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Date: 25 January 2017
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To: All Members of the Corporate Audit Committee

Councillors: Brian Simmons (Chair), Chris Dando, Andrew Furse, Barry Macrae and Christopher Pearce

Independent Member: John Barker

Chief Executive and other appropriate officers

Press and Public

Dear Member

Corporate Audit Committee: Thursday, 9th February, 2017

You are invited to attend a meeting of the **Corporate Audit Committee**, to be held on **Thursday, 9th February, 2017** at **2.00 pm** in the**. Kaposvar 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.

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 Guildhall Bath (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 - Reception: Civic Centre - 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. **Recording at Meetings**:-

   The Openness of Local Government Bodies Regulations 2014 now allows filming and recording by anyone attending a meeting. This is not within the Council's control.

   Some of our meetings are webcast. At the start of the meeting, the Chair will confirm if all or part of the meeting is to be filmed. If you would prefer not to be filmed for the webcast, please make yourself known to the camera operators.

   To comply with the Data Protection Act 1998, we require the consent of parents or guardians before filming children or young people. For more information, please speak to the camera operator

The Council will broadcast the images and sound live via the internet www.bathnes.gov.uk/webcast An archived recording of the proceedings will also be available for viewing after the meeting. The Council may also use the images/sound recordings on its social media site or share with other organisations, such as broadcasters.

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

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

7. **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.

This Agenda and all accompanying reports are printed on recycled paper

Protocol for Decision-making

Guidance for Members when making decisions
When making decisions, the Cabinet/Committee must ensure it has regard only to relevant considerations and disregards those that are not material.
The Cabinet/Committee must ensure that it bears in mind the following legal duties when making its decisions:

- Equalities considerations
- Risk Management considerations
- Crime and Disorder considerations
- Sustainability considerations
- Natural Environment considerations
- Planning Act 2008 considerations
- Human Rights Act 1998 considerations
- Children Act 2004 considerations
- Public Health & Inequalities considerations

Whilst it is the responsibility of the report author and the Council's Monitoring Officer and Chief Financial Officer to assess the applicability of the legal requirements, decision makers should ensure they are satisfied that the information presented to them is consistent with and takes due regard of them.

Corporate Audit Committee - Thursday, 9th February, 2017

at 2.00 pm in the Kaposvar 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 7.

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

   At this point in the meeting declarations of interest are received from Members in any of the agenda items under consideration at the meeting. Members are asked to indicate:

   (a) The agenda item number in which they have an interest to declare.

   (b) The nature of their interest.

   (c) Whether their interest is a **disclosable pecuniary interest** *or* an **other interest**, (as defined in Part 2, A and B of the Code of Conduct and Rules for Registration of Interests)

   Any Member who needs to clarify any matters relating to the declaration of interests is recommended to seek advice from the Council's Monitoring Officer or a member of his staff before the meeting to expedite dealing with the item during the meeting.

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 OF THE MEETING OF THE 8TH DECEMBER 2016 (Pages 7 - 12)

9. TREASURY MANAGEMENT STRATEGY (Pages 13 - 42)

10. EXTERNAL AUDIT UPDATE REPORT (Pages 43 - 60)

11. ANNUAL GOVERNANCE REVIEW UPDATE (Pages 61 - 70)

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

BATH AND NORTH EAST SOMERSET COUNCIL

CORPORATE AUDIT COMMITTEE

Minutes of the Meeting held

Thursday, 8th December, 2016, 2.00 pm

Councillors: Brian Simmons (Chair), Chris Dando, Andrew Furse and Christopher Pearce
Independent Member: John Barker
Officers in attendance: Tim Richens (Divisional Director- Business Support), Jeff Wring (Head of Audit West) and Andy Cox (Audit Manager)
Guests in attendance: Kevin Henderson (Grant Thornton)

111 EMERGENCY EVACUATION PROCEDURE

The Democratic Services Officer advised those present of the procedure.

112 ELECTION OF VICE-CHAIR

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

113 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

Apologies were received from Councillor Barry Macrae.

114 DECLARATIONS OF INTEREST

There were none.

115 TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

There was none.

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

There were none.

117 ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

There were none.

118 MINUTES: 27 SEPTEMBER 2016

RESOLVED to approve the Minutes of the meeting of 27 September 2016, subject to the following amendments:

In the penultimate paragraph of Minute 108:

in line 1 omit "*were*" after "*auditors*" in lines 3-4 "*Mr Morris replied that the performance said that the performance…"* omit *"said that the performance."*

119 EXTERNAL AUDIT UPDATE

Mr Henderson presented the Annual Audit Letter for the year ending 31 March 2016 and the external auditors' progress report and update.

The Chair asked about the valuation of long-term (non-current) assets (agenda page 22). Mr Henderson said that this had been a problem for the last couple of years. One of the issues was the much higher materiality used by the valuer than used by the external auditors. It had now been agreed with the Council's valuation team that they would carry out their valuation mid-year, rather than at the beginning of the year, and would, if there had been significant changes in value, revalue high-value items at 31st March.

A Member asked about the impact of materiality. Mr Henderson replied that if there was an error or combination of errors above the materiality threshold, the auditors would expect the Council's accounts to be amended. If the error was below the threshold, the auditor would simply report it. The Member noted that the materiality threshold for the Avon Pension Fund accounts was £38m.

Mr Henderson drew Members' attention to the progress update (agenda pages 36-37). He said that, as always, there had been issues relating to claims. DWP had written to the Council seeking information, which might result in additional work being requested from Grant Thornton. The issue concerned evidence relating to occupational and retirement pensions. Grant Thornton had no evidence supporting long-standing benefit claims, and had to report that fact. The Council would have to go through a separate process to obtain this evidence. If it could be obtained now, Grant Thornton would be able to amend the qualification letter. The Council may possibly have to pay a large amount to DWP.

He reminded Members that the new statutory deadline for the publication of Council accounts will apply from 2017/18. Both the Council and the auditors would treat this year as a dry run to prepare for this new deadline, with the accounts being published by 31st May 2017 and the audit commencing on 1st June 2017.

He drew attention to the information about the procurement options for engaging external auditors (agenda pages 44-47) and reminded the Committee that they had agreed at the previous meeting that their preferred option was to join a sector-led procurement exercise from Public Sector Audit Appointments Ltd. The Head of Audit West said that it had been for full Council to decide how to proceed and they had approved the use of PSAA in November. A Member said that he understood that a cap would be set on the amount of work that any single audit company would be able to undertake for a Council. Mr Henderson replied that audit companies would not be able to combine the role of external auditor with any other kind of work for a Council, so they would be faced with choices about what kind of Council work to accept.

Mr Henderson drew attention to two changes to the CIPFA/LASAAC Local Authority Accounting Code for 2016/17 (agenda page 49). CIPFA/LASAAC had now announced that the provision relating to measuring the costs of the Highway

Networks Asset would be deferred and that a decision about its implementation would be made in March 2017. The external auditor would therefore not do further detailed work on this until the final decision on implementation had been taken. The other change related to the Comprehensive Income and Expenditure Statement. Because of this requirement the 2015/16 figures would have to be restated. The Head of Audit West said that this change would make it easier for Members to read the accounts, since the revenue budget report and the mid-year budget position reports would be in exactly the same format as that used in the annual accounts.

Mr Henderson drew attention to training events and workshops open to Members (agenda page 54). The Head of Audit West suggested that a regional training event for members of corporate audit committees might be helpful. This would probably be hosted by North Somerset Council. Members indicated interest.

RESOLVED to note the report and updates provided by the external auditor.

120 TREASURY MANAGEMENT 6 MONTH PERFORMANCE UPDATE

The Divisional Director – Business Support presented this item.

He said that the report covered actual Treasury Management activities for the first six months of the current financial year. He said the policy of keeping the cash balances to as near zero as possible in order to minimise investments and borrowings had continued. During the period it had been possible to repay £5m of borrowing. There would have to be extra borrowing later in the current financial year as capital schemes are completed. As a result of a single-member decision an £8m stake in a commercial estate in Bath had been purchased, which would have to be funded at some point during the year. The policy of not holding direct investments in the Eurozone had continued. The Bank of England base rate cut would eventually feed through and he expected investment returns to fall further.

The Chair asked for an update on the Avon County Council residual debt (paragraph 5.9). The Divisional Director – Business said this is managed by Bristol City Council (BCC) on behalf of all the former Avon authorities. A share of it is notionally allocated to each of the successor councils, who pay BCC for a share of the interest on it. Discussions were taking place with BCC about the possibility of allocating a portion of the debt to the other councils, so that they can more actively manage this debt. The conversation with BCC was challenging, partly because they have had more than five Section 151 Officers within the past fourteen months. They had appointed a new permanent Section 151 Officer this week, whom he would meet in January 2017 in the hope that this matter could be resolved as a priority.

A Member asked whether the Treasury Management strategy would be modified in view of increasing market volatility. The Divisional Director – Business Support replied that the policy of keeping cash balances low would be maintained for as long as the low interest rate environment persisted. The chart on page 64 showed that the Council had been that a substantial proportion of the Council's investments was in the form of loans to other local authorities. This gave the Council a great deal of flexibility and there are quite a few local authorities who need to take on short-term debt. UK bank exposure was low and would probably remain so. Not many banks were looking for loans and the Council was very aware of the risks associated with banks. The Council did not loan money to NatWest because of their current position;

there are now many bankers who do not leave money with NatWest overnight. The Council had considerable exposure to banks, but only those that are AAA rated and the Council's funds were spread between banks to minimise risk. The Council did have a small exposure to building societies. He did not expect a significant change to the Council's current Treasury Management policy over the next twelve months.

