Bath & North East Somerset Council

Corporate Audit Committee

Date: **Thursday, 8th February, 2018**
Time: **2.00 pm**
Venue: **Brunswick Room - Guildhall, Bath**

Agenda

To: All Members of the Corporate Audit Committee

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

Independent Member: John Barker

Chief Executive and other appropriate officers

Press and Public

Chief Executive and other appropriate officers
Press and Public

The agenda is set out overleaf.

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NOTES:

1. **Inspection of Papers:** Papers are available for inspection as follows:

Council's website: https://democracy.bathnes.gov.uk/ieDocHome.aspx?bcr=1

Paper copies are available for inspection at the **Public Access points:-** Reception: Civic Centre - Keynsham, Guildhall - Bath, The Hollies - Midsomer Norton. Bath Central and Midsomer Norton public libraries.

2. **Details of decisions taken at this meeting** can be found in the minutes which will be circulated with the agenda for the next meeting. In the meantime, details can be obtained by contacting as above.

3. **Recording at Meetings**:-

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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.

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Cabinet - Thursday, 8th February, 2018

at 2.00 pm in the Brunswick Room - Guildhall, Bath

A G E N D A

1. EMERGENCY EVACUATION PROCEDURE

   The Chair will draw attention to the emergency evacuation procedure as set out under Note 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: 5TH DECEMBER 2017 (Pages 5 - 10)

9. EXTERNAL AUDIT UPDATE (Pages 11 - 50)

10. TREASURY MANAGEMENT STRATEGY (Pages 51 - 80)

11. ANNUAL GOVERNANCE STATEMENT (Pages 81 - 88)

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

Tuesday, 5th December, 2017, 2.00 pm

Councillors: Brian Simmons (Chair), Tim Ball (in place of Andrew Furse), Chris Dando and Barry Macrae
Independent Member: John Barker
Officers in attendance: Jeff Wring (Head of Audit West) and Andy Cox (Audit Manager (Audit West))
Guests in attendance: Barrie Morris (Grant Thornton), Peter Barber (Grant Thornton) and Sophie J. Morgan (Grant Thornton)

159 EMERGENCY EVACUATION PROCEDURE

The Democratic Services Officer advised the meeting of the procedure.

160 ELECTION OF VICE-CHAIR

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

161 APOLOGIES FOR ABSENCE AND SUBSTITUTIONS

Apologies were received from Councillors Chris Dando and Andrew Furse. Councillor Tim Ball substituted for Councillor Furse.

162 DECLARATIONS OF INTEREST

There were none.

163 TO ANNOUNCE ANY URGENT BUSINESS AGREED BY THE CHAIR

There was none.

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

There were none.

165 ITEMS FROM COUNCILLORS AND CO-OPTED AND ADDED MEMBERS

There were none.

166 MINUTES:12 SEPTEMBER 2017

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

Minute 156, page 4 (agenda page 8), third paragraph: progress on review of number of administrative staff and maintenance of separation of duty principles: the Divisional Director – Business Support advised that the review had been completed.

167 TREASURY MANAGEMENT MID-YEAR PERFORMANCE UPDATE

The Divisional Director – Business Support presented the report. She noted that, contrary to the expectation of the Council's treasury management advisors, the Bank of England had raised base rate by 0.25% to 0.5% on 2 November. In response to a question from the Chair about the impact on the Council's outstanding loans, she explained that it was the Public Works Loan Board rates that were significant. After the BoE rise some PWLB rates had been reduced, though it was expected they would rise in future.

In response to a question from a Member she explained that because of current low interest rates only a small amount of cash was invested to provide immediate cash flow, while most cash was used to finance capital investment instead of long-term borrowing.

RESOLVED:

1. to note the Treasury Management Report to 30th September 2017 prepared in accordance with the CIPFA Treasury Code of Practice.

2. to note the Treasury Management Indicators to 30th September 2017.

168 EXTERNAL AUDIT UPDATE AND ANNUAL AUDIT LETTER

Mr Morris commented on the Annual Audit Letter, which summarises the work undertaken by the external auditor during the year.

He said that the review of Housing Benefit returns for DWP had been completed. A qualification letter had been issued, which identified a number of issues and would be presented to the next meeting of the Committee. The proportion of errors was quite high, but the total value quite low. A Member asked whether there were any particular factors causing errors. The Divisional Director – Business Support replied that in some cases there were errors in applicants' claim forms. In others there were complexities, such as a transfer of tenancies, which gave rise to errors during processing. An error reduction action plan was in place and would be reviewed quarterly. Members were pleased to note this.

Mr Morris drew attention to the final fees for audit and provision of non-audit services (agenda page 39). An additional fee would be charged for the work on Housing Benefit claims.

Mr Barber introduced himself and his colleagues Sophie Morgan and Scott Corboy (not present at the meeting) as the Council's 2017/18 external audit team.

Ms Morgan commented on the External Audit Update Report.

A Member asked why the external auditor had drawn attention to the Independent Review of Building Regulations and Fire Safety (agenda page 52). Mr Barber and Mr

Morris pointed out that there could be impacts on the capital programme, corporate risk, including reputational risk, and control systems. A Member suggested that the Council needed to assess any relevant risks identified by the review report and the resources that needed to be allocated to address them. He hoped that the Government would provide additional funding to local authorities and the rest of the public sector for work on buildings that needed to be brought up to fire safety standards. The Divisional Director – Business Support responded that there had been a suggestion that the Government might do this, but they would want to see what the costs of doing so would be. There is nothing specific about it in next year's grant bid information, but it is possible to bid for funds for property maintenance. The Chair commented that as far as he knew there were no buildings in Bath and North East Somerset that had the same type of cladding as the Grenfell Tower.

Mr Barber commented on the planned audit fee for 2017/18 (agenda pages 63-64).

It was noted that this would be the last meeting of the Committee that Mr Morris would attend. Members thanked him for his past assistance and support and wished him well for the future.

RESOLVED to note the report and updates provided by the External Auditor.

169 INTERNAL AUDIT MID-YEAR PERFORMANCE UPDATE

The Audit Manager (Audit West) presented the report.

He said that staff resources had been severely stretched because of sickness, staff leaving and unplanned work. . The Head of Audit West said that the staffing situation could impact on the work being done for the Council for the rest of the year and on Audit West's external contracts. He had secured additional staff resources through the arrangement with Devon Audit Partnership; these were being deployed on audit work for the Avon Pension Fund. Attempts were also being made to recruit agency staff. However, it was unlikely that any new staff would be in place before the end of this financial year.

Members noted the reasons for current performance against plan but were concerned. One Member said that the magnitude of the risk to the Council of inadequate audit should be taken into account in decisions about the resourcing of the function; the consequences to the Council of making mistakes with Universal Credit, for example, could be severe. The Head of Audit West responded that the situation could be managed to a degree in the short term. He had informed the Committee about the steps he was taking to secure additional staff resource and he drew attention to the information in paragraph 4.2.4 of the report about reviewing the scope of scheduled audits. The focus would be on the highest risks. The current state of the employment market for auditors was such that it would be very difficult to recruit suitably qualified people in any case. The main cause for failure to deliver the plan had been sickness, and both the affected individuals were now back at work. The Member, however, felt that every reduction in staff resource in the Audit Team increased the risk for the Council, and that there should be a minimum complement of auditors which should not be reduced. Another Member agreed with this, and proposed that the resolution should be amended to express the Committee's concern about the impact of the recruitment freeze on the performance of Internal Audit. The proposed amendment was accepted by the Committee.

[Councillor Ball left the meeting.]

The Audit Manager (Audit West) reported on the follow-up and implementation of audit recommendations. A Member said he was extremely unhappy that recommendations made had not been implemented, and suggested that this should be brought to the attention of the relevant Cabinet Member. Another Member suggested that the Committee take a hard line if the recommendations were not implemented. The Head of Audit West responded that the when follow-up reviews took place, there were often legitimate reasons why recommendations had not been implemented. There was total transparency in reporting non-implementation to the Committee, but he felt that mitigating circumstances had to be taken into account, and that a judgement had to be made, based on the relative value of the risk, about when it was appropriate to report non-implementation to a higher level. If the recommendations about the use of council vehicles had not been implemented by the end of the current financial year, it would be appropriate to escalate the matter.

A Member commented that the results of audits suggested that there had been a deterioration in the overall control environment. He wondered if information about mitigating factors that justified not implementing audit recommendations could be provided to the Committee, as this would enable the Committee to have a better understanding of the impact that the work of Internal Audit was having. The principal focus of audit might be on finance, but it could also have an important influence on organisational culture. He requested that consideration be given to providing the Committee with some commentary that would enable it to have a wider view of governance standards within the Council. The Head of Audit West replied that he aim was always to be open and transparent in the information provided to the Committee. When recommendations were made or risks assessed as high, medium or low, not only financial factors were taken into consideration, but also the risk to the achievement of objectives or the level of performance. Each report contained a table like the one on agenda page 73, showing assurance level and the number of recommendations made and the number agreed by the service. Things can change significantly by the time of the follow-up. Change in the Council was now continuous, and that had to be taken into account in the follow-up. However if there was concern because recommendations were being repeatedly ignored, there were escalation procedures available to bring issues to the attention of the relevant Strategic Director, the Chief Executive or the Strategic Management Team. He had made it clear in his annual report that the level of risk in the Council was rising; the environment had changed from risk-averse/low risk to rising risk as a result of reductions in grant funding to the Council, changes to service delivery and the differing control frameworks of organisations with which the Council has digital interfaces. So a certain increase in risk level had to be accepted. Managers had to learn what level of management was required and what level of risk was acceptable. There were no systemic issues and what was reported to the Committee were the exceptions. A Member welcomed that reassurance, but did have concerns that the general control environment was under stress and that audit recommendations were not always treated seriously.

Mr Morris said that Members had made excellent points about the importance of the overall corporate culture and how it might be assessed and reported.

RESOLVED to note progress made against the Internal Audit Plan for 2017/18 and to express concern about the impact of the Council's recruitment freeze on the performance of Internal Audit.

170 INTERNAL AUDIT PROFESSIONAL STANDARDS REVIEW

The Head of Audit West presented the report. Members noted that Audit West's next quinquennial external assessment had to be completed by 30 March 2018. Audit West must comply with the revised Public Sector Internal Audit Standards, which came into effect from 1st April 2017. Members noted the results of the PSIA self-assessment contained in Appendix 1, in which compliance was assessed as red, amber or green. Red assessments were due to the need to refresh the Internal Audit Charter. The Committee was invited to approve the revised Internal Audit Charter contained in Appendix 2.

Mr Morris noted that the external assessment would be carried out by the Head of Devon Audit Partnership and asked whether there would be a conflict of interest through the relationship of Devon Audit Partnership with Audit West. The Head of Audit West replied that the Head of Devon Audit Partnership would not be involved in the direction or operation of any work that the Devon Audit Partnership is currently undertaking on behalf of Audit West.

RESOLVED:

1. To note that the Council's Internal Audit Service (Audit West) has to comply with the revised PSIAS which came into effect from 1st April 2017.

2. To note the Self-Assessment PSIAS RAG and approve the associated Action Plan (Appendix 1).

3. To approve the revised Internal Audit Charter (Appendix 2).

The meeting ended at 3.21 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:	**8th February 2018**	**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 Grant Certification Letter** **Appendix 2 – External Audit Plan for Council** **Appendix 3 – External Audit Plan for Pension Fund**		

1 THE ISSUE

1.1 The External Auditor will present their audit plan for the Council and Pension Fund, Grant Certification letter and provide a general update to the Committee on their work against their existing plan.

2 RECOMMENDATION

2.1 The Corporate Audit Committee is asked to note the report.

3 FINANCIAL IMPLICATIONS

3.1 There are reductions of 23% in the audit fee from previous years as a result of last year's national procurement process through PSAA Ltd. These were already factored into existing budgets.

