Chichester District Council

NOTICE OF MEETING

East Pallant House Chichester West Sussex PO19 1TY

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MEETING	**CORPORATE GOVERNANCE AND AUDIT COMMITTEE**
DATE / TIME	Thursday 23 January 2014 at 09.30 am
VENUE	Committee Room 2 East Pallant House Chichester PO19 1TY
CONTACT POINT	Bambi Jones – Principal Scrutiny Officer Direct line: 01243 534685 Email: bjones@chichester.gov.uk

Tuesday 14 January 2014

PAUL E OVER
Executive Director of Support Services and the Economy

AGENDA

This agenda should be retained for future reference with the minutes of this meeting

PART 1

1. **Chairman's Announcements**
Any apologies for absence that have been received will be noted at this point.

2. **Approval of Minutes** (Pages 1 to 6)
The Corporate Governance and Audit Committee is requested to approve the minutes of its ordinary meeting on Thursday 28 November 2013.

3. **Urgent items**
The chairman will announce any urgent items that due to special circumstances are to be dealt with under agenda item 10(b).

4. **Declarations of Interests**
These are to be made by members of the Corporate Governance and Audit Committee or other Chichester District Council members present in respect of matters on the agenda for this meeting.

5. **Public Question Time**
The procedure for submitting public questions in writing by no later than 12:00 on Wednesday 22 January 2014 is available upon request to Member Services (the contact details for which appear on the front page of this agenda).

6. **Certification of claims and returns annual report 2012-13** (Pages 7 to 14)
To note the results of work on the Council's claims and returns from the Council's external auditors, Ernst & Young LLP.

7. **Treasury Management Strategy** (Pages 15 to 37)
To consider the attached report requesting the committee to consider the Treasury Management Policy Statement, the Treasury Management Strategy Statement, the Minimum Revenue Provision Policy Statement and the Annual Investment Strategy for 2014-15.

8. **Budget Task & Finish Group report back**
Members of the task and finish group will feed back their findings following a meeting of the group on 17 December 2013.

9. **Internal Audit Report and Audit Plan Progress** (Pages 38 to 40)
To consider reports by Internal Audit and to note progress against the current year's Audit Plan. View Estates, Contracts and Housing Benefits.

10. **Late items**
(a) Items added to the agenda papers and made available for public inspection
(b) Items that the chairman has agreed should be taken as a matter of urgency by reason of special circumstances to be reported at the meeting

PART 2

[Items for which the press and public are likely to be excluded]

The public and press may be excluded from the meeting during any item of business whenever it is likely that there would be disclosure of 'exempt information' as defined in section 100 I of and Schedule 12A to the Local Government Act 1972

11. **Exclusion of the Press and Public**
The Corporate Governance and Audit Committee will consider the following resolution:

That in accordance with section 100A of the Local Government Act 1972 (the Act) the public and the press be excluded from the meeting during the consideration of the following item on the agenda for the reason that it is likely in view of the nature of the business to be transacted that there would be disclosure to the public of "exempt information" being information of the nature described in Paragraph 5 (information in respect of which a claim to legal professional privilege could be maintained in legal proceedings) of Part 1 of Schedule 12A to the Act and the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

12. **Westgate Leisure Centre Carbon Trust Scheme**
The committee will receive a verbal report on the legal position with regard to the rectification of the CHP engines at the Westgate Leisure Centre.

NOTES

With the aim of reducing paper consumption, certain restrictions have been introduced on the distribution of paper copies of longer appendices to reports where those appendices are circulated separately from the agenda:

(1) **Members of the Corporate Governance and Audit Committee, the Cabinet and Senior Officers:** They receive paper copies including the appendices.

(2) **Other Members of the Council:** The appendices may be viewed via the Members' Desktop and a paper copy will also be available for inspection in the Members' Room at East Pallant House.

(3) **The Press and Public:** The appendices relating to reports listed under Part I of the agenda which are not included with their copy of the agenda can be viewed as follows:

(a) on the council's website at www.chichester.gov.uk/committee_papers - Select Corporate Governance and Audit Committee then choose the date of this meeting
(b) at the main reception desk at East Pallant House Chichester
(c) by contacting Bambi Jones (Principal Scrutiny Officer) on 01243 534685 or bjones@chichester.gov.uk

MEMBERS

Mrs P M Tull (Chairman)
Mr A J French (Vice-Chairman)

Mrs C M M Apel	Mrs P A Hardwick
Mr M J Bell	Mr G H Hicks
Mr T Dignum	Mr R M J Marshall
Mr B Finch	Mr G V McAra

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Minutes of a meeting of the **Corporate Governance and Audit Committee** held at the Woolstaplers Room, the Novium Museum, Chichester on Thursday, 28 November 2013 at 09.30am.

Members (10)

Mrs P M Tull (Chairman)
Mr A J French (Vice-Chairman)

Mrs C M M Apel	Mr B Finch
Mr M Bell	Mr R Marshall
Mr T Dignum	Mr G McAra

Present (8)

Apologies for absence:
Mrs P Hardwick
Mr G Hicks

Officers Present for all agenda items
Mrs B Jones, Principal Scrutiny Officer
Mr J Ward, District Treasurer

Officers Present for Specific Items Only
Mr P Over, Executive Director of Support Services & the Economy
Mrs H Belenger, Accountancy Services Manager
Mr S James, Principal Auditor
Mrs L Le Vay, Design & Implementation Manager
Mrs B Bayliss, Planning Obligations Monitoring & Implementation Officer
Mrs C Dring, Benefits Manager

Chichester District Council Members present as observers or contributors
Mr S Oakley
Mrs C Purnell

149. **Chairman's Announcements**

Mrs Tull welcomed all to this meeting being held at the Novium. She advised that as Mr Ward was now the lead officer for this committee, Mr Over would not routinely be attending future meetings. The house rules were read out by Mrs H Wassell, the Front of House Officer at the museum.

150. **Minutes**

RESOLVED

That the Minutes of the meeting held on 19 September 2013 be signed as a correct record.

Matters arising: Mr Ward advised that all members' declarations of related party transactions had now been completed (minute 140). Mrs Jones advised that the generic email address for the committee would be forwarded to Mr King in order that all members would receive updates on the EY ITEM Club forecasts (minute 142).

151. **Urgent Items**

There were no urgent items for consideration at this meeting.

152. **Declarations of Interest**

There were no declarations of interest.

153. **Public Question Time**

No public questions had been submitted.

154. **Annual Audit Letter year ending 31 March 2013 – Ernst & Young LLP**

The Chairman welcomed Paul King from Ernst & Young (EY) to the meeting and the committee considered the agenda report (copy attached to the official minutes).

Mr King advised that there had been no issues to report to the Audit Committee or to the National Audit Office. The work on 2012/13 grant claims was essentially complete and the certificate would be issued in January 2014. The certificate on the housing benefit claim would be issued today in line with the 30 November deadline. In reviewing the housing benefit subsidy claim on behalf of the Department for Works & Pensions an error had been found which had resulted in an extra £100,000 (approximately) in the Council's favour. There would be an additional audit charge for this element of the review.

In response to a question by Mr McAra on how the Council compares with others with regard to value for money (VfM), Mr King advised that it was difficult to make comparisons as there were no scored comparisons as had been given in the past. Some councils had received qualification conclusions on one or two criteria of the VfM assessment, however the Council had an unqualified result, its arrangements being regarded as effective in order to receive this judgement. Mr Dignum suggested that the Council's costs per head figures be obtained to allow an element of comparison against other authorities. Mr Ward advised that the annual outturn figures were available and could be calculated to give cost per head, however he advised caution as individual services' cost per head figures were area specific and may not be directly comparable. However we could analyse whether we are spending more per head than other authorities.

Mr Ward thanked Mr King for the audit work carried out and Mr King responded saying that it had been a smooth first year's audit under Ernst & Young LLP.

RESOLVED

That the Ernst & Young LLP annual audit letter for the year ending 31 March 2013 be noted.

155. **Financial Strategy and Plan**

The committee considered the agenda report (copy attached to the official minutes).

Mr Ward advised that the committee was required to report to Cabinet and to Council on the Council's draft five year Financial Strategy. The following discussions took place.

