Public Document Pack

Contact: Michele Chesterman
Direct Dial: 01275 888097
E-mail: michele.chesterman@n-somerset.gov.uk
Date: Wednesday, 18 January 2023

To: All Members of the Audit Committee

Dear Sir or Madam

Summons to attend the Audit Committee – Thursday, 26 January 2023, 10.30 am – Kenn Room

You are requested to attend the Meeting of the Audit Committee to be held at 10.30 am on Thursday 26 January 2023..

The agenda is set out overleaf.

Yours faithfully

Assistant Director Legal & Governance and Monitoring Officer

To: Members of the Audit Committee

Councillors:

John Cato (Chairperson), Sandra Hearne (Vice Chairperson), Patrick Keating, Marcia Pepperall and Richard Tucker

Independent Members:

Peter Bray, Sharon Colk

This document and associated papers can be made available in a different format on request.

Agenda

1. **Public Participation (Standing Order 17 as amended by SO 5A) (Agenda item 1)**

   To receive and hear from any person who wishes to address the Committee. The Chairperson will select the order of the matters to be heard. Each person will be limited to a period of five minutes. Public participation time must not exceed thirty minutes.

   Requests to speak must be submitted to the Assistant Director, Legal & Governance and Monitoring Officer, or to the officer mentioned at the top of this agenda letter, by noon the working day before the meeting and the request must detail the subject matter of the address.

2. **Apologies for absence and notification of substitutes (Agenda item 2)**

3. **Declaration of Disclosable Pecuniary Interest (Standing Order 37) (Agenda item 3)**

   A Member must declare any disclosable pecuniary interest where it relates to any matter being considered at the meeting. A declaration of a disclosable pecuniary interest should indicate the interest and the agenda item to which it relates. A Member is not permitted to participate in this agenda item by law and should immediately leave the meeting before the start of any debate.

   If the Member leaves the meeting in respect of a declaration, he or she should ensure that the Chairperson is aware of this before he or she leaves to enable their exit from the meeting to be recorded in the minutes in accordance with Standing Order 37.

4. **Minutes of the meeting held on 24 November 2022 (Agenda item 4)** (Pages 5 - 12)

   24 November 2022 to approve as a correct record (attached)

5. **Matters referred by Council, the Executive, other Committees and Panels (if any) (Agenda item 5)**

6. **Risk Management Q2 Update (Agenda item 6)**

   Report of Head of Business Insight, Policy & Partnerships (attached)

7. **Annual Governance Statement 2022/23 (Agenda item 7)** (Pages 13 - 30)

   Report of Head of Audit and Assurance (attached)

8. **Internal Audit Plan 2023/24 - Audit Committee Consultation (Agenda item 8)** (Pages 31 - 34)

   Report of Head of Audit and Assurance (attached)

9. **North Somerset Council - Audit Progress Report and Sector Update (Agenda item 9)** (Pages 35 - 46)

Report of External Auditors (attached)

10. **Treasury Management Strategy 2023/24 (Agenda item 10)** (Pages 47 - 86)

Report of Head of Finance (attached)

11. **Update on Annual Accounts (Agenda item 11)** (Pages 87 - 98)

Report of Principal Accountant (Closure and Systems) (attached)

12. **Urgent business permitted by the Local Government Act 1972 (if any) (Agenda item 12)**

Any item of business which the Chairperson is of the opinion should be considered at the meeting as a matter of urgency by reason of special circumstances (to be specified in the Minutes). For a matter to be considered as an urgent item, the following question must be addressed:

"What harm to the public interest would flow from leaving it until the next meeting?" If harm can be demonstrated, then it is open to the Chairperson to rule that it be considered as urgent. Otherwise the matter cannot be considered urgent within the statutory provisions.

Exempt Items

Should the Audit Committee wish to consider a matter as an Exempt Item, the following resolution should be passed -

"(1) That the press, public, and officers not required by the Members, the Chief Executive or the Director, to remain during the exempt session, be excluded from the meeting during consideration of the following item of business on the ground that its consideration will involve the disclosure of exempt information as defined in Section 100I of the Local Government Act 1972."

Also, if appropriate, the following resolution should be passed –

"(2) That members of the Council who are not members of the Audit Committee be invited to remain."

Mobile phones and other mobile devices

All persons attending the meeting are requested to ensure that these devices are switched to silent mode. The chairman may approve an exception to this request in special circumstances.

Filming and recording of meetings

The proceedings of this meeting may be recorded for broadcasting purposes.

Anyone wishing to film part or all of the proceedings may do so unless the press and public are excluded for that part of the meeting or there is good reason not to do so, as directed by the Chairman. Any filming must be done as unobtrusively as possible from a single fixed position without the use of any additional lighting, focusing only on those actively participating in the meeting and having regard to the wishes of any members of the public present who may not wish to be filmed. As a matter of courtesy, anyone wishing to film proceedings is asked to advise the Chairman or the Assistant Director Legal & Governance and Monitoring Officer's representative before the start of the meeting so that all those present may be made aware that it is happening.

Members of the public may also use Facebook and Twitter or other forms of social media to report on proceedings at this meeting.

Emergency Evacuation Procedure

On hearing the alarm – (a continuous two tone siren)

Leave the room by the nearest exit door. Ensure that windows are closed.

Last person out to close the door.

Do not stop to collect personal belongings.

Do not use the lifts.

Follow the green and white exit signs and make your way to the assembly point.

Do not re-enter the building until authorised to do so by the Fire Authority.

Go to Assembly Point C – Outside the offices formerly occupied by Stephen & Co

North Somerset COUNCIL

Minutes

of the Meeting of

The Audit Committee
Thursday, 24 November 2022

New Council Chamber

Meeting Commenced: 10.30 am Meeting Concluded: 12.45 pm

Councillors:

John Cato (Chairman)
Sandra Hearne (Vice-Chairman)

Patrick Keating
Marcia Pepperall
Richard Tucker

Other Councillors in Attendance: Bridget Petty

Independent Members: Peter Bray, Sharon Colk

Also in attendance: David Johnson, External Auditors, Grant Thornton

Officers in attendance: Amy Webb (Director of Corporate Services), Melanie Watts (Head of Finance), Mark Anderson (Principal Accountant (Resources), Peter Cann (Head of Audit and Assurance), Michèle Chesterman (Committee Services Senior Officer), Emma Diakou (Head of Business Insight, Policy and Partnerships) and Alex Stafford (Emergency and Business Continuity Manager).

AUD 11 Declaration of Disclosable Pecuniary Interest (Standing Order 37) (Agenda item 3)

None

AUD 12 Minutes of the meeting held on 22 September 2022 (Agenda item 4)

Resolved: that the minutes of the meeting be approved as a correct record.

AUD 13 Risk Management Strategy (Agenda item 6)

The Head of Business Insight, Policy and Partnerships (Head BIPP) presented the report on the Risk Management Strategy. Members were informed that this was a refresh of the North Somerset Council Risk Management Strategy.

It was reported that the current Risk Management Strategy (2019-2024) had been jointly developed by North Somerset Council and Audit West. However, the

Director of Corporate Services had requested that the strategy be reviewed and refreshed ahead of schedule to ensure that there was a clear vision and set of aims for how risk was managed; clarity on approach; appropriate organisational-wide guidance be provided on how risks were identified, analysed and controlled, and there was assurance that risk was embedded within decision making and appropriately reported and escalated when required. The Risk Management Strategy had now been refreshed with the detail provided in the report and Members were directed to the draft strategy in Appendix 1.

Members were informed that alongside the Risk Management Strategy a number of toolkits had been updated to support risk identification, analysis and control, and escalation. The toolkits were available as part of the Programme Management Office internally for staff, as needed.

Members asked questions which were answered by officers on the following:

Q Why principle risk was not included here as it is now a requirement?
A The S151 Officer and the Head BIPP have discussed the difference between principle risk and strategic risk and are going to review this and discuss with the Corporate Leadership Team (CLT). It will be brought back to the Audit Committee.
Q How the Council's risk appetite was arrived at?
A By reference to individual directorates, and the Head BIPP, SI51, Audit West and CLT will be carrying out a workshop session to review and improved the process balancing resource and value at risk.
Q The frequency with which risk scores were re-evaluated.
A Monthly and reported quarterly to Audit Committee.

Other questions were asked relating to the links to climate emergency, biodiversity and the need for a clear matrix framework, the availability of risk management training for staff and consistency of approach, page 15 Impact Table – likelihood of high impact events and the need for a business continuity plan for these events.

Resolved: that the refreshed Risk Management Strategy be approved

AUD 14 **Internal Audit Update November 2022 (Agenda item 7)**

The representative from Audit West presented the update report on the delivery of the 2022/23 Annual Internal Audit Assurance Plan and summarised activity from 1 April to 1 November 2022.

It was noted that there had been no internal audit reports issued where it was considered that the systems of internal control were poor ('Level 1'). Work on the plan continued to progress and as at 1 November 2022 approximately 69% of audit activity was in progress or complete. There had been one audit report issued in draft where it was considered that the overall systems of control proved 'Limited Assurance'. All recommendations that were due to be implemented had been followed up. One investigation had been started and completed. Separate to this, a detailed fact-finding piece of work had also been completed at the request of Senior Management. Whilst no major changes to planned work were required, due to the additional time spent on the investigation, the fact-finding work and also extended work which would be likely on a planned audit (Home to School Transport), it was possible that a small amount of audit activity would be deferred into 2023/24. A range of fraud prevention and detection measures were in place, including recent provision of new fraud prevention training material, and also staff guidance in association with International Fraud Awareness Week.

In presenting the report, the representative drew members' attention to the fact that, as previously reported to the Audit Committee, one investigation had been undertaken so far this year relating to two allegations within the Place Directorate which related to reported non-compliance with procurement processes. The investigation had been completed and concluded that neither of the two allegations were substantiated. Internal Audit had also been asked to undertake a detailed review of the project management and decision-making process around the council's Garden Waste subscription service. Audit work in this service had already been planned for 2022/23, however the scope of the planned review changed and the depth of the work increased at the request of Senior Management. The work had now been completed and the findings reported to the Assistant Director (Neighbourhoods & Transport) and the Council's Section 151 Officer.

Members noted that the Counter Fraud Strategy had been revised and associated policies updated (approved by the Audit Committee in April 2022). Fraud prevention information had continued to be provided to staff, including through new bite-sized training PowerPoint videos entitled '5 Minutes of Fraud'. The videos were accessible to staff and provided a broad overview of fraud risks to look out for and guidance on what to do to prevent them from happening. Work would continue on the development of further videos to highlight new and emerging risks.

Data analytics work had been undertaken in order to prevent and detect internal fraud and error. Internal data matching took place throughout the year and this had been partly completed via IDEA – an internal audit data analytics software tool. Members noted that no fraud had been identified, however, 59 duplicate payments had been identified with an average value of £997. On investigation it was identified that the payments had already been identified by the Accounts Payable and had been either cancelled or reversed. As a result, no outstanding duplicate payments remained but work was ongoing with Accounts Payable team to understand the causes of how the payments originally occurred.

Members noted work on the National Fraud Initiative (NFI) continued and was on track to be completed by the end of the year. The results would be reported to committee when complete. There had also been an increase in Fraud referrals from external sources (28 to date). Members were pleased to hear that the dissemination of fraud alerts to staff and continued work with areas of particular exposure to fraud had resulted in the prevention of an attempted fraud of £58,560.

The representative from Audit West further commented on the progress of the Audit Plan (Section 2 of the report) and explained that there were currently 48 pieces of audit work within the plan and there had been no major changes to it since it was agreed in April 2022. Of the total number of audits: 8 audits had been completed and 5 were at reporting stage; 13 audits were in progress, 6 were ongoing pieces of work and 1 was in planning with 15 audits yet to commence.

Those not yet started would be reviewed in the same way as last year to ensure that the items to be started were still of relevance. Any changes would be reported back and agreed with members of the committee. Members were unclear what the reporting table under 2.1 was meant to convey and looked for greater clarity in the future.

The representative drew members' attention to Section 3 of the report on the implementation of recommendations and the risk profiles of those recommendations as requested by committee members. A total of 37 recommendations had been made this financial year. This included recommendations from the 2021/22 audits where the reports were issued in 2022/23. Specifically, there were 6 High, 26 Medium and 4 Low rated recommendations. One specific opportunity was also highlighted.

Whilst all of the recommendations that were due to be implemented had been followed up with the officer(s) responsible, responses were awaited on 11 recommendations relating to the Housing Jigsaw System to confirm recommendations had actually been implemented.

Members asked questions which were answered by the representative on the following areas: frequency of staff training on fraud awareness and prevention and what was included in mandatory staff training; on R5, the plan of action, and on R6 and all jigsaw system action why action from May were still outstanding, the return on investment, and if it was possible to provide a review of the return on investment of each internal audit exercise (i.e Item 1.13 page 39 £58,560 fraud prevention saving) to identify lessons learned and be increasingly more effective and the representative committed to consider this and report back to the committee.

Resolved: to note the progress in delivery of the 2022/23 Annual Internal Audit Assurance Plan.

AUD 15 The Audit Findings for North Somerset Council (year ended 31 March 2022) (Agenda item 8)

The representative from Grant Thornton presented the Audit Findings for North Somerset Council (year ended 31 March 2022) and drew members' attention to areas of note. Members were informed that the report was an updated version of the report presented to the September committee with changes highlighted in blue.

Members were directed to the headlines table (page 3 of the report and page 61 of the main pack) which summarised the key findings and other matters arising from the statutory audit of North Somerset Council ('the Council') and the preparation of the group and Council's financial statements for the year ended 31 March 2022 for those charged with governance.

Members were informed that work was ongoing and there were no matters that would require modification of audit opinion or material changes to the financial statements, subject to the following outstanding matters which included finalising of Other Land and Building testing including review of assumptions used by the valuer; finalisation of testing of pension liabilities including receipt of the updated pension fund auditor assurance response; group audit work to review and assess work undertaken by the component auditor; final review of audit file by the key audit partner; receipt of management representation letters; and review of the final set of financial statements.

The representative referred to the fact that the testing of fees and charges had included low value items which were defined as those below £1000 in line with the Council’s accrual policy. The testing identified two errors from five sample items with an extrapolated misstatement value of approximately £3.5m although the external auditors would not require that the Council adjusted for an extrapolated error. The value was below materiality and therefore assurance had been provided that the Council’s policy was appropriate. Testing of larger items within the sample population did not identify any errors.

Members noted that within the fixed asset register (FAR) there were a large number of assets that had a nil net book value (fully depreciated) and therefore at the end of their useful economic life. However, their gross book value remained on the FAR, with a value of £20.3m. The external auditors had queried with management whether these assets remained operational and if so whether the useful economic life assumptions were appropriate. A recommendation had been raised.

Members were informed that discussions had taken place with the pension fund auditor in connection with the controls surrounding the validity and accuracy of membership data; contributions data and benefits data, sent to the actuary by the pension fund, and the fund assets valuation in the pension fund financial statements. The discussions with the Pension Fund auditor had not identified any significant issues that needed to be reported at the current time.

Members also noted that it was the external auditors’ view that employee expense was a significant cost to the Council and testing had identified a number of weaknesses within the process. Assurances had been taken over the overall value of employee expenses through other audit procedures, including the overall reconciliation to monthly payroll records. The issues identified were control deficiencies rather than an indication of fraudulent activities and sufficient assurance had been gained that the employee expenses included in the statement of accounts were not materially misstated. A recommendation had been raised in Appendix A of the report.

The representative from Grant Thornton referred Members to matters to be discussed with management. In terms of infrastructure assets the code required infrastructure to be reported in the balance sheet at historic cost less accumulated depreciation and impairment and that where there was ‘enhancement’ to the assets, that the replaced components were derecognised. Where authorities were not fully compliant with these requirements, there might be a risk of material misstatement. It was noted that the external auditors had yet to undertake detailed testing in relation to this balance as there was uncertainty due to the potential issue of the statutory override. It was likely that management would wait for this to come into legislation with the impact being that the reporting date would be missed. Management had agreed with the audit team to wait for the statutory override before they gave their audit opinion.

Members asked questions which were answered by the representative on the following areas: which areas/assets are tested the external auditors; how an asset's lifetime is assessed; the nature of training provided to ensure data is entered accurately; whether there is a fixed asset register for the whole of the authority and if there was a minimum value of assets held.

Resolved: that the External Auditor's Audit Findings for North Somerset Council (year ended 31 March 2022) be noted.

AUD 16 **Business Continuity Co-ordination (Agenda item 9)**

The Emergency and Business Continuity Manager presented the report on Business Continuity Co-ordination. The officer explained that Business Continuity (BC) planning, preparedness and response had undergone significant change in the 2021/22 financial year, as responsibility for BC co-ordination was brought back in house. This reversed a decision made in 2010/11 to separate BC from emergency management functions and transfer BC to One West.