RESOLVED:

1. To note the Treasury Management Report to 30th September, prepared in accordance with CIPFA Treasury Code of Practice.

2. To note the Treasury Management Indicators to 30th September 2016.

121 INTERNAL AUDIT 6 MONTH PERFORMANCE UPDATE

The Audit Manager presented the report. He said that this was the sixth-month update against the Internal Audit plan. Appendix 1 contained the Audit Reviews Position Statement as at 30th September 2016. A summary of performance was contained in section 4.2 of the covering report. The level of unplanned work had been high, and had already used more days than the contingency allocation for the whole of this year, as detailed in 4.2.2.

He gave an update on the Member Allowances audit (4.7.2): all underpayments had now been corrected, and money had been recovered for two of the three overpayments and a payment plan put in place for the third.

He commented on the audit of Council vehicles (4.7.3). Members were surprised by the number of weaknesses identified. A Member noted that the scope of the audit was far wider than just financial issues. The Head of Audit West responded that Internal Audit reviewed many different risks and the controls that were in place to mitigate them. The Chair observed that drivers with the Dial-a-Ride with which he was associated were subject to strict procedures because of the requirements of the Road Traffic Act, and wondered why this did not apply to Council drivers. The Audit Manager replied that it was difficult to monitor whether Council drivers had completed the required procedures each morning in the absence of a formal check list. Services needed to ensure that these were provided to drivers. A Member noted that a number of the weaknesses identified were quite fundamental to the safe operation of the vehicle fleet, and wondered what explanation services had given for not carrying out fundamental checks. The Audit Manager replied that fleet managers had felt that they lacked the authority to enforce procedures. The Chair said that if someone was killed by a Council vehicle because daily checks had not been done, the Council could be prosecuted for corporate manslaughter. He suggested that staff who did not carry out these checks should be subject to instant dismissal. A Member said there seemed to be evidence of systemic failure and wondered how that could be addressed. The Audit Manager replied that the problem was that there was a lot of documentation relating to vehicle management, but little had been adopted at the corporate level. Services had accepted the recommendations, but corporate weight needed to be put behind them.

The Head of Audit West updated Members on progress with the Audit West partnership. He said that the partnership was now fully integrated and could now offer itself as a single brand to academies and other external bodies. North Somerset was under severe financial pressure and discussions were taking place with them about the consequences of a further reduction in their contract with the partnership. The Divisional Director – Business Support said that the Cabinet and Council had, as part of the 2016/17 budget plan, to give approval to Audit West becoming a stand-alone company to allow it to market its services more effectively, because as part of the Council it was under legal restrictions about the level of commercial activity it could undertake.

RESOLVED to note progress made against the Internal Audit Plan for 2016/17.

122 COUNTER FRAUD ANNUAL REPORT

The Head of Audit West presented the report.

The Audit Manager commented on the Internal Audit targeted investigations (section 4.3). The Divisional Director – Business Support said in relation to the second case that the amount of Deputyship work had increased by something like 200% over the last four years. The Deputyship role required specialist expertise and financial trust. There was a high turnover of Deputyship officers. The case highlighted the responsibilities attaching to the role.

RESOLVED to note:

(a) the Counter Fraud Strategy;
(b) the updated Anti-Bribery Policy;
(c) the updated Anti-Money Laundering Policy.

The meeting ended at 3.31 pm

Chair(person) ....

Date Confirmed and Signed ....

Prepared by Democratic Services

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Bath & North East Somerset Council		
MEETING:	**Corporate Audit Committee**	
MEETING DATE:	**9th February 2017**	EXECUTIVE FORWARD PLAN REFERENCE:
TITLE:	**Treasury Management Strategy Statement and Investment Strategy 2017/18**	
WARD:	All	
AN OPEN PUBLIC ITEM		

List of attachments to this report:

Appendix 1 - Treasury Management Strategy 2017/18

Appendix 2 - Investment Strategy 2017/18

Appendix 3 - Authorised Lending List

Appendix 4 - Economic and Interest Rate Forecast

1 THE ISSUE

1.1 In February 2012, the Council adopted the revised CIPFA Treasury Management in Public services Code of Practice 2011 Edition, 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 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.

1.3 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.

2 RECOMMENDATION

The Corporate Audit Committee recommend to Cabinet -

2.1 the actions proposed within the Treasury Management Strategy Statement (Appendix 1).

2.2 the Investment Strategy as detailed in Appendix 2.

3 RESOURCE IMPLICATIONS (FINANCE, PROPERTY, PEOPLE)

3.1 The resource implications are included in the report and appendices.

4 STATUTORY CONSIDERATIONS AND BASIS FOR PROPOSAL

4.1 This report is a statutory requirement.

5 THE REPORT

Background

5.1 The Local Government Act 2003 requires the Council to 'have regard to' the Prudential Code and to set Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

5.2 The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an 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.

5.3 The suggested strategy for 2017/18 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.

5.4 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 (which includes investments expected to produce revenue savings and generate new income) must be limited to a level whereby the net impact on the revenue budget from: -

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

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

5.5 The revised CIPFA Treasury Management in Public services Code of Practice 2011 Edition, adopted by Council in February 2012, requires the Treasury Management Strategy and policies to be scrutinised by an individual / group of individuals or committee, and the Corporate Audit Committee have been nominated by Council to carry out this function, and the report is on the agenda for the 9th February 2017 meeting.

2017/18 Treasury Management & Investment Strategy

5.6 The Strategy Statement for 2016/17 set Treasury Indicators for 2016/17 – 2018/19, which included a total borrowing requirement at the end of 2016/17 of £184 million. At the end of December 2016, external borrowing was at £120.0 million, which may increase before the end of the 2016/17 financial year should a review of the daily cashflow highlight additional liquidity funding is required.

5.7 The proposed Treasury Management Strategy is attached as Appendix 1 and includes the Treasury Management Indicators required by the Treasury Management Code.

5.8 The proposed investment strategy recognises the Council's current position as the accountable body for West of England Funds, including Regional Infrastructure Fund and Local Growth Fund. As and when this role moves to the West of England Mayoral Combined Authority (WoE MCA) then these arrangements will be covered in the WoE MCA's Treasury Management Strategy Statement

5.9 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.

5.10 The budget report, which is also on the agenda, includes appropriate provision for the revenue costs of the capital programme in accordance with this Treasury Management Strategy.

5.11 Appendix 1 also details the Council's current portfolio position as at 31st December 2016, which shows after the netting off of the £60.1 million investments, the Council's net debt position was £59.9 million.

5.12 The 2017/18 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, and the financial press. This has been the case in recent years, which protected the Council against losses of investment in Icelandic banks.

5.13 The Counterparty listing in Appendix 3 includes credit ratings from three agencies, as well as a sovereign rating for each country. Counterparties who now meet the minimum criteria as recommended in Appendix 2 as at 31st December 2016 are included in the listing in Appendix 3.

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

6 RATIONALE

6.1 This report is a statutory requirement.

6.2 : In accordance with the CLG Guidance, the Council will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, or in the Authority's capital programme or in the level of its investment balance

7 OTHER OPTIONS CONSIDERED

7.1 The Chief Financial Officer, having consulted the Cabinet Member for Finance and Efficiency, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are the table below.

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

8 CONSULTATION

8.1 Consultation has been carried out with the Cabinet Member for Finance & Efficiency, Section 151 Finance Officer and Monitoring Officer.

8.2 Consultation was carried out via e-mail.

9 RISK MANAGEMENT

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

9.2 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 Arlingclose.

9.3 The 2011 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. The Corporate Audit Committee carries out this scrutiny.

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

Contact person	*Tim Richens - 01225 477468 ; Giles Oliver - 01225 477022* *Tim_Richens@bathnes.gov.uk; Giles_Oliver@bathnes.gov.uk*
Background papers	*2016/17 Treasury Management & Investment Strategy.*
Please contact the report author if you need to access this report in an alternative format	

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APPENDIX 1

TREASURY MANAGEMENT STRATEGY – 2017/2018

Introduction

In February 2012 the Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice Fully Revised 2011 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year.

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.

The Authority has substantial amounts of borrowing and lending, and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

Revised strategy: In accordance with the CLG Guidance, the Authority will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, or in the Authority's capital programme or in the level of its investment balance.

Treasury Borrowing Limits for 2017/18 to 2019/20

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 2017/18 – 2019/20

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

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

	2017/18
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:

	2017/18	2018/19	2019/20
Upper limit on fixed interest rate exposures	£306m	£350m	£361m
Upper limit on variable interest rate exposures	£206m	£250m	£262m

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments 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	75%	0%
24 months and within five years	75%	0%
Five years and within 10 years	100%	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 long-term principal sum invested to final maturities over 364 days will be:

	2017/18	2018/19	2019/20
Limit on proportion of principal invested over 364 days	£50m	£50m	£50m

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 cash-flow and future capital receipts as the preferred financing method for the capital programme.