Disabled Facility Grants (DFGs)
With regard to the DFGs which will be diverted to WSCC as part of the Social Care Fund, Mrs Apel requested to know whether the large number of disabled people in the ward would be affected. Mr Ward responded that it was a mandatory grant so no-one should be disadvantaged. If the Council continued to provide DFGs we would need to ensure the funds were received from WSCC.

Business Rates
A discussion took place on whether charity shops and small businesses received special rates. This was depending upon the status, with small shops receiving a national scheme start-up subsidy. The Council does not have discretion to waive business rates but we can allocate grants to stimulate small businesses. Mr Dignum advised that business rates were effectively subsidised as there had been no rate revaluation for years with the next one scheduled for 2017.

New Homes Bonus (NHB)
Mr Dignum advised that the NHB was used to reward communities that take housing growth, and that the Council had taken the decision not to use the NHB to balance the budget but to ring fence it for its designed purpose. The pot had not been over-subscribed this year and therefore it had been decided to allocate £1.6m from NHB monies to fund the grants process for a further four years. The projects which had come forward this year had been very good and only one had been turned down. Birdham would have compensation in future for taking housing on a recent planning application.

Mr McAra wanted to know, with the estimate of approximately £1m NHB which will go directly to the Local Enterprise Partnership (LEP) from 2015/16, whether it was compulsory to participate in the LEP or whether the Council could opt out and retain the money. Mr Over advised that it was not compulsory to participate but we might lose valuable funding as the LEP would fund local economic initiatives in line with their business plan. To a question from Mrs Purnell, speaking from the gallery, as to whether the Council had a choice of which LEP to be involved in, Mr Over advised that we could, for instance, also choose to participate in the Solent LEP if we considered this to be beneficial.

Mr French considered the proposal for distributing the remaining £4m NHB for new projects over the coming years at 6.10(g) in the report to be fair. Mr Dignum stressed that this allocation of NHB monies would be reviewed each year.

Neighbourhood Plan
Mr Finch, in considering the cost of neighbourhood plans, asked whether the funding available was above £7,000 required as at present £3,000 goes to the projects and £4,000 is held back for central costs. Mr Ward advised that there was further funding available on adoption of the plan but it needed to go through the referendum first.

Information in appendices
Mr Bell queried the shortfall income figure in Appendix 1; Mr Ward advised that this figure projected the income below target over the next five years. Taking into account the deficit reduction programme in place the deficit would balance towards the end of the five year model.

Mr Ward explained the uncommitted resource of £8.8m in Appendix 4; allowing for future capital receipts half of this figure of £4m would go towards the Enterprise Hub if that project goes ahead. Mr Dignum advised that this £8.8m is effectively our capital programme; in future it would almost entirely be used for housing and grants. To a question from Mr Oakley, speaking from the gallery, about the element of S106 monies included in the £5.5m 'Other Reserves' figure, Mr Ward advised that this amounted to roughly £617,000.

Following the above full discussion, the Committee therefore

RECOMMENDS TO CABINET

1) In the short to medium term the Council maintains a minimum level of reserves of £5m for general purposes.
2) To maintain the current provision of £1.3m of revenue support to smooth the impact of funding reductions, and volatility associated with localisation of Business Rates.
3) The New Homes Bonus should be ~~allocated as~~ *reserved for the purposes* identified in paragraph 6.10 of the report.
4) The current unallocated resource of £8.8m, and its potential use as set out in paragraph 7.2 of the report is noted.
5) The Council should continue to aim to set balanced budgets without the use of reserves, although some use of reserves in the short term may be necessary.
6) That in order to achieve a balanced budget over the medium term, the Council continues to monitor the delivery of the Deficit Reduction Programme (£2.4m) and continues to monitor the five year Financial Strategy.
7) *Review the options available for participation in Local Enterprise Partnerships.*

Mr Finch left the meeting.

156. **Strategic and operational risk management mid-year report**

The committee considered the agenda report (copy attached to the official minutes).

Mrs Belenger advised that, following her recent attendance at a course on risks, she would be reviewing the risk register and relating all risks back to the Corporate

Plan. The future report layout may therefore change to incorporate this information. The members of the Strategic Risk Group, which had reviewed these risks, were confirmed to the committee upon request.

The Local Plan target risk score would remain at 6 until the outcome was clear. The new Lead Officer for the Local Plan post May 2014 would be identified to ensure continuity and to manage the risk. Mr Dignum was the portfolio holder for strategic risks. Mrs Belenger undertook to add the 10 strategic partnerships to the next report to this committee.

RESOLVED

1) That the current strategic risk register and the internal controls in place, plus any associated action plans to manage those risks, are noted.
2) That the revised high scoring organisational risks and the mitigation plans in place are noted.

157. **S106 exceptions report**

The committee considered the agenda report (copy attached to the official minutes).

Miss Le Vay introduced the report, advising that the outstanding contributions mentioned in item 6 had now been received and provided further updates on two of the agreements; Swanfield - the contractor for the bus shelter had been appointed and the licence applied for; St Georges Road - this had now been signed off by the ward members and portfolio holder.

The Council does not monitor progress on any of the West Sussex County Council (WSCC) S106 monies relating to education, transport, highways etc. Mr Oakley, speaking from the gallery, advised that there had been a delay in finding projects to be funded from the County's sustainable transport fund which is funded from Total Access Demand (TAD) contributions sought in addition to contributions for highways works to meet specific transport requirements relating to developments. In many instances funding is tied in to spend in a specific area depending on the terms of the S106 agreement so could not always be diverted to other worthy areas or initiatives.

Mr French confirmed that he had been approached by Mrs Grange to give authority as ward member to allow the transfer of housing monies out of his ward to spend on another community where there was a need.

Members requested that WSCC be contacted to consider the possible re-targeting of existing unallocated S106 monies, possibly taking this through the CLCs for agreement. Mr Ward undertook to speak with Miss Le Vay to establish the officer contact at WSCC to discuss this. Miss Le Vay advised that WSCC officers would be requested to attend the June 2014 meeting of the committee when the annual S106 report will be discussed, as was the case in June 2013.

RESOLVED

1) That the current progress of S106 agreements nearing their expenditure date is noted.

2) That WSCC be contacted to consider the possible re-purposing of allocated S106 monies to other initiatives.

158. **Internal Audit Report and Audit Plan Progress**

The committee considered the agenda report (copy attached to the official minutes).

Mr James presented the report, advising that the Income Reconciliation audit report had been posted on the Knowledge Hub but had not received any comment from members. Members expressed concern that the two service areas referred to in the audit report were not named; they were confirmed as Car Parks and Trade Waste. There had been issues with the Car Parks IT reporting system which was being investigated alongside the cash control process. Trade Waste was essentially a manual system and this review was ongoing.

To a question from Mr Marshall on whether training had been put in place for staff on income reconciliation, Mr Ward responded that training had been carried out by the service accountants with individual services on a one to one basis, but that this could be looked at again and followed up as required. The audit team offered advice on the running of reports. Core competencies had been included in all managers' role descriptions.

Reports had also been placed on the Knowledge Hub on Corporate Complaints and Health & Safety for the year 2012/13. There followed a discussion about the availability of audit reports on the Knowledge Hub and whether this was being used effectively by members of this committee as a consultation forum and indeed more widely by other members. The committee advised that in future they preferred to receive an email with the documents attached. If there was then the need to comment, this would be done on the Knowledge Hub in order that other members would be informed of their views.

RESOLVED

1) That the report and the progress made against the audit plan is noted.

(Note: The meeting closed at 11.34am)

_________________________________ (Chairman)

Date: _________________________________

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The Members of the Corporate Governance and Audit Committee
Chichester District Council
East Pallant House
1 East Pallant
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10 January 2014

Ref: CDC
Your ref:

Direct line: 0118 928 1556

Email: pking1@uk.ey.com

Dear Member

Certification of claims and returns annual report 2012-13

Chichester District Council

We are pleased to report on our certification work. This report summarises the results of our work on Chichester District Council's 2012-13 claims and returns.