The reasons for the decision to re-integrate BC into the Emergency Management Unit's (EMU) overall remit were summarised as follows: previous arrangement relied on good will as it did not include response to BC events; there were many synergies between Emergency Management and Business Continuity with BC and emergency plans dovetailing and complimenting each other; the response structure within the BC Corporate Plan relied on the structures and roles within EMU procedures and following lessons learned from the COVID response, BC was identified as an area for improvement.

The report provided members with an overview of the response structures of the Council's EMU and the activities to improve and reintegrate Business Continuity (BC) into the EMU's programme of work. It also highlighted the ongoing work to ensure critical services continued to function during Business Continuity impacts.

Members were provided with information in relation to the structure of the EMU, Identifying and planning for critical services including the development of a new BC Critical Service Plan Template which had been rolled out to 29 of 63 critical services (46%), a learning and development half day workshop on Business Continuity (delivered to 51 of 63 critical services (81%), responses to BC impacting events (Storm Eunice, Fuel Price protests on the M5, 2 periods of heatwaves 2022, ICT disruption affecting 60% of workforce – October 2022) and other notable responses (COVID Pandemic, Brexit planning, Fuel supply disruption 2021), national and regional exercises which had taken place and future exercises, debrief process and next steps.

Members asked questions which were responded to by the representative on the following: risk strategy approach for low likelihood risks; the nature of the ICT disruption affecting 60% of the workforce; the Business Continuity debrief process; the nature of any work assessing the value of Business Continuity; future exercises planned around flood risk; the single most threatening event of concern in terms of business continuity and emergency; the nature of learning and development training and whether it was in-house, and the resource sustainability and 'clout' of the emergency and business continuity team.

Resolved: that the report be noted.

AUD 17 **Audit Committee Annual Report 2021-22 (Agenda item 10)**

The Chairperson presented the Audit Committee Annual Report which set out a summary of the work undertaken by the Committee in the previous year. Members noted the Audit Committee had specific terms of reference given to it from Full Council and as such was required to report back annually to Council on its activities.

Members' attention was directed to Appendix 1 which provided a commentary over key areas of financial and corporate governance and associated assurance activities including internal audit; risk management; governance; anti-fraud and corruption; audit committee performance.

The Annual Report was being re-submitted to the Committee to allow the requested changes from the September 2022 Audit Committee to be included as follows:

Report.
7. last sentence, link to Performance Management Risk Framework for ease of use
Appendix 1.
2. last bullet of first bullet list, correction, ... constitution exc. Financial Regulations...
3.b.ii request further assurance on integrated risk management of treasury assets
6.ii the Assistant Director of Legal & Governance for completeness

The Chairperson thanked Members for their work on the committee and acknowledged how much work had been undertaken.

Resolved: that the Audit Committee Annual Report 2021/22 be approved;

And

Recommended to Council: that the report be received

AUD 18 **Treasury Management Mid-Year Report 2022/23 & Consideration for the 2023/24 Strategy (Agenda item 11)**

The Principal Accountant, Resources and Financial Planning, presented the report on the Treasury Management Mid-Year Report 2022/23 & Considerations for the 2023/24 Strategy. The report informed members of the treasury management activities during the first six months of 2022/23 and confirmed that the activities undertaken during the year had complied with both the requirements of the Accountability and Responsibility Framework and the approved Treasury Management Strategy approved by Council in February 2022 and also set out the framework and issues to be considered when drafting the Strategy for the 2023/24 financial year.

The officer informed members that the economic volatility and uncertainty of the first six months of the year, set against a backdrop of rising interest rates had influenced the council’s overall financial position as well as its treasury related activity and performance. Borrowing and investment balances were broadly consistent with the previous year.

The key messages for the period 1 April 2022 to 30 September 2022 were highlighted (context, borrowing, investment income, investment returns, cash flows and indicators), Balance Sheet Summary, Summary of Investment Returns and Activity [overview, security and liquidity, cash-flows and market rates, investment returns. (Table 4a provided an Analysis of Investment – non-pooled funds and Table 4b provided an Analysis of Investments – pooled funds), Budget Implications; Borrowing Activity and Further Update; Economic Impacts, Commercial Investments, Revisions to CIPFA codes and Initial considerations in relation to the draft Treasury Management Strategy for 2023/24 – background and draft proposal.

Members asked questions which were responded to by the representative on the following: commercial investments and returns, security and liquidity as well as yield with regard to monitoring against objectives; ESG, financial assets and the council's commitment to climate emergency and biodiversity, forecasts of bank rates and inflation rates and risk, forward facing scenario planning and potential financial pressures.

Resolved:

(1) that the treasury management in-year monitoring report to 30 September 2022, including performance, prudential indicators, and commercial investments be noted;

(2) that the proposed matters for inclusion in the Treasury Management Strategy 2023/24 be noted.

Chairperson

North Somerset Council

Report to the Audit Committee

Date of Meeting: 26th January 2023

Subject of Report: Annual Governance Statement 2022/23

Town or Parish: None

Officer/ Member Presenting: Peter Cann - Audit West

Key Decision: No

Recommendations

The Audit Committee notes the report and process for the Annual Governance Statement.

1. Summary of Report

This report provides a brief overview of the process for completion of the Annual Governance Statement for 2022/23.

Whilst the statement is prepared and authorised by management and the Leader of Council, the Audit Committee has specific terms of reference given to it which requires it to consider the Annual Governance Statement and the framework which supports it which includes primarily the local code of corporate governance.

The Committee are asked to note that whilst this report describes the outline process for completion of the statement, work will be completed with the Councils Section 151 Officer as the statement is compiled to identify any detailed parts of the process which may benefit from being refreshed. Ahead of this, any comments from the Committee regarding are welcomed.

Members are advised that feedback previously provided by the Audit Committee in respect of amendments to wording and presentation will be contained within the 2022/23 statement.

2. Policy

2.1 The council has adopted a Local Code of Corporate Governance (Appendix 1), which was consistent with the principles of the CIPFA/SOLACE Framework *Delivering Good Governance in Local Government*.

2.2 The Annual Governance Statement explains how North Somerset Council has complied with the Local Code of Corporate Governance and also meets the requirements of:

- The Accounts and Audit (England) Regulations 2015, specifically Regulation 4 (2) in respect of the annual review of the effectiveness of its system of internal control and Regulation 4 (4) in respect of the preparation and publication of an Annual Governance Statement.

3. Details

3.1 **Background –**

The Annual Governance Statement is based on a 'Local Code of Corporate Governance' which forms part of the Council's Constitution. As the Annual Governance Statement is statutory we are required to take account of any guidance which is provided by CIPFA/SOLACE.

This guidance is also used by the External Auditor in their audit of the accounts and we are therefore required to take account of these in preparation of the statement.

Delivering Good Governance in Local Government; Framework, published by CIPFA in association with SOLACE, sets the standard for local authority governance in the UK. The concept underpinning the framework is to support local government in taking responsibility for developing and shaping an informed approach to governance, aimed at achieving the highest standards in a measured and proportionate way.

The purpose of the Framework is to assist authorities individually in reviewing and accounting for their own unique approach, with the overall aim to ensure that:

- Resources are directed in accordance with agreed policy and according to priorities
- There is sound and inclusive decision making
- There is clear accountability for the use of those resources in order to achieve desired outcomes for service users and communities

Governance is a term used to describe the arrangements (including political, economic, social, environmental, administrative, legal, and other arrangements) put in place to ensure that the intended outcomes for stakeholders are defined and achieved.

Good governance enables the Council to effectively achieve its intended outcomes, whilst acting in the public interest at all times.

Our code is based on the following key principles of good governance –

- Behaving with integrity, demonstrating strong commitment to ethical values and respecting the rule of law
- Ensuring openness and comprehensive stakeholder engagement
- Defining outcomes in terms of sustainable, economic, social and environmental benefits
- Determining the interventions necessary to optimise the achievement of the intended outcomes
- Developing the entity’s capacity, including the capability of its leadership and the individuals within it
- Managing risks and performance through robust internal control and strong public financial management
- Implementing good practices in transparency, reporting and audit, to deliver accountability

The Code provides further detail for each of the key principles to describe expectations and is used as part of the Annual Governance Review each year. Attached to this report is the Code – Appendix 1. Last year’s Annual Governance Statement can be seen within https://www.n-somerset.gov.uk/sites/default/files/2022-07/Statement%20of%20Accounts%202021-22%20-%20Draft%20accounts%20FINAL%20220707.pdf

3.2 **Process for 2022/23 Statement**

An overview of the general process for the compilation and approval of the Annual Governance Statement for 2021/22 is attached at the end of this report at Annex A. This is similar to the process adopted in previous years but will be reviewed during each stage of completion alongside the Council's Section 151 Officer to identify any ways in which the process could be further enhanced.

The process diagram indicates the major steps in the process for compiling the statement and the outcome will be a final Annual Governance Statement ratified by the Audit Committee as part of the Annual Accounts approval process.

CIPFA/SOLACE guidance as detailed above and its key principles will be taken account of as normal within this years review and as reported last year there were two significant issues identified in the 2021/22 statement; i) Coronavirus Pandemic (COVID-19) and consequent ongoing implications around; impact on public health, the local economy, financial and organisational resilience, democracy and safeguarding, and ii) Capital Governance, identifying the need to enable greater transparency and oversight in this area through providing a clear, consistent and proportionate reporting mechanism.

The definition of a significant issue can be summarised as one of the following –

- Significant failures in decision making at Council or Executive
- Significant unexpected use of Resources
- Significant performance failings or failures in service delivery
- Significant issues from inspections, audits, complaints etc
- Significant issues failures in respect of statutory duties
- Significant issues from operational issues and third parties

Whilst the statement forms part of the Annual Accounts it is a separate document and is a management statement which is signed/ authorised by the Chief Executive and Leader of Council before being presented to the Audit Committee.

4. Consultation

This report describes the Annual Governance Review process which members are invited to comment upon. As part of wider and ongoing consultation, the 2022-23 Annual Governance Statement will also be updated to reflect the feedback provided by Committee Members at the Accounts Workshop in September 2022.

5. Financial implications

The Annual Governance Statement describes how the council complies with its Local Code of Governance which incorporates all the council's business and hence budget.

6. Legal Powers and Implications

Accounts & Audit Regulations set out the expectations of provision of an Annual Governance Statement. This is supported by CIPFA/SOLACE standards and the Council's Local Code of Corporate Governance. Implications of not providing this statement would include potential qualification of the Accounts, increase in External Audit fees, potential significant reputational risks and ultimately additional costs to rectify.

7. Climate Change & Environmental Implications

No direct implications however the review process will consider key risks (& assurances) which may include Climate Change and any significant issues where appropriate.

8. Risk Management

Failure to compile an Annual Governance Statement would result in non-compliance with statutory legislation and leave the Council open to criticism by External Audit and external stakeholders.

9. Equality Implications

None.

10. Corporate Implications

The production of an Annual Governance Statement is an explicit statutory requirement of the Accounts and Audit (England) Regulations.

The completed Annual Governance Statement is reviewed by the Council's External Auditor.

11. Options Considered

None, this is a statutory process.

AUTHOR

Peter Cann - Audit West peter.cann@n-somerset.gov.uk

BACKGROUND PAPERS

Council's Local Code of Corporate Governance

Annex A. Outline Methodology for Preparing the Annual Governance Statement 2022/23

Independent Assurance

- Audit Plan & Outcomes of work
- Head of Audit opinion
- Annual Audit Plan
- Counter fraud activity and investigations
- Risk Management

Senior Management

- Corporate Leadership Team
- Finance Business Partners
- Medium term financial plans and savings programmes
- Partnership working
- Client/Contract Management

Performance management

- Corporate Plan
- Performance & Risk Management
- Internal Management Reviews
- KPI & data quality
- Benchmarking
- Programme and Project Management

External Review/ Assurance

- External Audit plans, letters and reports
- Inspection reports
- Peer reviews
- External Commissioned reviews
- Ombudsman

Corporate Assurance

- Consultation/ complaints/ feedback
- Scrutiny process
- Audit Committee
- Statutory Officers
- Legal Services
- The Executive
- Equality Impact Assessments
- Codes of Conduct

Set out the arrangements for compilation and approval of the Annual Governance Statement 2022/23	
Audit Committe	Annual

Review progress made against any significant issues included in the 2021/22 Annual Governance Statement	
Audit Committee	Ongoing

Consideration of significant issues for 2022/23 Annual Governance Statement	
Corporate Leadership Team, Statutory Officers & Finance Business Partners	Ongoing

Approval of 2022/23 Annual Governance Statement

Leader, Chief Executive and Audit Committee - September 2023

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North Somerset Council

Local Code of Corporate Governance 2017

1 Delivering Good Governance

1.1 *Delivering Good Governance in Local Government; Framework*, published by CIPFA in association with SOLACE, sets the standard for local authority governance in the UK. The concept underpinning the framework is to support local government in taking responsibility for developing and shaping an informed approach to governance, aimed at achieving the highest standards in a measured and proportionate way. The purpose of the Framework is to assist authorities individually in reviewing and accounting for their own unique approach, with the overall aim to ensure that :

- Resources are directed in accordance with agreed policy and according to priorities
- There is sound and inclusive decision making
- There is clear accountability for the use of those resources in order to achieve desired outcomes for service users and communities

1.2 Governance is a term used to describe the arrangements (including political, economic, social, environmental, administrative, legal, and other arrangements) put in place to ensure that the intended outcomes for stakeholders are defined and achieved.

1.3 Good governance enables the Council to effectively achieve its intended outcomes, whilst acting in the public interest at all times.

1.4 The *Delivering Good Governance in Local Government; Framework*, sets out seven core principles of governance as detailed in the diagram below. North Somerset Council is committed to these principles of good governance and confirms this through the adoption, monitoring and development of this document - the Council's Local Code of Corporate Governance.

1.5 Our Local Code is underpinned by the Delivering Good Governance in Local Government; Framework and is comprised of policies, procedures, behaviours and values by which the Council is controlled and governed. These key governance areas and how the Council provides assurance that it is complying with these are set out in more detail within its Governance Assurance Framework.

1.6 The Council recognises that establishing and maintaining a culture of good governance is as important as putting in place a framework of policies and procedures. The Council expects members and officers to uphold the highest standards of conduct and behaviour and to act with openness, integrity and accountability in carrying out their duties.

2. Principles of Good Governance

2.1 This diagram illustrates how good governance is integral to supporting the delivery of the organisations priorities.

2.2 The principles of good governance therefore describe the outcomes this code is attempting to deliver. The guidance prescribes these as follows –

- **Behaving with integrity, demonstrating strong commitment to ethical values and respecting the rule of law**
- **Ensuring openness and comprehensive stakeholder engagement**
- **Defining outcomes in terms of sustainable, economic, social and environmental benefits**
- **Determining the interventions necessary to optimize the achievement of the intended outcomes**
- **Developing the entity's capacity, including the capability of its leadership and the individuals within it**
- **Managing risks and performance through robust internal control and strong public financial management**
- **Implementing good practices in transparency, reporting and audit, to deliver accountability**

2.3 Further information regarding each of the above principles and the behaviours and actions that demonstrate good governance in practice are detailed at Appendix A

3 Status

3.1 Regulation 6(1)(a) of the Accounts and Audit regulations 2015 require an authority to conduct a review at least once in a year of the effectiveness of its systems of internal control and include a statement reporting on the review with any published statement of Accounts. This is known as an Annual Governance Statement.

3.2 The Accounts and Audit Regulations 2015 stipulate that the Annual Governance Statement must be prepared in accordance with proper practices in relation to accounts. Therefore a local authority in England shall provide this statement in accordance with Delivering Good Governance in Local Government Framework (2016) and this section of the Code.

4 Monitoring and review

4.1 The Council will monitor its governance arrangements for their effectiveness in practice and will review them on a continuing basis to ensure that they are up to date. This process of review to produce the Annual Governance Statement sets out in more detail how the Council will seek assurance on its adherence to the adopted principles of governance detailed in this code.

4.2 On an annual basis, the Chief Executive and Leader of the Council will therefore publish an Annual Governance Statement which will:

- assess how the Council has complied with this Code of Corporate Governance
- provide an opinion on the effectiveness of the Council's arrangements
- Provide details of how continual improvement in the systems of governance will be achieved.

5 Certification

5.1 We hereby certify our commitment to this Code of Corporate Governance and will ensure that the Council continues to review, evaluate and develop the Council's Governance arrangements to ensure continuous improvement of the Council's systems.