	2017/18	2018/19	2019/20
Operational boundary – borrowing	£306m	£350m	£361m
Operational boundary – other long-term liabilities	£2m	£2m	£2m
Operational boundary – TOTAL	**£308m**	**£352m**	**£363m**
Authorised limit – borrowing	£338m	£382m	£392
Authorised limit – other long-term liabilities	£2m	£2m	£2m
Authorised limit – TOTAL	**£340m**	**£384m**	**£394m**

External Context & Prospects for Interest Rates (from Arlingclose Ltd)

The Council has appointed Arlingclose 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 background: The major external influence on the Authority's treasury management strategy for 2017/18 will be the UK's progress in negotiating a smooth exit from the European Union. Financial markets were wrong-footed by the referendum outcome and have since been weighed down by uncertainty over whether leaving the Union also means leaving the single market. Negotiations are expected to start once the UK formally triggers exit in early 2017 and last for at least two years. Uncertainty over future economic prospects will therefore remain throughout 2017/18.

The fall and continuing weakness in sterling and the near doubling in the price of oil in 2016 have combined to drive inflation expectations higher. The Bank of England is forecasting that Consumer Price Inflation will breach its 2% target in 2017, the first time since late 2013, but the Bank is expected to look through inflation overshoots over the course of 2017 when setting interest rates so as to avoid derailing the economy.

Initial post-referendum economic data showed that the feared collapse in business and consumer confidence had not immediately led to lower GDP growth. However, the prospect of a leaving the single market has dented business confidence and resulted in a delay in new business investment and, unless counteracted by higher public spending or retail sales, will weaken economic growth in 2017/18.

Looking overseas, with the US economy and its labour market showing steady improvement, the market has priced in a high probability of the Federal Reserve increasing interest rates in December 2016 (*). The Eurozone meanwhile has continued to struggle with very low inflation and lack of momentum in growth, and the European Central Bank has left the door open for further quantitative easing.

The impact of political risk on financial markets remains significant over the next year. With challenges such as immigration, the rise of populist, anti-establishment parties and negative interest rates resulting in savers being paid nothing for their frugal efforts or even penalised for them, the outcomes of Italy's referendum on its constitution (December 2016) (*), the French presidential and general elections (April – June 2017) and the German federal elections (August – October 2017) have the potential for upsets.

(*) Updates since Arlingclose drafting i) US interest rates were raised by 0,25% ii) Italy rejected constitutional changes

Credit outlook: Markets have expressed concern over the financial viability of a number of European banks recently. Sluggish economies and continuing fines for pre-crisis behaviour have weighed on bank profits, and any future slowdown will exacerbate concerns in this regard.

Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however continue to fall.

Interest rate forecast: The Authority's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.25% during 2017/18**.** The Bank of England has, however, highlighted that excessive levels of inflation will not be tolerated for sustained periods. Given this view and the current inflation outlook, further falls in the Bank Rate look less likely. Negative Bank Rate is currently perceived by some policymakers to be counterproductive but, although a low probability, cannot be entirely ruled out in the medium term, particularly if the UK enters recession as a result of concerns over leaving the European Union.

Gilt yields have risen sharply, but remain at low levels. The Arlingclose central case is for yields to decline when the government triggers Article 50. Long-term economic fundamentals remain weak, and the quantitative easing (QE) stimulus provided by central banks globally has only delayed the fallout from the build-up of public and private sector debt. The Bank of England has defended QE as a monetary policy tool, and further QE in support of the UK economy in 2017/18 remains a possibility, to keep long-term interest rates low.

Arlingclose Interest Rate Forecasts

Arlingclose central interest rate forecast – December 2016

	Bank Rate	3 month LIBID	12 month LIBID	20-year gilt yield*
Q1 2017	0.25	0.25	0.60	1.70
Q2 2017	0.25	0.25	0.50	1.50
Q3 2017	0.25	0.25	0.50	1.40
Q4 2017	0.25	0.30	0.50	1.40
H1 2018	0.25	0.30	0.50	1.40
H2 2018	0.25	0.30	0.55	1.43
H1 2019	0.25	0.30	0.77	1.53
H2 2019	0.25	0.30	0.90	1.63

* The Council can currently borrow from the PWLB at 0.80% above gilt yields

The Council has budgeted for investment interest rates that will be made at an average rate of 0.3% for 2017/18 & beyond, reflecting the planned short-term duration of investments.

A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix 3.

Local Context

Current Portfolio Position

The Council's treasury portfolio position at 31st December 2016 comprised:

	Principal	Ave. rate
	£m	%
External Borrowing		
Fixed rate funding – PWLB	80	3.93
Fixed rate funding – LA's	20	1.16
Variable rate funding – LOBOs	20	4.50*
Other long term liabilities	Nil	N/A
TOTAL GROSS EXTERNAL DEBT	**120.0**	**3.56**
Investments		
Short Term Investments	60.1	0.40
Long Term Investments	Nil	N/A
TOTAL INVESTMENTS**	**60.1**	**0.40**
NET DEBT	**59.9**	**3.16**

* 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 CHC Pooled budgets.

Borrowing Strategy

As at 31st December 2016, the Council held £120.0 million of loans, of which £110m were long-term, 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 2017 is expected to be £223 million, and is forecast to rise to £338 million by March 2018 as capital expenditure is incurred.

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

The maximum expected long-term borrowing requirement for 2017/18 is:

	£m
Not borrowed in previous years	*103*
Forecast increase in CFR	*115*
Loans maturing in 2017/18	*0*
TOTAL	***218***

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

By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal borrowing will be monitored regularly against the potential risk for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Arlingclose will assist the Authority with this 'cost of carry' and breakeven analysis, which may determine whether the Authority borrows additional sums at long-term fixed rates in 2017/18 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

Alternatively, the Authority may arrange forward starting loans during 2017/18, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

In addition, the Authority may borrow short-term loans (normally for up to one month) 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 (PWLB) and any successor body
- any institution approved for investments that meets the investment criteria (this includes other local authorities)
- any other bank or building society approved by the Prudential Regulation Authority to operate in the UK
- UK public and private sector pension funds (except the Avon Pension Fund)
- Capital market bond investor
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

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

- operating and finance leases
- hire purchase
- Private Finance Initiative
- sale and leaseback

The Authority has previously raised the majority of its long-term borrowing from the Public Works Loan Board, but it continues to investigate other sources of finance, such as local authority loans and bank loans, that may be available at more favourable rates.

LGA Bond Agency: UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities may be required to provide bond investors with a joint and several guarantee over the very small risk that other local authority borrowers default on their loans; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be subject to specific approval in accordance with the Council's appropriate delegation.

The Authority holds £20m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBOS have options during 2017/18, and although the Authority understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Authority will take the option to repay LOBO loans at no cost if it has the opportunity to do so.

Short-term and variable rate loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

Debt Rescheduling

The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Some bank lenders may also be prepared to negotiate premature redemption terms. The Authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall saving or reduction in risk.

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 and callable deposits). The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

The Authority 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 Authority is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

Derivative counterparties
Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

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APPENDIX 2

INVESTMENT STRATEGY

Investment Policy

Both the CIPFA Code and the CLG Guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

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 recent 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. The regulations require 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 1st April 2010. The Fund's investment managers (currently the subject of Fund Pooling Proposals) 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 0.3% of the overall assets of the Fund. These investments will operate within the framework of this Investment Strategy, but the maximum counterparty limit and investment term with any counterparty are set annually by the Avon Pension Fund Committee. These limits are in addition to the Council's limits for counterparties as set out in Appendix 3.

The West of England Mayoral Combined Authority (MCA)

The West of England Combined Authority (MCA) is expected to be established in the first part of 2017, with elections for the West of England Mayor to take place in May 2017. The MCA will have its own investment and borrowing powers, and it is expected that transfers of responsibilities will ultimately lead to changes in the Bath and North Council's cash flows. However at this stage it is not considered that any changes to the Council's Treasury Management Strategy are necessary and no changes are being recommended arising from the establishment of the MCA.

The Chief Finance Officer will be exploring options to undertake a lead role for the Treasury Management Function, with due recovery of cost. The MCA will be required to approve its own Treasury Management Strategy Statement.

West of England Revolving Investment Fund (RIF)

In 2016/17 Bath and North East Somerset Council was the Accountable Body for the West of England Revolving Investment Fund, and acts as an agent holding Government grants until they are ready to be distributed to Local Authorities for infrastructure works over the coming years.

It is expected that this role will transfer to the MCA, following completion of the quarterly grant distributions. Investment with maturity dates beyond the date of transfer will be paid to the MCA on maturity along with its ring-fenced interest. The alternative may be to novate these investments.

These funds are kept separate from those of the Council, and therefore do not form part of the Council's counterparty limit restrictions. The funds are invested primarily to protect the capital, and in order to achieve this high level of capital security, investments are made predominately with UK Central Government and UK Local Authorities. Any interest earned on these investments is reinvested into the fund.

Local Growth Fund (LGF)

In 2016/17 the Council, acting in its capacity as Accountable Body for the West of England Local Enterprise Partnership (WoE LEP), received £42.407m of Local Growth Fund (LGF) from Central Government. These are projected to be fully spent after quarter 4 claims are settled.

