-elected	IAAP
A committee of a local authority, including a joint committee of two or more such authorities	Non-elected	Full Council
The Council of the Isles of Scilly	Elected	Full Council

The Broads Authority	Non-elected	IAAP
A national park authority	Non-elected	IAAP
Police and Crime Commissioner and Chief Constable	Elected	Police and Crime Commissioner
A single purpose fire and rescue authority	Non-elected	IAAP
An authority established for an area in England by an order under section 207 of the Local Government and Public Involvement in Health Act 2007 (joint waste authorities)	Non-elected	IAAP
An economic prosperity board established under section 88 of the Local Democracy, Economic Development and Construction Act 2009	Non-elected	IAAP
A combined authority established under section 103 of that Act	Non-elected	IAAP
The accounts of the collection fund of the Common Council and the accounts of the City fund	Elected	Full Council
The accounts relating to the superannuation fund maintained and administered by the Common Council under the Local Government Pension Scheme Regulations 1995	Elected	Full Council
Passenger Transport Executive	Non-elected	IAAP

This page is intentionally left blank