Scope of work

Local authorities claim large sums of public money in grants and subsidies from central government and other grant-paying bodies and are required to complete returns providing financial information to government departments. In some cases these grant-paying bodies and government departments require certification from an appropriately qualified auditor of the claims and returns submitted to them.

Under section 28 of the Audit Commission Act 1998, the Audit Commission may, at the request of authorities, make arrangements for certifying claims and returns because scheme terms and conditions include a certification requirement. When such arrangements are made, certification instructions issued by the Audit Commission to appointed auditors of the audited body set out the work they must undertake before issuing certificates and set out the submission deadlines.

Certification work is not an audit. Certification work involves executing prescribed tests which are designed to give reasonable assurance that claims and returns are fairly stated and in accordance with specified terms and conditions.

In 2012-13, the Audit Commission did not ask auditors to certify individual claims and returns below £125,000. The threshold below which auditors undertook only limited tests remained at £500,000. Above this threshold, certification work took account of the audited body's overall control environment for preparing the claim or return. The exception was the housing and council tax benefits subsidy claim where the grant paying department set the level of testing.

Where auditors agree it is necessary audited bodies can amend a claim or return. An auditor's certificate may also refer to a qualification letter where there is disagreement or uncertainty, or the audited body does not comply with scheme terms and conditions.

Statement of responsibilities

In March 2013 the Audit Commission issued a revised version of the 'Statement of responsibilities of grant-paying bodies, authorities, the Audit Commission and appointed auditors in relation to claims and returns' (statement of responsibilities). It is available from the Chief Executive of each audited body and via the Audit Commission website.

The statement of responsibilities serves as the formal terms of engagement between the Audit Commission's appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

This annual certification report is prepared in the context of the statement of responsibilities. It is addressed to those charged with governance and is prepared for the sole use of the audited body. We, as appointed auditor, take no responsibility to any third party.

Summary

Section 1 of this report outlines the results of our 2012-13 certification work and highlights any significant issues.

We checked and certified two claims and returns with a total value of £84.4m. We met all submission deadlines.

We would note that as our certification work related to 2012-13, it covers the arrangements for Housing and Council Tax Benefits and for National non-domestic rates that existed during the year. It therefore did not cover the new localisation arrangements that started from 1 April 2013

We issued one qualification letter in respect of your Housing and Council Tax Benefits Claim and details of this is included in section 2. Our work also found errors which the Council corrected and increased the settlement payment to the Council by £107,815. Fees for certification work are summarised in section 2.

We welcome the opportunity to discuss the contents of this report with you at your next meeting.

Yours faithfully

Paul King
Director
Ernst & Young LLP

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Certification of claims and returns annual report 2012-13

Contents

1. Summary of 2012-13 certification work

We certified 2 claims and returns in 2012-13. The main findings from our certification work are provided below.

Housing and council tax benefits subsidy claim

Scope of work	Results
Value of claim presented for certification	£43,007,383
Limited or full review	Full
Amended	Amended – subsidy increased by £107,815
Qualification letter	Yes
Fee - 2012-13 Fee - 2011-12	£11,300 [this is the fee to the council and includes a proposed variation of £3000 to the indicative fee covering the cost of extended testing undertaken] £9,890
Recommendations from 2011-12:	**Findings in 2012-13**
None	The adjustment occurred as the Council had not made manual adjustments set out in two supplementary system reports (BENCHK087 and BENCHK099). Matters subject to our qualification report are summarised below.

Councils run the Government's housing and council tax benefits scheme for tenants and council taxpayers. Councils responsible for the scheme claim subsidies from the Department for Work and Pensions (DWP) towards the cost of benefits paid.

The certification guidance requires auditors to complete more extensive ‘40+’ testing (extended testing) if initial testing identifies errors in the calculation of benefit or compilation of the claim. We found errors and carried out further testing in two areas.

Extended ‘40+’ testing and other testing identified errors which the Council amended. They had a small net impact on the claim. We have reported underpayments, uncertainties and the extrapolated value of other errors to the DWP in a qualification letter. The following are the main issues are included in our qualification letter:

Uprating of War Disablement Pension (WDP)

Testing identified that War Disablement Pension (WDP) has not been uprated since the 2008/09 subsidy year. Although benefit has not been overpaid, it was misclassified between cells on the claim. The Council has identified all affected claims and has corrected the income in the 2013/14 subsidy year. Due to the volume of claims and the number of subsidy years, the Council has been unable to quantify the overall impact in respect of the 2012/13 subsidy year.

Council Tax - Eligible Excess Benefit (Current Year)

Initial testing identified one case where the excess benefit was incorrectly classified as eligible following the death of a claimant. Extended testing identified 5 further cases with the same error.

The value of the errors found ranged from £3.31 to £216.29 and the benefit periods ranged from 1.29 weeks to 13 weeks. Given the nature of the population and the variation in the errors found, we concluded that it was unlikely that even significant additional work will result in amendments to the claim form that would allow us to conclude that it was fairly stated.

The impact of the incorrect classification of excess benefit as 'administrative delay' rather than 'eligible error', once extrapolated over the population of such cases, is that the subsidy due to the Council will increase by just over £100,000. This is because the rates of subsidy on the value of 'administrative delay' cases vary with the total value of such cases. As the value increases there are thresholds above which the rate of subsidy reduces. The adjustment to the claim to correct the mis-classification has the effect of reducing the value of 'administrative delay' cases to a level that is below one of the thresholds, and therefore attracts a higher level of subsidy.

National non-domestic rates return

Scope of work	Results
Value of return presented for certification	£41,275,343
Limited or full review	Full (11-12 Limited review undertaken)
Amended	No
Qualification letter	No
Fee – 2012-13 Fee – 2011-12	£1,000 £147
Recommendations from 2011-12:	**Findings in 2012-13**
None	None

The Government runs a system of non-domestic rates using a national uniform business rate. Councils responsible for the scheme collect local business rates and pay the rate income over to the Government. Councils have to complete a return setting out what they have collected under the scheme and how much they need to pay over to the Government.

We found no errors on the national non-domestic rates return and we certified the amount payable to the pool without qualification.

2. 2012-13 certification fees

For 2012-13 the Audit Commission replaced the previous schedule of maximum hourly rates with a composite indicative fee for certification work for each body. The indicative fee was based on actual certification fees for 2010-11 adjusted to reflect the fact that a number of schemes would no longer require auditor certification. There was also a 40 per cent reduction in fees reflecting the outcome of the Audit Commission procurement for external audit services.

The indicative composite fee for Chichester District Council for 2012-13 was £9,300. The actual fee for 2012-13 is £12,300 and includes a proposed variation to the indicative fee to cover the cost of extended testing on the Council's Housing and Council Tax Benefit claim. The final fee for 2012-13 is subject to determination by the Audit Commission.

This compares to a charge of £10,407 in 2011-12. We were not the Council's auditors in 2011-12 and cannot comment on other reasons for variations between certification fees between 2011-12 and 2012-13.

Claim or return	2011-12	2012-13	2012-13
	Actual fee £	Indicative fee £	Actual fee £
Total	**10,407***	**9,300****	**12,300****

* This figure includes a figure of £370 for annual reporting and for planning, supervision and review have been allocated directly to the claims and returns.

** 2012-13 Fees for annual reporting and for planning, supervision and review have been allocated directly to the claims and returns.

3. Looking forward

For 2013-14, the Audit Commission has calculated indicative certification fees based on the latest available information on actual certification fees for 2011-12, adjusted for any schemes that no longer require certification.

The Council's indicative certification fee for 2013-14 is £6,200. The actual certification fee for 2013-14 may be higher or lower than the indicative fee, if we need to undertake more or less work than in 2011-12 on individual claims or returns. Details of individual indicative fees are available at the following link: [http://www.audit-commission.gov.uk/audit-regime/audit-fees/201314-fees-and-work-programme/individual-certification-fees/]

We must seek the agreement of the Audit Commission to any proposed variations to indicative certification fees. The Audit Commission expects variations from the indicative fee to occur only where issues arise that are significantly different from those identified and reflected in the 2011-12 fee.