The Local Growth Fund was allocated through competitive bidding, following submission of a Strategic Economic Plan by the LEP outlining local priorities to maximise growth, and is part of the wave of Growth Deals negotiated with Government, which were first announced in July 2014, and expanded in January 2015. Following the recent Spending Review, the West of England has an indicative LGF allocation totalling £149.296m to 2020/21.

The LEP determines the priority infrastructure projects to receive funding, including investment in transport improvements, superfast broadband and training facilities for young people. To maximise local flexibility, it is not tied to specific projects; areas can flex funding between individual schemes to respond to local changes.

Investments are made in line with the council's overall Treasury Management Strategy. Interest is earmarked to fund the Council's corporate support and governance costs that come with performing the Accountable Body function for the LEP.

It is expected in 2017/18 the Mayoral Combined Authority, will act as Accountable Body for the West of England Local Enterprise Partnership (WoE LEP) and will receive £43.930m of Local Growth Fund (LGF) from Central Government. Any residual funds from 2016-17 will also transfer to the Authority.

Approved Investment Counterparties

The Council may invest its surplus funds with any of the counterparties in the following table, subject to the cash and time limits shown:

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporates	Registered Providers
UK Central Govt.	N/A	N/A	£unlimited 50 Years	N/A	N/A
AAA	£10m 5 Years	£15m 20 Years	£10m 50 Years	£10m 20 Years	£5m 20 Years
AA+	£10m 5 Years	£15m 10 Years	£15m 25 Years	£5m 10 Years	£5m 10 Years
AA	£10m 4 Years	£15m 5 Years	£15m 15Years	£5m 5 Years	£5m 10 Years
AA-	£10m 3 Years	£15m 4 Years	£10m 10 Years	£5m 4 Years	£5m 10 Years
A+	£10m 2 Years	£15m 3 Years	£10m 5 Years	£5m 3 Years	£5m 5 Years
A	£10m 13 Month	£10m 2 Years	£10m 5 Years	£5m 2 Years	£5m 5 Years
A-	£10m 6 Months	£10m 13 months	£10m 5 Years	£5m 13 Months	£5m 5 Years
BBB+	£5m 3 Months	£10m 6 Months	£10m 2 Years	£3m 6 months	£3m 2 Years
BBB	£5m Overnight	£5m 3 Months	N/A	N/A	N/A
None	£1m 6 Months	N/A	£10m 25 Years	£50,000 5 Year	£3m 5 Years
Pooled Funds	£10m Per Fund				

The majority of the Council's investments will be made for relatively short periods and in higher credit rated investments, giving priority to security and liquidity ahead of yield. However, where the Council has identified a core cash balance that is not required for any cash outflows in the short term, these funds will be considered suitable for a wider range of investments, with a greater focus on achieving a level of investment income that can support Council services. These may include long-term investments with registered providers of social housing, small businesses or corporate bond funds where an enhanced return is paid to cover the additional risks presented. Standard risk mitigation techniques, such as wide diversification and external credit assessments, will be employed, and no such investment will be made without a specific recommendation from the Council's treasury management adviser.

In addition, the Authority may invest with organisations and pooled funds without credit ratings, following an external credit assessment and advice from the Authority's treasury management adviser.

Banks Unsecured

Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail.

Current Bank Account: The Council's current accounts are held with National Westminster Bank plc (NatWest), which is close to the bottom of the above credit rating criteria. The Council will treat NatWest as "high credit quality" for the purpose of making investments that can be withdrawn on the next working day, subject to the bank maintaining a credit rating no lower than BBB-.

Banks Secured

Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

Government

Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

Corporates
Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent.
Loans to unrated companies will only be made as part of a diversified pool in order to spread the risk widely. They will however only be made following a favourable external credit assessment and on the specific advice of the Council's treasury management adviser.

Registered Providers
Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain the likelihood of receiving government support if needed.

Pooled Funds
Shares in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

Other Organisations
The Council may also invest cash with other organisations, for example by making loans to small businesses. Because of the higher perceived risk of unrated businesses, such investments may provide considerably higher rates of return. They will however only be made following a favourable external credit assessment and on the specific advice of the Council's treasury management adviser.

Risk Assessments & 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, unless an investment-specific rating is available.

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 an BBB+ rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

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 Chief Financial Officer.

The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. 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.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

Foreign countries

Investments in foreign countries will be limited to those that hold an AAA or AA+ sovereign credit rating from all three major credit rating agencies and to a maximum of £15m per country for those rated AAA and £10 million per country for those rated AA+. There is no limit on investments in the UK, irrespective of the sovereign credit rating.

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).

Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

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 "high credit quality" organisations as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

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 denominated in foreign currencies, 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, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown below.

	£m
Total long-term investments	50
Total investments without credit ratings or rated below A-	10
TOTAL	**60**

The time limit for long-term investments in UK Local Authorities & Local Government will be 50 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.

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 2017/18

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 approved credit ratings.

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. A wider range of instruments, including structured deposits, certificates of deposit, gilts and corporate bonds may be used to diversify the portfolio. The use of external fund managers that have the skills and resources to manage the risks inherent in a portfolio of long-term investments may be considered.

The Council has already reduced its cash position to repay fixed interest debt held at higher rates. The continuing low level of short-term interest rates will mean the on-going use of internal cash resources to minimise the new borrowing. This approach will be regularly reviewed in light of market conditions and the wider economic outlook.

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

<u>Treasury management advisers</u>
The Council's has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues, although 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 Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.

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 2017/18 authorised borrowing limit of £347 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.

Proposed Counterparty List - Unsecured Bank Investments

2017/18

CRITERIA	Max Duration	Authority Limit (£m)	FITCH RATINGS S/Term	FITCH RATINGS L/Term	FITCH RATINGS Support	Moody's Ratings S/Term	Moody's Ratings L/Term	S&P Ratings S/Term	S&P Ratings L/Term
UK Banks	**Sovereign Rating**			**AA**			**Aa1**		**Aau**
Barclays Bank plc	6 months	10	F1	A	5	P-1	A1	A-2	A-
Close Brothers Ltd	13 months	10	F1	A	5	P-1	Aa3		
Goldman Sachs International	13 months	10	F1	A		P-1	A1	A-1	A+
HSBC Bank plc	3 Years	10	F1+	AA-	1	P-1	Aa2	A-1+	AA-
Lloyds Banking Group									
Lloyds Bank plc	2 Years	10	F1	A+	5	P-1	A1	A-1	A
Bank of Scotland plc	2 Years	10	F1	A+	5	P-1	A1	A-1	A
Royal Bank of Scotland Group									
National Westminster Bank plc	3 Months	5	F2	BBB+	5	P-2	A3	A-2	BBB+
Royal Bank of Scotland plc	3 Months	5	F2	BBB+	5	P-2	A3	A-2	BBB+
Santander UK plc **(domiciled in UK)**	13 months	5	F1	A	2	P-1	Aa3	A-1	A
UK Building Societies									
Nationwide	13 months	10	F1	A	5	P-1	Aa3	A-1	A
Coventry	13 months	10	F1	A	5	P-1	A2	-	-
Leeds	6 months	10	F1	A-	5	P-2	A2	-	-
Foreign Banks									
Australia	**Sovereign Rating**			**AAA**			**Aaa**		**AAAu**
Australia & New Zealand Banking Group	3 Years	10	F1+	AA-	1	P-1	Aa2	A-1+	AA-
Commonwealth Bank of Australia	3 Years	10	F1+	AA-	1	P-1	Aa2	A-1+	AA-
National Australia Bank Ltd	3 Years	10	F1+	AA-	1	P-1	Aa2	A-1+	AA-
Westpac Banking Corporation	3 Years	10	F1+	AA-	1	P-1	Aa2	A-1+	AA-
Canada	**Sovereign Rating**			**AAA**			**Aaa**		**AAA**
Bank of Montreal	2 Years		F1+	AA-	2	P-1	Aa3	A-1	A+
Bank of Nova Scotia	2 Years	10	F1+	AA-	2	P-1	Aa3	A-1	A+
Canadian Imperial Bank of Commerce	2 Years	10	F1+	AA-	2	P-1	Aa3	A-1	A+
Royal Bank of Canada	3 Years	10	F1+	AA	2	P-1	Aa3	A-1+	AA-
Toronto-Dominion Bank	3 Years	10	F1+	AA-	2	P-1	Aa1	A-1+	AA-
		10							
Finland	**Sovereign Rating**			**AA+**			**Aa1**		**AA+**
OP Corporate Bank plc	2 Years	10				P-1	Aa3	A-1+	AA-
Germany	**Sovereign Rating**			**AAA**			**Aaa**		**AAAu**
Landesbank Hessen-Thuringen	13 months	10	F1+	A+		P-1	A1	A-1	A
Netherlands	**Sovereign Rating**			**AAA**			**Aaa**		**AAAu**
Bank Nederlandse Gemeenten	5 Years	10	F1+	AA+	1	P-1	Aaa	A-1+	AAA
Cooperatieve Rabobank UA	2 Years	10	F1+	AA-		P-1	Aa2	A-1	A+
ING Bank NV	13 months	10	F1	A+	5	P-1	A1	A-1	A
Singapore	**Sovereign Rating**			**AAA**			**Aaa**		**AAAu**
Development Bank of Singapore Ltd	3 Years	10	F1+	AA-	1	P-1	Aa1	A-1+	AA-
Oversea-Chinese Banking Corp	3 Years	10	F1+	AA-	1	P-1	Aa1	A-1+	AA-
United Overseas Bank Ltd	3 Years	10	F1+	AA-	1	P-1	Aa1	A-1+	AA-
Sweden	**Sovereign Rating**			**AAA**			**Aaa**		**AAAu**
Svenska Handelsbanken	3 Years	10	F1+	AA	2	P-1	Aa2	A-1+	AA-
Nordea Bank NV	3 Years	10	F1+	AA-	2	P-1	Aa3	A-1+	AA-
Switzerland	**Sovereign Rating**			**AAA**			**Aaa**		**AAAu**
Credit Suisse AG	13 months	10	F1+	A	5	P-1	A1	A-1	A
USA	**Sovereign Rating**			**AAA**			**Aaa**		**AA+u**
J P Morgan Chase Bank NA	2 Years	10	F1+	AA-	5	P-1	Aa3	A-1	A+
Supernational									
Council of Europe Development	5 Years	10	F1+	AA+	-	P-1	Aa1	A-1+	AA+
European Bank for Reconstruction & Dev	5 Years	10	F1+	AAA	-	P-1	Aaa	A-1+	AAA
European Investment Bank	5 Years	10	F1+	AAA	-	P-1	Aaa	A-1+	AAA
Inter-American Development Bank	5 Years	10	F1+	AAA	-	P-1	Aaa	A-1+	AAA
IBRD (World Bank)	5 Years	10	F1+	AAA	-	P-1	Aaa	A-1+	AAA
Nordic Investment Bank	5 Years	10	-	-	-	P-1	Aaa	A-1+	AAA