Leader of the Council	**Chief Executive**
Date:	Date:

Principles	Sub-Principles	Behaviour and actions that demonstrate good governance in practice:
A. Behaving with integrity, demonstrating strong commitment to ethical values and respecting the rule of law	Behaving with integrity	• Ensuring members and officers behave with integrity and lead a culture where acting in the public interest is visibly and consistently demonstrated thereby protecting the reputation of the organisation • Ensuring members take the lead in establishing specific standard operating principles or values for the organisation and its staff and that they are communicated and understood. These should build on the Seven Principles of Public Life (the Nolan Principles) • Leading by example and using the above standard operating principles or values as a framework for decision making and other actions • Demonstrating, communicating and embedding the standard operating principles or values through appropriate policies and processes which are reviewed on a regular basis to ensure that they are operating effectively
	Demonstrating strong commitment to ethical values	• Seeking to establish, monitor and maintain the organisation's ethical standards and performance • Underpinning personal behaviour with ethical values and ensuring they permeate all aspects of the organisation's culture and operation • Developing and maintaining robust policies and procedures which place emphasis on agreed ethical values • Ensuring that external providers of services on behalf of the organisation are required to act with integrity and in compliance with ethical standards expected by the organisation
	Respecting the rule of law	• Ensuring members and staff demonstrate a strong commitment to the rule of the law as well as adhering to relevant laws and regulations • Creating the conditions to ensure that the statutory officers, other key post holders, and members, are able to fulfil their responsibilities in accordance with legislative and regulatory requirements • Striving to optimise the use of the full powers available for the benefit of citizens, communities and other stakeholders • Dealing with breaches of legal and regulatory provisions effectively • Ensuring corruption and misuse of power are dealt with effectively

Core Principles	Sub-Principles	Behaviour and actions that demonstrate good governance in practice:
B. Ensuring openness and comprehensive stakeholder engagement	**Openness**	• Ensuring an open culture through demonstrating, documenting and communicating the organisation's commitment to openness • Making decisions that are open about actions, plans, resource use, forecasts, outputs and outcomes. The presumption is for openness. If that is not the case, a justification for the reasoning for keeping a decision confidential should be provided • Providing clear reasoning and evidence for decisions in both public records and explanations to stakeholders and being explicit about the criteria, rationale and considerations used. In due course, ensuring that the impact and consequences of those decisions are clear • Using formal and informal consultation and engagement to determine the most appropriate and effective interventions/ courses of action
	Engaging comprehensively with institutional stakeholders	• Effectively engaging with institutional stakeholders to ensure that the purpose, objectives and intended outcomes for each stakeholder relationship are clear so that outcomes are achieved successfully and sustainably • Developing formal and informal partnerships to allow for resources to be used more efficiently and outcomes achieved more effectively – Ensuring that partnerships are based on: trust – a shared commitment to change – a culture that promotes and accepts challenge among partners and that the added value of partnership working is explicit
	Engaging with individual citizens and service users effectively	• Establishing a clear policy on the type of issues that the organisation will meaningfully consult with or involve communities, individual citizens, service users and other stakeholders to ensure that service (or other) provision is contributing towards the achievement of intended outcomes • Ensuring that communication methods are effective and that members and officers are clear about their roles with regard to community engagement • Encouraging, collecting and evaluating the views and experiences of communities, citizens, service users and organisations of different backgrounds including reference to future needs • Implementing effective feedback mechanisms in order to demonstrate how views have been taken into account • Balancing feedback from more active stakeholder groups with other stakeholder groups to ensure inclusivity • Taking account of the impact of decisions on future generations of tax payers and service users

Core Principles	Sub-Principles	Behaviour and actions that demonstrate good governance in practice:
C. Defining outcomes in terms of sustainable economic, social, and environmental benefits	Defining outcomes	• Having a clear vision, which is an agreed formal statement of the organisation's purpose and intended outcomes containing appropriate performance indicators, which provide the basis for the organisation's overall strategy, planning and other decisions • Specifying the intended impact on, or changes for, stakeholders including citizens and service users. It could be immediately or over the course of a year or longer • Delivering defined outcomes on a sustainable basis within the resources that will be available • Identifying and managing risks to the achievement of outcomes • Managing service users' expectations effectively with regard to determining priorities and making the best use of the resources available
	Sustainable economic, social and environmental benefits	• Considering and balancing the combined economic, social and environmental impact of policies and plans when taking decisions about service provision • Taking a longer-term view with regard to decision making, taking account of risk and acting transparently where there are potential conflicts between the organisation's intended outcomes and short-term factors such as the political cycle or financial constraints • Determining the wider public interest associated with balancing conflicting interests between achieving the various economic, social and environmental benefits, through consultation where possible, in order to ensure appropriate trade-offs • Ensuring fair access to services

Core Principles	Sub-Principles	Behaviour and actions that demonstrate good governance in practice:
D. Determining the interventions necessary to optimise the achievement of the intended outcomes	**Determining interventions**	• Ensuring decision makers receive objective and rigorous analysis of a variety of options indicating how intended outcomes would be achieved and associated risks. Therefore ensuring best value is achieved however services are provided • Considering feedback from citizens and service users when making decisions about service improvements or where services are no longer required in order to prioritise competing demands within limited resources available including people, skills, land and assets and bearing in mind future impacts
	Planning interventions	• Establishing and implementing robust planning and control cycles that cover strategic and operational plans, priorities and targets • Engaging with internal and external stakeholders in determining how services and other courses of action should be planned and delivered • Considering and monitoring risks facing each partner when working collaboratively, including shared risks • Ensuring arrangements are flexible and agile so that the mechanisms for delivering goods and services can be adapted to changing circumstances • Establishing appropriate key performance indicators (KPIs) as part of the planning process in order to identify how the performance of services and projects is to be measured • Ensuring capacity exists to generate the information required to review service quality regularly • Preparing budgets in accordance with objectives, strategies and the medium term financial plan • Informing medium and long term resource planning by drawing up realistic estimates of revenue and capital expenditure aimed at developing a sustainable funding strategy
	Optimising achievement of intended outcomes	• Ensuring the medium term financial strategy integrates and balances service priorities, affordability and other resource constraints • Ensuring the budgeting process is all-inclusive, taking into account the full cost of operations over the medium and longer term • Ensuring the medium term financial strategy sets the context for ongoing decisions on significant delivery issues or responses to changes in the external environment that may arise during the budgetary period in order for outcomes to be achieved while optimising resource usage • Ensuring the achievement of ‘social value’ through service planning and commissioning

Core Principles	Sub-Principles	Behaviour and actions that demonstrate good governance in practice:
E. Developing the entity's capacity, including the capability of its leadership and the individuals within it	Developing the entity's capacity	• Reviewing operations, performance and use of assets on a regular basis to ensure their continuing effectiveness • Improving resource use through application of techniques such as benchmarking and other options in order to determine how resources are allocated so that defined outcomes are achieved Recognising the benefits of partnership working where added value can be achieved • Developing & maintaining an effective workforce plan to enhance the strategic allocation of resources
	Developing the capability of the entity's leadership and other individuals	• Developing protocols to ensure that elected and appointed leaders negotiate with each other regarding their respective roles early on in the relationship and that a shared understanding of roles and objectives is maintained • Publishing a statement that specifies the types of decisions that are delegated and those reserved for the collective decision making of the governing body • Ensuring the leader and the chief executive have clearly defined and distinctive leadership roles within a structure whereby the chief executive leads in implementing strategy and managing the delivery of services and other outputs set by members and each provides a check and a balance for each other's authority • Developing the capabilities of members and senior management to achieve effective leadership and to enable the organisation to respond successfully to changing legal and policy demands as well as economic, political and environmental changes and risks by: ensuring members and staff have access to appropriate induction tailored to their role and that ongoing training and development matching individual and organisational requirements is available and encouraged – ensuring members and officers have the appropriate skills, knowledge, resources and support to fulfil their roles and responsibilities and ensuring that they are able to update their knowledge on a continuing basis – ensuring personal, organisational and system-wide development through shared learning, including lessons learnt from governance weaknesses both internal and external – Ensuring that there are structures in place to encourage public participation – Taking steps to consider the leadership's own effectiveness and ensuring leaders are open to constructive feedback from peer review and inspections – Holding staff to account through regular performance reviews which take account of training – Ensuring arrangements are in place to maintain the health and wellbeing of the workforce and support individuals in maintaining their own physical and mental wellbeing

Core Principles	Sub-principles	Behaviour and actions that demonstrate good governance in practice:
F. Managing risks and performance through robust internal control and strong public financial management	**Managing risk**	• Recognising that risk management is an integral part of all activities and must be considered in all aspects of decision making • Implementing robust and integrated risk management arrangements and ensuring that they are working effectively • Ensuring that responsibilities for managing individual risks are clearly allocated
	Managing performance	• Monitoring service delivery effectively including planning, specification, execution and independent post implementation review • Making decisions based on relevant, clear objective analysis and advice pointing out the implications and risks inherent in the organisation's financial, social and environmental position and outlook • Ensuring an effective scrutiny or oversight function is in place which provides constructive challenge and debate on policies and objectives before, during and after decisions are made thereby enhancing the organisation's performance and that of any organisation for which it is responsible (Or, for a committee system) Encouraging effective and constructive challenge and debate on policies and objectives to support balanced and effective decision making • Providing members and senior management with regular reports on service delivery plans and on progress towards outcome achievement • Ensuring there is consistency between specification stages (such as budgets) and post implementation reporting (e.g. financial statements)
	Robust internal control	• Aligning the risk management strategy and policies on internal control with achieving objectives • Evaluating and monitoring risk management and internal control on a regular basis • Ensuring effective counter fraud and anti-corruption arrangements are in place • Ensuring additional assurance on the overall adequacy and effectiveness of the framework of governance, risk management and control is provided by the internal auditor – Ensuring an audit committee or equivalent group/ function, which is independent of the executive and accountable to the governing body: provides a further source of effective assurance regarding arrangements for managing risk and maintaining an effective control environment – that its recommendations are listened to and acted upon

	Managing data	• Ensuring effective arrangements are in place for the safe collection, storage, use and sharing of data, including processes to safeguard personal data • Ensuring effective arrangements are in place and operating effectively when sharing data with other bodies • Reviewing and auditing regularly the quality and accuracy of data used in decision making and performance monitoring
	Strong public financial management	• Ensuring financial management supports both long term achievement of outcomes and short-term financial and operational performance • Ensuring well-developed financial management is integrated at all levels of planning and control, including management of financial risks and control

Core Principles	Sub-Principles	Behaviour and actions that demonstrate good governance in practice:
G. Implementing good practices in transparency, reporting, and audit to deliver effective accountability	Implementing good practice in transparency	• Writing and communicating reports for the public and other stakeholders in a fair, balanced and understandable style appropriate to the intended audience and ensuring that they are easy to access and interrogate • Striking a balance between providing the right amount of information to satisfy transparency demands and enhance public scrutiny while not being too onerous to provide and for users to understand
	Implementing good practices in reporting	• Reporting at least annually on performance, value for money and stewardship of resources to stakeholders in a timely and understandable way • Ensuring members and senior management own the results reported • Ensuring robust arrangements for assessing the extent to which the principles contained in this Framework have been applied and publishing the results on this assessment, including an action plan for improvement and evidence to demonstrate good governance (the annual governance statement) • Ensuring that this Framework is applied to jointly managed or shared service organisations as appropriate • Ensuring the performance information that accompanies the financial statements is prepared on a consistent and timely basis and the statements allow for comparison with other, similar organisations
	Assurance and effective accountability	• Ensuring that recommendations for corrective action made by external audit are acted upon • Ensuring an effective internal audit service with direct access to members is in place, providing assurance with regard to governance arrangements and that recommendations are acted upon • Welcoming peer challenge, reviews and inspections from regulatory bodies and implementing recommendations • Gaining assurance on risks associated with delivering services through third parties and that this is evidenced in the annual governance statement • Ensuring that when working in partnership, arrangements for accountability are clear and the need for wider public accountability has been recognised and met

North Somerset Council

Report to the Audit Committee

Date of Meeting: 26th January 2023

Subject Of Report: Audit Plan – Audit Committee Consultation

Town or Parish: None

Officer/ Member Presenting: Peter Cann - Audit West

Key Decision: No

Recommendations

The Audit Committee is asked to:

- Comment on any areas or themes they would like to be considered in relation to the Internal Audit Plan for 2023/24.
- Note the intention to keep the plan under regular review, including a six-month progress assessment, in order to prioritise resources as required.

1. Summary of Report

This report updates the Audit Committee on the methodology used to create the Internal Audit Plan and asks for comments on areas or themes they would like to be considered within the plan for 2023/24.

2. Policy

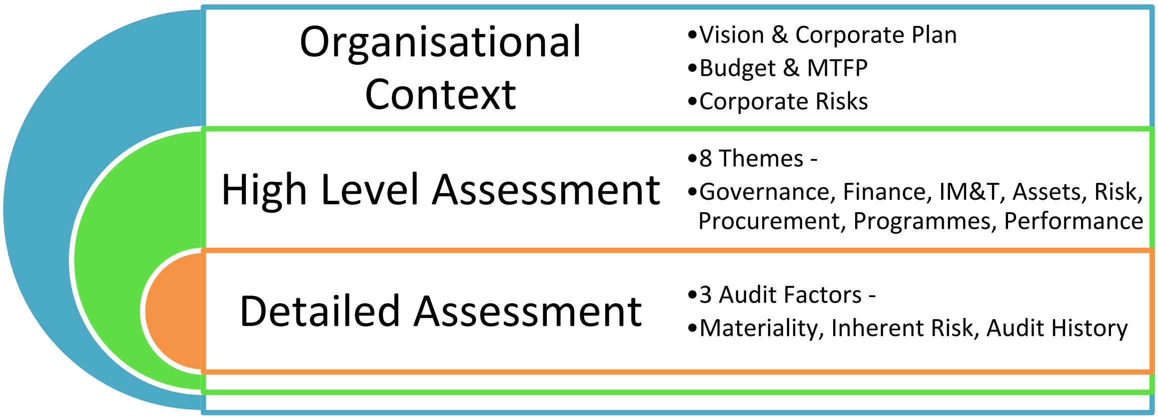
The work of the Internal Audit Service is to provide independent assurance to the council's senior officers and members that governance, risk management and controls are sufficient in ensuring delivery of the council's objectives.

3. Details

3.1 The planning process is based on the fundamental requirement that the audit plan proposed will deliver sufficient work to enable the Chief Internal Auditor to independently assess the internal control framework and give a reasonable assurance opinion at the end of each year.

3.2 The model used to develop the audit plan – the Reasonable Assurance Model - has previously been reported to the Committee in detail. It was created and adopted in conjunction with a number of other councils in the South West and its approach won a Public Finance award.

3.3 The outline of the model is as follows with the key elements in the middle section which introduce a high-level assessment of themes based on good governance.



3.4 A key part of the planning process is therefore extensive stakeholder consultation. Conversations in this regard usually take place between December to March, however this process has been shortened this year to meet revised Committee meeting deadlines. Discussions will therefore take place with the following officers/ groups up until the end of February:

- Section 151 Officer
- Finance Business Partners & Head of Finance
- Directorate Leadership Teams
- Statutory Officers
- Audit Committee (through formal and informal meetings)

3.5 <u>Rolling Plan Review</u>

3.5.1 During the financial year 2020/21 in particular, members will recall that some changes to planned work were required in order to redirect audit resources to unforeseen issues arising from the then emerging COVID-19 pandemic. At approximately six months in, it was considered that the audit plan should be rebased for the rest of that financial year as a better understanding had been gained of the impact of COVID-19 and how resources should be subsequently prioritised. This was discussed and agreed at the time with the Audit Committee.

3.5.2 Whilst only small adjustments were then required to the plans for subsequent years (2021/22 and 2022/23), the Internal Audit Service will continue to ensure a fluid approach for the next financial year. Therefore, whilst the usual consultation process will follow and a full-year audit plan will initially be produced to cover the period 1st April 2023 – 31st March 2024, the plan will be kept under continual review and adjusted to cover any further unforeseen requirements over the first six months. A review of the annual plan at the six-month stage will then take place, if necessary, in order to adequately prioritise and resource the second half of the financial year.

3.6 <u>Audit Committee - Consultation & Input</u>

3.6.1 The Audit Committee is a key stakeholder and ultimately approve the Audit Plan. Therefore the purpose of the report is to obtain views and feedback on areas which the planning process can consider and take account of before it is finalised in early March.

3.6.2 The Chartered Institute of Internal Auditors has published a report which tracks the risks for 2023 as highlighted by organisations and to which should be taken into account when preparing their audit plans.

The top risk areas from the report which are particularly relevant to the public sector are detailed below. This list may assist the committee as a point of reference to help understand where they feel audit coverage may be beneficial.