4 THE REPORT

4.1 Appendix 1 details the results of External Audit's work on certifying the Housing Benefit subsidy claim.

4.2 Appendices 2 and 3 detail the audit plan for the Council and Avon Pension Fund.

4.3 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	

Grant Thornton

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25 January 2018

Dear Donna

Certification work for Bath and North East Somerset Council for year ended 31 March 2017

We are required to certify the Housing Benefit subsidy claim submitted by Bath and North East Somerset Council ('the Council'). This certification typically takes place six to nine months after the claim period and represents a final but important part of the process to confirm the Council's entitlement to funding.

The Local Audit and Accountability Act 2014 gave the Secretary of State power to transfer Audit Commission responsibilities to other bodies. Public Sector Audit Appointments (PSAA) took on the transitional responsibilities for HB COUNT issued by the Audit Commission in February 2015.

We have certified the Housing Benefit subsidy claim for the financial year 2016/17 relating to subsidy claimed of £46.634 million. Further details are set out in Appendix A.

We identified a number of issues from our certification work which we wish to highlight for your attention. There were a number of errors from the extended testing that we carried out on this year's subsidy return which recurred from 2015/16. There were two new areas where we identified errors. The extrapolated financial impact on the claim, which we have reported to the DWP, was relatively insignificant to the total subsidy receivable.

As a result of the errors identified, the claim was amended and qualified, and we reported our findings to the DWP. The DWP may require the Council to undertake further work or provide assurances on the errors we have identified.

The indicative fee for 2016/17 for the Council was based on the final 2014/15 certification fees, reflecting the amount of work required by the auditor to certify the Housing Benefit subsidy claim that year. The indicative scale fee set by PSAA for the Council for 2016/17 was £13,755. Due to the additional work required to address the issues we identified, we are seeking a variation of £1,780, which will make the actual fee for the year £15,535, which is subject to confirmation from PSAA. This is set out in more detail in Appendix B.

Yours sincerely

Grant Thornton UK LLP

Grant Thornton UK LLP

Appendix A - **Details of claims and returns certified for 2016/17**

Claim or return	Value	Amended	Amendment value	Qualified	Comments
Housing benefits subsidy claim	£46,633,619	Yes	£(1,011)	Yes	See below

Findings from certification of housing benefits subsidy claim

Cross cutting qualification issues
Our review of the uprating of system parameters identified a number of instances where income categories were uprated to one penny per week below expectations, due to the Northgate system applying a percentage uprating. An initial calculation shows that benefit could be overstated by a maximum of £68 in 2016/17 (based on the number of claims with each income type, assuming benefit was in payment for the whole year).

Claims where rent is manually updated
We identified errors in one class of benefit where rental liability was incorrectly stated, where this was updated manually. As a result of this issue, rent was incorrectly stated and benefit miscalculated. We identified:

- 2 errors out of 60 cases where rent was incorrectly recorded in respect of Rent Allowances, leading to an extrapolated overpayment of £322.

Earned income
We identified errors in one class of benefit where earned income was incorrectly stated. As a result of the errors, claimants' income was misstated and benefit miscalculated. We identified:

- 15 errors out of 60 cases where earned income was incorrectly stated in respect of Rent Allowances, leading to an extrapolated overpayment of £56,058.

Childcare costs
We identified errors in one class of benefit where childcare costs were incorrectly stated. As a result of the errors, claimants' income was misstated and benefit miscalculated. We identified:

- 10 errors out of 60 cases where childcare costs were incorrectly stated in respect of rent allowances, leading to an extrapolated overpayment of £3,083.

State and Occupational Pension
We identified errors in one class of benefit where state and occupational pensions were miscalculated, or did not have sufficient evidence to support one or more elements of pension income. As a result of the errors, claimants' income was misstated and benefit miscalculated. We identified:

- 8 errors out of 60 cases where state and occupational pensions were miscalculated, or the Authority did not have sufficient evidence to support one or more elements of pension income in respect of Rent Allowances, leading to an extrapolated overpayment of £6,838.

Rental Liability
We identified an error in one class of benefit where rental liability had been incorrectly recorded, which led to the LHA rate being used incorrectly. As a result of the error, the claimant's rental liability was misstated and benefit miscalculated. We identified:

- 1 error out of 60 cases where rental liability had been incorrectly recorded, in respect of Rent Allowances, leading to an extrapolated overpayment of £10,284.

Claimants transferring to Universal Credit
We identified errors in one class of benefit where claimants had moved to universal credit, and an overpayment occurred as a result of late notification of the change. The Authority classified the subsequent overpayment as an eligible overpayment, but should have classified the overpayment as DWP error. As a result of the errors, expenditure was classified incorrectly. We identified:

- 38 errors out of 60 cases where claimants had transferred to universal credit and an overpayment had been misclassified, in respect of Rent Allowances, leading to an extrapolated misclassification of £25,189.

Non HRA Rent Rebates
We identified a number of errors within the Non HRA Rent Rebates population. Officers were able to review the whole of the population and we agreed the amendment of £1,011 required to the claim as a result.

Observations
We identified errors in one class of benefit where no impact on subsidy was noted and therefore have not been classified as errors for subsidy purposes.

- 1 case where benefit was underpaid due to earnings being incorrectly applied, in respect of Rent Rebates.
- 1 case where there was no impact on subsidy due to deductions being incorrectly applied, in respect of Rent Rebates.
- 1 case where there was no impact on subsidy due to earnings being incorrectly calculated, in respect of Rent Rebates.
- 1 case where there was no impact on subsidy due to a lack of evidence to support child benefit, in respect of Rent Rebates.

Recommended actions for officers
We recommend that the Council as part of its internal quality assurance process, should increase its focus or level of testing in respect of the areas where we identified errors from our testing.

Appendix B: Fees for 2016/17 certification work

Claim or return	2014/15 fee (£)	2016/17 indicative fee (£)	2016/17 actual fee (£)	Variance (£)	Explanation for variances
Housing benefits subsidy claim (BEN01)	£18,340	£13,755	£15,535	£1,780	Additional testing required for new errors (Claimants moving to universal credit; LHA rate incorrect); 100% re-performance of Non HRA Rent Rebates.
Total	£18,340	£13,755	£15,535	£1,780	

Grant Thornton

External Audit Plan

Year ending 31 March 2018

Bath & North East Somerset Council

January 2018

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Appendix

A. Revised ISAs	17

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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 planning 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 the Council 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.

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Introduction & headlines

Purpose

This document provides an overview of the planned scope and timing of the statutory audit of Bath and North East Somerset Council ('the Council') for those charged with governance.

Respective responsibilities

The National Audit Office ('the NAO') has issued a document entitled Code of Audit Practice ('the Code'). This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. Our respective responsibilities are also set in the Terms of Appointment and Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA), the body responsible for appointing us as auditor of Bath and North East Somerset Council. We draw your attention to both of these documents on the PSAA website.

Scope of our audit

The scope of our audit is set in accordance with the Code and International Standards on Auditing (ISAs) (UK). We are responsible for forming and expressing an opinion on the:

- financial statements (including the Annual Governance Statement) that have been prepared by management with the oversight of those charged with governance (the Corporate Audit Committee); and
- Value for Money arrangements in place at the Council for securing economy, efficiency and effectiveness in your use of resources.

The audit of the financial statements does not relieve management or the Corporate Audit Committee of your responsibilities. It is the responsibility of the Council to ensure that proper arrangements are in place for the conduct of its business, and that public money is safeguarded and properly accounted for. We have considered how the Council is fulfilling these responsibilities.

Our audit approach is based on a thorough understanding of the Council's business and is risk based.

Significant risks	Those risks requiring specific audit consideration and procedures to address the likelihood of a material financial statement error have been identified as: • The revenue cycle contains fraudulent transactions • Management over-ride of controls • Valuation of property, plant and equipment • Valuation of pension fund net liability We will communicate significant findings on these areas as well as any other significant matters arising from the audit to you in our Audit Findings (ISA 260) Report.
Materiality	We have determined planning materiality to be £8.194m (PY £7.784m), which equates to 2% of your prior year gross expenditure for the year. We are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. Clearly trivial has been set at £0.410m (PY £0.390m).
Value for Money arrangements	Our risk assessment regarding your arrangements to secure value for money have identified the following VFM significant risk: • Medium term financial plan
Audit logistics	Our interim visit will take place in January and our final visit will take place in June. Our key deliverables are this Audit Plan and our Audit Findings Report. Our fee for the audit will be no less than £123,832 (PY: £123,832) for the Council.
Independence	We have complied with the Financial Reporting Council's Ethical Standard and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements

Deep business understanding

Changes to service delivery

Commercialisation

The scale of investment activity, primarily in commercial property, has increased as local authorities seek to maximise income generation. These investments are often discharged through a company, partnership or other investment vehicle. Bath and North East Somerset Council need to ensure that their commercial activities, particularly in relation to Aequus, are presented appropriately, in compliance with the CIPFA Code of Practice and statutory framework, such as the Capital Finance Regulations. Where borrowing to finance these activities, local authorities need to comply with CIPFA's Prudential Code. A new version is due to be published in December 2017.

Devolution

The Cities and Local Government Devolution Act 2016 provides the legal framework for the implementation of devolution deals with combined authorities and other areas.

Working together with other public sector service providers will allow the Council to deliver better results which will help businesses to improve their productivity.

The Council is part of the West of England Combined Authority (WECA). Through the West of England devolution deal, significant powers and responsibilities have been devolved to WECA, which was established in 2017.

The first West of England Mayor was elected in May 2017.

Changes to financial reporting requirements

Accounts and Audit Regulations 2015 (the Regulations)

The Department of Communities and Local Government (DCLG) is currently undertaking a review of the Regulations, which may be subject to change. The date for any proposed changes has yet to be confirmed, so it is not yet clear or whether they will apply to the 2017/18 financial statements.

Under the 2015 Regulations local authorities are required to publish their accounts along with the auditors opinion by 31 July 2018.

Forthcoming provisions for IFRS 9 and IFRS 15

CIPFA/LASAAC has issued a companion publication 'Forthcoming provisions for IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers in the Code of Practice on Local Authority Accounting in the United Kingdom 2018'.

This sets out the changes to the 2018/19 Code in respect of IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers. It has been issued in advance of the 2018/19 Code to provide local authorities with time to prepare for the changes.

Changes to the CIPFA 2017/18 Accounting Code

CIPFA have introduced other minor changes to the 2017/18 Code which confirm the going concern basis for local authorities, and updates for Leases, Service Concession arrangements and financial instruments.

Key challenges

Financial pressures

Bath and North East Somerset Council currently has a budget gap of £(48.99)m over the five years to 2022/23 which is significant.

Over the two years to 2019/20, the budget gap is £(30.96)m. So far, £14.80m of savings have been identified but a further £16.16m savings are required over the period. This includes a significant gap of £12.77m to find in 2018/19.

The Council has a good record of delivering its financial plans, although for 2016/17 the Council reported an overspend. This was in part due to savings plans not fully delivering with 90% of the planned £12.6 million savings being delivered. The other key issue was the pressure on children's and adult social care budgets.

Since setting the budget for 2017/18 significant pressures have been emerging and a revised predicted outturn was reported in October 2017. The 2017/18 outturn is now forecast to be £3.8m over budget for the full year. In the short term the Council has one off reserves that can be used to mitigate these pressures but the longer term implications are challenging.

Our response

- We will consider your arrangements for managing and reporting your financial resources as part of our work in reaching our Value for Money conclusion.
- We will consider whether your financial position leads to uncertainty about the going concern assumption and will review any related disclosures in the financial statements.
- We will keep you informed of changes to the Regulations and any associated changes to financial reporting or public inspection requirements for 2017/18 through on-going discussions and invitations to our technical update workshops.
- As part of our opinion on your financial statements, we will consider whether your financial statements reflect the financial reporting changes in the 2017/18 CIPFA Code.