Summary Guide to Credit Ratings

Rating	Details
AAA	Highest credit quality – lowest expectation of default, which is unlikely to be adversely affected by foreseeable events.
AA	Very high credit quality - expectation of very low default risk, which is not likely to be significantly vulnerable to foreseeable events.
A	High credit quality - expectations of low default risk which may be more vulnerable to adverse business or economic conditions than is the case for higher ratings.
BBB	Good credit quality - expectations of default risk are currently low but adverse business or economic conditions are more likely to impair this capacity.
BB	Speculative - indicates an elevated vulnerability to default risk, particularly in the event of adverse changes in business or economic conditions over time.
B	Highly speculative - indicates that material default risk is present, but a limited margin of safety remains. Capacity for continued payment is vulnerable to deterioration in the business and economic environment.
CCC	Substantial credit risk - default is a real possibility.
CC	Very high levels of credit risk - default of some kind appears probable.
C	Exceptionally high levels of credit risk - default is imminent or inevitable.
RD	Restricted default - indicates an issuer that has experienced payment default on a bond, loan or other material financial obligation but which has not entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, and which has not otherwise ceased operating.
D	Default - indicate san issuer that has entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, or which has otherwise ceased business.

Appendix 4 –

Arlingclose Economic & Interest Rate Forecast

Underlying assumptions:

- The medium term outlook for the UK economy is dominated by the negotiations to leave the EU. The long-term position of the UK economy will be largely dependent on the agreements the government is able to secure with the EU and other countries.

- The global environment is also riddled with uncertainty, with repercussions for financial market volatility and long-term interest rates. Donald Trump's victory in the US general election and Brexit are symptomatic of the popular disaffection with globalisation trends. The potential rise in protectionism could dampen global growth prospects and therefore inflation. Financial market volatility will remain the norm for some time.

- However, following significant global fiscal and monetary stimulus, the short term outlook for the global economy is somewhat brighter than earlier in the year. US fiscal stimulus is also a possibility following Trump's victory.

- Recent data present a more positive picture for the post-Referendum UK economy than predicted due to continued strong household spending.

- Over the medium term, economic and political uncertainty will likely dampen investment intentions and tighten credit availability, prompting lower activity levels and potentially a rise in unemployment.

- The currency-led rise in CPI inflation (currently 1.0% year/year) will continue, breaching the target in 2017, which will act to slow real growth in household spending due to a sharp decline in real wage growth.

- The depreciation in sterling will, however, assist the economy to rebalance away from spending. The negative contribution from net trade to GDP growth is likely to diminish, largely due to weaker domestic demand. Export volumes will increase marginally.

- Given the pressure on household spending and business investment, the rise in inflation is highly unlikely to prompt monetary tightening by the Bank of England, with policymakers looking through import-led CPI spikes to the negative effects of Brexit on economic activity and, ultimately, inflation.

- Bank of England policymakers have, however, highlighted that excessive levels of inflation will not be tolerated for sustained periods. Given this view and the current inflation outlook, further monetary loosening looks less likely.

Forecast:

- Globally, the outlook is uncertain and risks remain weighted to the downside. The UK domestic outlook is uncertain, but likely to be weaker in the short term than previously expected.
- The likely path for Bank Rate is weighted to the downside. The Arlingclose central case is for Bank Rate to remain at 0.25%, but there is a 25% possibility of a drop to close to zero, with a very small chance of a reduction below zero.
- Gilt yields have risen sharply, but remain at low levels. The Arlingclose central case is for yields to decline when the government triggers Article 50.

	Dec-16	**Mar-17**	**Jun-17**	**Sep-17**	**Dec-17**	**Mar-18**	**Jun-18**	**Sep-18**	**Dec-18**	**Mar-19**	**Jun-19**	**Sep-19**	**Dec-19**	**Average**
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	**0.12**
Arlingclose Central Case	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**
Downside risk	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	**0.40**
3-month LIBID rate														
Upside risk	0.05	0.05	0.10	0.10	0.10	0.15	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.18**
Arlingclose Central Case	**0.25**	**0.25**	**0.25**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.29**
Downside risk	0.20	0.25	0.25	0.25	0.30	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.34**
1-yr LIBID rate														
Upside risk	0.10	0.10	0.15	0.15	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	**0.23**
Arlingclose Central Case	**0.60**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.60**	**0.70**	**0.85**	**0.90**	**0.90**	**0.90**	**0.65**
Downside risk	0.10	0.15	0.15	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	**0.24**
5-yr gilt yield														
Upside risk	0.25	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.39**
Arlingclose Central Case	**0.50**	**0.40**	**0.35**	**0.35**	**0.35**	**0.40**	**0.40**	**0.40**	**0.45**	**0.50**	**0.55**	**0.60**	**0.65**	**0.45**
Downside risk	0.30	0.45	0.45	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	**0.47**
10-yr gilt yield														
Upside risk	0.30	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.39**
Arlingclose Central Case	**1.15**	**0.95**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.90**	**0.95**	**1.00**	**1.05**	**1.10**	**1.15**	**0.96**
Downside risk	0.30	0.45	0.45	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	**0.47**
20-yr gilt yield														
Upside risk	0.25	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.39**
Arlingclose Central Case	**1.70**	**1.50**	**1.40**	**1.40**	**1.40**	**1.40**	**1.40**	**1.45**	**1.50**	**1.55**	**1.60**	**1.65**	**1.70**	**1.75**
Downside risk	0.40	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	**0.57**
50-yr gilt yield														
Upside risk	0.25	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.39**
Arlingclose Central Case	**1.60**	**1.40**	**1.30**	**1.30**	**1.30**	**1.30**	**1.30**	**1.35**	**1.40**	**1.45**	**1.50**	**1.55**	**1.60**	**1.41**
Downside risk	0.40	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	**0.57**

Bath & North East Somerset Council		
MEETING:	**Corporate Audit Committee**	
MEETING DATE:	**9th February 2017**	**AGENDA ITEM NUMBER**
TITLE:	**External Audit Update**	EXECUTIVE FORWARD PLAN REFERENCE: E
AN OPEN PUBLIC ITEM		
List of attachments to this report: **Appendix 1 – External Audit Update Report**		

1 THE ISSUE

1.1 The External Auditor will provide a general update to the Committee on their work..

2 RECOMMENDATION

2.1 The Corporate Audit Committee is asked to note the report and updates provided by the External Auditor.

3 FINANCIAL IMPLICATIONS

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

4 THE REPORT

4.1 Appendix 1 provides an update on the External Auditors work for Bath & North East Somerset Council along with references to a number of national initiatives, announcements and publications which may be of use to the Council.

4.2 The External Auditor will provide a fuller verbal briefing on all these areas at the meeting.

5 RISK MANAGEMENT

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

6. EQUALITIES

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

7 CONSULTATION

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

Contact person	Jeff Wring (01225 47323)
Background papers	
Please contact the report author if you need to access this report in an alternative format	

Corporate Audit Committee
Bath and North East Somerset Council
Progress Report and Update
Year ended 31 March 2017

February 2017

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Introduction

This paper provides the Corporate Audit Committee with a report on progress in delivering our responsibilities as your external auditors.

Members of the Corporate Audit Committee can find further useful material on our website www.grant-thornton.co.uk, where we have a section dedicated to our work in the public sector. Here you can download copies of our publications:

- CFO Insights – reviewing council's 2015/16 spend (December 2016); http://www.grantthornton.co.uk/en/insights/cfo-insights-reviewing-councils-201516-spend/
- Fraud risk, 'adequate procedures', and local authorities (December 2016); http://www.grantthornton.co.uk/en/insights/fraud-risk-adequate-procedures-and-local-authorities/
- New laws to prevent fraud may affect the public sector (November 2016); http://www.grantthornton.co.uk/en/insights/new-laws-to-prevent-fraud-may-affect-the-public-sector/
- Brexit: local government – transitioning successfully (December 2016) http://www.grantthornton.co.uk/en/insights/brexit-local-government--transitioning-successfully/

If you would like further information on any items in this briefing, or would like to register with Grant Thornton to receive regular email updates on issues that are of interest to you, please contact either your Engagement Lead or Engagement Manager.