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Chichester District Council

CORPORATE GOVERNANCE & AUDIT COMMITTEE 23 January 2014

Treasury Management Strategy 2014-15

1. Contacts

Report Author:
Helen Belenger, Accountancy Services Manager,
Tel: 01243 521045 E-mail: hbelenger@chichester.gov.uk

2. Recommendation

2.1. That the Committee considers and recommends to Cabinet the Treasury Management Policy Statement, the Treasury Management Strategy Statement, the Minimum Revenue Provision Policy Statement and the Investment Strategy for 2014-15.

3. Background

3.1. Local authorities' treasury management activities are prescribed by statute i.e. the Local Government Act 2003, and the regulations issued under that Act. This is where the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management Code of Practice derives its legal status.

3.2. In March 2012 the Council adopted CIPFA's Treasury Management in the Public Services: Code of Practice 2011 Edition (the CIPFA Code), which requires the Council to approve a treasury management strategy before the start of each financial year.

3.3. In addition, the Department for Communities and Local Government (DCLG) 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.

3.4. This report will fulfil the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the CLG guidance, when considered by Full Council in March 2014.

4. Outcomes to be achieved

4.1. The Committee is requested to comment on the proposed changes as set out in paragraph 5 for the Treasury Management Strategy, Investment Strategy and make their recommendations for Cabinet approval.

4.2. The proposed changes are to allow the opportunity to place investments for longer terms in order to reduce the exposure to interest rate risk, increase the diversity of potential counterparties and expand the different types of investments available for the medium to long term.

5. Proposal

5.1. The appendices attached to this report have been amended and updated for the forthcoming financial year. Appendix 1 sets out the Council's treasury management policy, treasury management strategy and investment strategy.

5.2. The draft prudential indicators are shown in Appendix 2 to enable members to have an understanding of the implications of the Council's spending plans and their impact on the treasury management activities as set out in the strategy and investment policy. These indicators will be updated as necessary with the spending plans of the Council as they are approved by Cabinet and Full Council as part of the budget cycle.

5.3. Estimated Interest rates

The financial strategy reflects a down grading on the estimated rate of return for the current and future years:

Assumptions for 2014-15 Strategy

Assumed Interest Rates	2013/14 Revised	2014/15	2015/16	2016/17	2017/18	2018/19
Investment Rates	1.20%	1.00%	1.00%	1.10%	1.15%	1.20%

The view of the treasury advisors is that bank base rate will remain at 0.50% until 2015. Previously an average rate of return of 1.20% was built into the 2013-14 Treasury Management Strategy and the financial years beyond. However, based on the view of the advisers lower rates have been reflected in the 2014-15 Treasury Management Strategy and the financial years beyond.

5.4. In comparison with past and current performance, as previously reported to the Committee and Cabinet, the 2012-13 annual rate of return was 1.15%, and in June 2013 the annualised rate was 1.22%. The performance in the second quarter was an annualised rate of 1.33%, which reduced to 1.18% in the third quarter. The rates will continued to be monitored up to budget setting and performance reported to members as stated in the Strategy.

5.5. Benchmarking undertaken for 2012-13 has again highlighted that for notice accounts and short term investments under 364 days the rate of return is well below the averages.

	CDC Return	Average (all)	Average (similar authorities)
Notice Accounts	0.54 %	0.82%	0.82%
Up to 364 days	0.50%	1.34%	1.31%
Over 1 year	5.23%	2.59%	2.71%
Callable & Structured	2.25%	2.16%	2.25%
DMAF (UK government)	0.25%	0.25%	0.25%
Combined (overall)	1.15%	1.10%	1.26%

The two business reward accounts opened with HSBC in 2012 have achieved a small improvement in the return experienced for notice accounts.

5.6. At the end of 2012-13 the Council still held long term investments of £10m of which £4m was due to be repaid in 2013-14. This included the investment with an interest rate of 6.22%. Generally these higher interest rates on the longer term bank deposits offset the low interest rates on the short term investments, mainly with other local authority, and so helped to improve the overall return on the Council’s investment portfolio. Local authorities tend to operate very close to the current Debt Management Office (DMO) rate of 0.25%.

5.7. No Money Market Funds have been used in the current year, as the compliance process to set up a number of accounts are still to be concluded. These prime liquid funds are operated under strict guidelines and FSA rules. Whilst the fund returns have decreased they can still offer slightly better value for short term deposits especially if compared to the DMO of 0.25%.

5.8. In considering the investment strategy, the CLG Investment Guidance requires the Council to the note the following 3 matters each year as part of the investment strategy:

(a) The use of Treasury Management Advisers: The Council currently have a contract with Arlingclose Limited.

(b) Investment Training: How the training needs of the officers involved on treasury management are identified and addressed, plus the provision of training for those members who scrutinise and approve the treasury management strategy. Member training is currently delivered by Arlingclose annually prior to approval of the forth coming year’s Strategy Statement.

(c) Investment of money borrowed in advance of need: As the Council does not anticipate the need to borrow in the foreseeable future, it is therefore not expecting to borrow in advance of need, and so it is not necessary to set out any operational criteria for this situation in the Treasury Management Strategy Statement for 2014-15.

5.9. The credit rating criteria used for selecting investment counterparties is set out in table 4 in appendix 1, paragraph 12. This highlights the minor amendments being recommended in relation to the maximum timescales for investment for the lower credit rated building societies, a reduction in the maximum amount that could be placed in banks and other organisations, and money market funds.

5.10. The main issue to consider is how best to manage the interest rate risk as the Council continues to hold 65% of its investments for periods under a year. This inflates the amount of investment held in the short term, but assists with the objective of security for the Council’s investment portfolio, as the potential risk of credit worthiness due to increased uncertainty over time is minimised. The effect is lower rate of return.

5.11. It is also proposed to lift the 5 year limit for investing with other Local Authorities for a period up to 10 years. Other long term investment options included in the Strategy if deemed viable are, covered bonds, lending to Registered Providers of

Social Housing, and local authority property funds, subject to further investigation and external advice.

5.12. The strategy's target average credit rating score for the investment portfolio will remain at A+, and so continues the agreed credit risk that the Council is willing to accept with the investment counterparties. Greater counterparty diversity was achieved with the changes incorporated in the 2013-14 Strategy, and so no further changes other than those suggested in paragraph 5.10 and 5.11 are being proposed.

5.13. The Treasury Management and Investment Strategies will be considered by Cabinet in February and Full Council in March.

6. Alternatives that have been considered

6.1. Neither the CLG Investment Guidance nor the CIPFA Code of Practice prescribes any particular treasury management strategy for local authorities to adopt. The Strategy is considered by the Corporate Governance and Audit Committee to comment on whether there is an appropriate balance between risk management and cost effectiveness on the rate of return on investments.

6.2. The impact of alternative strategies, with their financial and risk management implications are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Reduced risk of losses from credit related defaults
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

7. Resource and legal implications

7.1. The estimated rate of return for the forthcoming financial year and future financial years has been taken into account in the 5 year model under pinning the Council's Financial Strategy and resources statement.

8. Consultation

8.1. In adhering to the CIPFA Code, the forthcoming financial year's Treasury Management Strategy, Investment Strategy and TMP's are required to be considered by those members charged with governance, before being considered by Cabinet and then Full Council for approval.

9. Community impact and corporate risks

9.1. The statutory and regulatory framework under which the treasury management function operates is very stringent, and each authority has to decide its own appetite for risk and the rate of return it could achieve.

9.2. Risk management is covered within the Treasury Management Strategy and specifically within TMP 1, an extract of which is shown in appendix 3.

10. Other Implications

	Yes	No
Crime & Disorder:		✓
Climate Change:		✓
Human Rights and Equality Impact:		✓
Safeguarding:		✓
Other (Please specify): Non- compliance or loss of an investment due to default by a counterparty could affect the financial wellbeing of the council dependent on the size of the loss and the ability to fund losses from its unallocated reserves.	✓	

11. Appendices

11.1. Appendix 1- Treasury Management Policy Statement, Treasury Management Strategy Statement, and Annual Investment Strategy for 2014-15.