Significant risks identified (continued)

Significant risks are defined by professional standards as risks that, in the judgement of the auditor, require special audit consideration because they have a higher risk of material misstatement. Such risks often relate to significant non-routine transactions and judgmental matters. In identifying risks, audit teams consider the nature of the risk, the potential magnitude of misstatement, and its likelihood.

Risk	Reason for risk identification	Key aspects of our proposed response to the risk
The revenue cycle includes fraudulent transactions	Under ISA (UK) 240 there is a rebuttable presumed risk that revenue may be misstated due to the improper recognition of revenue. This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition. Having considered the risk factors set out in ISA240 and the nature of the revenue streams at the Council, we have determined that the risk of fraud arising from revenue recognition can be rebutted for revenue sources of funding via taxation and direct government funding, because: • there is little incentive to manipulate revenue recognition • opportunities to manipulate revenue recognition are very limited • The culture and ethical frameworks of local authorities, including Bath and North East Somerset Council mean that all forms of fraud are seen as unacceptable We have not rebutted the presumption for Other Fees and Charges only, as for Bath and North East Somerset Council, we have concluded that the greatest risk of material misstatement relates to the occurrence of other fees and charges and the existence of associated receivables. Therefore we consider this to be a significant risk for Bath and North East Somerset Council.	We will: • document our understanding of management's controls over revenue recognition; • review and test revenue recognition policies; and • test material revenue streams.
Management over-ride of controls	Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities. The Council faces external scrutiny of its spending, and this could potentially place management under undue pressure in terms of how they report performance. Management over-ride of controls is a risk requiring special audit consideration.	We will: • gain an understanding of the accounting estimates, judgements applied and decisions made by management and consider their reasonableness; • obtain a full listing of journal entries, identify and test unusual journal entries for appropriateness; and • evaluate the rationale for any changes in accounting policies or significant unusual transactions.

Significant risks identified

Risk	Reason for risk identification	Key aspects of our proposed response to the risk
Valuation of property, plant and equipment	The Council revalues its land and buildings on a rolling basis to ensure that carrying value is not materially different from fair value. This represents a significant estimate by management in the financial statements. We identified the valuation of land and buildings revaluations and impairments as a risk requiring special audit consideration.	We will: • review management's processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work; • evaluate the competence, expertise and objectivity of any management experts used; • hold discussions with the valuer about the basis on which the valuation is carried out and challenge the key assumptions; • review and challenge the information used by the valuer to ensure it is robust and consistent with our understanding; • test revaluations made during the year to ensure they are input correctly into the Council's asset register; and • evaluate the assumptions made by management for those assets not revalued during the year and how management has satisfied themselves that these are not materially different to current value.
Valuation of investment property	The Council revalues its investment properties on an annual basis to ensure that carrying value is not materially different from fair value. This represents a significant estimate by management in the financial statements. We identified the valuation of investment property revaluations as a risk requiring special audit consideration.	We will: • review management's processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work; • evaluate the competence, expertise and objectivity of any management experts used; • hold discussions with the valuer about the basis on which the valuation is carried out and challenge the key assumptions; • review and challenge the information used by the valuer to ensure it is robust and consistent with our understanding; • test revaluations made during the year to ensure they are input correctly into the Council's asset register; and • evaluate the assumptions made by management for those assets not revalued during the year and how management has satisfied themselves that these are not materially different to current value.

Significant risks identified (continued)

Risk	Reason for risk identification	Key aspects of our proposed response to the risk
Valuation of pension fund net liability	The Council's pension fund asset and liability as reflected in its balance sheet represent a significant estimate in the financial statements. We identified the valuation of the pension fund net liability as a risk requiring special audit consideration.	We will: • identify the controls put in place by management to ensure that the pension fund liability is not materially misstated. We will also assess whether these controls were implemented as expected and whether they are sufficient to mitigate the risk of material misstatement; • Evaluate the competence, expertise and objectivity of the actuary who carried out your pension fund valuation. We will gain an understanding of the basis on which the valuation is carried out • Undertake procedures to confirm the reasonableness of the actuarial assumptions made. • Check the consistency of the pension fund asset and liability and disclosures in notes to the financial statements with the actuarial report from your actuary

Reasonably possible risks identified

Reasonably possible risks (RPRs) are, in the auditor's judgment, other risk areas which the auditor has identified as an area where the likelihood of material misstatement cannot be reduced to remote, without the need for gaining an understanding of the associated control environment, along with the performance of an appropriate level of substantive work. The risk of misstatement for an RPR is lower than that for a significant risk, and they are not considered to be areas that are highly judgmental, or unusual in relation to the day to day activities of the business.

Reasonably Possible Risk	Reason for risk identification	Key aspects of our proposed response to the risk
Employee remuneration	Payroll expenditure represents a significant percentage of the Council's operating expenses. We therefore identified completeness of payroll expenses as a risk requiring particular audit attention	We will • evaluate the Council's accounting policy for recognition of payroll expenditure for appropriateness; • gain an understanding of the Council's system for accounting for payroll expenditure and evaluate the design of the associated controls; • obtain year-end payroll reconciliation and ensure amount in accounts can be reconciled to the ledger and through to payroll reports. • agree payroll related accruals to supporting documents and review any estimates for reasonableness.
Operating expenses	Non-pay expenses on other goods and services also represents a significant percentage of the Council's operating expenses. Management uses judgement to estimate accruals of un-invoiced costs. We identified completeness of non- pay expenses as a risk requiring particular audit attention.	We will • evaluate the Council's accounting policy for recognition of non-pay expenditure for appropriateness; • gain an understanding of the Council's system for accounting for non-pay expenditure and evaluate the design of the associated controls; • review non-pay payments made post year end to ensure that they have been charged to the appropriate financial period.

Other Risk	Reason for risk identification	Key aspects of our proposed response to the risk
Group accounts	The Council has a wholly owned subsidiary, Aequus Developments Limited (ADL), which was incorporated in March 2016. In 2016/17 the company was not consolidated. Activity at ADL has increased significantly in 2017/18; The Council will need to consider whether Group Accounts will be produced in 2017/18.	We will • Review the Group structure of the Council; • Obtain an copy of the Group materiality document to be prepared by the Council; • Review the qualitative and quantitative materiality of the Council's subsidiaries in relation to the Council's operations.

Other matters

Other work

In addition to our responsibilities under the Code of Practice, we have a number of other audit responsibilities, as follows:

- We carry out work to satisfy ourselves that disclosures made in your Annual Governance Statement are in line with the guidance issued and consistent with our knowledge of the Council.
- We will read your Narrative Statement and check that it is consistent with the financial statements on which we give an opinion and that the disclosures included in it are in line with the requirements of the CIPFA Code of Practice.
- We carry out work on your consolidation schedules for the Whole of Government Accounts process in accordance with NAO group audit instructions.
- We consider our other duties under the Act and the Code, as and when required, including:
    - giving electors the opportunity to raise questions about your 2017/18 financial statements, consider and decide upon any objections received in relation to the 2017/18 financial statements;
    - issue of a report in the public interest; and
    - making a written recommendation to the Council, copied to the Secretary of State.
- We certify completion of our audit.

Other material balances and transactions

Under International Standards on Auditing, "irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance and disclosure". All other material balances and transaction streams will therefore be audited. However, the procedures will not be as extensive as the procedures adopted for the risks identified in this report.

Going concern

As auditors, we are required to “obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern” (ISA (UK) 570). We will review management's assessment of the going concern assumption and evaluate the disclosures in the financial statements.

Materiality

The concept of materiality

The concept of materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to the monetary misstatements but also to disclosure requirements and adherence to acceptable accounting practice and applicable law. Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Materiality for planning purposes

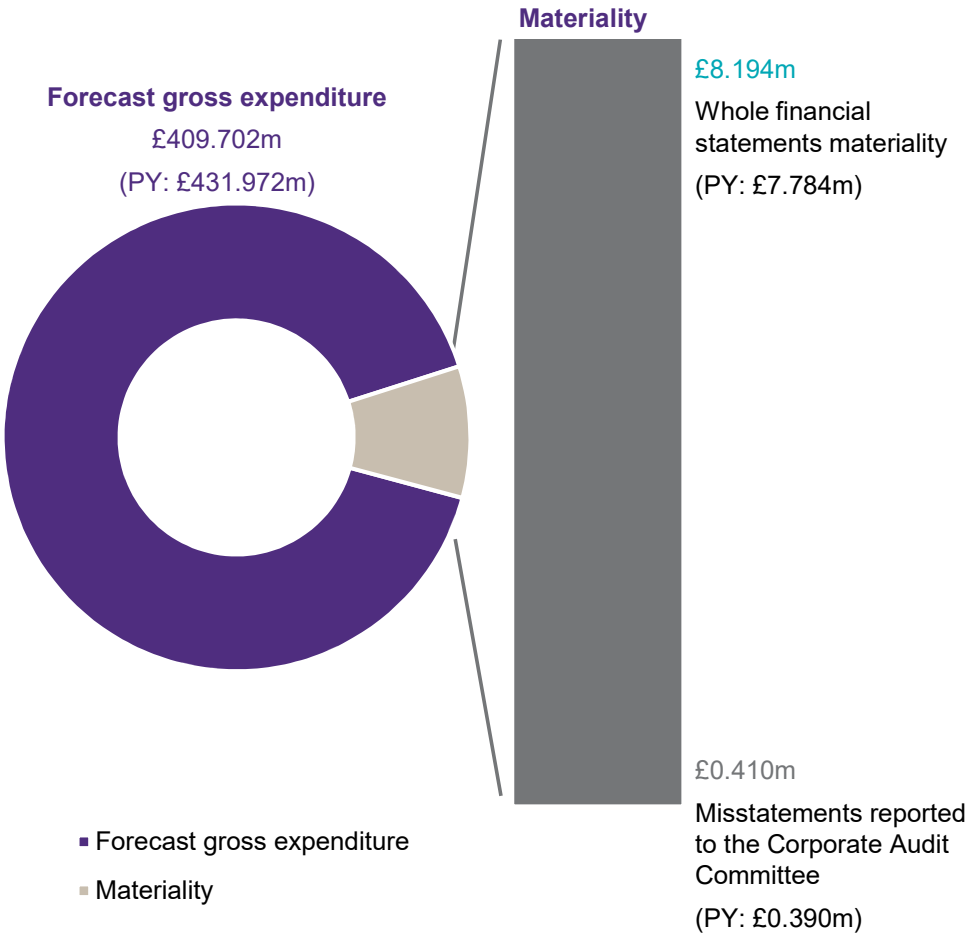
We propose to calculate financial statement materiality based on a proportion of the gross expenditure of the Council for the financial year. In the prior year we used the same benchmark. We have determined planning materiality (the financial statements materiality determined at the planning stage of the audit) to be £8.194m (PY £7.784m), which equates to 2% of your forecast gross expenditure for the year. ISA 320 also requires auditors to determine separate, lower, materiality levels where there are 'particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as whole could reasonably be expected to influence the economic decisions of users. We have identified disclosures of senior officers' remuneration and members' allowances and have determined applicable materiality to be £5,000.

We reconsider planning materiality if, during the course of our audit engagement, we become aware of facts and circumstances that would have caused us to make a different determination of planning materiality.

Matters we will report to the Corporate Audit Committee

Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Corporate Audit Committee any unadjusted misstatements of lesser amounts to the extent that these are identified by our audit work. Under ISA 260 (UK) 'Communication with those charged with governance', we are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 (UK) defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria. In the context of the Council, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £0.410m (PY £0.390m).

If management have corrected material misstatements identified during the course of the audit, we will consider whether those corrections should be communicated to the Corporate Audit Committee to assist it in fulfilling its governance responsibilities.