The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our audit process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect your business or any weaknesses in your internal controls. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

Progress at February 2017

2016/17 work	Planned Date	Complete?	Comments
Fee Letter We are required to issue a 'Planned fee letter for 2016/17' by the end of April 2016	April 2016	Yes	
Accounts Audit Plan We are required to issue a detailed accounts audit plan to the Council setting out our proposed approach in order to give an opinion on the Council's 2016-17 financial statements.	April 2017	In progress	Our plan will be presented to the Corporate Audit Committee at its meeting on 13th April 2017.
Interim accounts audit Our interim fieldwork visit plan included: • updated review of the Council's control environment • updated understanding of financial systems • review of Internal Audit reports on core financial systems • early work on emerging accounting issues • early substantive testing • Value for Money conclusion risk assessment.	January 2017	Yes	There are no significant issues to bring to your attention.

Progress at February 2017

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2016/17 work	Planned Date	Complete?	Comments
Final accounts audit Including: • audit of the 2016/17 financial statements • proposed opinion on the Council's accounts • proposed Value for Money conclusion • review of the Council's disclosures in the consolidated accounts against the Code of Practice on Local Authority Accounting in the United Kingdom 2015/16	June 2017	Not yet due	As a dry run for the 2017/18 accounts, when the deadline for the draft accounts is brought forward to 31st May, the finance team plan to complete the 2016/17 draft accounts by 31st May 2017. We are due to start our audit on 5th June and to complete it by end of June. To enable us to complete the work in this short period of time we will need the finance team and others to provide good quality, comprehensive working papers and to promptly respond to queries and requests raised during the audit.
Value for Money (VfM) conclusion The scope of our work is unchanged to 2015/16 and is set out in the final guidance issued by the National Audit Office in November 2016. The Code requires auditors to satisfy themselves that; "the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources". The guidance confirmed the overall criterion as; "in all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people". The three sub criteria for assessment to be able to give a conclusion overall are: • Informed decision making • Sustainable resource deployment • Working with partners and other third parties	January to April 2017	Not yet due	We are currently completing our risk assessment for the value for money conclusion. This will determine the work to be undertaken to address significant risks. Further details will be included in the Audit Plan to be presented to the Corporate Audit Committee in April 2017. However, our expectation is that our work will focus on the Council's financial performance and medium term financial plan.
Other areas of work Meetings with Members, Officers and others	We met with the Divisional Director: Business Support on 4th January. At the meeting we were given an update on issues such as the Council's financial position, devolution, Your Care Your Way and the Council's development company (Aequus).		
	We informed the Committee at its meeting in December 2016 that the requirement to include the highways network asset in the accounts had been deferred. However, we reviewed the progress made by the Council so that any issues could be addressed. From the limited review undertaken, we did not identify any issues to bring to the Council's attention.		

Technical Matters

Delivering Good Governance

In April, CIPFA and SOLACE published 'Delivering Good Governance in Local Government: Framework (2016)' and this applies to annual governance statements prepared for the 2016/17 financial year.

The key focus of the framework is on sustainability – economic, social and environmental – and the need to focus on the longer term and the impact actions may have on future generations.

Local authorities should be:

- reviewing existing governance arrangements against the principles set out in the Framework
- developing and maintaining an up-to-date local code of governance, including arrangements for ensuring on-going effectiveness
- reporting publicly on compliance with their own code on an annual basis and on how they have monitored the effectiveness of their governance arrangements in the year and on planned changes.

The framework applies to all parts of local government and its partnerships and should be applied using the spirit and ethos of the Framework rather than just rules and procedures.

Sector issues and developments

Local Government Association

Below is a selection of reports issued recently which may be of interest to audit committee members. Thee are available on the website:

http://www.local.gov.uk/publications

Department for Communities and Local Government

Provisional LG Finance Settlement for 2017/18

12 January 2017
The LGA has published its responses to the DCLG consultation on proposals for the local government finance settlement for 2017 to 2018 and for the approach to future local government finance settlements.

http://www.local.gov.uk/documents/10180/8150261/Local+Government+Finance+Settlement+1718+LGA+response.pdf/dd8d32e1-ec9f-4314-8121-7aae2195f89f

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A councillor's workbook on neighbourhood and community engagement

11 January 2017
Neighbourhood and community engagement has a rightful place as one of the key processes involved in planning and decision making. As such, it should not be viewed d as an additional task, but as a core part of the business

Building our homes, communities and future: The LGA housing commission final report

22 December 2016

The Local Government Association (LGA) Housing Commission was established to help councils deliver their ambition for places. It has been supported by a panel of advisers and has engaged with over 100 partners; hearing from councils, developers, charities, health partners, and many others. All partners agree that there is no silver bullet, and all emphasise the pivotal role of councils in helping provide strong leadership, collaborative working, and longer-term certainty for places and the people that live there.

Local Government Association

Below is a selection of reports issued recently which may be of interest to audit committee members. Thee are available on the LGA website:

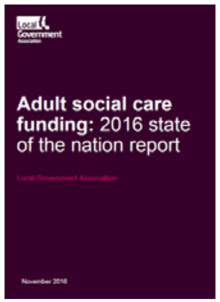
http://www.local.gov.uk/publications

Business Plan December 2016/November 2017

30 December 2016
Britain's exit from the EU means that we are reshaping the way our country is run. Our vision is one of a rejuvenated local democracy, where power from Westminster and from the EU is significantly devolved to local level and citizens feel they have a meaningful vote and real reason to participate in civic life and their communities.

Stronger together: shared management in local government

29 November 2016
Around 45 councils across England share a chief executive and senior management team in about 20 different partnerships. Most also share at least some services. These councils have already delivered savings of at least £60 million through greater efficiencies and the other benefits of collaboration, with more savings planned



Adult social care funding: 2016 state of the nation report

2 November 2016
Adult social care is an absolutely vital public service that supports some of our most vulnerable people and promotes the wellbeing and independence of many more

Grant Thornton

Integrated Thinking and Reporting

Focusing on value creation in the public sector

Grant Thornton has seconded staff to the International Integrated Reporting Council on a pro bono basis for a number of years.

They have been working on making the principles of Integrated Reporting <IR> relevant to the public sector and co-authored a recent report by CIPFA and the World Bank: *Integrated thinking and reporting: focusing on value creation in the public sector - an introduction for leaders.*

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Around one third of global gross domestic product (GDP) is made up by the public sector and this is being invested in ensuring there is effective infrastructure, good educational opportunities and reliable health care. In many ways, it is this investment by the public sector that is helping to create the conditions for wealth creation and preparing the way for the success of this and future generations.

Traditional reporting frameworks, focussed only on historic financial information, are not fit-for-purpose for modern, multi-dimensional public sector organisations.

Integrated Reporting supports sustainable development and financial stability and enables public sector organisations to broaden the conversation about the services they provide and the value they create.

The public sector faces multiple challenges, including:

- Serving and being accountable to a wide stakeholder base;
- Providing integrated services with sustainable outcomes;
- Maintaining a longer-term perspective, whilst delivering in the short term; and
- Demonstrating the sustainable value of services provided beyond the financial.

The <IR> Framework is principle based and enables organisations to tailor their reporting to reflect their own thinking and strategies and to demonstrate they are delivering the outcomes they were aiming for.

Integrated Reporting can help public sector organisations deal with the above challenges by:

- Addressing diverse and often conflicting public accountability requirements;
- Focussing on the internal and external consequences of an organisation's activities;
- Looking beyond the 'now' to the 'near' and then the 'far';
- Considering the resources used other than just the financial.

The report includes examples of how organisations have benefitted from Integrated Reporting.

CIPFA Publications

Challenge question:

- Have you reviewed the CIPFA guide to Integrated Reporting in the public sector?

Apprentice Levy-Are you prepared?

Grant Thornton update

What is the levy?

The UK has been struggling on productivity, now estimated to be 20% behind the G7 average. Developing apprenticeships is set to play a key part in tackling this and bridging the skills gap.

Announced by government in July 2015, the levy is to encourage employers to offer apprenticeships in meeting their skill, workforce and training needs, developing talent internally. The levy is designed to give more control to employers, through direct access to training funds and creation of apprenticeships through the Trailblazer process.

What is the levy?

From April 2017, the way the government funds apprenticeships in England is changing. Some employers will be required to pay a new apprenticeship levy, and there will be changes to the funding for apprenticeship training for all employers.

All employers will receive an allowance of £15,000 to offset against payment of the levy. This effectively means that the levy will only be payable on paybill in excess of £3 million per year.

The levy will be payable through Pay As You Earn (PAYE) and will be payable alongside income tax and National Insurance.

Each employer will receive one allowance to offset against their levy payment. There will be a connected persons rule, similar the Employment Allowance connected persons rule, so employers who operate multiple payrolls will only be able to claim one allowance.