11.2. Appendix 2 – Prudential Indicators and MRP Statement 2014-15.

11.3. Appendix 3 – Treasury Management Practices (TMP's) Extract of TMP 1 Risk Management.

12. Background Papers

12.1. Financial Strategy Resources position 2014-15 updated.

Treasury Management Policy Statement, Treasury Management Strategy Statement and Annual Investment Strategy for 2014-15

1. Treasury Management Policy Statement

Chichester District Council defines its treasury management activities as:

- The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

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

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

- The investment policy objective for this Council is the prudent investment of its treasury balances. The Council's investment priorities are security of capital and liquidity of its investments so that funds are available for expenditure when needed. Both the CIPFA Code and the DCLG guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The generation of investment income to support the council's spending plans is an important, but secondary objective.

- The Council's borrowing objective, being debt free and with relatively substantial resources still available for its capital investment spending plans, means that it does not intend to borrow any monies, except for short term cash flow purposes for revenue and capital commitments.

2. Treasury Management Strategy Statement

The Treasury Management Strategy details the expected activities of the treasury function in the forthcoming year 2014-15. The publication of the strategy is a statutory requirement.

3. The Treasury Management Strategy Statement and Annual Investment Strategy are underpinned by the CIPFA Code of Practice and Treasury Management Practices (TMPs) which provide prescriptive information as to how the treasury management function should be carried out.

External Context

4. **Economic background**

The Bank of England's Monetary Policy Committee (MPC) through its recent forward guidance is committed to keeping policy rates low for an extended period using the Labour Force Survey unemployment rate of 7% as a threshold for when it would consider whether or not to raise interest rates, subject to certain knock-outs. Unemployment was 7.7% in August 2013, but is not forecast to fall below the threshold until 2016, due to the UK's flexible workforce.

The flow of credit to households and businesses is slowly improving but is still below pre-crisis levels. The fall in consumer price inflation from the high of 5.2% in September 2011 to 2.7% in September 2013 will allow real wage increases (i.e. after inflation) to slowly turn positive and aid consumer spending.

Stronger growth data in 2013 (0.4% in Q1, 0.7% in Q2 and 0.8% in Q3) alongside a pick-up in property prices mainly stoked by government initiatives to boost mortgage lending have led markets to price in an earlier rise in rates than warranted under Forward Guidance and the broader economic backdrop. However, with jobs growth picking up slowly, many employees working shorter hours than they would like and benefit cuts set to gather pace, growth is likely to only be gradual. Arlingclose forecasts the MPC will maintain its resolve to keep interest rates low until the recovery is convincing and sustainable.

In the US expectations for the slowing in the pace of asset purchases ('tapering') by the Federal Reserve and the end of further asset purchases will remain predominant drivers of the financial markets. The Fed did not taper in September and has talked down potential tapering in the near term. It now looks more likely to occur in early 2014 which will be supportive of bond and equity markets in the interim.

5. **Credit outlook**

The credit risk of banking failures has diminished, but not dissipated altogether. Regulatory changes are afoot in the UK, US and Europe to move away from the bank bail-outs of previous years to bank resolution regimes in which shareholders, bond holders and unsecured creditors are 'bailed in' to participate in any recovery process. This is already manifesting in relation to holders of subordinated debt issued by the Co-op which have suffered a haircut on its conversion bail-in to alternative securities and/or equity. There are also proposals for EU regulatory reforms to Money Market Funds which will, in all probability, result in these funds moving to a VNAV (variable net asset value) basis and losing their 'triple-A' credit rating wrapper. Diversification of investments between creditworthy counterparties to mitigate bail-in risk will become even more important in the light of these developments.

6. **Prospects for Interest Rates**

As part of the service to the Council its appointed treasury adviser Arlingclose assist the Council to formulate a view on interest rates. Arlingclose forecast that the Bank Rate will remain flat until late 2016.The Bank of England Base Rate, the official base rate paid on commercial bank reserves has been 0.50% since March 2009.

7. The table below shows the November 2013 HM Treasury Survey Medium Term forecasts for the average annual Official Bank Rate.

Table 1: HM Treasury Survey Medium Term Forecasts for Average Annual Official Bank Rate

	Average Annual Official Bank Rate %			
	2014	**2015**	**2016**	**2017**
Highest	0.90	1.80	2.20	2.63
Average	0.53	0.78	1.34	2.11
Lowest	0.50	0.50	0.69	1.40

For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 1.00% for 2014-15.

8. Current Portfolio Position

The Council's treasury portfolio position as at 3rd January 2013 comprised:

Table 2: Current Investment Portfolio Position.

Investments	**Actual Portfolio £m**	**Average Rate %**
Call Accounts	5.2	0.64
Short Term investments	30.5	0.53
Long Term Investments	11.0	1.91
Total Investments	**46.7**	**1.18**

Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 3: Balance Sheet Summary and Forecast

	31.3.13 Actual £m	**31.3.14 Estimate £m**	**31.3.15 Estimate £m**	**31.3.16 Estimate £m**	**31.3.17 Estimate £m**	**31.3.18 Estimate £m**
General Fund CFR	-1.297	-1.440	-1.440	-1.440	-1.440	-1.440
Internal borrowing	-0.143	0	0	0	0	0
Borrowing CFR	**-1.440**	**-1.440**	**-1.440**	**-1.440**	**-1.440**	**-1.440**
Fund Balances						
Usable reserves	-32.584	-26.471	-22.831	-21.516	-20.920	-20.413
Working capital	-0.826	-1.289	-1.106	-0.859	-0.619	-0.400
Investments	**34.850**	**29.200**	**25.377**	**23.815**	**22.979**	**22.253**

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment.

The Council is currently debt free and its capital expenditure plans do not currently imply any need to borrow over the forecast period. Investments are forecast to fall to £22.253m as capital receipts and other revenue resources are used to finance capital expenditure, and reserves are used to finance the revenue budget.

CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2014-15 as it maintains its debt free status.

9. Borrowing Strategy

As part of the Council's Financial Strategy the Resources and Capital Principles are stated as:

"**Borrowing could be used for "invest to save" projects providing the cost of servicing the debt is contained within the revenue savings/income the project generates. The payback period for invest to save projects should be shorter than the life of the asset.**

(a) At present, there are no plans to borrow to finance new capital expenditure in the current 5 year plan but this remains an option if deemed to be prudent. Short term internal borrowing (for schemes that pay back within the 5 year time frame of the capital programme) can be accommodated without incurring external interest charges, provided the resulting savings are recycled into reserves. Longer term pay back periods will have to accommodate both the external interest and a minimum revenue provision (MRP) in accordance with the Council's MRP policy, which links repayment of the debt to the life of the asset.

(b) Borrowing would add pressure on the revenue budget as MRP and interest would become payable. The capacity to make these payments would need to be identified in advance, namely the further efficiency savings generated by the investment in the assets."

10. Investment Strategy

The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's investment balance has ranged between £34.85 and £50.35 million, but this is expected to reduce to lower levels in the forthcoming year due to the anticipated capital programme spending.

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

12. The Council may invest its surplus funds with any of the counterparties in table 4 below, subject to the cash and time limits shown.

Table 4: Approved Investment Counterparties

Counterparty		**Cash limit**	**Time limit**
Banks, building societies, other organisations and securities whose lowest published long-term credit rating from Fitch, Moody's and Standard & Poor's is:	AAA	~~£8m~~ £5m each, of which no more than £3m over 1 year	5 years
	AA+		5 years
	AA		4 years
	AA-		3 years
	A+		2 years
	A	£2m each	1 year
	A-		6 months
UK Central Government (irrespective of credit rating)		unlimited	5 years
UK Local Authorities (irrespective of credit rating)		~~£8m~~ £5m each	~~5~~ years 15 years
UK Registered Providers of Social Housing whose lowest published long-term credit rating is A- or higher		£4m each	5 years
UK Registered Providers of Social Housing whose lowest published long-term credit rating is BBB- or higher and those without credit ratings		£2m each	5 years
UK Building Societies whose lowest published long-term credit rating is BBB+ or BBB and societies without credit ratings with assets greater than £250m		£2m each	~~6 months (Higher Rated) 3 months (Lower Rated)~~ 6 months
Money market funds and similar pooled funds		£4m each ~~£5m each~~	1 year

13. There is no intention to restrict investments to bank deposits, and investments may be made with any public or private sector organisations that meet the above credit rating criteria. This reflects a lower likelihood that the UK and other governments will support failing banks as the bail-in provisions in the *Banking Reform Act 2014* and the EU *Bank Recovery and Resolution Directive* are implemented.