Group audit scope and risk assessment

In accordance with ISA (UK) 600, as group auditor we are required to obtain sufficient appropriate audit evidence regarding the financial information of the components and the consolidation process to express an opinion on whether the group financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

Component	Significant?	Level of response required under ISA (UK and Ireland) 600	Risks identified	Planned audit approach
Aequus Developments Ltd	To be confirmed once the Council have determined if Group Accounts will be required for 2017/18	To be confirmed	To be confirmed	To be confirmed
Bath Tourism Plus Ltd	No	N/A – component is not significant	No significant risks identified.	No specific audit work proposed.

Audit scope:

Comprehensive – the component is of such significance to the group as a whole that an audit of the components financial statements is required

Targeted – the component is significant to the Group, audit evidence will be obtained by performing targeted audit procedures rather than a full audit

Analytical – the component is not significant to the Group and audit risks can be addressed sufficiently by applying analytical procedures at the Group level

Involvement in the work of component auditors

The nature, time and extent of our involvement in the work of the component auditor will begin with a discussion on risks, guidance on designing procedures, participation in meetings, followed by the review of relevant aspects of the component auditor's audit documentation and meeting with appropriate members of management.

Value for Money arrangements

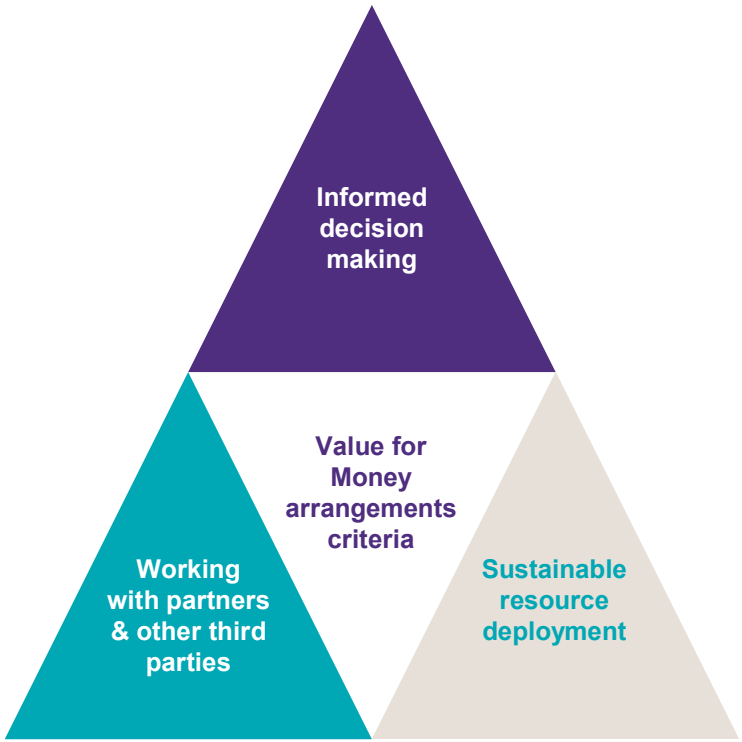
Background to our VFM approach

The NAO issued its guidance for auditors on Value for Money work for 2017/18 in November 2017. The guidance states that for local government bodies, auditors are required to give a conclusion on whether the Council has proper arrangements in place.

The guidance identifies one single criterion for auditors to evaluate:

"In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people."

This is supported by three sub-criteria, as set out below:



Significant VFM risks

Those risks requiring specific audit consideration and procedures to address the likelihood that proper arrangements are not in place at the Council to deliver value for money.

Medium Term Financial Plan

The ongoing challenge of meeting the savings outlined by Central Government continue to put pressures on Local Government finances. Bath and North East Somerset Council currently has a budget gap of £(48.99)m over the five years to 2022/23 which is significant.

Over the two years to 2019/20, the budget gap is £(30.96)m. So far, £14.80m of savings have been identified but a further £16.16m savings are required over the period. This includes a significant gap of £12.77m to find in 2018/19.

The 2017/18 outturn is now forecast to be £3.8m over budget for the full year. In the short term the Council has one off reserves that can be used to mitigate these pressures but the longer term implications are challenging .The continued pressure from Adult and Children's services has resulted in overspends annually and further enforces the need to identify alternative methods of achieving the Council's financial position for the future.

We will review the actions taken to identify savings and how these have been challenged and consider the plans to identify further savings.

We will review monitoring arrangements, including the robustness of the Council's Medium Term Financial Plan, the delivery of the 2017/18 budget, and the action taken when plans are not being delivered.

Audit logistics, team & audit fees

Peter Barber

Engagement Lead

Peter leads or relationship with you and takes overall responsibility for the delivery of a high quality audit, meeting the highest professional standards and adding value to the Council.

Sophie Morgan

Audit Manager

Sophie plans, manages and leads the delivery of the audit, is your key point of contact for your finance team and is your first point of contact for discussing any issues.

Scott Corboy

Incharge Auditor

Scott's role is to assist in planning, managing and delivering the audit fieldwork, ensuring the audit is delivered effectively, efficiently and supervises and co-ordinates the on-site audit team.

Audit fees

The planned audit fees are no less than £123,832 (PY: £123,832) for the financial statements audit and £16,760 (PY: £13,755) for the grant certification audit. Our fees for grant certification cover only housing benefit subsidy certification, which falls under the remit of Public Sector Audit Appointments Limited. Fees in respect of other grant work, such as reasonable assurance reports, are shown under 'Fees for other services'.

In setting your fee, we have assumed that the scope of the audit, and the Council and its activities, do not significantly change.

Our requirements

To ensure the audit is delivered on time and to avoid any additional fees, we have detailed our expectations and requirements in the following section 'Early Close'. If the requirements detailed overleaf are not met, we reserve the right to postpone our audit visit and charge fees to reimburse us for any additional costs incurred.

Early close

Meeting the early close timeframe

Bringing forward the statutory date for publication of audited local government accounts to 31 July this year, across the whole sector, is a significant challenge for local authorities and auditors alike. For authorities, the time available to prepare the accounts is curtailed, while, as auditors we have a shorter period to complete our work and face an even more significant peak in our workload than previously.

We have carefully planned how we can make the best use of the resources available to us during the final accounts period. As well as increasing the overall level of resources available to deliver audits, we have focused on:

- bringing forward as much work as possible to interim audits
- starting work on final accounts audits as early as possible, by agreeing which authorities will have accounts prepared significantly before the end of May
- seeking further efficiencies in the way we carry out our audits
- working with you to agree detailed plans to make the audits run smoothly, including early agreement of audit dates, working paper and data requirements and early discussions on potentially contentious items.

We are satisfied that, if all these plans are implemented, we will be able to complete your audit and those of our other local government clients in sufficient time to meet the earlier deadline.

Client responsibilities

Where individual clients do not deliver to the timetable agreed, we need to ensure that this does not impact on audit quality or absorb a disproportionate amount of time, thereby disadvantaging other clients. We will therefore conduct audits in line with the timetable set out in audit plans (as detailed on page 13). Where the elapsed time to complete an audit exceeds that agreed due to a client not meetings its obligations we will not be able to maintain a team on site. Similarly, where additional resources are needed to complete the audit due to a client not meeting their obligations we are not able to guarantee the delivery of the audit by the statutory deadline. Such audits are unlikely to be re-started until very close to, or after the statutory deadline. In addition, it is highly likely that these audits will incur additional audit fees.

Our requirements

To minimise the risk of a delayed audit or additional audit fees being incurred, you need to ensure that you:

- produce draft financial statements of good quality by the deadline you have agreed with us, including all notes, the narrative report and the Annual Governance Statement
- ensure that good quality working papers are available at the start of the audit, in accordance with the working paper requirements schedule that we have shared with you
- ensure that the agreed data reports are available to us at the start of the audit and are reconciled to the values in the accounts, in order to facilitate our selection of samples
- ensure that all appropriate staff are available on site throughout (or as otherwise agreed) the planned period of the audit
- respond promptly and adequately to audit queries.

In return, we will ensure that:

- the audit runs smoothly with the minimum disruption to your staff
- you are kept informed of progress through the use of an issues tracker and weekly meetings during the audit
- we are available to discuss issues with you prior to and during your preparation of the financial statements.

Independence & non-audit services

Auditor independence

Ethical Standards and ISA (UK) 260 require us to give you timely disclosure of all significant facts and matters that may bear upon the integrity, objectivity and independence of the firm or covered persons. relating to our independence. We encourage you to contact us to discuss these or any other independence issues with us. We will also discuss with you if we make additional significant judgements surrounding independence matters.

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Financial Reporting Council's Ethical Standard and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements. Further, we have complied with the requirements of the National Audit Office's Auditor Guidance Note 01 issued in December 2016 which sets out supplementary guidance on ethical requirements for auditors of local public bodies.

We confirm that we have implemented policies and procedures to meet the requirements of the Ethical Standard. For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Council.

Non-audit services

The following non-audit services were identified:

Service	Fees £	Threats	Safeguards
Audit related			
Reporting Accountant's report on Regional Growth Fund	TBC	Self-Interest (because this may be a recurring fee)	The level of this recurring fee taken on its own is not considered a significant threat to independence as the fee for this work is low (2016/17 fee: £3,390) in comparison to the total fee for the audit of £123,832 and in particular relative to Grant Thornton UK LLP's turnover overall. Further, it is a fixed fee and there is no contingent element to it. These factors mitigate the perceived self-interest threat to an acceptable level.
Certification of Teachers' Pension return	£4,200	Self-Interest (because this is a recurring fee)	The level of this recurring fee taken on its own is not considered a significant threat to independence as the fee for this work is low (2016/17 fee: £4,200) in comparison to the total fee for the audit of £123,832 and in particular relative to Grant Thornton UK LLP's turnover overall. Further, it is a fixed fee and there is no contingent element to it. These factors mitigate the perceived self-interest threat to an acceptable level.

The amounts detailed are fees agreed to-date for audit related and non-audit services to be undertaken by Grant Thornton UK LLP in the current financial year. These services are consistent with the Council's policy on the allotment of non-audit work to your auditors. Any changes and full details of all fees charged for audit related and non-audit related services by Grant Thornton UK LLP and by Grant Thornton International Limited network member Firms will be included in our Audit Findings report at the conclusion of the audit.

None of the services provided are subject to contingent fees.

Appendix

A. Revised ISAs

Appendix A: Revised ISAs

Detailed below is a summary of the key changes impacting the auditor's report for audits of financial statement for periods commencing on or after 17 June 2016.

Section of the auditor's report	Description of the requirements
Conclusions relating to going concern	We will be required to conclude and report whether: • The directors use of the going concern basis of accounting is appropriate • The directors have disclosed identified material uncertainties that may cast significant doubt about the Council's ability to continue as a going concern.
Material uncertainty related to going concern	We will need to include a brief description of the events or conditions identified that may cast significant doubt on the Council's ability to continue as a going concern when a material uncertainty has been identified and adequately disclosed in the financial statements. Going concern material uncertainties are no longer reported in an Emphasis of Matter section in our audit report.
Other information	We will be required to include a section on other information which includes: • Responsibilities of management and auditors regarding other information • A statement that the opinion on the financial statements does not cover the other information unless required by law or regulation • Reporting inconsistencies or misstatements where identified
Additional responsibilities for directors and the auditor	We will be required to include the respective responsibilities for directors and us, as auditors, regarding going concern.
Format of the report	The opinion section appears first followed by the basis of opinion section.

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Grant Thornton

External Audit Plan

Year ending 31 March 2018

Avon Pension Fund

29 January 2018

Contents

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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 planning 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 the Fund 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.

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Introduction & headlines

Purpose

This document provides an overview of the planned scope and timing of the statutory audit of Avon Pension Fund ('the Fund') for those charged with governance.