- Cybersecurity and data security
- Human capital, diversity and talent management
- Macroeconomic and geopolitical uncertainty
- Climate change and environmental sustainability
- Business continuity, crisis management and disasters response
- Financial risk
- Organisational governance and corporate reporting

4. Consultation

In developing and delivering the Annual Audit Assurance Plan the Internal Audit Service is consulting widely with officers and members. Ongoing consultation will continue with the Audit Committee throughout the year after the plan has been approved.

5. Financial Implications

There are no direct financial implications from this report, however finance is considered throughout the planning process including consideration of the Budget and MTFP.

6. Risk Management

Significant risks to the council arising from an ineffective Internal Audit Service include lack of internal control, failures of governance and weak risk management. Specific risks include supplementary External Audit Fees, undetected fraud and inadequate coverage. Internal Audit assists the council in identifying risks, improvement areas and recommending good practice. Directorate and Strategic Risk Registers are also reviewed when developing the internal audit plan.

7. Legal Powers and Implications

Accounts & Audit Regulations set out the expectations of provision of an Internal Audit service. This is supported by S151 of the Local Government Act and CIFPA Codes of Practice and the IIA professional standards for delivery of an adequate Internal Audit Service. Implications of not providing this service may include qualification of the Accounts, increase in External Audit fees, potential rise in fraud and corruption and misappropriation of assets and resources.

8. Climate Change & Environmental Implications

The plan process will consider key risks (& opportunities) which will directly or indirectly include focus on Climate Change and report back on whether assurances can be given on the delivery of the organisations plan to mitigate the risk in this area.

9. Equality Implications

Embedded within the audit process is consideration of compliance with statutory guidance and regulations which includes those relating to equality and diversity.

10. Corporate Implications

Failure to deliver the agreed Annual Assurance Plan may result in an inability to provide assurance to officers and members of the council's corporate governance.

11. Options Considered

Audit Methodology is driven by professional standards and legislative requirements and the model created subjected to external assessment. The plan itself is subject to wide consultation in order to ensure sufficient options and approaches have been considered.

AUTHOR

Peter Cann - Audit West Peter.cann@n-somerset.gov.uk

BACKGROUND PAPERS

Annual Audit Assurance Plan 2022/23 Audit Committee April 2022

North Somerset Council
Audit Progress Report and Sector Update

Year ending 31 March 2023

January 2023

Contents

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 Authority or all 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.

Introduction

Your key Grant Thornton team members are:

Barrie Morris
Key Audit Partner
T 0117 305 7708
E barrie.morris@uk.gt.gom

David Johnson
Audit Manager
T 0117 305 7727
E david.a.johnson@uk.gt.com

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

The paper also includes:

- a summary of emerging national issues and developments that may be relevant to you as a local authority; and
- includes a number of challenge questions in respect of these emerging issues which the Committee may wish to consider (these are a tool to use, if helpful, rather than formal questions requiring responses for audit purposes)

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

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

Progress at January 2023

Financial Statements Audit 2021-22 Accounting for infrastructure

The Code of Practice on Local Authority Accounting in the United Kingdom 2021/22 requires infrastructure to be reported in the Balance Sheet at historic cost less accumulated depreciation and impairment and that where there is 'enhancement' to the assets, that the replaced components are derecognised. Where authorities are not fully compliant with these requirements, there may be a risk of material misstatement.

Many authorities do not possess the records to be able to fully comply with the requirements. Following extensive consultation and discussions with interested parties DLUHC now laid a Statutory Instrument before Parliament which came into force on 25 December 2022 which should simplify accounting for infrastructure assets until the 2024/25 financial year, following which the CIPFA Code of Practice on Local Authority Accounting is expected to introduce longer term financial reporting requirements in this area.

Further guidance on the temporary solution for accounting for Infrastructure Assets was published by CIPFA in Bulletin 12 on 11 January 2023. We continue to discuss this area with management with a view to completing the testing by the end of January 2023 and shortly thereafter issuing the audit opinion

Financial Statements Audit 2022-23

We will undertake our initial planning for the 2022/23 audit in February 2023, and interim audit in February and March. We begin our work on your draft financial statements in July.

We will issue a detailed audit plan, setting out our proposed approach to the audit of the Authority's 2022/23 financial statements in March 2023.

The Accounts and Audit Regulations 2015 were amended by SI 2021 No. 263. The Department for Levelling Up, Housing and Communities (DLUHC) previously stated their intention to introduce secondary legislation to extend the deadline for publishing audited local authority accounts to 30 November 2022 for the 2021/22 accounts. This is enacted by The Accounts and Audit (Amendment) Regulations 2022 (SI 2022 No. 708) that came into force on 22 July 2022. The deadline for publishing audited local authority accounts for 2021/22 is extended to 30 November 2022 and thereafter changed to 30 September for years up to 2027/28.

Value for Money

The new Code of Audit Practice (the "Code") came into force on 1 April 2020 for audit years 2020/21 and onwards. The most significant change under the new Code was the introduction of an Auditor's Annual Report, containing a commentary on arrangements to secure value for money and any associated recommendations, if required.

The new approach is more complex, more involved and is planned to make more impact.

Under the 2020 Code of Audit Practice, for relevant authorities other than local NHS bodies auditors are required to issue our Auditor's Annual Report no later than 30 September or, where this is not possible, issue an audit letter setting out the reasons for delay.

As a result of the ongoing pandemic, and the impact it has had on both preparers and auditors of accounts to complete their work as quickly as would normally be expected, the National Audit Office has updated its guidance to auditors to allow us to postpone completion of our work on arrangements to secure value for money and focus our resources firstly on the delivery of our opinions on the financial statements. This is intended to help ensure as many as possible could be issued in line with national timetables and legislation. The extended deadline for the issue of the Auditor's Annual Report is now no more than three months after the date of the opinion on the financial statements. We anticipate issuing our Auditor's Annual Report in January 2023.

Progress at January 2023(cont.)

Other areas

Certification of claims and returns

We certify the Authority's annual Housing Benefit Subsidy claim in accordance with procedures agreed with the Department for Work and Pensions (DwP). The certification work for the 2021/22 claim began in June. DwP extended the deadline for reporting the findings of this work to 31 January 2023. We will report our findings to the Audit Committee in March 2023

We certify the Authority's annual Teachers' Pensions return in accordance with procedures agreed with Teachers' Pensions. The certification work for the 2021/22 return began in October, and was completed by the deadline of 30 November.

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Meetings

We met with Finance Officers in November 2022 as part of our quarterly liaison meetings and continue to be in discussions with finance staff regarding emerging developments and to ensure the audit process is smooth and effective.

Events

We provide a range of workshops, along with network events for members and publications to support the Authority. Your officers have been invited to our Accounts Workshop in February 2023, which will provide an opportunity to work through new reporting requirements for local authority accounts and give insight into elements of the audit approach.

Further details of the publications that may be of interest to the Authority are set out in our Sector Update section of this report.

Audit Fees

During 2017, PSAA awarded contracts for audit for a five year period beginning on 1 April 2018. 2021/22 is the fourth year of that contract. Since that time, there have been a number of developments within the accounting and audit profession. Across all sectors and firms, the Financial Reporting Council (FRC) has set out its expectation of improved financial reporting from organisations and the need for auditors to demonstrate increased scepticism and challenge and to undertake additional and more robust testing.

Our work in the Local Government sector in the period 2018/19 to 2021/22 has highlighted areas where financial reporting, in particular, property, plant and equipment and pensions, needs to improve. There is also an increase in the complexity of Local Government financial transactions and financial reporting. This combined with the FRC requirement that all Local Government audits are at or above the "limited improvements" (2) rating means that additional audit work is required.

We continue to review the impact of these changes on both the cost and timing of audits. We will discuss this with your s151 Officer including any proposed variations to the Scale Fee set by PSAA Limited, and will communicate fully with the Audit Committee.

As a firm, we remain absolutely committed to meeting the expectations of the FRC with regard to audit quality and local government financial reporting.

Audit Deliverables

2022/23 Deliverables	Planned Date	Status
Audit Plan We are required to issue a detailed audit plan to the Audit Committee setting out our proposed approach in order to give an opinion on the Authority's 2022/23 financial statements and to issue a commentary on the Authority's value for money arrangements in the Auditor's Annual Report	March 2023	Not yet due
Interim Audit Findings We will report to you the findings from our interim audit within our Progress Report.	March 2023	Not yet due
Audit Findings Report The Audit Findings Report will be reported to the September Audit Committee.	September 2023	Not yet due
Auditors Report This includes the opinion on your financial statements.	September 2023	Not yet due
Auditor's Annual Report This report communicates the key outputs of the audit, including our commentary on the Authority's value for money arrangements.	December 2023	Not yet due

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2021/22 Audit-related Deliverables	Planned Date	Status
Teachers Pensions Scheme – certification This is the report we submit to Teachers Pensions based upon the mandated agreed upon procedures we are required to perform.	TBC	Not yet due
Housing Benefit Subsidy – certification This is the report we submit to Department of Work and Pensions based upon the mandated agreed upon procedures we are required to perform.	TBC	Not yet due

Sector Update

Authorities continue to try to achieve greater efficiency in the delivery of public services, whilst facing the challenges to address rising demand, ongoing budget pressures and social inequality.

Our sector update provides you with an up to date summary of emerging national issues and developments to support you. We cover areas which may have an impact on your organisation, the wider local government sector and the public sector as a whole. Links are provided to the detailed report/briefing to allow you to delve further and find out more.

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Our public sector team at Grant Thornton also undertake research on service and technical issues. We will bring you the latest research publications in this update. We also include areas of potential interest to start conversations within the organisation and with audit committee members, as well as any accounting and regulatory updates.

- Grant Thornton Publications
- Insights from local government sector specialists
- Reports of interest
- Accounting and regulatory updates

More information can be found on our dedicated public sector and local government sections on the Grant Thornton website by clicking on the logos below:

Public Sector

Local government

Audit Market Developments

Financial Reporting Council Report On The Quality Of Local Audit

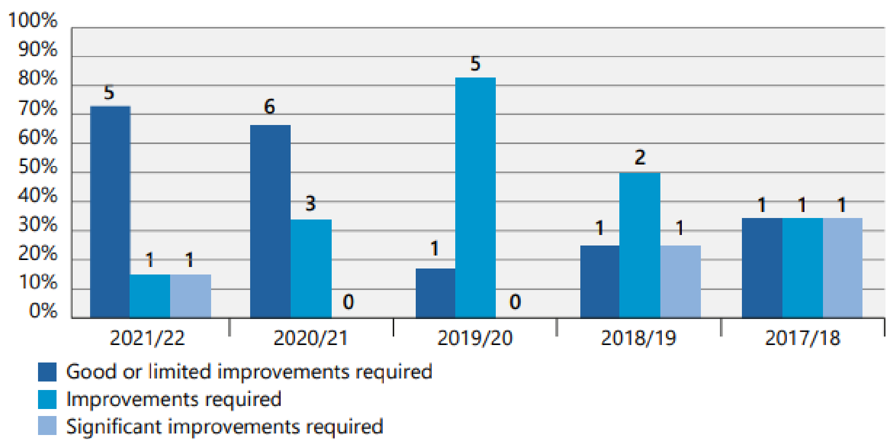
In late October 2022 the Financial Reporting Council (FRC) published its inspection findings into the quality of major local body audits in England, which includes large health and local government bodies.

The Quality Assurance Department (QAD) of the Institute of Chartered Accountants in England and Wales (ICAEW) inspects a sample of local audits that do not meet the definition of a 'major' local audit and the FRC's report also includes a summary of their findings.

The FRC reported that 71% of Grant Thornton audits inspected (7 in total) were assessed as either good or limited improvements required.

This is a pleasing result and reflects on our significant investment in audit quality over recent years. The positive direction of travel over the past five years is illustrated below:

Our assessment of the quality of financial statement audits reviewed



The FRC also inspected our work on VfM arrangements at four bodies.

It is pleasing to note that all of these inspections were assessed as requiring no more than limited improvements (which is the same as the previous year).

As far as the ICAEW are concerned, overall, the audit work reviewed was found to be of a good standard.

Seven of the eight files reviewed (88%) were either 'good' or 'generally acceptable', but one file 'required improvement'.

The ICAEW identified one of our files as 'requiring improvement' – but it should be noted that this was a 2019-20 file and therefore the learnings from prior years' review could not have been taken into account, an issue recognised by the ICAEW in their report to us.

The ICAEW found that our VfM work was good on each of the files reviewed, and they did not identify any issues with this aspect of the audit teams' work.

Whilst are pleased with our continuing improvement journey, we continue to invest in audit quality to ensure that the required standards are met.

The full report can be found here.

Financial Reporting Council

Audit Market Developments (continued)

Local Government External Audit Procurement

Public Sector Audit Appointments Ltd (PSAA) has recently announced the outcome of its national procurement of audit services across the Local Government sector.

This exercise covers the audits from 2023/24 to 2027/28 and covers the 470 local government, police and fire bodies (99% of eligible local bodies) that opted into the national scheme.

We are delighted to have been reappointed as the largest supplier of local government audit. The public sector has played a significant role within the firm for over 30 years and we remain committed to the success of the sector.

Our UK Public Sector Assurance (PSA) team employs 440 people, including 39 Key Audit Partners and specialists in financial reporting, audit quality, and value for money.

The team is dedicated to public audit work in local government and the NHS, with contracts with PSAA, Audit Scotland and over 100 health bodies. The Public Sector Assurance team is a regular commentator on issues facing the sector and oversees the firm's thought leadership, such as its series of publications on grants and public interest reports.

Mark Stocks, lead Partner for PSA at Grant Thornton, said 'This is a very welcome outcome and reflects our previous delivery as well as our ongoing commitment to invest in the public sector.'

Further information can be found here

Grant Thornton – Nearly 60 councils at risk of 'running out of money' next year

Grant Thornton has warned that the soaring cost of living combined with a decade of austerity could see up to a sixth of English councils fully deplete their reserves in 2023-24 without substantial spending cuts .

Research found that, as a result of higher inflation, councils are expected to have a cumulative budget deficit of £7.3bn by 2025-26 – an increase of £4.6bn since forecasts made at the beginning of this year.

Grant Thornton said that although reserves were bolstered by more than £5bn in 2020-21 due to higher government funding, these balances will "continue to unwind through the long tail of Covid-19" with close to 60 councils forecast to use all earmarked and unallocated reserves next year.

Without additional income, authorities would need to make savings of over £125 per person by 2025-26, equal to the average yearly spend on homelessness, sports and leisure, parks and open spaces, libraries and waste services.

Phillip Woolley, Head of Public Services Consulting at Grant Thornton, said: "Local government has faced unprecedented demands and pressures over the last decade and without action from both central government and councils, in the face of these inflationary pressures, the list of authorities in need of exceptional support looks set to grow quickly.

"Our research shows the additional Covid-19 funding, while critical to support immediate challenges, has not addressed underlying systemic issues or the precariousness of councils' financial sustainability in the face of economic instability.

"Local authorities are also now facing the risk of interest rate rises, increasing debt financing costs and the real risk of reduced funding from central government, in response to the current economic turmoil facing the country. Without committed intervention from all sides, there is a risk that the sector levels down instead of up."

Grant Thornton estimated unitary authorities would have the largest budget gap (£1.8bn) by 2025-26, but district councils would have the largest gap compared to net spending at 10.2%.

The firm added that austerity and changing policy demands have left councils struggling to innovate in their services and prevented investment in finance and procurement, diminishing the sector's ability to tackle medium-term challenges.

Grant Thornton said additional government funding alone will not lead to improvements, and that councils should focus on improving governance and developing financial stability plans.

Joanne Pitt, local government policy manager at CIPFA, said: "With no spending review and no fair funding review, CIPFA shares Grant Thornton's concerns about the financial sustainability of some in the sector.

"While there are actions local authorities can take to strengthen their own financial resilience, they are facing significant inflationary pressures and rising demand which makes this hugely challenging for the sector."

Audit Committees: Practical Guidance For Local Authorities And Police – CIPFA

In October CIPFA published this guide, stating “This fully revised and updated edition takes into account recent legislative changes and professional developments and supports the 2022 CIPFA Position Statement. It includes additional guidance and resources to support audit committee members, and those working with and supporting the committee’s development.”

CIPFA go on to state “Audit committees are a key component of governance. Their purpose is to provide an independent and high-level focus on the adequacy of governance, risk and control arrangements. They play an important role in supporting leadership teams, elected representatives, police and crime commissioners and chief constables.

This edition updates CIPFA’s 2018 publication to complement the 2022 edition of the CIPFA Position Statement on audit committees.

The suite of publications has separate guidance resources for audit committee members in authorities, members of police audit committees, and a supplement for those responsible for guiding the committee.