Employers in England are also able to get 'more out than they put in', through an additional government top-up of 10% to their levy contribution.

When employers want to spend above their total levy amount, government will fund 90% of the cost for training and assessment within the funding bands.

The existing funding model will continue until the levy comes into effect May 2017. The levy will apply to employers across all sectors.

Paybill will be calculated based on total employee earnings subject to Class1 National Insurance Contributions. It will not include other payments such as benefits in kind. It will apply to total employee earnings in respect of all employees.

What will the levy mean in practice

Employer of 250 employees, each with a gross salary of £20,000:

Paybill: 250 x £20,000 = £5,000,000

Levy sum: 0.5% x = £25,000

Allowance: £25,000 - £15,000 = £10,000 annual levy

How can I spend my levy funds?

The funding can only be used to fund training and assessment under approved apprenticeship schemes. It cannot be used on other costs associated with apprentices, including wages and remuneration, or training spend for the wider-team.

Through the Digital Apprenticeship Service (DAS), set up by government, employers will have access to their funding in the form of digital vouchers to spend on training.

Training can be designed to suit the needs of your organisation and the requirements of the individual in that role, in addition to specified training for that apprenticeship. Training providers must all be registered with the Skills Funding Agency (SFA).

What do I need to start thinking about now?

- How much is the levy going to cost and have we budgeted for it?
- How do we ensure compliance with the new system?
- Which parts of my current spend on training are applicable to apprenticeships?
- Are there opportunities to mitigate additional cost presented by the levy?
- How is training in my organisation structured?
- How do we develop and align to our workforce development strategy

Off-payroll working in the public sector

The Chancellor's Autumn Statement 2016 speech delivered a number of changes that will impact the UK business environment and raise considerations for you as an employer.

In particular, the Chancellor announced that the measures that were proposed in Budget 2016 that could affect services supplied through personal service companies (PSCs) to the public sector will be implemented.

At present, the so-called IR35 rules require the worker to decide whether PAYE and NIC are due on the payments made by a PSC following an engagement with a public sector body. The onus will be moved to the payer from April 2017. This might be the public sector body itself, but is more likely to be an intermediary, or, if there is a supply chain, to the party closest to the PSC.

The public sector body (or the party closest to the PSC) will need to account for the tax and NIC and include details in their RTI submission.

The existing IR35 rules will continue outside of public sector engagements.

HMRC Digital Tool – will aid with determining whether or not the intermediary rules apply to ensure of "*consistency, certainty and simplicity*"

When the proposals were originally made, the public sector was defined as those bodies that are subject to the Freedom of Information rules. It is not known at present whether this will be the final definition. Establishing what bodies are caught is likely to be difficult however the public sector is defined.

A further change will be that the 5% tax free allowance that is given to PSCs will be removed for those providing services to the public sector.

Impact

- Increased costs
- Responsibility moved to the engager
- Increased risks for the engager
- Consider current arrangements in place

Areas / risks to consider

- Interim and / or temporary staff engaged through an intermediary or PSC
- Where using agencies ensure they're UK based and operating PAYE
- Update on-boarding / procurement systems, processes and controls
- Additional take on checks and staff training / communications
- Review of existing PSC contractor population before April 2017
- Consider moving long term engagements onto payroll
-

Salary Sacrifice Arrangements-Autumn Statement

The Chancellor's Autumn Statement 2016 speech delivered a number of changes that will impact the UK business environment and raise considerations for you as an employer.

In particular, the proposals from earlier this year to limit the tax and NIC advantages from salary sacrifice arrangements in conjunction with benefits will be implemented from April 2017.

Although we await the details, it appears that there is a partial concession to calls made by Grant Thornton UK and others to exempt the provision of cars from the new rules (to protect the car industry). Therefore, the changes will apply to all benefits other than pensions (including advice), childcare, Cycle to Work schemes and ultra-low emission cars.

Arrangements in place before April 2017 for cars, accommodation and school fees will be protected until April 2021, with others being protected until April 2018.

These changes will be implemented from April 2017.

As you can see, there is a limited opportunity to continue with salary sacrifice arrangements and a need also to consider the choice between keeping such arrangements in place – which may still be beneficial – or withdrawing from them

What should you be thinking about?

- Review the benefits you offer - particularly if you have a flex renewal coming up
- Consider your overall Reward and Benefit strategy
- Consider your Employee communications

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Bath & North East Somerset Council		
MEETING:	Corporate Audit Committee	
MEETING DATE:	9th February 2017	**AGENDA ITEM NUMBER**
TITLE:	Annual Governance Statement – 2016/17 Review and Update on 2015/16 Significant Issue(s)	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
List of attachments to this report: Appendix 1 – Annual Governance Review – Outline of Framework. Appendix 2 – Summary of Significant Issue 2015/16 and Actions		

1 THE ISSUE

1.1 The aim of the report is to update the Committee on the Annual Governance Review and allow the Committee to contribute to the process which will result in the publication of the Council's Annual Governance Statement 2016/17.

2 RECOMMENDATION

2.1 The Corporate Audit Committee is asked to note progress of the review and raise any issues for consideration as part of the Annual Governance Review.

3 FINANCIAL IMPLICATIONS

3.1 A robust review of the Council's internal control and governance framework and the subsequent implementation of action plans form an essential part of the financial management framework.

4 THE REPORT

4.1 The Council has adopted a Code of Corporate Governance and uses a methodology for producing an Annual Governance Statement based on the Accounts & Audit Regulations and the CIPFA / SOLACE `Delivering Good Governance in Local Government'. These regulations have recently been updated with some minor changes and our ongoing review reflects these.

4.2 The methodology requires:-

- The involvement of all Divisional Directors
- The use of Service Specialists to review evidence with relation to :-
    - Finance
    - Strategic Performance
    - Corporate Communications
    - Information Governance
    - Human Resources
    - Health & Safety
    - Environmental Impact & Sustainability
    - Equalities & Diversity
    - Safeguarding
    - Procurement

4.3 The review of governance covers all significant corporate systems, processes and controls, spanning the whole range of Council activities, including in particular those designed to ensure:

- Council policies are implemented;
- Quality services are delivered efficiently and effectively;
- Council's values and ethical standards are met;
- Compliance with laws and regulations;
- Financial statements and other published performance information are accurate and reliable;
- Human, financial, environmental and other resources are managed efficiently and effectively.

4.4 The 2016/17 Annual Governance Review has commenced and by March all Divisional Directors will have had the opportunity to contribute to the review and highlight any potential issues for consideration for reporting in the Annual Governance Statement.

4.5 In addition to consulting ‘key’ Corporate Officers and Divisional Directors, Strategic Directors (including the Chief Executive) and Cabinet will be asked for their input.

4.6 The Annual Governance Statement is a ‘management’ statement and as such is signed by the Chief Executive and Leader of the Council whilst the Audit Committee oversee the process and delivery of any actions where significant issues are identified.

4.7 In deciding which issues are `significant' Councils are required to exercise sound judgement and guidance is limited to that provided by the Chartered Institute of Financial Accounts (CIPFA) as follows:

- The issue has seriously prejudiced or prevented achievement of a principal objective;

- The issue has resulted in a need to seek additional funding to allow it to be resolved, or has resulted in a significant diversion of resources from another aspect of the business;
- The issue has led to a material impact on the accounts;
- The audit committee, or equivalent, has advised that it should be considered significant for this purpose;
- The 'Head of Internal Audit' has reported on it as significant, for this purpose, in the annual opinion on the internal control environment;
- The issue, or its impact, has attracted significant public interest or has seriously damaged the reputation of the organisation;
- The issue has resulted in formal action being taken by the Chief Financial Officer and / or the Monitoring Officer.

4.8 Work on the governance review will continue following this Committee meeting. Key milestones in finalising the Annual Governance Statement are:

1) Report to Audit Committee.

2) Report to Senior Management Team.

3) Chief Executive & Leader of the Council sign the Statement linked to the approval of the Annual Accounts.

4.9 It should be noted that a requirement of the Accounts and Audit Regulations 2015 is that the 2017/18 audited Statement of Accounts (including the annual governance statement) will be published by the earlier date of 31st July 2018. Based on this requirement we have already amended the governance review timetable / processes to complete the work within the revised timescales as a 'dry run'.

4.10 As part of the agreed process the Corporate Audit Committee is required to monitor the implementation of any agreed actions which have been recorded against 'Significant Issues' reported in the previous year's Annual Governance Statement. The 2015/16 Annual Governance Statement recorded the financial challenge faced by the Council as a 'Significant Issue'. The description of the Issue and mitigating actions were recorded in the Statement (See Appendix 2).