Respective responsibilities

The National Audit Office ('the NAO') has issued a document entitled Code of Audit Practice ('the Code'). This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. Our respective responsibilities are also set in the Terms of Appointment and Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA), the body responsible for appointing us as auditor of Avon Pension Fund. We draw your attention to both of these documents on the PSAA website.

Scope of our audit

The scope of our audit is set in accordance with the Code and International Standards on Auditing (ISAs) (UK). We are responsible for forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance (the Corporate Audit Committee).

The audit of the financial statements does not relieve management or the Corporate Audit Committee of your responsibilities.

Our audit approach is based on a thorough understanding of the Fund's business and is risk based.

Significant risks	Those risks requiring specific audit consideration and procedures to address the likelihood of a material financial statement error have been identified as: • The revenue cycle includes fraudulent transactions (rebutted) • Management over-ride of controls • The valuation of Level 3 investments is incorrect We will communicate significant findings on these areas as well as any other significant matters arising from the audit to you in our Audit Findings (ISA 260) Report.
Materiality	We have determined planning materiality to be £43.5m (PY £43.5m), which equates to 1% of your net assets. We are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. Clearly trivial has been set at £2.1m (PY £2.1m). We have considered transactions with investment managers as a key area of focus of users of the financial statements and determined that a lower specific materiality will be set for investment management expenses of £2m (PY £2m).
Audit logistics	Our interim visit will take place in February 2018 and our final visit will take place in July 2018. Our key deliverables are this Audit Plan and our Audit Findings Report which will be reported to you in July 2018. Our fee for the audit will be no less than £28,805 (PY: £28,805) for the Fund. Where requests are received from other auditors of other bodies for assurance in respect of information held by the Fund and provided to the actuary to support their individual IAS 19 calculations these will be billed in addition to the audit fee on a case by case basis.
Independence	We have complied with the Financial Reporting Council's Ethical Standard and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements

Deep business understanding

Changes to service delivery

Pooling

Arrangements for the pooling of investments continue to develop. The Department of Communities and Local Government (DCLG) have reported on the progress of pools and noted the pace of development, including the launching of procurements for pool operators, appointing senior officers and preparing applications for Financial Conduct Authority (FCA) authorisation. This remains a challenging agenda, with arrangements required to be in place from 1 April 2018. These arrangements will have a significant impact on how investments are managed and monitored, with much of the operational responsibility moving to the pool operator. It remains key that administering authorities (through Pension Committees and Pension Boards) continue to operate strong governance arrangements, particularly during the transition phase where funds are likely to have a mix of investment management arrangements.

On 18 July 2017 the Brunel Pension Partnership Local Government Pension Scheme (LGPS) Funds formally created BPP Ltd, a £27.5 billion investment company. The company, a FCA regulated entity, will implement the asset allocation strategies for the 10 member LGPS Funds. Under these new arrangements, the Avon Pension Fund will retain responsibility for setting its investment strategy (or asset allocation), as well as the funding and administration strategies. The company structure will be in place and operational by April 2018.

Markets in Financial Instrument Directive (MiFID II)

January 2018 sees the implementation of MiFID II. The impact for the Fund is that to be able to continue to access the same investments as previously, they need to apply to 'opt up' and gain election to professional status. Without this change in status some financial institutions could terminate their relationship with the fund, which may have an adverse impact on the achievement of its investment strategy

Changes to financial reporting requirements

Accounts and Audit Regulations 2015 (the Regulations)

The DCLG is currently undertaking a review of the Regulations, which may be subject to change. The date for any proposed changes has yet to be confirmed, so it is not yet clear or whether they will apply to the 2017/18 financial statements.

Under the 2015 Regulations local authorities are required to publish their accounts along with the auditors opinion by 31 July 2018.

Changes to the CIPFA 2017/18 Accounting Code

CIPFA have introduced minor changes to the 2017/18 Code, these include a new disclosure of investment manager transaction costs and clarification on the approach to investment concentration disclosure.

On-going Matters

- Indexation and equalisation of guaranteed minimum pension (GMP) in public service pensions schemes
- Reforms to public sector exit packages and the application, or not, of the 2013 Fair Deal changes to the LGPS
- The LGPS Scheme Advisory Board (SAB) work on options for academies within the LGPS and review of Tier 3 employer risks

Key challenges

Financial pressures

At the latest triennial valuation, the fund was measured as 96% funded. This position has since improved and as at 30 June 2017, the funding had increased to 99% funded.

General Data Protection Regulations (GDPR)

GDPR comes into effect in May 2018 and replaces the Data Protection Act 1998. It introduces new obligations on data controllers. The Fund is both a data controller and a data processor and needs to ensure that it has appropriate processes in place to comply with the changes being introduced.

The Pensions Regulator (TPR) 2016 Governance and Administration Survey

Published in May 2017 whilst showing improvements in governance TPR noted that its focus for 2017-18 would be scheme governance, record keeping, internal controls and member communication and that tolerance for scheme shortcomings in these areas was reducing and that they were more likely to use their enforcement powers where scheme managers have not taken sufficient action to address issues or meet their duties.

Our response

- We will consider whether your financial position leads to uncertainty about the going concern assumption and will review any related disclosures in the financial statements.
- We will keep you informed of changes to the Regulations and any associated changes to financial reporting or public inspection requirements for 2017/18 through on-going discussions.
- As part of our opinion on your financial statements, we will consider whether your financial statements reflect the financial reporting changes in the 2017/18 CIPFA Code.
- We will continue to monitor key milestones of BPP Ltd to determine what specific audit procedures are required in the 2017-18 audit programme. We will discuss with management how BPP Ltd will implement the Fund's investment strategy.

Significant risks identified

Significant risks are defined by professional standards as risks that, in the judgement of the auditor, require special audit consideration because they have a higher risk of material misstatement. Such risks often relate to significant non-routine transactions and judgmental matters. In identifying risks, audit teams consider the nature of the risk, the potential magnitude of misstatement, and its likelihood.

Risk	Reason for risk identification	Key aspects of our proposed response to the risk
The revenue cycle includes fraudulent transactions	Under ISA (UK) 240 there is a rebuttable presumed risk that revenue may be misstated due to the improper recognition of revenue. This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.	Having considered the risk factors set out in ISA240 and the nature of the revenue streams at the Fund, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because: • there is little incentive to manipulate revenue recognition • opportunities to manipulate revenue recognition are very limited • the culture and ethical frameworks of local authorities, including Bath & North East Somerset Council as the Administering Authority of Avon Pension Fund, mean that all forms of fraud are seen as unacceptable Therefore we do not consider this to be a significant risk for Avon Pension Fund.
Management over-ride of controls	Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities. Management over-ride of controls is a risk requiring special audit consideration.	We will: • gain an understanding of the accounting estimates, judgements applied and decisions made by management and consider their reasonableness • obtain a full listing of journal entries, identify and test unusual journal entries for appropriateness • evaluate the rationale for any changes in accounting policies or significant unusual transactions.

Significant risks identified

Risk	Reason for risk identification	Key aspects of our proposed response to the risk
The valuation of Level 3 investments is incorrect	Under ISA 315 significant risks often relate to significant non-routine transactions and judgemental matters. Level 3 investments by their very nature require a significant degree of judgement to reach an appropriate valuation at year end.	We will: • gain an understanding of the Fund's process for valuing level 3 investments and evaluate the design of the associated controls • review the nature and basis of estimated values and consider what assurance management has over the year end valuations provided for these types of investments. • for a sample of investments, test the valuation by obtaining and reviewing the audited accounts, (where available) at the latest date for individual investments and agreeing these to the fund manager reports at that date. Reconcile those values to the values at 31 March 2018 with reference to known movements in the intervening period.

Reasonably possible risks identified

Reasonably possible risks (RPRs) are, in the auditor's judgment, other risk areas which the auditor has identified as an area where the likelihood of material misstatement cannot be reduced to remote, without the need for gaining an understanding of the associated control environment, along with the performance of an appropriate level of substantive work. The risk of misstatement for an RPR is lower than that for a significant risk, and they are not considered to be areas that are highly judgmental, or unusual in relation to the day to day activities of the business.

Risk	Reason for risk identification	Key aspects of our proposed response to the risk
Contributions	Contributions from employers and employees' represents a significant percentage of the Fund's revenue.	We will: • evaluate the Fund's accounting policy for recognition of contributions for appropriateness; • gain an understanding of the Fund's system for accounting for contribution income and evaluate the design of the associated controls; • test a sample of contributions to source data to gain assurance over their accuracy and occurrence; • rationalise contributions received with reference to changes in member body payrolls and the number of contributing pensioners to ensure that any unusual trends are satisfactorily explained.
Pension Benefits Payable	Pension benefits payable represents a significant percentage of the Fund's expenditure.	We will: • evaluate the Fund's accounting policy for recognition of pension benefits expenditure for appropriateness; • gain an understanding of the Fund's system for accounting for pension benefits expenditure and evaluate the design of the associated controls; • test a sample of individual pensions in payment by reference to member files; • rationalise pensions paid with reference to changes in pensioner numbers and increases applied in year to ensure that any unusual trends are satisfactorily explained.

Reasonably possible risks identified

Risk	Reason for risk identification	Key aspects of our proposed response to the risk
The valuation of Level 2 investments is incorrect	While level 2 investments do not carry the same level of inherent risks associated with level 3 investments, there is still an element of judgement involved in their valuation as their very nature is such that they cannot be valued directly.	We will • gain an understanding of the Fund's process for valuing Level 2 investments and evaluate the design of the associated controls. • review the nature and basis of estimated values and consider what assurance management has over the year end valuations provided for these types of investments. • consider the competence, expertise and objectivity of any management experts used. • review the qualifications of the fund managers in valuing the level 2 investments at year end and gain an understanding of how the valuation of these investment has been reached. • for a sample of investments, test the valuation by obtaining independent information from custodian/manager on units and unit prices.

Other matters

Other work

The Fund is administered by Bath & North East Somerset Council (the 'Council'), and the Fund's accounts form part of the Council's financial statements. Therefore as well as our general responsibilities under the Code of Practice a number of other audit responsibilities also follow in respect of the Fund, such as:

- We consider our other duties under the Act and the Code, as and when required, including:
    - giving electors the opportunity to raise questions about your 2017/18 financial statements, consider and decide upon any objections received in relation to the 2017/18 financial statements;
    - issue of a report in the public interest; and
    - making a written recommendation to the Council, copied to the Secretary of State.
- We carry out work to satisfy ourselves on the consistency of the pension fund financial statements included in the pension fund annual report with the audited Fund accounts.

Other material balances and transactions

Under International Standards on Auditing, "irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance and disclosure". All other material balances and transaction streams will therefore be audited. However, the procedures will not be as extensive as the procedures adopted for the risks identified in this report.

Going concern

As auditors, we are required to "obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern" (ISA (UK) 570). We will review management's assessment of the going concern assumption and evaluate the disclosures in the financial statements.

Materiality

The concept of materiality

The concept of materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to the monetary misstatements but also to disclosure requirements and adherence to acceptable accounting practice and applicable law. Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Materiality for planning purposes

We propose to calculate financial statement materiality based on a proportion of the net assets of the Fund for the financial year. In the prior year we used the same benchmark. We have determined planning materiality to be £43.5m (PY £43.5m), which equates to 1% of your net assets. We are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. Clearly trivial has been set at £2.1m (PY £2.1).