New aspects include legislation changes in Wales and new expectations in England following the Redmond Review. All authorities and police bodies are encouraged to use the publication to review and develop their arrangements in accordance with the Position Statement.

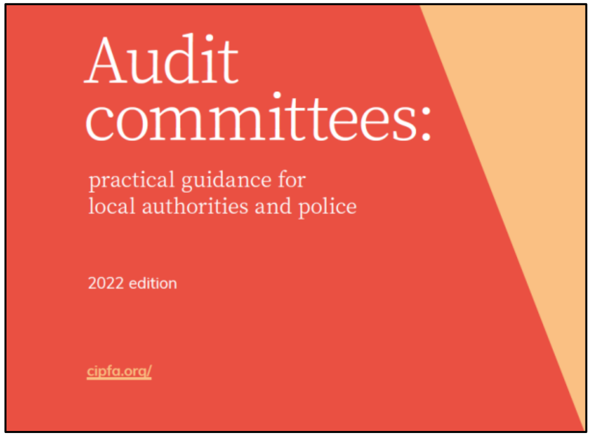
The appendices include suggested terms of reference, a knowledge and skills framework and effectiveness improvement tools.”

The guide covers a number of key areas for Audit Committees, including:

- Purpose
- Core functions:
  - Governance, Risk and Control
  - Accountability and Public Reporting
  - Assurance and Audit arrangements
  - Ensuring focus
- Independence and accountability
- Membership and effectiveness

The guide can be purchased via the CIPFA website:

[Audit Committee Guidance: 2022 update | CIPFA]



Grant Thornton

grantthornton.co.uk

North Somerset Council

REPORT TO THE AUDIT COMMITTEE

DATE OF MEETING: 26 JANUARY 2023

SUBJECT OF REPORT: DRAFT TREASURY MANAGEMENT STRATEGY 2023/24

TOWN OR PARISH: ALL

OFFICER/MEMBER PRESENTING: MELANIE WATTS, HEAD OF FINANCE

KEY DECISION: N/A
REASON: Not an Executive Decision

RECOMMENDATIONS

The Audit Committee is requested to;

i. note the contents of the report which summarise the key components of the draft Treasury Management Strategy for 2023/24 and associated impacts, and

ii. support the development of a policy and framework linked to the council becoming known as a responsible investor bringing social, environmental and governance issues into part of its investment strategy

1. SUMMARY OF REPORT

The purpose of the report is to present the council's draft annual ***treasury management strategy*** (TMS) for the 2023/24 financial year and builds on the previous report on this matter, which was considered by the Audit Committee at its meeting in November 2022.

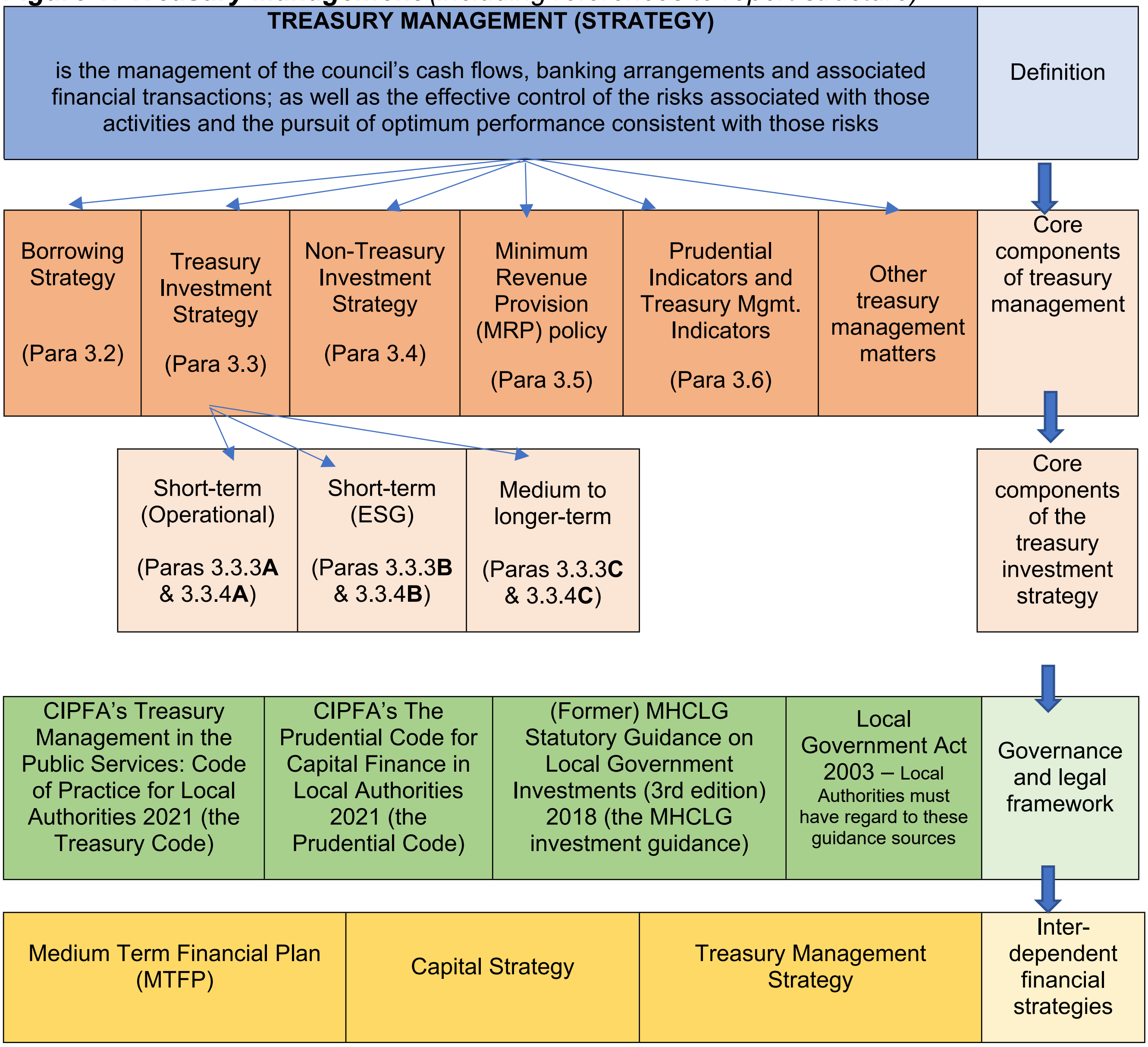
The report contains details of;
- how the council plans to manage its cash-flows and resources in the year ahead to ensure effective treasury management,
- the proposed Prudential & Treasury Indicators for 2023/24, and
- the proposed policy for making Minimum Revenue Provision in respect of the repayment of the council's external debt, within the revenue budget.

2. POLICY

The council's budget process should ensure that all resources are planned, aligned, and managed effectively to achieve the corporate aims and objectives of the council. The council's treasury related strategies link directly into the revenue and capital budget planning processes and all aim to support effective service delivery across the council, in this year, as well as across the medium term.

Treasury management, its definition, constituent parts and its relationships with other policies and regulation is depicted in Figure 1 below.

Figure 1: Treasury Management *(including references to report structure)*



Each of the core components of treasury management, as noted above, are summarised in **Section 3** with further technical detail provided within the Treasury Management Strategy in **Appendix 1**.

3. DETAILS

3.1 Introduction and background

The council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is therefore to ensure that this cash flow is adequately planned, with cash being available when it is needed. Much of the day-to-day **treasury** activity is linked to investing surplus monies in low-risk counterparties or instruments commensurate with the councils' low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the council's capital plans. These capital plans provide a guide to the borrowing need of the council, essentially the longer-term cash flow planning, to ensure that the council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet council risk or cost objectives, subject to it being appropriate and affordable having considered premature redemption costs.

The contribution the **treasury management** function makes to the council is therefore critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

As expected, given the nature of the transactions undertaken in this area, together with the significant amount and types of risk involved, treasury management is heavily regulated both in terms of legal statute, technical investment guidance provided by government departments as well as Codes of Practice issued by the Chartered Institute of Public Finance and Accountancy (CIPFA). The council is required to adhere to and give due regard, to all these relevant frameworks.

CIPFA defines treasury management as "the management of the local authority's borrowing, 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." This definition not only describes the various elements of treasury management activity, it also demonstrates how interlinked they are with other, which can make it difficult to explain the council's technical and strategic plans for the year ahead, in a way that can be easily understood.

The report has therefore been drafted to summarise the council's proposed approach for the 2023/24 financial within each of the following sections, with further detail contained within the appendices at the end of the paper.

- **Borrowing strategy** – paragraph 3.2
  To support the council's capital spending plans

- **Treasury investment** strategy – paragraph 3.3
  A) To support the daily operations of council services

B) To ensure that the council is a responsible investor *** new for 2023/24**
C) To manage longer-term cash-flows and generate financial returns to support the annual revenue budget

- **Non-treasury investment** strategy – paragraph 3.4
  To support place-making ambitions across the district and to support the annual revenue budget

- Minimum revenue provision policy – paragraph 3.5
- Prudential indicators and treasury management indicators 3.6

3.2 Borrowing Strategy

3.2.1. Background and local context:

In some instances, the council may find itself in a position whereby it may need to borrow short-term loans to cover unplanned cash flow shortages arising from operations. However, most of the council's borrowing activity is linked to its capital spending plans.

CIPFA's Prudential Code for Capital Finance in Local Government, requires the council to determine that all its capital expenditure and investment decisions are affordable, prudent, and sustainable, and it must ensure that it sets limits on the amount that it can afford to borrow in the context of wider capital planning.

To understand whether new borrowing plans can be deemed affordable, the council must first understand its current borrowing position and then overlay planned changes.

On 31st December 2022, the council held £177m of borrowing which it has drawn down over several years to fund previous capital expenditure.

- £140m of this debt is held with the Public Works Loan Board (PWLB) at an average rate of 3.87%
- £3m of this debt is held with Salix at an average rate of 0%
- £12m of this debt relates to debt managed by Bristol City Council, in respect of the former Avon County Council organisation
- £22m of this debt relates to long-term leasing arrangements, the largest of which relates to the Sovereign Centre

The prudential indicators associated with the council's long-term borrowing position (as noted in the report to Audit Committee in November 2022) show that existing loans are sustainable and affordable which is a reliable platform to move forward from.

The 2023/24 capital strategy is currently being developed although will not be complete in time for the Audit Committee report, that being said an update was provided within the latest report on the Medium Term Financial Plan to indicate that new borrowing to finance capital spending over the short-term would be scaled back to ensure that the consequential impact on the revenue budget would fall within approved levels.

The TM report to the Executive in February will therefore include the actual level of new borrowing to support the capital plans, although this is not expected to be of a significant scale. The borrowing strategy noted below is therefore the most likely approach that the council will take although may be subject to slight change depending on the final capital strategy proposals.

3.2.2. Summary of current position:

The council currently holds £177m of long-term debt. Given the level of surplus cash-balances currently being held then the financial plan shows that the council does not anticipate a need to externalise any new borrowing that is planned for 2023/24.

3.2.3. Objectives:

The council's main objectives when borrowing will be to achieve a low but certain cost of finance, while retaining flexibility should plans change in future.

3.2.4. Proposed Strategy for 2023/24:

The Strategy for 2023/24 remains largely unchanged in that 'external' borrowing decisions will be deferred in respect of the 2023/24 financial year and the focus would instead be to draw-down and access the council's internal borrowing through reducing cash balances.

3.2.5. Borrowing strategy beyond 2023/24:

Given the levels of planned investment the council recognises that it may be required to borrow externally over the period 2024-2026 however, before any future borrowing is considered, officers would seek advice from the council's treasury management advisors in relation to the potential costs of different options and to ensure an option proposal aligned to the objectives.

Whilst the council has previously raised most of its long-term borrowing from the PWLB it will consider long-term loans from other sources in the future, including banks, pension funds, and other local authorities, and will investigate the possibility of issuing bonds and similar instruments, to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code. An important change for local authorities to note is that they are no longer able to draw down loans from the PWLB if any of their capital spending plans relate to buying investment assets primarily for yield. Given that the council does not intend to borrow for yield, then it is likely that we will retain access to PWLB loans if needed.

3.3 Treasury investment strategy

3.3.1. Background and local context

Given that the primary purpose of treasury management is linked to the management of day-to-day cash-flows, then it must be accepted that the council will make investment decisions on an almost daily basis to smooth cash-flows and ensure that cash is planned and available when needed. These decisions and transactions are known as **treasury investments** and sums are often placed in short-term, low risk, highly liquid products which is commensurate with the council's low-risk appetite.

In addition to the daily cash-flows that are related to the annual budget, at any one time the council's balance sheet will show that it is also holding surplus cash-flows in respect of prior year activities, examples include the receipt of capital grants in advance of spending plans and the retention of monies within reserves, which may be held to fund future spending or be held to manage risk. It is necessary for these funds to also be placed in treasury investments during the year however, it is possible that some of these investments could be placed in a more strategic way that is more aligned to the nature and timescale of the relevant cash-flow, i.e. investments could be made across a longer-period of time if it is understood that the monies may not be required for a specific period of time.

Irrespective of whether the treasury related investment is placed for a short or a longer period, it is essential that **all** such investments are placed in accordance with the both the legal framework as well as the council's approach to risk and defined objectives.

Before considering its Strategy for treasury investments for the year ahead it is therefore important to firstly understand the following, some of which are described in more detail throughout the report and the appendices;

- the current level of investment balances held and performance,
- current regulatory framework and future changes,
- annual cash-flow forecasts for the year ahead,
- planned profile of spending linked to capital receipts, grants, and reserves,
- new investment plans,
- market conditions, interest rates and future expectations,
- Environmental, Social and Governance (ESG) related considerations, and
- any other strategic decisions that may have been taken elsewhere within the council's treasury management strategy (i.e., borrowing strategy, approach to risk, required asset allocations, choice of assets)

3.3.2. Summary of current position:

In the past 12 months, the council's treasury investment balance has ranged between £154m and £191m which is comparable to the level in the previous 12 months. A review has been undertaken which show that this is, to a large extent, linked to legacy issues relating to Covid-19 and more recently the cost of living pressures, notably surrounding the cash flows related to the many support packages and intervention measures that the government continues to put place. The ability of the council to lever in external funding for large capital projects also reduces the need to draw down on the council's core cash-flows. Forecasts do indicate that these levels are expected to reduce by 31 March 2023 as sums are paid to businesses, providers and potentially returned to the government.

The majority of the council investments are held as short-term, with the duration being less than 1 year; £10m is held as long-term investments as the investments were placed several years ago for strategic purposes.

Arlingclose facilitate regular benchmarking programs to assess how the council's treasury management investment decisions and outcomes compare with other local authorities. Recent results show that the council's investment portfolio is not considered high risk, and, whilst investment returns have increased due to the current economic environment, the portfolio is providing returns in line with the risks being taken. This supports the council's approach in recent years whereby it has chosen to place funds prudently to protect monies and reduce exposure to risk.

Market conditions currently show that interest rates are continuing to increase, driven by the recent bank of England base rate rises, which means that it will be important to consider the ongoing impact of interest rates on future treasury investment related decisions. The council's Medium Term Financial Plan assumes that £850,000 of additional income will be generated from higher returns during 2023/24.

The '*borrowing strategy*' described in para 3.2.4 above recommends that external borrowing is not taken, but spending will instead be offset against current surplus cash balances, i.e., it will be funded internally. This will mean that lower levels of surplus cash balances may be available during 2023/24.

3.3.3. Objectives: i.e. what we would like to happen

The council's previous investment strategy had two core objectives, one focused upon the management of short-term funds and the other on longer-term investments however, following a change in CIPFA code of practice which requires councils to include specific reporting ESG related investments outcomes, the council is expanding its objectives in relation to setting **treasury investment** objectives for the year ahead.

The objectives for 2023/24 will be categorised and cover the following areas;

A) Continued support of daily operational activity of the council as a whole to support business as usual activity ensuring compliance with current external regulation and internal guidance.

The council must ensure that its' treasury investments support the management of core cash-flows on a daily basis so that services can continue to be delivered to residents and this is achieved through the management of short-term cash deposit type investments.

There is currently a robust governance framework in place to cover these activities with approval levels and institutions clearly defined within the approved strategy and this is supported by routine reporting to the Audit Committee.

In terms of treasury related objectives, both the CIPFA Code and the MHCLG Guidance require councils to have underlying objectives supporting investment, with two of these being;

- Security – protecting the capital sum invested from loss; and
- Liquidity – ensuring the funds invested are available for expenditure when needed

The generation of yield is distinct from these two prudential objectives although guidance says that this <u>does not</u> mean that local authorities are recommended to ignore potential revenues but, recognises that it would be reasonable to consider what yield could be obtained, consistent with these priorities once proper levels of security and liquidity are determined, as well as the council's own appetite to risk.