4.11 The latest position with regard to these actions is as follows -

a) Using the Corporate Plan to help focus services on doing the right things for the Bath & North East Somerset Community; *The Corporate Plan was approved in February 2016 and was used as a framework to help manage the ongoing budget, MTFP and strategic review process.*

b) Using the Medium Term Financial Plan to enable sensible prioritisation of resources in the right areas and transparency on savings to be achieved; *The latest MTFP and budget proposals will be reported to Cabinet and Council in February indicating significant savings and additional income generation proposals totalling £14.7M. A Council Tax increase of 3.5% (including the adult social care 2% increase) is also to be recommended to Council. The Council has a prudent level of general reserves and can use these to support and smooth the effects of policy changes and delivery of the financial savings.*

c) Regularly monitoring of delivery against the annual revenue budget, alongside sensible utilisation and management of its reserves; Performance against budget is regularly reported to Cabinet throughout the year. *The current forecast outturn position reported to February Cabinet is for an overspend of £1,039,000 which equates to 0.37% of gross budgeted spend (excluding Schools).The forecast outturn position includes the* *requirement for the delivery of £12.644m savings as part of the approved budget for 2016/17, a significant element of which was been confirmed as delivered.*

d) Working effectively with Key Partners, especially those in the West of England and in Health to support the most vulnerable in the community; *Significant work at a WOE level has occurred throughout the year over many different areas to improve efficiency and effectiveness of services, most notably agreement to the creation of a new WOE Mayoral Combined Authority and continuation of schemes within the City Region Deal. In addition we have extended our joint working with the NHS through the letting of community health and social care services to Virgin Care through our Your Care Your Way programme.*

e) Adopting a range of innovative tools such as the use of council owned companies, more commercialisation, increases in digital provision, asset rationalisation, shared and devolved services and invest to save initiatives; *Additional support and validation of our proposals was sought by EY and an intensive programme of works occurred throughout the summer and autumn months to identify a range of options to close the existing and future budget gaps. This involved a rigorous process of consideration of innovative and best practice examples from around the country. All of this work was supported closely by Cabinet Portfolio holders and a series of challenge sessions held to clarify and validate proposals and existing budgets.*

f) Enabling its key governance mechanisms to both support key change projects and monitor delivery of significant savings programmes; *All levels of decision making both at officer and member level have been actively involved in the development, delivery and monitoring of savings proposals and associated delivery programmes. Cabinet Members took a very active role in the Strategic Review, budget setting and MTFP processes.*

g) Ensuring that any Strategic Review projects of its key support and governance services such as Finance and Audit enable the strengthening and prioritisation of the right skills and expertise within those functions to support sound financial control. *Both Finance and Audit have continued to ensure that they have prioritised their resources to support the ongoing financial challenge, most notably this included extensive senior finance management involvement within the strategic review, budget setting and MTFP processes.*

4.12 Based on our review work so far and taking into account the key criteria for inclusion and actions relating to the significant issue for 2015/16 we have identified the following areas as meriting further management consideration as to whether they should be included within the 2016/17 statement –

- Ongoing Financial Challenge

- Creation of new WOE Mayoral Combined Authority

- East of Bath Park & Ride Scheme

- Your Care Your Way Programme

This does not mean that there have been governance failures in these areas but rather that they have had a potentially significant impact on the Council's operations, its governance and/or its resources This review work is ongoing and to assist this process the Committee's views are sought about any other issues they would recommend for consideration.

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. No significant issues to report for the Committee.

6. EQUALITIES

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

7. CONSULTATION

7.1 The report was consulted on with the S151 Officer for comment.

Contact person	Andy Cox (01225 477316) Jeff Wring (01225 477323)
Background papers	None
Please contact the report author if you need to access this report in an alternative format	

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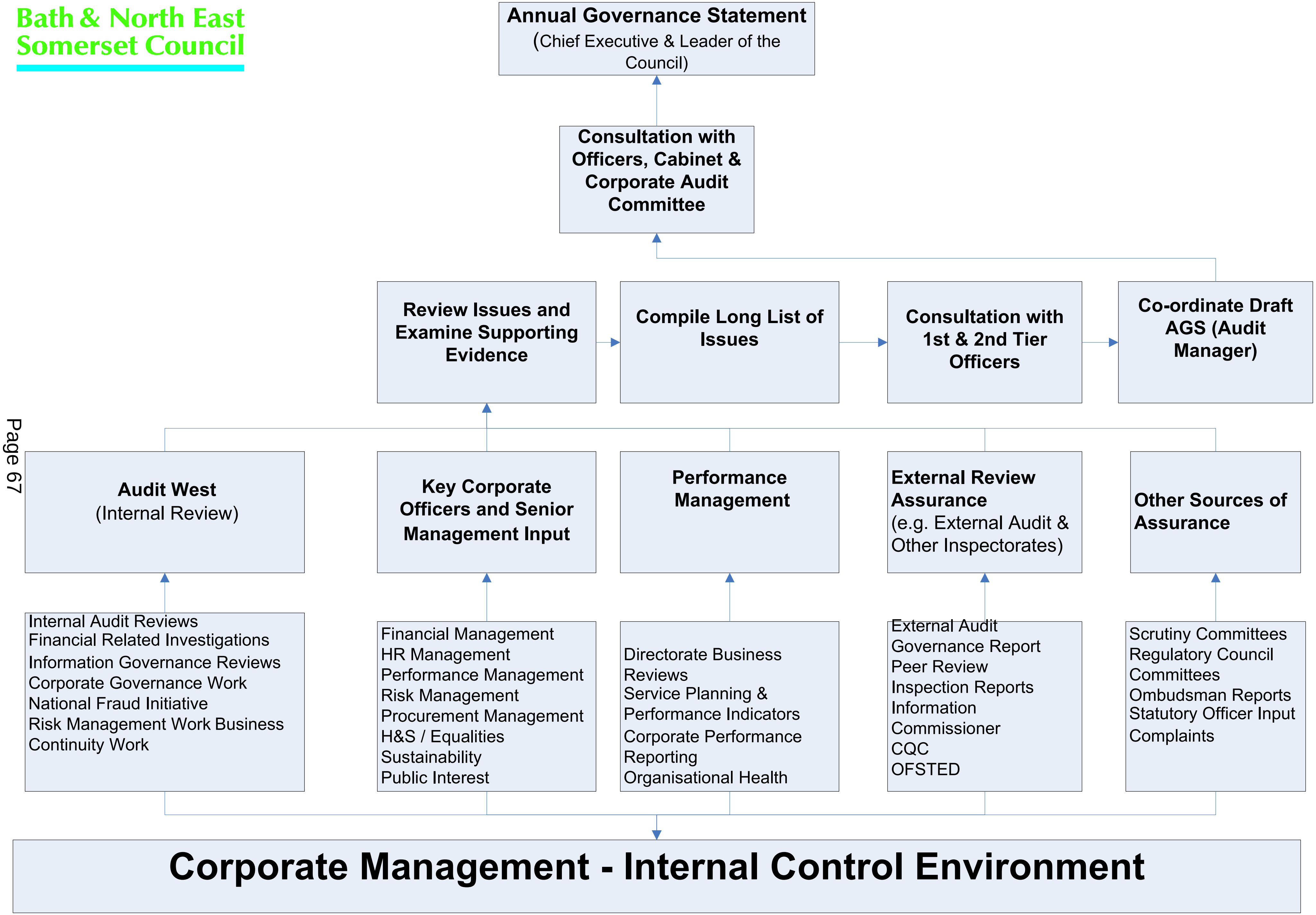
Bath & North East Somerset Council



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AGS 2015/16 - SIGNIFICANT GOVERNANCE ISSUE

Issue in 2015/16 Statement	Commentary & Mitigating actions for 16/17
Financial Challenge The unprecedented financial challenge continues into its fifth year, with public sector austerity likely to last until at least 2020. The Council has responded positively with over £30M of savings already delivered, however at least £43M of additional savings still need to be identified over the remaining period. Therefore the Council has been actively planning to meet this challenge with over £28M of new savings initiatives already being worked on for future years. Whilst no significant governance failures have occurred, the Council acknowledge that the level of grant reductions from central government are a significant issue and represent a real challenge in being able to continue to deliver excellent services to the whole community at all times. Whilst all areas of the Council are under scrutiny this is especially important in the area of Health and Social Care where we are not only dealing with our most vulnerable members of the community but we are reliant on working with partners across different sectors, some of whom are also facing severe financial pressures, such as our colleagues in NHS bodies. This puts additional strain on being able to meet the challenge and entails making difficult choices. We therefore need robust governance and sensible plans to enable services to deliver against all of these challenges. The Council is however well placed to do this but will need the support of the whole of its governance framework to deliver on this effectively.	The Council has already set out many of its plans to deliver services into the future against the backdrop of these significant financial reductions. Robust governance and sound risk management will continue to be required to ensure that all aspects of delivery are supported and scrutinised to enable the challenge to be met. Actions will include – - Using the Corporate Plan to help focus services on doing the right things for the Bath & North East Somerset Community; - Using the Medium Term Financial Plan to enable sensible prioritisation of resources in the right areas and transparency on savings to be achieved; - Regularly monitoring of delivery against the annual revenue budget, alongside sensible utilisation and management of its reserves; - Working effectively with Key Partners, especially those in the West of England and in Health to support the most vulnerable in the community; - Adopting a range of innovative tools such as the use of council owned companies, more commercialisation, increases in digital provision, asset rationalisation, shared and devolved services and invest to save initiatives; - Enabling its key governance mechanisms to both support key change projects and monitor delivery of significant savings programmes; - Ensuring that any Strategic Review projects of its key support and governance services such as Finance and Audit enable the strengthening and prioritisation of the right skills and expertise within those functions to support sound financial control. Overseeing delivery against this agenda is a key role for the Cabinet and Senior Management and they will continue to be pro-active in working to ensure that significant risks to the organisation are appropriately mitigated and controlled to ensure that the Council is able to meet these future challenges

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