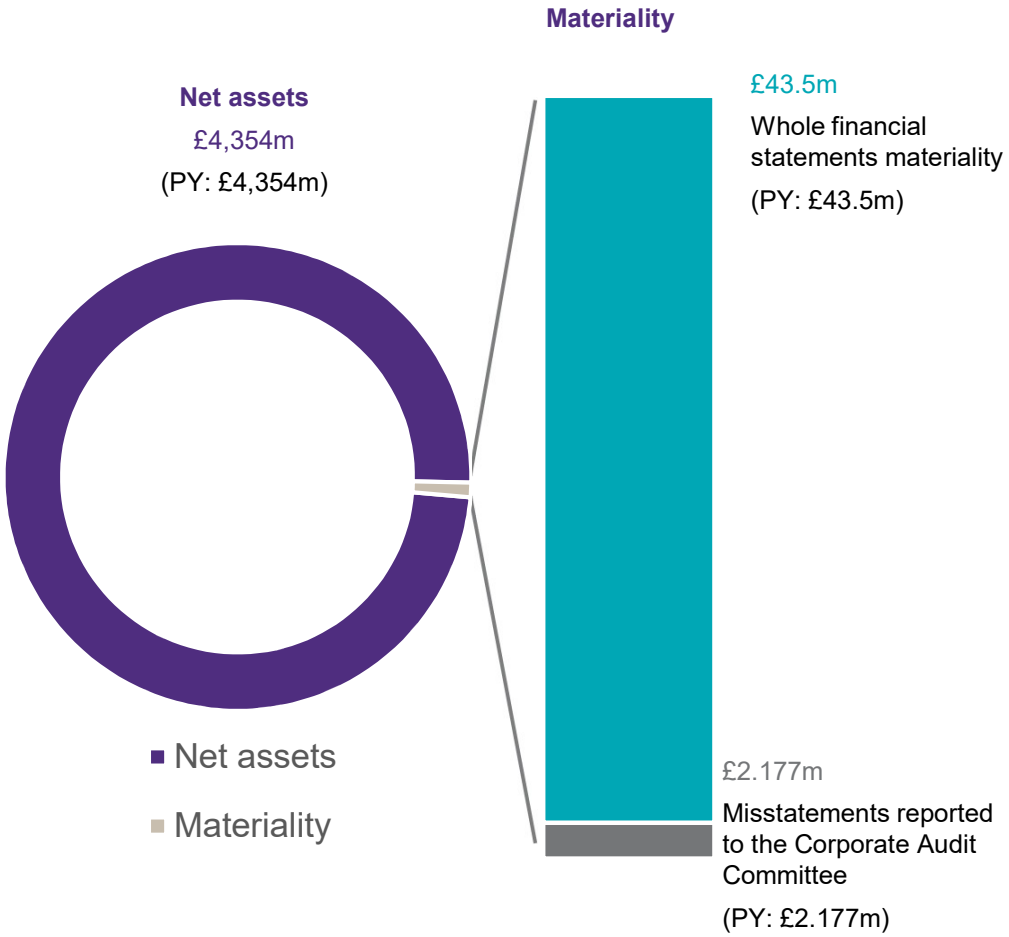
We have determined that a lower specific materiality will be set for the investment management expenses of £2m (PY £2m).

We reconsider planning materiality if, during the course of our audit engagement, we become aware of facts and circumstances that would have caused us to make a different determination of planning materiality

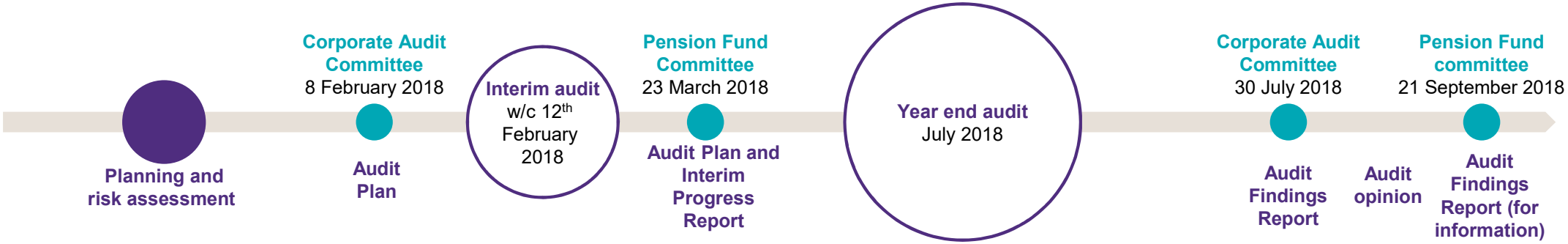
Matters we will report to the Corporate Audit Committee

Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Corporate Audit Committee any unadjusted misstatements of lesser amounts to the extent that these are identified by our audit work. Under ISA 260 (UK) 'Communication with those charged with governance', we are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 (UK) defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria. In the context of the Fund, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £2.1m (PY £2.1m).

If management have corrected material misstatements identified during the course of the audit, we will consider whether those corrections should be communicated to the Corporate Audit Committee to assist it in fulfilling its governance responsibilities.



Audit logistics, team & audit fees



Julie Masci, Engagement Lead

Responsible for overall quality control; accounts opinions; final authorisation of reports; attendance at Corporate Audit and Pensions Committees.

Michelle Burge, Audit Manager

Responsible for overall management of the audit; quality assurance and quality of audit work and outputs.

Beth Garner, Audit In charge

Responsible of management of audit fieldwork, including accounts; coordination of work completed by audit assistants; coordination of work of specialists and advisors where delegated by the Manager.

Audit fees

The planned audit fees are no less than £28,805 (PY: £28,805) for the financial statements audit. In setting your fee, we have assumed that the scope of the audit, and the Fund and its activities, do not significantly change.

Where requests are received from other auditors of other bodies for assurance in respect of information held by the Fund and provided to the actuary to support their individual IAS 19 calculations these will be billed in addition to the audit fee on a case by case basis.

Our requirements

To ensure the audit is delivered on time and to avoid any additional fees, we have detailed our expectations and requirements in the following section 'Early Close'. If the requirements detailed overleaf are not met, we reserve the right to postpone our audit visit and charge fees to reimburse us for any additional costs incurred.

Early close

Meeting the early close timeframe

Bringing forward the statutory date for publication of audited local government accounts to 31 July this year, across the whole sector, is a significant challenge for local authorities and auditors alike. For authorities, the time available to prepare the accounts is curtailed, while, as auditors we have a shorter period to complete our work and face an even more significant peak in our workload than previously.

We have carefully planned how we can make the best use of the resources available to us during the final accounts period. As well as increasing the overall level of resources available to deliver audits, we have focused on:

- bringing forward as much work as possible to interim audits
- starting work on final accounts audits as early as possible, by agreeing which authorities will have accounts prepared significantly before the end of May
- seeking further efficiencies in the way we carry out our audits
- working with you to agree detailed plans to make the audits run smoothly, including early agreement of audit dates, working paper and data requirements and early discussions on potentially contentious items.

We are satisfied that, if all these plans are implemented, we will be able to complete your audit and those of our other local government clients in sufficient time to meet the earlier deadline.

Client responsibilities

Where individual clients do not deliver to the timetable agreed, we need to ensure that this does not impact on audit quality or absorb a disproportionate amount of time, thereby disadvantaging other clients. We will therefore conduct audits in line with the timetable set out in audit plans (as detailed on page 11). Where the elapsed time to complete an audit exceeds that agreed due to a client not meetings its obligations we will not be able to maintain a team on site. Similarly, where additional resources are needed to complete the audit due to a client not meeting their obligations we are not able to guarantee the delivery of the audit by the statutory deadline. Such audits are unlikely to be re-started until very close to, or after the statutory deadline. In addition, it is highly likely that these audits will incur additional audit fees.

Our requirements

To minimise the risk of a delayed audit or additional audit fees being incurred, you need to ensure that you:

- produce draft financial statements of good quality by the deadline you have agreed with us, including all notes
- ensure that good quality working papers are available at the start of the audit, in accordance with the working paper requirements schedule that we have shared with you
- ensure that the agreed data reports are available to us at the start of the audit and are reconciled to the values in the accounts, in order to facilitate our selection of samples
- ensure that all appropriate staff are available on site throughout (or as otherwise agreed) the planned period of the audit
- respond promptly and adequately to audit queries.

In return, we will ensure that:

- the audit runs smoothly with the minimum disruption to your staff
- you are kept informed of progress through the use of an issues tracker and weekly meetings during the audit
- we are available to discuss issues with you prior to and during your preparation of the financial statements.

Independence & non-audit services

Auditor independence

Ethical Standards and ISA (UK) 260 require us to give you timely disclosure of all significant facts and matters that may bear upon the integrity, objectivity and independence of the firm or covered persons. relating to our independence. We encourage you to contact us to discuss these or any other independence issues with us. We will also discuss with you if we make additional significant judgements surrounding independence matters.

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Financial Reporting Council's Ethical Standard and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements. Further, we have complied with the requirements of the National Audit Office's Auditor Guidance Note 01 issued in December 2016 which sets out supplementary guidance on ethical requirements for auditors of local public bodies.

We confirm that we have implemented policies and procedures to meet the requirements of the Ethical Standard. For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Fund.

Non-audit services

No non-audit services were identified.

Appendices

A. Revised ISAs

Appendix A: Revised ISAs

Detailed below is a summary of the key changes impacting the auditor's report for audits of financial statement for periods commencing on or after 17 June 2016.

Section of the auditor's report	Description of the requirements
Conclusions relating to going concern	We will be required to conclude and report whether: • The directors use of the going concern basis of accounting is appropriate • The directors have disclosed identified material uncertainties that may cast significant doubt about the Fund's ability to continue as a going concern.
Material uncertainty related to going concern	We will need to include a brief description of the events or conditions identified that may cast significant doubt on the Fund's ability to continue as a going concern when a material uncertainty has been identified and adequately disclosed in the financial statements. Going concern material uncertainties are no longer reported in an Emphasis of Matter section in our audit report.
Other information	We will be required to include a section on other information which includes: • Responsibilities of management and auditors regarding other information • A statement that the opinion on the financial statements does not cover the other information unless required by law or regulation • Reporting inconsistencies or misstatements where identified
Additional responsibilities for directors and the auditor	We will be required to include the respective responsibilities for directors and us, as auditors, regarding going concern.
Format of the report	The opinion section appears first followed by the basis of opinion section.

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Bath & North East Somerset Council		
MEETING:	**Corporate Audit Committee**	
MEETING DATE:	**8th February 2018**	EXECUTIVE FORWARD PLAN REFERENCE: E
TITLE:	**Treasury Management Strategy Statement and Investment Strategy 2018/19**	
WARD:	All	
AN OPEN PUBLIC ITEM		
List of attachments to this report: Appendix 1 - Treasury Management Strategy 2018/19 Appendix 2 - Investment Strategy 2018/19 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.

1.4 CIPFA issued an updated Treasury Management in Public Services: Code of Practice in late December 2017 and the code will be effective for the 2018/19 Financial Year. In accordance with Arlingclose advice we have continued to seek approval of our Treasury Management Strategy (TMS) under the requirements of the 2011 Codes, not least because the new code does not recommend any changes to the format or content of the TMS. CIPFA is currently planning to publish updated guidance notes on the changes to the code later in 2018 and if any changes to this strategy are required they will be reported in future treasury management reports and further approvals will be sought at full council.

2 RECOMMENDATION

The Corporate Audit Committee is asked to note –

- The actions proposed within the Treasury Management Strategy Statement (Appendix 1) to February Council and the Investment Strategy as detailed in Appendix 2 to February Council.

- The Treasury Management Indicators detailed in Appendix 1

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 2018/19 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, Arlingclose.

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 8th February 2018 meeting.

2018/19 Treasury Management & Investment Strategy

5.6 The Strategy Statement for 2017/18 set Treasury Indicators for 2017/18 – 2019/20, which included a total borrowing requirement at the end of 2017/18 of £308 million. At the end of December 2017, external borrowing was at £176.9 million, which may increase before the end of the 2017/18 financial year should a review of the Council's cashflow and capital investment decisions highlight additional borrowing is required. The level of borrowing is in line with the policy of utilising internal cash to reduce net borrowing costs and investment counterparty risk.