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

15. **Current Account Bank**: Following a competitive tender exercise held in 2008, the Council's current accounts are held with HSBC plc which is currently rated above the minimum A- rating in table 4.

16. **Registered Providers**: Formerly known as Housing Associations, Registered Providers of Social Housing are tightly regulated by the Homes and Communities Agency and retain a high likelihood of receiving government support if needed. The Authority will consider investing with unrated Registered Providers with adequate credit safeguards, subject to receiving independent advice.

17. **Building Societies**: The Council takes additional comfort from the building societies' regulatory framework and insolvency regime where, in the unlikely event of a building society liquidation, the Council's deposits would be paid out in preference to retail depositors. The Council will therefore consider investing with unrated building societies where independent credit analysis shows them to be

suitably creditworthy and with assets greater than £250m. The Government has announced plans to amend the building society insolvency regime alongside its plans for wide ranging banking reform, and investments in lower rated and unrated building societies will therefore be kept under continuous review.

18. **Money Market Funds**: These funds are pooled investment vehicles consisting of money market deposits and similar instruments. They have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager. Fees of between 0.10% and 0.20% per annum are deducted from the interest paid to the Council. Funds that offer same-day liquidity and aim for a constant net asset value will be used as an alternative to instant access bank accounts.

19. **Other Pooled Funds:** Table 3 above indicates that the Council will have substantial cash balances available for investment over the medium term. It will therefore consider using pooled bond, equity and property funds that offer enhanced returns over the longer term, but are potentially more volatile in the shorter term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

20. **Risk Assessment and Credit Ratings**: The Council uses long-term credit ratings from the three main rating agencies Fitch Ratings, Moody's Investors Service and Standard & Poor's Financial Services to assess the risk of investment default. The lowest available counterparty credit rating will be used to determine credit quality, unless an investment-specific rating is available. 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.

21. Where a credit rating agency announces that a A- 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 in a timely manner 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.

22. **Other Information on the Security of Investments**: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations, in which it invests, including credit default swap prices, financial statements, information on potential government support 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.

23. 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 Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office 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.

24. **Specified Investments**: The CLG Guidance defines specified investments as those:

- denominated in pound 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 Authority 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 AAA. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

25. **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 in table 5 below.

Table 5: Non-Specified Investment Limits

	Cash limit
Total long-term investments	£15m
Total investments without credit ratings or rated below A-	£10m
Total investments in foreign countries rated AAA	£10m

26. **Investment Limits**: The Authority's revenue reserves available to cover investment losses are forecast to be £25.64 million on 31st March 2014. In order that no more than 19.5% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £5 million. A group of banks under the same ownership or a group of funds under the same management will be treated as a single organisation for limit purposes. Limits will also be placed on investments in brokers' nominee accounts, foreign countries and industry sectors as below:

Table 4: Investment Limits

	Cash limit
Any single organisation, except the UK Central Government	£5m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£5m per group
Any group of pooled funds under the same management	£4m per manager
Negotiable instruments held in a broker's nominee account	£5m per broker
Foreign countries	£5m per country

Registered Providers	£4m in total
Building Societies	£5m in total
Money Market Funds	£4m in total

27. **Approved Instruments:** The Council may lend or invest money using any of the following instruments:

- interest-bearing bank accounts,
- fixed term deposits and loans,
- callable deposits and loans where the Council may demand repayment at any time (with or without notice),
- callable deposits and loans where the borrower may repay before maturity, but subject to a maximum of £3 million in total,
- certificates of deposit,
- bonds, notes, bills, commercial paper and other marketable instruments, and
- shares in money market funds and other pooled funds.

Investments may be made at either a fixed rate of interest, or at a variable rate linked to a market interest rate, such as LIBOR, subject to the limits on interest rate exposures below.

28. Liquidity management: The Council uses spread sheets for cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a pessimistic basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium term financial plan and cash flow forecast.

29. <u>Treasury Management Indicators</u>

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

a. Security: The Authority 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.

	Target
Portfolio average credit rating	A+

b. Liquidity: The methods for cash flow forecasting is set out in paragraph 28, and the on long-term investments are set by reference to the Council's medium term financial planning for both revenue and capital spending plans.

The Council seeks to maintain its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments by adhering to the limit below and minimising the use of its overdraft facility:

- Liquid short term deposit limit of 65% of investments to remain liquid (specified investments) with a maturity date of 12 months or less.
- Bank overdraft of £350,000.

c. 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 of investments will be:

	2014/15	2015/16	2016/17
Upper limit on fixed interest rate exposure of net investment principal	£22m	£20m	£18m
Upper limit on variable interest rate exposure of net investment principal	£55m	£50m	£45m

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

d. Maturity Profile of Borrowing

As the Council is debt free it currently holds no fixed long term borrowing for which a maturity profile exists. The investment profile needs to take account of the liquidity requirement of maintaining 60% of investments under 364 days, and the long term investment limits as set in paragraph 29 e.

e. Principal Sums Invested for Periods Longer than 364 days: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2014/15	2015/16	2016/17
Limit on principal invested beyond year end	£6m	£5m	£4m

30. <u>Other Items</u>

There are a number of additional items that the Authority is obliged by CIPFA or CLG to include in its Treasury Management Strategy.

31. **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 Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the 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 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.

32. **Investment Training:**

Member and officer training is an essential requirement in terms of understanding roles, responsibilities and keeping up to date with changes and in order to comply with the CIPFA Treasury Management Code of Practice.

The training needs of the officers involved on treasury management are identified through the annual performance and development appraisal process, and additionally when the responsibilities of individual members of staff change. Staff attend relevant training courses, seminars and conferences.

To address the training need of members, training will be provided to members of both Cabinet and the Corporate Governance and Audit Committee in advance of them considering the forthcoming year's strategies. The training will be provided by Arlingclose in January 2014.

33. **Treasury Management Advisers:** The Council contracts with Arlingclose Limited as its treasury management advisers and receives specific advice on investment, debt and capital finance issues. However, responsibility for final decision making remains with the Council and its officers.

The quality of this service is controlled and monitored against the contract by the Accountancy Services Manager.

34. The current contract ends May 2014, so a procurement exercise, in accordance with the Council's Contract Standing Orders, will be undertaken to obtain a new contract.

35. **Investment of Money Borrowed in Advance of Need**: As the Council does not anticipate the need to borrow in the foreseeable future, except in the short-term for cash flow purposes only, it is therefore not expecting to borrow in advance of need, and so does not need to set out any operational criteria for this situation in 2013-14 Strategy.

36. Financial Implications

The budget for investment income in 2014-15 is £0.331million, based on an average investment portfolio of £33.1 million at an interest rate of 1.00%. If actual levels of investments and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

Prudential Indicators and MRP Statement 2014-15

1. Prudential Indicators 2014-15

The Local Government Act 2003 requires the Council to have regard to the Chartered Institute of Public Finance and Accountancy's *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

(a) Estimates of Capital Expenditure: The Council's planned capital expenditure and financing may be summarised as follows. Further detail is provided in Council's Budget Spending Plans will be reported to the February 2014 Cabinet.

Capital Expenditure and Financing	2013/14 Original £m	2013/14 Revised £m	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
Capital Expenditure	**10.156**	**10.437**	**7.690**	**2.739**	**2.440**	**2.507**	**2.085**
Financed By:							
Capital Receipts	8.251	6.750	2.655	1.137	0.966	1.207	0.893
Government Grants	0.730	0.895	0.678	0.781	0.528	0.528	0
Other contributions	1.005	0.859	1.402	0.272	0.471	0.316	0.721
Reserves	0.043	1.783	2.426	0.026	0.025	0.006	0.121
Revenue	0.127	0.150	0.529	0.523	0.450	0.450	0.350
Total Financing	**10.156**	**10.437**	**7.690**	**2.739**	**2.440**	**2.507**	**2.085**

(b) Estimates of Capital Financing Requirement: The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purposes.