B) For the council to pay regard to recent changes in investment guidance and to become a 'responsible investor' through the development of a **proposed new strand** of its treasury investment strategy which actively considers environmental, social and governance (ESG) principles when investing in the short-term. ESG policies involve central factors in measuring the sustainability and ethical impact of an investment within an organisation or sector.

ESG considerations are increasingly becoming an important factor in global investors' decision making, but the framework for evaluating investment opportunities is still developing and therefore the council's own approach to ESG investments is also currently limited and does not reflect ESG scoring or other real-time ESG criteria at an individual investment level.

It is proposed that the council supports progress in this area by approving a commitment to become a responsible investor and more specifically, that part of its short-term treasury investment activity (up to £6m) should be centred on delivering ESG outcomes.

C) Management of medium to longer-term investments – the council previously made a series of decisions following the identification of funds that were unlikely to be called upon in the short-term, to place these in a longer-term type investment.

The types of investments made, as well as the underlying objectives for these investments, often differ from the day-to-day short-term deposits. Whilst they still follow the CIPFA Code and the MHCLG Guidance in terms of security, the balance between liquidity and return become more blended. Previous decisions relating to these investments show that one of the core objectives was to bring a steady income stream into the councils' annual revenue budget. Whilst short-term interest rates can vary quite a lot over a relatively short period of time, some longer-term investments often provide a more stable annual return.

3.3.4. Treasury Investment Strategy for 2023/24: i.e. what we are planning to do to achieve the objectives for the year

Given the breath of different objectives and requirements within the overall treasury function it is not possible to summarise the council's investment strategy within a single paragraph and so efforts have been made to summarise the different strands of the investment strategy across the following;

A) **Short-term investments** covering **daily operations** - the council will continue to place the majority of its short-term treasury investments in fixed and variable-term cash deposits with a range of counter-parties, which are often described as traditional investments.

This Strategy would ensure liquidity is maintained to support the council's daily operational activities, it limits the council's exposure to interest rate risk losses, reduces the risk of capital losses as well as minimising exposure to credit risk through diversification of counter-parties and countries. These will be achieved through the application of limits on the amount and period of its investments with individual counterparties, and in individual countries.

B) **Short-term investments** focused on **ESG** outcomes – **new for 2023/24** - the council will consider options for investments of up to £6 million of short-term funds with institutions who ring-fence the use of such funds for ESG-related matters.

The framework, scope, governance and investment criteria will be developed through consultation with the Audit Committee and treasury advisers before the start of the financial year.

It is anticipated that the new investments will give due regard to the current credit ratings for security as they would need to remain in line with the wider council policy however, where appropriate and at the council's discretion, some flexibility will be provided to allow for slightly longer durations of investment and potentially lower returns to support the ESG focus. Any investment will be subject to new governance approvals, which will be developed alongside the new ESG policy and framework.

It is likely that when investing in banks and funds, the council would seek to prioritise banks that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the Net Zero Asset Managers Alliance and/or the UK Stewardship Code.

C) Longer term investments - the council will continue to monitor and assess the performance of its existing medium to longer-term investments to ensure that they continue to meet the required core objectives, which are largely in alternative investment products although has **<u>no plans</u>** to place any more funds in long-term investments during 2023/24.

This is largely because of the work that has been done to review the medium-term capital financing requirements of the council, linked to borrowing plans, which shows that a large proportion of medium-term funds will be required and would therefore not be available to be locked away.

This Strategy continues to recognise that the current level of longer-term cash balances are appropriately balanced over the period, and that these investments provide some diversification of the portfolio in terms of product, counter-party / credit risk and inflationary risk. Over recent years it has been seen that in a low interest rate environment these types of investment will often provide higher rates of return compared to traditional investments however, it must be accepted that they may also potentially provide a capital loss should prices fall beyond the initial investment levels. Any capital loss generated would need to be reflected within the council's annual revenue budget from April 2025, which is when the extended statutory override period expires.

3.3.5. Approved counterparties and limits:

The council may undertake treasury related investments of surplus funds with any of the counterparty types below, subject to the limits shown.

Table 3: Approved counterparties and limits

Sector	Overall Limit[1]	In-house Limit	Tradition Limit	Time Limit	Sector Limit
UK Central Government	**no limit**	unlimited	unlimited	50 years	no limit
UK Local Authorities[3]	**£15m**	£10m	£5m	25 years	no limit
Banks* and other organisations* (unsecured) whose lowest published long-term credit rating from Fitch, Moody's and Standard and Poor's is:					
AAA	**£30m**	£30m	£0m	5 years	no limit
AA+	**£25m**	£25m	£0m	5 years	no limit
AA	**£22m**	£22m	£0m	4 years	no limit
AA-	**£20m**	£16m	£4m	3 years	no limit
A+	**£18m**	£14m	£4m	2 years	no limit
A	**£16m**	£12m	£4m	13 months	no limit
A-	**£13m**	£9m	£4m	13 months	no limit
UK Building societies (unsecured) that have an asset size of more than £0.4bn*	**£10m**	£6m	£4m	13 months	£50m
Money market funds[2] and similar pooled vehicles whose lowest published credit rating is AAA*	**£15m**	£15m	£0m	N/A	no limit
Pooled Investment funds	**£5m per fund**	*£5m per fund*	£0m	N/A	£10m
ESG-focussed short term deposits	**£6m**	£6m	£0m	13 months	no limit
The Council's Bank accounts	**net £9m**	net £9m	£0m	no limit	no limit

[1] limits shown are per organisation
[2] as defined in the Local Authorities (Capital Finance and Accounting) Regulations 2003
[3] as defined in the Local Government Act 2003
**There is no intention to restrict investments to banks and building society deposits, and investments may be made with any public or private sector organisation that meets the credit rating criteria above.*

This table must be read in conjunction with the notes and details in **Appendix 1**

3.3.6. Investment limits:

The maximum that could be lent to any one organisation (other than the UK Government) will therefore **be £30m**. This will limit the potential loss in the case of a single financial institution. It should be noted that a group of banks under the same ownership will be treated as a single organisation for limit purposes.

3.3.7. Minimum credit rating:

Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than [A-]. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be considered.

3.4 Non-treasury investment strategy

Non-treasury investments often include purchases which are deemed to be capital expenditure in nature, whether that be the purchase of financial assets, such as share capital in any body corporate or non-financial assets, such as the purchase of land or buildings.

To date, the council has not purchased share capital as this would provide potential exposure and further risk in terms of capital losses, which goes against the legal and regulatory framework in place for treasury related investments.

The council does however have non-treasury investments in the form of property through the commercial investment portfolio. The commercial strategy was approved by Council in January 2019, following professional advice provided by Montagu Evans. The strategy established a framework under which the council could acquire a portfolio of investments in commercial property which generate an income stream which can be used to contribute to the revenue budget pressures, whilst potentially providing capital appreciation over the longer-term.

Under this arrangement two assets have been acquired and the arrangements for the governance and management of associated risks of the council's service investments and commercial property investments is detailed in Section 5 of the Treasury Management Strategy shown at **Appendix 1**.

<u>No further</u> commercial investments are being sought as this would be prohibited under the new borrowing permissions, which do not allow councils to borrow to generate a yield. There are no proposed changes to this area of the strategy for 2023/24.

3.5 Minimum Revenue Provision Statement

When the council funds capital expenditure by long-term borrowing, the costs are charged to the council tax-payer in future years, reflecting the long-term use of the assets procured. There are two elements to this cost – the interest on borrowing is charged in the year it is payable, and the principal (or capital) element is charged as a "minimum revenue provision" (MRP).

The Local Government Act 2003 requires the council to have regard to the former Ministry for Housing, Communities and Local Government's guidance on Minimum Revenue Provision (the MHCLG Guidance), most recently issued in 2018.

The broad aim of the MHCLG Guidance is to ensure that capital expenditure is financed 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 MHCLG Guidance requires the council to approve an Annual MRP Statement each year, and recommends several options for calculating a prudent amount of MRP. The council's policy adopts options recommended in the Guidance, as well as locally determined prudent judgements in applying the recommended methodologies.

It is recommended that the council continues to apply the following policy to determine its MRP for 2023/24:

a. For capital expenditure incurred before 1st April 2008, the MRP for 'Supported borrowing' will be determined by writing down the Council's Capital Financing Requirement using a 'straight line' basis over the estimated average life of the relevant assets of 33 years. This approach results in the council charging the same value each year for this element of the MRP.

b. For capital expenditure incurred after 31st March 2008, the MRP for 'Prudential borrowing' will be determined by charging the expenditure over the expected useful life of the relevant asset, starting in the year after the asset becomes operational.

c. For assets acquired by finance leases, and for the transferred debt from Avon County Council, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.

d. Where former operating leases have been brought onto the balance sheet on 1st April 2023 due to the adoption of the IFRS 16 Leases accounting standard, and the asset values have been adjusted for accruals, prepayments, premiums and/or discounts, then the annual MRP charges will be adjusted so that the total charge to revenue remains unaffected by the new standard.

e. Capital expenditure incurred during 2023/24 will not be subject to an MRP charge until 2024/25.

The 2023/24 capital strategy is being developed but will not be complete in time for this report. The TM report to the Executive in February will therefore include confirmation that MRP associated with the capital spending approvals has been included within the budget for 2023/24 and the planned spending for 2023/24 has been factored into the council's medium term financial plan for 2024/25.

3.6 Prudential Indicators

Under the Local Government Act 2003, and the associated CIPFA Prudential Code for Capital Finance in Local Authorities, 'Prudential Indicators' relating to the revenue implications of capital programme decisions need to be approved by members and considered when setting the revenue and capital budgets.

The 2023/24 capital strategy is being developed but will not be complete in time for this report. The TM report to the Executive in February will therefore include the prudential indicators although the Treasury Management and investment indicators are included in this report, at Appendix 2.

The CIPFA Treasury Management Code of Practice also requires locally decided indicators relating to treasury activities to be approved. These indicators provide information to Members on the affordability of the council's borrowing plans, and whether the impact of treasury management actions on the council's revenue budget are sustainable. The indicators are detailed in **Appendix 2**.

4. CONSULTATION

The Audit Committee has a key role to play in reviewing the council's treasury management arrangements and practices, and they routinely receive performance monitoring reports on the subject covering both prior and current years, as well as reports which provide an opportunity for discussion to take place to consider the proposed strategy for the year ahead. The latest reports were considered by the Committee in November 2022 and a further report will be considered at the meeting in January 2023.

Over recent years Member training and workshops have been provided to support understanding of technical matters, with the latest session held being in January 2022. The timing of the session enabled further opportunities to consider the proposed Strategy for 2022/23. It is proposed that a further workshop session will be held during March 2023 to enable work to start of the development of the council's ESG investment policy.

Previous meetings were facilitated by Arlingclose, the council's external advisors and featured information relating to the legal framework, the definitions and differences between capital and treasury investments and impacts, the types of investments available to the council and how these might fit in with the council's borrowing plans, as well as further information to understand the more strategic factors which are likely to influence treasury strategy decisions of a council. It is proposed that they also attend future sessions.

5. FINANCIAL IMPLICATIONS

Financial implications are contained throughout the report. Treasury management decisions impact on both the revenue budget and the balance sheet in current and future years.

6. LEGAL POWERS AND IMPLICATIONS

Under the Local Government Act 2003 s1, and s12, local authorities may:

- invest money or borrow money:
- for any purpose relevant to their functions
- for prudent financial management

Under Local Government Act 2003 s2, and s13, local authorities must not:

- exceed their affordable borrowing limit
- borrow in foreign currency
- mortgage their property as security for loans borrowed

Under Local Government Act 2003 s3, s14, and s15, local authorities must:

- set and review affordable borrowing limits / authorised limits
- have regard to guidance published by CLG and CIPFA
    - CLG Investment Guidance
    - CIPFA Code of Practice on Treasury Management
    - CIPFA Prudential Code

The council has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 Edition (the CIPFA Code) which requires it to approve a treasury management strategy before the start of each financial year.

Under this guidance, the role of the (Full) Council is to:

- Set the budget and capital programme, including debt and investment interest, and the Minimum Revenue Provision
- Approve the Capital Strategy

- Approve the Treasury Management Strategy (which includes the (Non-Treasury) Investment Strategy)
- Approve the Prudential Indicators
- Approve Treasury Management Indicators
- Approve the MRP policy statement

Under the Local Authorities (Functions and Responsibilities) (England) Regulations 2000, local authorities must not delegate the approval of an annual strategy to any committee or person.

The role of the Executive is to consider these strategies, and, if appropriate, recommend them for approval by Council.

Treasury risk management at the council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2021 Edition (the CIPFA Code) which requires the Council to approve a treasury management 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 the CIPFA Code.

7. CLIMATE CHANGE AND ENVIRONMENTAL IMPLICATIONS

Over recent years the council has made concerted efforts to better understand the extent to which its overarching treasury management strategy has or may have on climate change and other environmental implications. This has been a challenge because many of the decisions relating to either borrowing or investments will have few direct impacts although there could be many indirect impacts though the ongoing actions or decisions of other organisations.

For example, when the council places a short-term fixed cash deposit type investment with either a bank, building society or another local authority, then its contractual arrangement is linked to the terms of that trade deal (e.g. value, maturity date, interest rate etc). The details relate to the temporary exchange of the cash sum and there are no other restrictions about what will happen with money. The counter-party 'could' then choose to invest it into something that is not supported by the council.

Until recently the council recognises that it has had limited choice or options in this area however, some degree of change is expected to happen following the emergence of Environmental, Social and Governance (ESG) policies. This is where organisations are choosing to bring other considerations into their treasury strategies and decision-making processes and also introduce new investment products or services to the market.

The council welcomes the introduction of ESG policies and hopes that they will provide a broader range of opportunities that can be considered within future investment decisions, particularly those that will deliver positive outcomes for climate change and the environment more generally.

It is therefore proposed that Council will include a specific recommendation within its treasury management strategy for 2023/24, which will enable the S151 Officer to develop a framework for up to £6m of ESG related investments through consultation with the members of the Audit Committee and also the council's treasury management advisors Arlingclose.

The development of the ESG investment policy will not detract from the core functions that need to take place within the existing treasury management strategy, i.e. the management of cash-flows and also meeting the requirements within the approved revenue budget, but it will provide an opportunity to ensure that climate and other environmental implications are considered and reported on.

When developed, the council's new ESG investment policy must still be compliant with the external and internal regulatory framework and would therefore continue to give focus to security and liquidity, then yield.

To support this aim, the council requested that Arlingclose provide an ESG report focused on the ESG-related developments and information available, particularly those that relate to the council's cash, money market funds, and strategic pooled fund investments. Appendix 1 has been updated to include a section considering potential ESG treasury investment options for the council which will provide an initial area of focus for the Audit Committee to work on.

Until the new policy is fully developed and implemented the council will continue to;

- avoid any <u>direct</u> treasury management investments in fossil fuel related companies;

- engage with advisors to explore and assess the potential for any future investment opportunities in funds with a Renewable Energy & Sustainability focus;

- maintain funds placed in a "Green Deposit Account", which is an investment facility that ensures deposits are linked to a wide range of projects in the pursuit of transition to a lower carbon economy. These projects cover a variety of themes including energy efficiency renewable energy, green transport, sustainable food, agriculture and forestry and greenhouse gas emission reductions.

8. RISK MANAGEMENT

Members will be aware that there is a direct link between the levels of risk and the levels of return achieved on investment, although there are many other factors which also affect the capital financing budgets.

The council's treasury management activities expose it to a variety of financial risks, notably:

a. credit risk – the risk that other parties might fail to pay amounts due to the council. Includes bail-in risk – the risk that shareholders and depositors in banks and building societies bear losses in the event of counter-party's failure or reduction in net asset value,
b. liquidity and re-financing risk – the risk that the council might not have funds available to meet its commitments to make payments as they fall due,
c. market risk (interest rate and price risks) – the risk that financial loss might arise for the council because of changes in such measures as interest rates, investment valuations, and stock market movements.

The council's Treasury Management Strategy sets out the council's approach to managing these risks.

A summary of the risks relating to treasury management that the council is exposed to, and the mitigation arrangements in place through the Treasury Management Strategy, is detailed at **Appendix 3.**

The priority of the Treasury Management Strategy will continue to be the reduction of risk to safeguard public resources.

The risk appetite of the council is low to give priority to the security of its investments. The council will also aim to achieve the optimum return on its investments commensurate with desired levels of security and liquidity.

It should be noted that the council's Treasury Management Strategy sets out how the council manages and mitigates these risks but cannot eliminate risks completely.