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 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.

5.9 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.

5.10 Appendix 1 also details the Council's current portfolio position as at 31st December 2017, which shows after the netting off of the £29.3 million investments, the Council's net debt position was £147.6 million.

5.11 The 2018/19 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 previous years, which has protected the Council against losses of investment, for example in Icelandic banks.

5.12 The Counterparty listing in Appendix 3 includes credit ratings from three agencies, as well as a sovereign rating for each country. Counterparties who now meet the minimum criteria as recommended in Appendix 2 as at 31st December 2017 are included in the listing in Appendix 3.

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

5.14 The Council has met the conditions to opt up to MiFID II professional status and intends for this to continue in 2018/19 in order to continue to have access to products including money market funds, pooled funds, treasury bills, bonds, shares and to continue to receive the same level of support from our treasury management advisors.

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 balance leading to a higher impact in

	higher investment income	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 persons	*Giles Oliver - 01225 477022 giles_oliver@bathnes.gov.uk* *Donna Parham 01225 477468 donna_parham@bathnes.gov.uk*
Background papers	*2017/18 Treasury Management & Investment Strategy.*
Please contact the report author if you need to access this report in an alternative format	

APPENDIX 1

TREASURY MANAGEMENT STRATEGY – 2018/2019

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.

CIPFA issued an updated Treasury Management in Public Services: Code of Practice in late December 2017 and the code will be effective for the 2018/19 Financial Year.

The Arlingclose advice received has been that Local authorities are legally obliged to "have regard" to the Treasury Management Code and the Prudential Code "as amended or reissued from time to time" by relevant Capital Finance Regulations. The Council is awaiting publication, expected later in 2018, by CIPFA of the associated new Treasury Management Code Guidance Notes which will include the Treasury Management indicators, and new DCLG Investment Guidance, so it can fully consider any changes that may be required to the treasury management strategy.

The advice received is therefore to continue to obtain full council approval for the 2018/19 Treasury Management Strategy under the requirements of the 2011 Codes, not least because the new code does not recommend any changes to the format or content of the TMS. If any updates are required once further guidance notes are published these will be reported in future treasury management reports.

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. Other than code changes, other 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 2018/19 to 2020/21

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 2018/19 – 2020/21

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.

	2018/19
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:

	2018/19	2019/20	2020/21
Upper limit on fixed interest rate exposures	£403m	£442m	£451m
Upper limit on variable interest rate exposures	£246m	£285m	£294m

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:

	2018/19	2019/20	2020/21
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.

	2018/19	2019/20	2020/21
Operational boundary – borrowing	**£403**	**£442m**	**£451m**
Operational boundary – other long-term liabilities	**£2m**	**£2m**	**£2m**
Operational boundary – TOTAL	**£405m**	**£444m**	**£453m**
Authorised limit – borrowing	**£434m**	**£473m**	**£481m**
Authorised limit – other long-term liabilities	**£2m**	**£2m**	**£2m**
Authorised limit – TOTAL	**£436m**	**£475m**	**£483m**

External Context & Prospects for Interest Rates (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 2018/19 will be the UK's progress in negotiating its exit from the European Union and agreeing future trading arrangements. The domestic economy has remained relatively robust since the surprise outcome of the 2016 referendum, but there are indications that uncertainty over the future is now weighing on growth. Transitional arrangements may prevent a cliff-edge, but will also extend the period of uncertainty for several years. Economic growth is therefore forecast to remain sluggish throughout 2018/19.

Consumer price inflation reached 3.0% in September 2017 as the post-referendum devaluation of sterling continued to feed through to imports. Unemployment continued to fall and the Bank of England's Monetary Policy Committee judged that the extent of spare capacity in the economy seemed limited and the pace at which the economy can grow without generating inflationary pressure had fallen over recent years. With its inflation-control mandate in mind, the Bank of England's Monetary Policy Committee raised official interest rates to 0.5% in November 2017.

In contrast, the US economy is performing well and the Federal Reserve is raising interest rates in regular steps to remove some of the emergency monetary stimulus it has provided for the past decade. The European Central Bank is yet to raise rates, but has started to taper its quantitative easing programme, signalling some confidence in the Eurozone economy.

Credit outlook: High profile bank failures in Italy and Portugal have reinforced concerns over the health of the European banking sector. Sluggish economies and fines for pre-crisis behaviour continue to weigh on bank profits, and any future economic 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. In addition,

the largest UK banks will ringfence their retail banking functions into separate legal entities during 2018. There remains some uncertainty over how these changes will impact upon the credit strength of the residual legal entities.
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 remain very low.

Interest rate forecast: The Authority's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.50% during 2018/19, following the rise from the historic low of 0.25%. The Monetary Policy Committee re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.
Future expectations for higher short term interest rates are subdued and on-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions. The risks to Arlingclose's forecast are broadly balanced on both sides. The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.

Arlingclose Interest Rate Forecasts

Arlingclose central interest rate forecast – November 2017

	Bank Rate	3 month LIBID	12 month LIBID	20-year gilt yield*
Q1 2018	0.50	0.50	0.70	1.85
Q2 2018	0.50	0.50	0.70	1.85
Q3 2018	0.50	0.50	0.70	1.85
Q4 2018	0.50	0.50	0.70	1.85
H1 2019	0.50	0.50	0.80	1.87
H2 2019	0.50	0.50	0.80	1.92
H1 2020	0.50	0.50	0.80	1.97
H2 2020	0.50	0.50	0.80	2.05

*
The Council can currently borrow from the PWLB at 0.60% above gilt yields

The Council has budgeted for investment interest rates will be made at an average rate of 0.45% for 2018/19 & beyond, reflecting the planned short-term duration of investments.

A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix 4.

Local Context

Current Portfolio Position

The Council's treasury portfolio position at 31st December 2017 comprised:

	Principal	Ave. rate
	£m	%
External Borrowing		
Fixed rate funding – PWLB	124.4	3.36%
Fixed rate funding – LA's	32.5	1.0%
Variable rate funding – LOBOs *	20.0	4.50*%
Other long term liabilities	Nil	N/A
TOTAL GROSS EXTERNAL DEBT	**176.9**	**3.06%**
Investments		
Short Term Investments	29.3	0.31%
Long Term Investments	0	
TOTAL INVESTMENTS**	**29.3**	**0.31%**
NET DEBT	**147.6**	**3.61%**

* These market loans are 'Lenders Options, Borrow Options' or LOBO's. They were taken out on October 2004 and April 2005 and were fixed at a relatively low rate of interest for an initial period and are now payable at 4.5%. The loans are classed as variable, as the lender has the option to change the interest rate at 6 monthly intervals, however at this point the borrower also has the option to repay the loan without penalty.

** Total Investments includes Schools balances where schools have not opted for an external bank account.

Borrowing Strategy

As at 31st December 2017, the Council held £176.9 million of long-term loans, and we will continue to monitor appropriate opportunities for borrowing in line with the overall Capital Financing Requirement.

The Council's capital financing requirement (CFR, or underlying need to borrow) as at 31st March 2018 is expected to be £282 million, and is forecast to rise to £434 million by March 2019 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 2018/19 is:

	£m
Not borrowed in previous years	*105*
Forecast increase in CFR	*152*
Loans maturing in 2018/19	*19*
TOTAL	***276***

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 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. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in 2018/19 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 2018/19, 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.

<u>Sources of borrowing</u>
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 as 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 2018/19, 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.

As a result of the second Markets in Financial Instruments Directive (MiFID II), local authorities will be treated as retail clients but can "opt up" to professional client status, providing that they meet certain criteria which includes having an investment balance of at least £10 million and the persons authorised to make investment decisions on behalf of the authority having at least a year's relevant professional experience. In addition, the regulated financial services firms to whom this directive applies must assess that these persons have the expertise, experience and knowledge to make investment decisions and understand the risks involved.

The Council has met the conditions to opt up to MiFID professional status and intends for this to continue in 2018/19 in order continue to have access to products including money market funds, pooled funds, treasury bills, bonds, shares and to continue to receive the same level of support from our treasury management advisors.

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 cash balance held internally is a working balance to cover pension payments at any point in time and it is estimated will be an average of £20 million, being around 0.45% of the overall assets of the Fund. The regulations require that this cash is accounted for separately and invested separately from the Council's cash.

Investments held 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 Fund's investment managers, are responsible for the investment of cash held within their portfolios and this policy does not relate to their cash investments. The Brunel Pension Partnership does not have any direct impact on the Council's treasury management activities.

The West of England Combined Authority

The West of England Combined Authority was established in 2017. The Authority has its own investment and borrowing powers, and is required to approve its own Treasury Strategy Statement.

The Council's Treasury Management Team undertake a lead role for the Treasury Management Function for the combined authority, with recovery of cost through an agreed Service Level Agreement.

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

(continued)

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporates	Registered Providers
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*				

* Amount refers to the principal invested (excluding any market valuation changes)

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.

The Council is considering investment in the CCLA Property Fund during 2018/19 with a view to providing further diversification of its commercial property investments and the potential for earning a higher investment yield

on the core investment balance the Council must hold to maintain the "Professional" investor status required under MIFID II. Any future investment is already covered under the existing Investment strategy for pooled funds and any final investment decision is delegated to the S151 Officer and will be subject to consultation with the Cabinet Member for Finance & Efficiency.

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 a 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- (except for UK Government and Local Authorities)	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 2018/19

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:

Treasury management advisers
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 2018/19 authorised borrowing limit of £434 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 Investements
2018/19

CRITERIA									
			FITCH RATINGS			Moody's Ratings		S&P Ratings	
	Duration	Council Limit (£m)	S/Term	L/Term	Support	S/Term	L/Term	S/Term	L/Term
UK Banks	**Sovereign Rating**			**AA+**			**Aa1**		**AAA**
Barclays Bank plc	13 months	10	F1	A	5	P-1	A1	A-1	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	Aa3	A-1+	AA-
Lloyds Banking Group									
Lloyds Bank plc	13 months	10	F1	A+	5	P-1	Aa3	A-1	A
Bank of Scotland plc	13 months	10	F1	A+	5	P-1	Aa3	A-1	A
Royal Bank of Scotland Group									
National Westminster Bank plc	3 Months	5	F2	BBB+	5	-	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	10	F1	A	2	P-1	Aa3	A-1	A
Standard Chartered Bank	2 Years	10	F1	A+	5	P-1	A1	A-1	A
UK Building Societies									
Nationwide	13 months	10	F1	A+	5	P-1	Aa3	A-1	A
Yorkshire	6 months	10	F1	A-	5	P-2	A3	NR	NR
Coventry	13 months	10	F1	A	5	P-1	A2	-	-
Leeds	6 months	10	F1	A-	5	P-2	A3	-	-
Foreign Banks									
Australia	**Sovereign Rating**			**AAA**			**Aaa**		**AAAu**
Australia & New Zealand Banking Group	3 Years	10	F1+	AA-	1	P-1	Aa3	A-1+	AA-
Commonwealth Bank of Australia	3 Years	10	F1+	AA-	1	P-1	Aa3	A-1+	AA-
National Australia Bank Group									
National Australia Bank Ltd	3 Years	10	F1+	AA-	1	P-1	Aa3	A-1+	AA-
Westpac Banking Corporation	3 Years	10	F1+	AA-	1	P-1	Aa3	A-1+	AA-
Canada	**Sovereign Rating**			**AAA**			**Aaa**		**AAA**
Bank of Montreal	2 Years	10	F1+	AA-	2	P-1	A1	A-1	A+
Bank of Nova Scotia	2 Years	10	F1+	AA-	2	P-1	A1	A-1	A+
Canadian Imperial Bank of Commerce	2 Years	10	F1+	AA-	2	P-1	A1	A-1	A+
Royal Bank of Canada	3 Years	10	F1+	AA	2	P-1	A1	A-1+	AA-
Toronto-Dominion Bank	3 Years	10	F1+	AA-	2	P-1	Aa2	A-1+	AA-
Finland	**Sovereign Rating**			**AA+**			**Aa1**		**AA+**
OP Corporate Bank	2 Years	10	F1	A+	5	P-1	Aa3	A-1+	AA-
Germany	**Sovereign Rating**			**AAA**			**Aaa**		**AAAu**
Landesbank Hessen-Thuringen	13 months	10	F1+	A+	WD	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 Centrale Raiffe	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-	5	P-1	Aa3	A-1+	AA-
Nordea Bank NV	3 Years	10	F1+	AA	5	P-1	Aa2	A-1+	AA-
Switzerland	**Sovereign Rating**			**AAA**			**Aaa**		**AAAu**
Credit Suisse AG	13 months	10	F1	A	5	P-1	A1	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)P-1	Aaa	A-1+	AAA
IBRD (World Bank)	5 Years	10	F1+	AAA	-	P-1	Aaa	A-1+	AAA
Kreditanstalt Fuer Wiefrauf	5 Years	10	F1+	AAA	1	P-1		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
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:

- In a 7-2 vote, the MPC increased Bank Rate in line with market expectations to 0.5%. Dovish accompanying rhetoric prompted investors to lower the expected future path for interest rates. The minutes re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.
- Further potential movement in Bank Rate is reliant on economic data and the likely outcome of the EU negotiations. Policymakers have downwardly assessed the supply capacity of the UK economy, suggesting inflationary growth is more likely. However, the MPC will be wary of raising rates much further amid low business and household confidence.
- The UK economy faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. While recent economic data has improved, it has done so from a low base: UK Q3 2017 GDP growth was 0.4%, after a 0.3% expansion in Q2.
- Household consumption growth, the driver of recent UK GDP growth, has softened following a contraction in real wages, despite both saving rates and consumer credit volumes indicating that some households continue to spend in the absence of wage growth. Policymakers have expressed concern about the continued expansion of consumer credit; any action taken will further dampen household spending.
- Some data has held up better than expected, with unemployment continuing to decline and house prices remaining relatively resilient. However, both of these factors can also be seen in a negative light, displaying the structural lack of investment in the UK economy post financial crisis. Weaker long term growth may prompt deterioration in the UK's fiscal position.
- The depreciation in sterling may assist the economy to rebalance away from spending. Export volumes will increase, helped by a stronger Eurozone economic expansion.
- Near-term global growth prospects have continued to improve and broaden, and expectations of inflation are subdued. Central banks are moving to reduce the level of monetary stimulus.
- Geo-political risks remains elevated and helps to anchor safe-haven flows into the UK government bond (gilt) market.

Forecast:

- The MPC has increased Bank Rate, largely to meet expectations they themselves created. Future expectations for higher short term interest rates are

subdued. On-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions.

- Our central case for Bank Rate is 0.5% over the medium term. The risks to the forecast are broadly balanced on both sides.

- The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.19**
Arlingclose Central Case	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**
Downside risk	0.00	0.00	0.00	0.00	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	**-0.15**
3-month LIBID rate														
Upside risk	0.10	0.10	0.10	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.22**
Arlingclose Central Case	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**
Downside risk	-0.10	-0.10	-0.15	-0.15	-0.15	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	**-0.20**
1-yr LIBID rate														
Upside risk	0.15	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	**0.27**
Arlingclose Central Case	**0.70**	**0.70**	**0.70**	**0.70**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.77**
Downside risk	-0.15	-0.20	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.15	-0.15	**-0.26**
5-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**0.75**	**0.75**	**0.80**	**0.80**	**0.80**	**0.85**	**0.90**	**0.90**	**0.95**	**0.95**	**1.00**	**1.05**	**1.10**	**0.89**
Downside risk	-0.20	-0.20	-0.25	-0.25	-0.25	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	**-0.33**
10-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.30**	**1.30**	**1.35**	**1.40**	**1.45**	**1.50**	**1.55**	**1.55**	**1.36**
Downside risk	-0.20	-0.25	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	**-0.33**
20-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**1.85**	**1.85**	**1.85**	**1.85**	**1.85**	**1.90**	**1.90**	**1.95**	**1.95**	**2.00**	**2.05**	**2.05**	**2.05**	**1.93**
Downside risk	-0.20	-0.30	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	**-0.38**
50-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	**1.75**	**1.80**	**1.85**	**1.90**	**1.95**	**1.95**	**1.95**	**1.95**	**1.82**
Downside risk	-0.30	-0.30	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	**-0.39**

Bath & North East Somerset Council		
MEETING:	Corporate Audit Committee	
MEETING DATE:	8th February 2018	**AGENDA ITEM NUMBER**
TITLE:	Annual Governance Statement – Update Report	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
List of attachments to this report: Appendix 1 – Annual Governance Review – Outline of Framework. Appendix 2 – Significant Issue 2016/17 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 2017/18.

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 revised Local Code of Corporate Governance during the year which the Committee recommended 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' (see Appendix 1).

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 2017/18 Annual Governance Review has commenced and by end of February 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 the 2017/18 audited Statement of Accounts (including the annual governance statement) will be published by the earlier date of 31st July 2018 (previously the requirement was to published by 30th September).

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 2016/17 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 'Financial challenge' continues to be a 'Significant Issue' and it will be recorded as an issue in the 2017/18 Statement. The latest position with regard to the 2016/17 actions is detailed within the reports to Council on controlling in-year budgets for 2017/18 as well as the budget proposals for 2018/19. Links to those reports are as follows –

Report to Cabinet 7th February – Revenue & Capital Budget Monitoring

https://democracy.bathnes.gov.uk/documents/s49789/E2892%20Revenue%20and%20Capital%20Budget%20Monitoring%202.pdf

Report to Cabinet 7th February – Budget & Council Tax 2018/19 & Financial Outlook

https://democracy.bathnes.gov.uk/documents/s49792/E3004%20Revenue%20and%20Capital%20Budget%20201819.pdf

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 2016/17 we have identified the following areas as meriting further management consideration in relation to the 2017/18 statement –

- Current and Ongoing Financial Challenge

- New Virgin Care Contract to provide community health and care services.

- East of Bath Park & Ride Scheme

- Modern Libraries 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

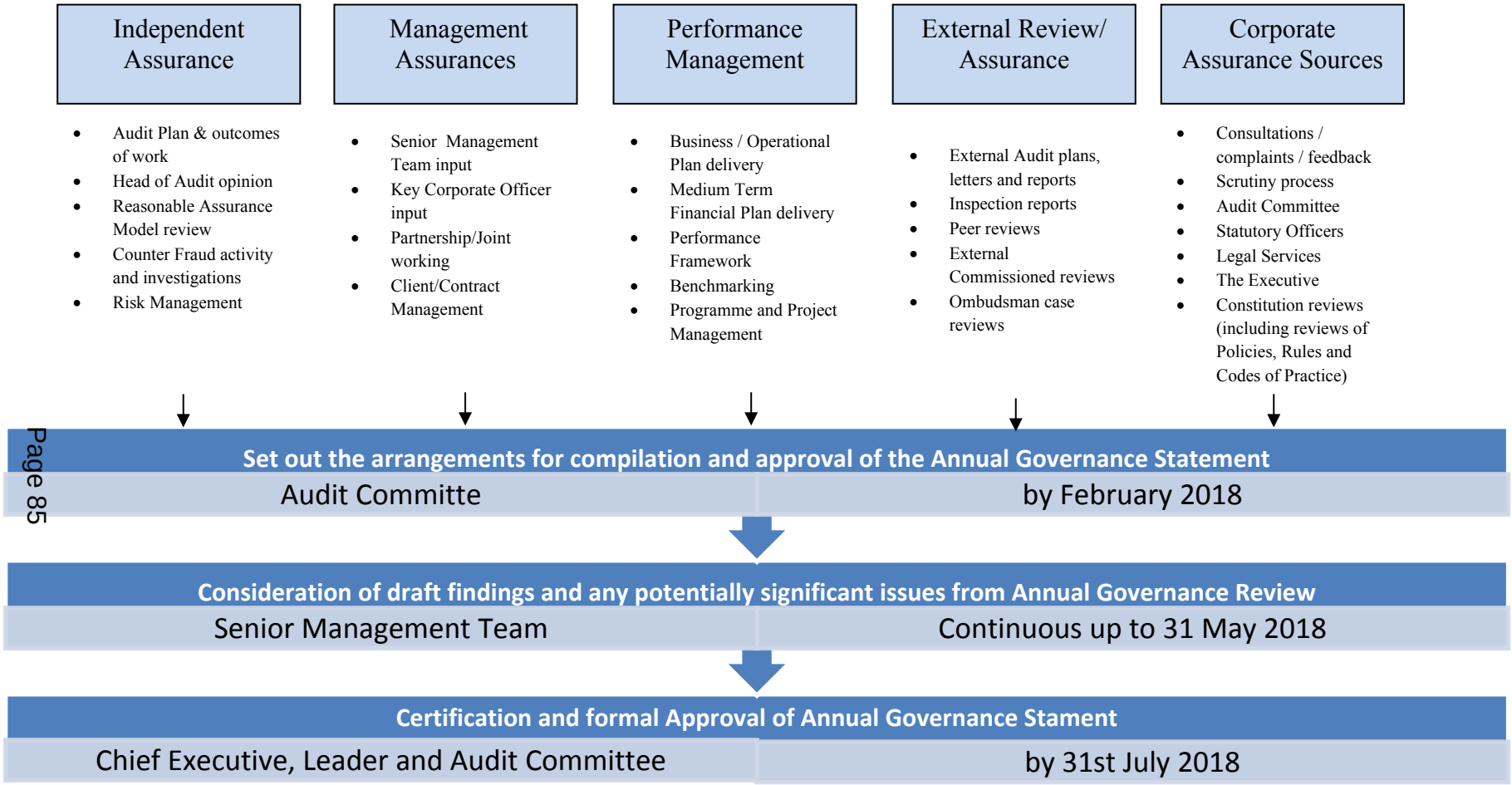
6.1 A proportionate equalities impact assessment has been carried out using corporate guidelines, no significant issues to report.

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	Report to Corporate Audit Committee 12th September – Local Code of Corporate Governance https://democracy.bathnes.gov.uk/documents/s48089/CACLocalofCGSept17.pdf
Please contact the report author if you need to access this report in an alternative format	

APPENDIX 1 - High Level Methodology for Preparing the Annual Governance Statement



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Appendix 2. SIGNIFICANT GOVERNANCE ISSUES 2016/17

Issue in 16/17	Commentary & Mitigating actions for 17/18
Financial Challenge As detailed last year the significant issue identified around the financial challenge continues to be ever more severe, with public sector austerity likely to last up to 2025. The Council has responded positively with over £42M of savings already delivered, however at least £30M of additional savings still need to be identified over the remaining period. Therefore the Council has been actively planning to meet this challenge with new savings initiatives already being worked on for future years. Despite this the Council's financial sustainability is being challenged and its outturn position for 2016/17 resulted in a £2.2M overspend with again the major challenges and spend pressures being in the sectors of Adult Social Care and Children's Services. Whilst again no significant governance failures have occurred, the Council acknowledge that the level of grant reductions from central government are a significant issue and represent the most significant set of challenges it has faced in being able to continue to deliver excellent services to the whole community at all times. Nationally the pressures in Social Care have started to be recognised and some temporary funding has been provided for future years. However this does not close the gap and increased health and social care integration and service transformation continues to be necessary. 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.	As with last year 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 again 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; - More regular 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; - Reviewing the Capital Programme to reduce risk and improve management capacity and a number of specific actions in relation to Adult Care to re-assess demand management and contract management; - Instituting a range of new stringent cost control mechanisms on staff costs, goods, works and services; 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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