Capital Financing Requirement	31.03.13 Actual £m	31.03.14 Revised £m	31.03.15 Estimate £m	31.03.16 Estimate £m	31.03.17 Estimate £m	31.03.18 Estimate £m	31.03.19 Estimate £m
CFR	**-1.297**	**-1.440**	**-1.440**	**-1.440**	**-1.440**	**-1.440**	**-1.440**

The CFR is forecast is not expected to change over the next five years as capital expenditure is anticipated to be financed by the Council's capital resources.

In principle the CFR should equal zero, as the Council has fully funded its capital investment programme since becoming debt free following its Large Scale Voluntary Transfer (LSVT) of its housing stock in 2001, however a negative balance post LSVT is relatively common. To bring the CFR back to a more meaningful figure i.e. zero, there is the option to leave part of capital expenditure unfinanced or effectively financed from internal borrowing which will increase the CFR to zero. In the Council's Annual Statement of Accounts for 2012-13, £143,000 of capital expenditure was left unfinanced increasing the CFR from a negative balance of £1.440m to its current year-end balance of -£1.297m. In the 2013-14 accounts this situation has been "corrected" in order to bring the CFR back to the negative £1.440 position.

(c) Gross Debt and the Capital Financing Requirement: In order to ensure that over the medium term debt will only be for a capital purpose, the Authority should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

Debt	**31.03.14 Revised £m**	**31.03.15 Estimate £m**	**31.03.16 Estimate £m**	**31.03.17 Estimate £m**	**31.03.18 Estimate £m**	**31.03.19 Estimate £m**
Borrowing (Operational Boundary only)	5	**5**	5	5	5	5
Finance leases	0	**0**	0	0	0	0
Total Debt	**5**	**5**	**5**	**5**	**5**	**5**

Total debt is actually expected to remain at zero, as the no borrowing is anticipated except if required under the operational boundary limit, and is the reason for this being higher than the CFR during the forecast period.

(d) Operational Boundary for External Debt: The operational boundary is based on the Council's estimate of most likely, i.e. prudent, but not worst case scenario for external debt. It links directly to the Council's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance lease, Private Finance Initiative and other liabilities that are not borrowing but form part of the Authority's debt.

Operational Boundary	**2013/14 Revised £m**	**2014/15 Estimate £m**	**2015/16 Estimate £m**	**2016/17 Estimate £m**	**2017/18 Estimate £m**	**2018/19 Estimate £m**
Borrowing	5	**5**	5	5	5	5
Other long-term liabilities	0	**0**	0	0	0	0
Total Debt	**5**	**5**	**5**	**5**	**5**	**5**

(e) Authorised Limit for External Debt: The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	2013/14 Revised £m	2014/15 Estimate £m	2015/16 Estimate £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
Borrowing	10	**10**	10	10	10	10
Other long-term liabilities	0	**0**	0	0	0	0
Total Debt	**10**	**10**	**10**	**10**	**10**	**10**

(f) Ratio of Financing Costs to Net Revenue Stream: This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2013/14 Revised %	2014/15 Estimate %	2015/16 Estimate %	2016/17 Estimate %	2017/18 Estimate %	2018/19 Estimate %
General Fund	-3.99	**-3.20**	-2.35	-2.21	-2.11	-2.03

The estimates of financing costs reflect the assumptions within the Financial Strategy reported to Cabinet on 3rd December 2013, and will be updated to reflect the Council's spending plans, when they are considered by Cabinet in February 2014. These indicators have been updated to reflect the current phasing of the capital programme and the effect on the cash flow forecasts for investments.

The fact that the percentages remain negative shows that the investment interest remains an income source to the Comprehensive Income and Expenditure Account, although this is diminishing year on year due to the extent of the capital investment reducing the amount of funds available to invest, and it should be noted that the investment interest is used to fund one off projects/capital spending rather than balance the revenue budget.

(g) Incremental Impact of Capital Investment Decisions: This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax levels. The incremental impact is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement arising from the capital programme proposed to Cabinet in February as part of the Council's spending plans.

Incremental Impact of Capital Investment Decisions	2014/15 Estimate £	2015/16 Estimate £	2016/17 Estimate £	2017/18 Estimate £	2018/19 Estimate £
General Fund - increase in annual band D Council Tax	**-0.41**	-4.08	-0.92	-2.58	-2.31

Adoption of the CIPFA Treasury Management Code: The Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* in March 2012.

Annual Minimum Revenue Provision Statement 2014/15

Where the Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Council to have regard to the Department for Communities and Local Government's *Guidance on Minimum Revenue Provision* (the CLG Guidance) most recently issued in 2012.

The broad aim of the CLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The CLG Guidance requires the Council to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance

> As the Council expects that its General Fund Capital Financing Requirement will be negative on 31st March 2014 and in line with the CLG Guidance it will therefore charge no MRP in 2014/15.

The Council's MRP policy for all borrowing after 31st March 2008 is based on the asset life method.

> *For new borrowing whether supported by the Government or not, MRP provision will be made over the estimated life of the asset for which the borrowing is undertaken. This will be done on a straight line basis in-line with the asset life determined for depreciation purposes and the MRP provision will commence in the financial year following the one in which the asset becomes operational.*

MRP is payable in the financial year following that in which the capital expenditure was incurred. The guidance allows for an important exception to this rule. In the case of expenditure on a new asset, MRP would not have to be charged until the financial year following the year in which the asset became operational. In respect of major schemes, this would enable an "MRP Holiday" delaying the on-set of the revenue charge for possibly up to 2 or 3 years.

Based on the Council's estimate of its Capital Financing Requirement on 31st March 2014, the budget for MRP has been set is set as zero for 2014-15.

TREASURY MANAGEMENT PRACTICE NOTES (Extract)

TMP 1 – RISK MANAGEMENT

General Statement

The Section 151 Officer will oversee the design, implementation and monitoring of all arrangements for the identification, management and control of treasury management risk. The Section 151 Officer will ensure that reports are presented at least annually, on the adequacy/suitability thereof and will report, as a matter of urgency, the circumstances of any actual or likely difficulty in achieving the Council's objectives. In respect of each of the following risks, the arrangements that seek to ensure compliance with these objectives are set out in this document.

[1] Credit and Counter party risk management

The Office of the Deputy Prime Minister, (now Communities and Local Government), issued Investment Guidance in 2004, and also the Local Authorities (Capital Finance and Accounting) (Amendment) (England) Regulations 2007 (SI 2007/573), which constrain the types of investments that local authorities can use, and so forms the structure of the Council's policy. The CLG issued further guidance effective from 1 April 2010, where the Council had to state its approach to assessing the risk of loss of investments; this has been incorporated into the Council's policy.

The key intention of the Guidance is to maintain the current requirement that councils invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires the Council to have regard to the CIPFA publications Treasury Management in Public Services: Code of Practice and Cross-Sectoral Guidance Notes and the sector specific guidance; Guidance Notes for Local Authorities including Police Authorities and Fire Authorities. The Council first adopted the TM Code in 2003, and adopted the revised 2009 TM Code in March 2010, and adopted the revised 2011 TM Code February 2012. Accordingly, the Council will ensure that its counter party lists and limits reflect a prudent attitude towards organisations with whom fund may be deposited, and will limit its investment activities to the instruments, methods and techniques referred to in TMP4 (Approved instruments, methods and techniques) and listed in the schedule to this document.

It also recognises the need to have, and will therefore maintain, a formal counter party policy in respect of those organisations from which it may borrow, or with whom it may enter into other financing or derivative arrangements.

Monitoring Investment Counterparties

The assessment of credit worthiness or credit rating of investment counterparties will be monitored regularly. The Council obtains credit rating via its treasury advisers who monitors all 3 credit ratings (FITCH, Moody's and Standard and Poor's), and will notify any changes in ratings as they occur. This includes and takes account of changes, ratings watches and rating outlooks as necessary. In accordance with the revised TM Code the Council will need to have regard to the ratings issued by the three main agencies, and base its decisions on the lowest rating. The Council is already mindful of the other possible sources of information available to assess the credit worthiness of investment counterparties. This includes information direct from brokers, the Financial Times, news agencies and its treasury advisers monitoring the Credit Default Swaps (CDS) market. Officers assess trends of interest rates offered by counterparties.