9. EQUALITY IMPLICATIONS

Have you undertaken an Equality Impact Assessment? N/A

10. CORPORATE IMPLICATIONS

The safeguarding of public money is critical to the council's reputation, and the measures contained within the report are intended to address member and public concerns and ensure an appropriate balance of return on investment whilst ensuring managing associated risks.

11. OPTIONS CONSIDERED

This report has been developed alongside the Medium Term Financial Plan and revenue budget and also the Capital Strategy, which supports the capital programme, which means that decisions are fully integrated. It also sets out the council's expectation for interest rates and highlights the uncertainties and risks in the forecast due to market conditions.

The report considers those aspects of treasury policy that change annually or more frequently, highlighting the council's views or interpretation of factors that may influence treasury management decisions and proposes how these matters will be dealt with during 2023/24.

The CIPFA Code and MHCLG statutory guidance require the authority to set out its approach to non-treasury investments. A summary of the impact and the council's approach is included in **paragraph 3.2** of this report.

The council's Treasury Management Strategy is broadly consistent with the previous strategy and is developed from and complies with the council's Treasury Management Policy and takes account of the CIPFA code and MHCLG guidance referred to above. That being said, a new recommendation has been included with regards to making a commitment to become a responsible investor in the future.

AUTHOR:

Amy Webb, Director of Corporate Services
Amy.webb@n-somerset.gov.uk

Mark Anderson, Principal Accountant (Resources & Financial Planning)
Mark.Anderson@n-somerset.gov.uk

Melanie Watts, Head of Finance
Melanie.Watts@n-somerset.gov.uk

APPENDICES:

1. Treasury Management Strategy for 2023/24
2. Prudential Indicators for 2023/24
3. Treasury Risk Register
4. Considerations to support proposed framework for ESG related investments
5. Glossary of Terms

BACKGROUND PAPERS:

Treasury Management Strategy 2022/23

Other relevant guidance includes:

- CIPFA – The Prudential Code for Capital Finance in Local Authorities 2021
- MHCLG – Statutory Guidance on Local Government Investments (3rd edition) 2018
- CIPFA - Treasury Management in Public Services – Guidance notes for local authorities 2021

1 EXECUTIVE SUMMARY

Treasury management is the management of the council's cash flows, borrowing and investments, and the associated risks. The council has and will continue, to borrow and invest substantial sums of money and is therefore exposed to wide range of risks which could have material consequences, such as the loss of invested funds. The successful identification, monitoring and control measures in respect of financial risk are therefore central to the council's prudent financial management and operation within this area.

The council maintains an overarching treasury management 'strategy' which is supported by a range of individual policies which aim to describe some of the principles and practices to which the different areas of treasury related activity will comply.

It is important to note that this document contains a lot of detailed and sometimes technical information that will outline the risks and issues pertaining to the management of the council's cash-flows and ultimately inform any decisions that may be taken as a result.

Decisions that relate to this area are clearly significant however they are not undertaken in isolation but instead are driven by many factors and considerations, whether those be be external influences (such as guidance, regulation or market forces) as well as internal influences (such as other financial and operational strategies, council priorities or the approach to risk).

Given that an overarching strategy cannot document or describe all of those issues in detail, this document is not intended to be a prescriptive listing of all of the council's considerations or processes, the document will instead provide sufficient information to outline the council's approach and framework in core areas.

Alongside this policy, the council must have regard to the (former) Ministry for Communities and Local Government (MCLG) guidance (the MHCLG guidance), under section 15(1)(a) of the Local Government Act 2003. This guidance provides for each authority to determine its own controls within a given framework.

Any external investment managers employed by the council are required, contractually, to comply with this Strategy.

Given that the underlying regulatory framework supporting treasury management activities remains broadly unchanged from 2022/23, as have the council's Corporate Plan aims and objectives, it is not proposed to make significant changes to the Strategy for 2023/24 financial year.

One area of change will however be the council's decision to become known as a responsible investor which will involve developing an ESG focused investment policy for the future. Further details and supporting information are contained throughout the report and the strategy document.

2 STRATEGY OVERVIEW

Under the Local Government Act 2003, the council may invest money or borrow money:
- for any purpose relevant to its functions, and
- for prudent financial management.

The council could potentially invest its money for three broad purposes:
- Treasury management investments – i.e., management of operational cashflows. Investment of surplus cash balances generated as a result of its day-to-day activities, for example when income is received in advance of expenditure,
- Service investments - to support local public services by lending to, or buying shares in other organisations, and
- Non treasury related investments - to earn investment income, usually rental income, and to provide capital appreciation, from a portfolio of property investments.

The Strategy for 2023/24 in respect of the following aspects of the treasury management function is based upon the S151 Officers views on risks and interest rates, supplemented with advice provided by the council's treasury advisors, currently Arlingclose Ltd.

The strategy covers:
- Section 3 - current treasury portfolio
- Section 4 - the treasury investment strategy
- Section 5 - the non-treasury investment strategy
- Section 6 - the borrowing strategy
- Section 7 - interest rates and economic outlook
- Section 8 - other treasury management matters

3 CURRENT TREASURY PORTFOLIO

The Council's current treasury portfolio, as at 31st December 2022 is as follows:

Table 4: Current portfolio of borrowing and investment balances

LONG-TERM DEBT	**Principal £m**		**Average rate**	**Average term**
Fixed rate – PWLB & Salix	£143.2	£143.2	3.87%	1-36 years
Other long-term liabilities; - Ex-Avon loan debt - Other (incl leasing) *	 £11.3 £22.2	 £33.5	 4.75% 4.60%	 1-30 years 1-40 years
TOTAL DEBT		**£176.7m**		
SHORT-TERM TREASURY INVESTMENTS	**Principal £m**		**Average rate**	**Average term**
Managed in-house; - UK banks - UK building societies - Local authority/ DMO - Non-UK banks	 £6.0 £40.0 £73.0 £32.0	 £151.0	 2.27% 1.59% 2.11% 2.44%	 12 months 10 months 7 months 6 months
Cash managed by Tradition; - Building Society	 £10.0	 £10.0	 1.51%	 10 months
LONG-TERM TREASURY INVESTMENTS	**Principal £m**		**Average rate**	**Average term**
Managed in-house; - CCLA - UBS Multi Asset Income Fund - Ninety-One Diversified Income Fund	 £5.0 £1.0 £4.0	 £10.0	 4.52% 4.41% 3.39%	 3-5 years 3-5 years 3-5 years
TOTAL TREASURY INVESTMENTS		**£171.0m**		
TOTAL NET DEBT		**£5.7m**		

**The lease principal, rate, and term as at the previous year end (31st March 2022) - updated figures will be calculated at the end of the financial year.*

The maturity profile of the Council's PWLB borrowing and investments is as follows (excluding Avon loan debt and lease liabilities):

Table 5: maturity profile of the Council's PWLB borrowing and investments

MATURITY PROFILE	**PWLB LONG TERM DEBT £m**	**INVESTMENTS £m**	**NET DEBT / (INVESTMENT) £m**
Maturing Jan to March 2023	£6.4	£88.0	(£81.6)
Maturing 2023/24 & 2024/25	£8.3	£73.0	(£64.7)
Maturing 2025/26 to 2027/28	£22.4	£10.0	£12.4
Maturing 2028/29 to 2032/33	£31.1	£0	£31.1
Maturing 2033/34 to 2037/38	£33.0	£0	£33.0
Maturing 2038/39 to 2042/43	£22.0	£0	£22.0
Maturing after 2042/43	£20.0	£0	£20.0
TOTALS	**£143.2**	**£171.0**	**(£27.8)**

4 TREASURY INVESTMENT STRATEGY

3.7 The council typically receives its income in cash (e.g., from taxes and grants) before it pays for its expenditure in cash (e.g., through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local bodies and central government. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from CIPFA.

3.8 **Contribution:** The contribution that these investments make to the objectives of the council is to support effective treasury management activities.

3.9 **Objectives:** Both the CIPFA Code and the MHCLG Guidance require councils to invest their treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield.

3.10 **Strategy:** The council minimises its exposure to credit risk through diversification, through the application of limits on the amount and period of its investments with individual counterparties, and in individual countries.

3.11 The council's current investment strategy allows surplus cash balances to be managed by two treasury teams, each having distinct and separate controls and flexibilities. This allows the council to spread risk by investing in different financial products, and utilising experienced external cash managers, who do not have responsibilities for managing the council's daily cash-flows. The treasury teams are;

a. Tradition UK Ltd
b. In-house Treasury Team

3.12 **Approved counterparties:** The approved counterparties and notes are included in **Table 3** in the main body of the report. Further details on each of the permitted counterparties are included below.

3.13 The maximum duration of the investment will depend upon its lowest published long-term credit rating, time limits are included within the table.

3.14 Long-term investments will be limited to 50% of the counter-party limit (except the UK Government). The combined value of short-term and long-term investments with any organisation will not exceed the limits for investments in the table above.

3.15 **Government:** Loans to, and 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 generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Government are deemed to be zero credit risk due to its ability to create additional currency and therefore may be made in unlimited amounts for up to 50 years.

3.16 **Banks and building societies (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. See below for arrangements relating to operational bank accounts.

3.17 **Money market funds:** Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the council will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

3.18 **Strategic pooled funds:** Bond, equity and property funds that offer enhanced returns over the longer term but are more volatile in the short 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.

3.19 **ESG-focussed short term deposits:** Some banks and credit institutions now offer deposit accounts where the funds raised by the banks in these accounts are ring fenced to only be lent on for activities with an ESG focus. Such deposit accounts afford the same protections as other deposits with the bank hence allowing the council to support the ESG agenda whilst acting within the strict requirements for security and liquidity. As detailed in paragraph 4.45 below, the criteria governing the selection of ESG-focussed short-term deposits will be developed through consultation with the Audit Committee and treasury advisers.

3.20 Note: Any funds placed with an institution under this category will also count towards the overall limit for that individual counterparty under whichever sector limit it falls. For example, if £6m is placed with a bank on an ESG deposit, that £6m will also count towards the overall limit for that bank.

3.21 **Operational bank accounts:** The council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £9m per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the council maintaining operational continuity.

3.22 **Risk assessment and credit ratings**: One of the ways that the council manages credit risk is by using credit ratings.

3.23 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.

3.24 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.

3.25 Credit ratings are obtained and monitored by the council's treasury advisers on at least a monthly basis, who will notify changes in ratings as they occur.

3.26 **Other Information on the security of investments:** Full regard will 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, reports in the quality financial press and analysis and advice from the council's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

3.27 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, 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, or with other local authorities. This will cause investment returns to fall but will protect the principal sum invested.

3.28 Investment Limits

3.29 The council's revenue reserves that may be deemed as 'available' and could potentially be called up to cover investment losses should the need arise are forecast to be £52 million on 31st March 2023 and £40 million on 31st March 2024, although it should be noted that these are currently being held for other purposes are would not expect to be needed. In order that no more than 75% 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 £30 million. A group of entities under the same ownership will be treated as a single organisation for limit purposes.

3.30 Credit risk exposures arising from non-treasury investments, financial derivatives and balances in operational bank accounts count against the relevant investment limits.

3.31 Limits are also placed on fund managers and foreign countries as below. 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.

Table 6: Additional investment limits

	Cash limit
Any group of pooled funds under the same management	£15m per manager
Foreign countries	£12m per country (£8m in-house & £4m cash-manager)

3.32 Liquidity management

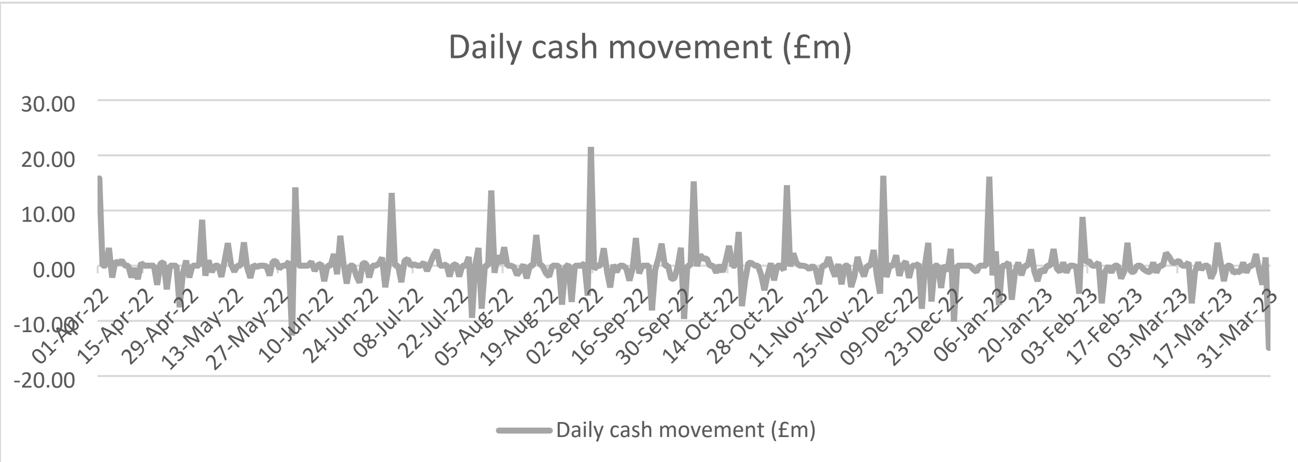
3.33 The council uses a series of control spreadsheets to monitor and forecast the council's cash flows, to determine the maximum period for which funds may prudently be committed, and to manage the council's exposure to liquidity and re-financing risks. The forecast is compiled on a prudent basis, with receipts under-estimated and payments over-estimated to minimise the risk of the council 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.

3.34 The council will spread its liquid cash amongst four providers (e.g., bank accounts and money market funds) to ensure that access to cash is maintained in the event of operational difficulties at any one provider.

3.35 The council has an agreed overdraft facility, and access to sources of cash such as borrowing from the PWLB, and other counterparties, such as banks and other local authorities. In addition, the council's investment holdings can be readily realised, if required.

3.36 Management of cash-flows

Table 7: Daily cash-flow movements can be seen in the table below.



3.37 Although the cash-flow movements could be described as fluctuating or potentially even volatile, trends do begin to emerge when the nature of the movements are understood, for example;

- Significant inflows include council tax and business rates income, government grants and subsidy used to support and fund parts of the annual revenue budget including schools, contributions from stakeholders in respect of funding agreements (e.g., health partners), grants and contributions used to fund capital projects. Some of these inflows follow a regular pattern, which may be weekly, bi-weekly, monthly, or quarterly and others do not, they simply arrive into the council's bank accounts.

- Significant outflows include monthly payments to staff, pension providers and government agencies, payments to suppliers 3 times each week covering both revenue and capital spending, payment of housing benefits, payments to major preceptors such as Fire, Police, Environment Agency, Town and Parish councils.

3.38 Over the past two years the council's cash-flows have been significantly impacted by government support packages for both Covid and more recently, the cost of living/ energy pressures, as it has received significant amounts of additional funding and support packages, both in relation to the council's own budget, as well as when it has been acting as an agent for the government by passporting monies onto individuals, suppliers, and businesses.

3.39 Whilst the new capital investment spending totals are anticipated for next year, the spending profiles associated with them have yet to be developed in any detail although it is estimated that less spending will be incurred during the first quarter of the year.

3.40 The intended borrowing strategy for 2023/24 recommends that external borrowing is not taken, but spending will instead be offset against current surplus cash balances, i.e., it will be funded internally, which means that cash-flow forecasts for next year will decrease from current levels.

3.41 Environmental Social and Governance investment approach

3.42 **The Climate Emergency:** In 2019 North Somerset Council declared a Climate emergency reflecting the concern that the council has over climate change, and the commitment of the council to address the issue with regards to evaluating the climate change impact of all our decisions. Actions available to be taken by the treasury management function are limited in scope due to the principles of Security, Liquidity and Yield, as set out in the CIPFA Treasury Management Code and MHCLG Investment Guidance, which remain at the heart of local authority treasury decisions and risk management.

3.43 **Background:** CIPFA Treasury Management Code 2021 includes the requirement that a council's credit and counterparty policies should set out its policy and practices relating to environmental, social and governance (ESG) investment considerations, although it is not implied that this policy will currently include ESG scoring or other real-time ESG criteria at individual investment level.

3.44 Until recently the council recognises that it has had limited choice or options in this area however, some degree of change is expected to happen following the emergence of ESG policies and the increased emphasis on ESG matters in the new Treasury Management Code referred to above. This is where organisations are choosing to bring other considerations into their treasury strategies and decision-making processes and also introduce new investment products or services to the market.