Officers monitor the credit ratings via the information supplied by its treasury advisers, to ensure compliance to the rating criteria, and where necessary taking into account any other information which may influence the decision as to whether to exclude a counter party or not. Monthly counterparty lists matching the Council's criteria are supplied by its treasury advisers.

On occasions ratings may be downgraded after an investment has been made, however, the criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria or due to adverse information in the public domain, will be removed from the approved list immediately by the Section 151 Officer, and if required new counterparties which meet the criteria will be added to the list.

[2] Liquidity Risk Management

The Council will ensure it has adequate though not excessive cash resources, borrowing arrangements, overdraft facilities to enable it at all times to have a level of funds available to it which are necessary for the achievement of its business/service objectives.

The Council will only borrow in advance of need where there is a clear business case for doing so and will only do so for the current capital programme.

To maintain flexibility a minimum of 65% of investments to remain liquid (specified investments) with a maturity of date of 12 months or less.

[3] Interest rate risk management

The Council will manage its exposure to fluctuations in interest rates with a view to containing its interest costs, or securing its interest revenues, in accordance with the amounts provided in its budgetary arrangements as amended in accordance with TMP6 (Reporting requirements and managing information arrangements).

The effects of varying levels of inflation, in so far as they can be identified as impacting directly on its Treasury Management activities, will be controlled by the Council as an integral part of its strategy for managing its overall exposure to inflation.

It will achieve this by the prudent use of its approved financing and investment instruments, methods and techniques, primarily to create stability and certainty of costs and revenues, but at the same time retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of interest rates. This should be subject to the consideration and, if required approval of any policy or budgetary implications.

To minimise the financial risk to which the Council is exposed in both cash deposits and borrowing i.e.

(i) to minimise the interest burden to the Council arising from any borrowing:
(ii) to optimise the interest earned. Unless otherwise directed by the Council whilst protecting capital sums deposited.

In order to achieve this objective the following specific policies should be adopted:

(i) to maintain the Council's debt free position and undertake no new borrowing unless the business case is proven for invest to save projects
(ii) to retain an appropriate minimum level of reserves in order to maintain flexibility in the use of interest earned from deposits
(iii) to lend surplus funds only to approved institutions in accordance with DCLG Investment Guidance. A list of Approved Cash Deposit Instruments is attached at TMP 4 [5].
(iv) To minimise short term borrowing by efficient cash flow management.
(v) To ensure that the use of any hedging tools such as derivatives are only used for the management of risk and prudent management of the financial affairs of the council, and that the policy for the use of derivatives is clearly detailed in the annual strategy.

In balancing risk against return, local authorities should be more concerned to avoid risks than to maximise returns.

[4] Exchange rate Risk Management

Whilst the Council does not invest in foreign denominations, it does occasionally make payments to suppliers. In so doing it will manage its exposure to fluctuations in exchange rates so as to minimise any detrimental impact on its budgeted income expenditure levels. Any large contracts let by the Council must be denominated in £Sterling and the Section 151 Officer consulted on any proposed departure from this policy.

[5] Refinancing risk management

The Council will ensure that its borrowing, private financing and partnership arrangements are negotiated, structured and documented, and the maturity profile of the monies so raised are managed, with a view to obtaining offer terms for renewal or refinancing, if required, which are competitive and as favourable to the Council as can reasonably be achieved in the light of market conditions prevailing at the time.

The Council will actively manage its relationship with counter parties in these transactions in such a manner as to secure this objective, and will avoid over reliance on any one source of funding if this might jeopardise achievement of the above.

[6] Legal and regulatory risk management

The Council will ensure that all of its treasury management activities comply with its statutory powers and regulatory requirements. It will demonstrate such compliance if required to do so, to all parties with whom it deals in such activities. In framing its credit and counter party policy the Council will ensure that there is evidence of counter parties' powers, authority and compliance in transactions they may effect with the Council, particularly with regard to duty of care and fees charged.

The Council recognises that future legislative or regulatory changes may impact on its treasury management activities and, in so far as it is reasonable to do so, will seek to minimise the risk of these impacting adversely on the organisation.

[7] Fraud error and corruption, and contingency management

The Council will ensure that it has identified the circumstances that may expose it to the loss through fraud, error, corruption or other eventualities in its treasury management dealings. Accordingly it will employ suitable systems and procedures and will maintain effective contingency management arrangements, to these ends.

[8] Market Risk Management

The Council will seek to ensure that its stated treasury management policies and objectives will not be compromised by adverse market fluctuations in the value of the principal sums it invests and will accordingly seek to protect itself from the effects of such fluctuations.

Agenda Item 9

Chichester District Council

Corporate Governance & Audit Committee 23 January 2014

Audit Reports & Progress Report

1. Contact

Report Author:
Stephen James – Principal Auditor
Tel: 01243 534736 Email: sjames@chichester.gov.uk

2. Recommendations

2.1. That the committee notes the audit reports and audit plan progress and raises any issues of concern.

3. Main Report

3.1. Two audit reports – Contracts and Performance Indicators have been placed on the Members Bulletin Board. If any members wish to discuss the reports please contact the report author.

4. Climate Change Implications

None

5. Human Rights and Equality Impact

None

6. Appendices

Appendix 1 – Progress Report, Audit Plan

Progress Report – Audit Plan

As at 31st December 13

Appendix 1 to agenda item 9

Audits	Auditor	No of Days	Days Remaining	Position with Audit
Security of Assets	Kevin McLafferty	15	15	
Safety Inspections - Allianz	Julie Ball	20	20	
CDC Business Continuity	Kevin McLafferty	10	10	
Emergency Planning	Kevin McLafferty	10	10	
Data Protection / Freedom of Information Review	Julie Ball	15	8.25	
Project Management	Ann Kirk	10	8.25	
Value for Money	Julie Ball	10	10	
Records Management / Data Quality	Julie Ball	10	7.75	
Rent Deposit Scheme Review	Kevin McLafferty	10	10	
Housing Benefits and Council Tax Support	Kevin McLafferty	15	0	Draft Report
Property Estates and Shops	Kevin McLafferty	20	0	Draft Report
Service Reviews	Ann Kirk	15	15	
Audits	**Auditor**	**No of Days**	**Days Remaining**	**Position with Audit**
Carry Forwards	All Audit Staff	70	35.5	
Other Audit Activities	**Auditor**	**No of Days**	**Days Remaining**	**Position with Audit**
Audit Reviews	Stephen James	10	0	
Quality Audits - Chichester Contract Services	Stephen James	20	0	
Corporate Advice	All Audit Staff	10	6.5	
Contingency	All Audit Staff	113	64.25	
AGS, Evidence & Partnerships	Stephen James	30	5.5	
PSIAS	Stephen James	20	20	
E&Y - International Standard of Auditing	Ann Kirk / Julie Ball	50	26	

Individual Service Risk Registers & Corporate Risk Registers	Stephen James	5	5	
NFI	Ann Kirk	20	0	
Internet & E-mail	Julie Ball	5	4	
Performance Standard	Ann Kirk / Julie Ball	5	0	
Mileage	Ann Kirk / Julie Ball	5	2.75	
Follow Ups	Ann Kirk / Julie Ball	20	0	
Completed Audits	**Auditor**	**Published**		
Fraud Prevention	Kevin McLafferty	Jun-13		
Bank Reconciliation	Ann Kirk	Jun-13		
Customer Services	Julie Ball	Jun-13		
CPE / Car Parks	Julie Ball / Ann Kirk	Sep-13		
Debt Recovery Review	Ann Kirk	Sep-13		
Energy Usage	Kevin McLafferty	Sep-13		
Reconciliation Review	Julie Ball	Sep-13		
Tangmere Section 106 Review	Stephen James	Sep-13		
Performance Indicators	Ann Kirk / Julie Ball	Jan-14		
Contracts	Ann Kirk	Jan-14		