3.45 The council will develop a framework for ESG related investments through consultation with the Section 151 Officer, members of the Audit Committee and also the council's treasury management advisors Arlingclose. It is anticipated that the credit rating of security of such deposits would need to remain in line with the wider council policy however, where appropriate and at the council's discretion, some flexibility will be provided to allow for slightly longer durations of investment and potentially lower returns to support the ESG focus. Any investment will be subject to new governance approvals, which will be developed alongside the new ESG policy and framework.

3.46 **The proposed framework:** could consider the following

- the council's definitions of 'ESG' in relation to investments (remembering that there
- are no universally accepted definitions or metrics)
- the council's priorities and expected outcomes
- a realistic timeframe
- income expectations (many green funds rely on capital appreciation rather than income noting that regulations in England and Wales do not currently permit local authorities to take capital growth to revenue until the investment is sold)
- ESG approach (screening, the use of exclusions, a comprehensive ban or something more granular)
- the underlying assets of any externally managed pooled funds in the portfolio
- external fund managers' approach to ESG integration
- external fund managers approach to stewardship (ie active engagement with the investee companies to improve corporate responsibility and long term sustainability)
- governance and reporting framework including policy approval, monitoring, reporting and risk management.

3.47 Other considerations

3.48 One key theme of ESG investment is that there is now a focus on engagement with companies which are not necessarily environmentally focussed, hence it is less the types of company such a fund will invest in, as opposed to how the fund will use its influence to encourage more ESG focused behaviour. This is known as the engagement approach, which contrasts with the divestment approach that focusses on precluding investment in any company deemed to be weak in ESG matters.

3.49 As noted above, the CIPFA Code sets out a suggested framework for managing treasury management risk. Regarding investment activity, the Code primarily states that public sector organisations should focus on security and portfolio liquidity and seek value for money (minimise net debt costs) within their risk parameters. Most the council's treasury balances must be invested with highly secure institutions, where it is possible to withdraw funds at short notice and the risk of losses to the taxpayer are minimised as much as possible. To fulfil these criteria, the council is currently limited, as detailed in this strategy, to short term deposits with highly rated banks, building societies, money market funds and government institutions such as other local authorities.

3.50 The new Prudential Code also makes it difficult to enter into any new long term investments if the council has a borrowing requirement over the same period. The work that has been done to review the medium-term capital financing requirements of the council, linked to borrowing plans, shows that a large proportion of medium-term funds will be required and would therefore not be available to be locked away.

3.51 Arlingclose was requested to provide an ESG report focused on the ESG-related developments and information available as they relate to the council's cash, money market funds, and strategic pooled fund investments.

3.52 None of the council's current pooled funds are specifically designed as "ESG funds". Most funds, including those the council are already invested in, do engage on ESG concerns. "ESG funds" will have their own specific approach, which may include exclusion, or specific ESG criteria above and beyond engagement, amongst other things.

3.53 Arlingclose also provided an ESG "funds suite" which provides analysis on funds which have ESG, sustainability or responsible practices as an integral part of their objectives, in theory going beyond the integration of ESG risk analysis, which is a standard part of most funds. This may include funds which screen out certain sectors or look to provide environmental solutions or support social best practice or are 'impact' funds.

3.54 Please note that not all pooled funds, ESG or otherwise, are suitable for local authorities. Funds may be defined as capital expenditure by regulations, requiring an annual charge for minimum revenue provision that may exceed investment returns. Some ESG funds pay little or no income and principally aim for capital growth, but regulations in England and Wales do not currently permit local authorities to take capital growth to revenue until the investment is sold. The asset classes being invested in may not meet authorities' risk appetite or investment horizon.

3.55 **Approach to ESG Treasury investment**

3.56 Until the new policy is fully developed and implemented the council will continue to;

- avoid any <u>direct</u> treasury management investments in fossil fuel related companies;
- engage with advisors to explore and assess the potential for any future investment opportunities in funds with a Renewable Energy & Sustainability focus;
- maintain funds placed in a "Green Deposit Account", which is an investment facility that ensures deposits are linked to a wide range of projects in the pursuit of transition to a lower carbon economy. These projects cover a variety of themes including energy efficiency renewable energy, green transport, sustainable food, agriculture and forestry and greenhouse gas emission reductions.

3.57 When investing in banks and funds, it is likely the council will seek to prioritise banks that are signatories to the UN Principles for Responsible Banking and funds operated by managers that are signatories to the UN Principles for Responsible Investment, the Net Zero Asset Managers Alliance and/or the UK Stewardship Code.

3.58 Direct involvement and financing of green energy projects is treated as capital expenditure, and as such is not covered within the remit of treasury management.

5 NON-TREASURY INVESTMENT STRATEGY

3.59 This non-treasury management investment strategy focuses on the council's service investments and commercial property investments.

3.60 Service investments: Loans

3.61 Loans to social enterprises and local businesses may potentially be considered where they contribute to the council's overall objectives, through inclusion in the MTFP, treasury management and capital strategies. Where investment in regeneration and infrastructure in North Somerset clearly support local public services, and stimulate local economic growth, financing may also potentially be considered on projects that offer adequate security and returns, subject to the council having sufficient resources available to it at that time.

3.62 The only loan approved to date is an amount of £0.9m lent to a care home provider in 2008. The care provider has subsequently made repayments (including interest) in line with its agreed schedule. The outstanding balance at the time of writing is £0.8m.

3.63 Commercial investments: Property

3.64 The council's Commercial Investment Strategy was approved by Council in January 2019. In line with this strategy, the council has made two investments in commercial property to earn investment income, through a combination of rental and car parking income, whilst potentially providing capital appreciation over the long-term.

3.65 The investments made under the strategy to date consist of one outright purchase funded from long term borrowing, the North Worle District Centre, and one property acquired under a finance lease, the Sovereign Centre in Weston-super-Mare. Other sums have been set aside for improvements to the Sovereign Centre. There were no purchases or sale of assets during the year.

3.66 In February 2021 the Executive approved a revised Sovereign Centre Business Plan, setting out the challenges, opportunities, and a new vision for the property. As part of this Business Plan, some of the vacant retail space within the centre is to be converted into office space to diversify away from pure retail use. Funding for this investment will come from the Getting Building Fund, which is a government grant with the regional allocation administered by the West of England Combined Authority (Weca).

3.67 After servicing costs, fees and borrowing costs, and contributions into the smoothing reserve, these assets are budgeted to generate an annual net return to the revenue budget of £0.0m (2022/23 £0.0m).

3.68 Commercial property investments are likely to be less liquid than financial investments, as property may take time to sell in certain market conditions. The council's commercial property investments are considered sufficiently proportionate to its overall investment and borrowing balances to not be likely to significantly impact on the council's overall liquidity position.

3.69 The council has no plans to dispose of its commercial investment properties currently.

6 BORROWING STRATEGY

3.70 Local context

3.71 Forecast changes to the capital financing requirement and borrowing forecasts are shown in the balance sheet analysis in the table below. The 2023/24 capital strategy is being developed but will not be complete in time for this report. The TM report to the Executive in February will therefore include the capital financing requirement compared to forecast borrowing table and commentary as well as implications from the capital strategy on the council's borrowing requirement.

3.72 **Sources of borrowing:** the approved sources of long-term and short-term borrowing are:

a) HM Treasury's PWLB lending facility (formerly the Public Works Loan Board)
b) Other Local Authorities and Pension Funds (except the Avon Pension Fund)
c) UK Municipal Bond Agency plc and other special purpose companies created to enable local authority bond issues
d) Funds administered by the West of England Combined Authority including
   i) Revolving Infrastructure Fund
   ii) Local Growth Fund
   iii) Economic Development Fund
e) any institution approved for investments (see above)
f) any other bank or building society on the Financial Services Authority list

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

a) leases
b) private finance initiative schemes
c) sale and leaseback
d) revolving infrastructure grants

3.74 The council's debt portfolio is managed to ensure that the maturity profile will not leave any one future year with a high level of repayments that could present difficulties in refinancing. Fixed rate loans are usually taken to lock into known interest rates, thus protecting against fluctuations and providing certainty when managing and setting the budget.

3.75 Whilst the above deals with past or present borrowing requirements, it is also possible to borrow in advance of need where there is a clear business case for doing so and only for the approved capital programme or to finance future debt maturities, as permitted by the guidance. Borrowing in advance of need introduces additional credit and interest risk. Whilst there is no present intention to borrow in advance, all risks will be considered as part of any borrowing decision, should conditions favour such action.

3.76 Furthermore, 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. The council 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 cost saving or a reduction in risk.

7 INTEREST RATES AND ECONOMIC OUTLOOK

3.77 **Economic background:** The ongoing impact on the UK from the war in Ukraine, together with higher inflation, higher interest rates, uncertain government policy, and a deteriorating economic outlook, will be major influences on the council's treasury management strategy for 2023/24.

3.78 The Bank of England (BoE) increased Bank Rate by 0.5% to 3.5% in December 2022. This followed a 0.75% rise in November which was the largest single rate hike since 1989 and the ninth successive rise since December 2021. The December decision was voted for by a 6 3 majority of the Monetary Policy Committee (MPC), with two dissenters voting for a no-change at 3% and one for a larger rise of 0.75%.

3.79 The November quarterly Monetary Policy Report (MPR) forecast a prolonged but shallow recession in the UK with CPI inflation remaining elevated at over 10% in the near-term. While the projected peak of inflation is lower than in the August report, due in part to the government's support package for household energy costs, inflation is expected remain higher for longer over the forecast horizon and the economic outlook remains weak, with unemployment projected to start rising.

3.80 The UK economy contracted by 0.3% between July and September 2022 according to the Office for National Statistics, and the BoE forecasts Gross Domestic Product (GDP) will decline 0.75% in the second half of the calendar year due to the squeeze on household income from higher energy costs and goods prices. Growth is then expected to continue to fall throughout 2023 and the first half of 2024.

3.81 CPI inflation is expected to have peaked at around 11% in the last calendar quarter of 2022 and then fall sharply to 1.4%, below the 2% target, in two years' time and to 0% in three years' time if Bank Rate follows the path implied by financial markets at the time of the November MPR (a peak of 5.25%). However, the BoE stated it considered this path to be too high, suggesting that the peak in interest rates will be lower, reducing the risk of inflation falling too far below target. Market rates have fallen since the time of the November MPR.

3.82 The labour market remains tight for now, with the most recent statistics showing the unemployment rate was 3.7%. Earnings were up strongly in nominal terms by 6.1% for both total pay and for regular pay but factoring in inflation means real pay for both measures was -2.7%. Looking forward, the November MPR shows the labour market weakening in response to the deteriorating outlook for growth, leading to the unemployment rate rising to around 6.5% in 2025.

3.83 Interest rates have also been rising sharply in the US, with the Federal Reserve increasing the range on its key interest rate by 0.5% in December 2022 to 4.25%-4.5%. This rise follows four successive 0.75% rises in a pace of tightening that has seen rates increase from 0.25%-0.50% in March 2022. Annual inflation has been slowing in the US but remains above 7%. GDP grew at an annualised rate of 3.2% (revised up from 2.9%) between July and September 2022, but with official interest rates expected to rise even further in the coming months, a recession in the region is widely expected at some point during 2023.

3.84 Inflation rose consistently in the Euro Zone since the start of the year, hitting a peak annual rate of 10.6% in October 2022, before declining to 10.1% in November. Economic growth has been weakening with an upwardly revised expansion of 0.3% (from 0.2%) in the three months to September 2022. As with the UK and US, the European Central Bank has been on an interest rate tightening cycle, pushing up its three key interest rates by 0.50% in December, following two consecutive 0.75% rises, taking its main refinancing rate to 2.5% and deposit facility rate to 2.0%.

3.85 **Credit outlook:** Credit default swap (CDS) prices have generally followed an upward trend throughout 2022, indicating higher credit risk. They have been boosted by the war in Ukraine, increasing economic and political uncertainty and a weaker global and UK outlook, but remain well below the levels seen at the beginning of the Covid-19 pandemic.

3.86 CDS price volatility was higher in 2022 compared to 2021 and the divergence in prices between ringfenced (retail) and non-ringfenced (investment) banking entities has emerged once again.

3.87 The weakening economic picture during 2022 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several local authorities and financial institutions, revising them from to negative from stable.

3.88 There are competing tensions in the banking sector which could impact bank balance sheet strength going forward. The weakening economic outlook and likely recessions in many regions increase the possibility of a deterioration in the quality of banks' assets, while higher interest rates provide a boost to net income and profitability.

3.89 However, the institutions on our adviser Arlingclose's counterparty list remain well-capitalised and their counterparty advice on both recommended institutions and maximum duration remain under constant review and will continue to reflect economic conditions and the credit outlook.

3.90 **Interest rate forecast:** The council's treasury management adviser Arlingclose forecasts that Bank Rate will continue to rise in 2022 and 2023 as the Bank of England attempts to subdue inflation which is significantly above its 2% target.

3.91 While interest rate expectations reduced during October and November 2022, multiple interest rate rises are still expected over the forecast horizon despite looming recession. Arlingclose expects Bank Rate to rise to 4.25% by June 2023 under its central case, with the risks in the near- and medium-term to the upside should inflation not evolve as the Bank forecasts and remains persistently higher.

3.92 Yields are expected to remain broadly at current levels over the medium-term, with 5-, 10- and 20-year gilt yields expected to average around 3.5%, 3.5%, and 3.85% respectively over the 3-year period to December 2025. The risks for short, medium and longer-term yields are judged to be broadly balanced over the forecast horizon. As ever, there will undoubtedly be short-term volatility due to economic and political uncertainty and events.

3.93 For the purpose of setting the budget, it has been assumed that new short-term treasury investments will be made at an average rate/yield of 4.25%. No new long-term borrowing will be undertaken, which means that interest payments will not be required, although MRP will be a factor.

8 OTHER TREASURY MANAGEMENT MATTERS

3.94 The CIPFA Code requires the council to include the following in its treasury management strategy:

3.95 **Financial Derivatives**: Councils may make 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).

3.96 In line with the CIPFA Code, the council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications. The council has no plans to make use of financial derivatives in 2023/24.

3.97 **Markets in Financial Instruments Directive:** The council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers, and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the council's treasury management activities, the Section 151 Officer believes this to be the most appropriate status.

1.1 INTRODUCTION

Having adopted both the CIPFA Treasury Management in the Public Services Code of Practice, and the Prudential Code for Capital Finance in Local Authorities, the council is required follow the elements within the Guidance and set 'indicators' which demonstrate that it follows good practice and has implemented and operates within appropriate systems of control before making capital financing and treasury management decisions.

1.2 PRUDENTIAL INDICATORS 'PRUDENTIAL CODE':

The 2023/24 capital strategy is being developed but will not be complete in time for this report. The TM report to the Executive in February will therefore include the prudential indicators. The Treasury Management and investment indicators are included in this report below.

1.3 TREASURY MANAGEMENT INDICATORS: 'TREASURY CODE'

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

1.3.1 Security: Credit risk indicator

The council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score 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.

Table 1.3.1: Credit risk indicator:

Credit risk indicator	**Target**
Portfolio average credit score	6.1

1.3.2 Interest rate exposures

This indicator is set to control the council's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Table 1.3.2: Interest rate risk indicator:

Interest rate risk indicator	**Limit (£m)**
Upper limit on one-year revenue impact of a 1% rise in interest rates	1.0
Upper limit on one-year revenue impact of a 1% fall in interest rates	1.0

The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at new market rates.

1.3.3 Maturity structure of borrowing

Refinancing risk is the risk that a borrower cannot refinance by borrowing to repay existing debt. To address this risk, limits are set of the proportions of the council's borrowing which are due to fall due in specified periods.

Table 1.3.3: Upper & lower limits on borrowing maturities, as a % of total borrowing:

Maturity Structure of Borrowing	Upper	Lower
Under 12 months	50%	0%
12 months and within 24 months	30%	0%
24 months and within five years	40%	0%
5 years and within 10 years	50%	0%
10 years and above	100%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

1.3.4 Long-term treasury management investments

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 prudential limits on the long-term treasury management investments will be:

Table 1.3.4: Long term treasury management investments in £ millions:

Price risk indicator	2023/24	2024/25	2025/26
Limit on principal invested with maturities longer than 365 days beyond year end	£50m	£40m	£40m

Long-term investments with no fixed maturity date include strategic pooled funds but exclude money market funds and bank accounts with no fixed maturity date as these are considered short-term.

1.4 NON-TREASURY MANAGEMENT INDICATORS: 'INVESTMENT GUIDANCE'

The council has set the following quantitative indicators to allow elected members and the public to assess the council's total risk exposure resulting from its investment decisions.

1.4.1 Total risk exposure

The first indicator below shows the council's total exposure to potential investment losses. This includes amounts the council is contractually committed to lend but have yet to be drawn down and guarantees the council has issued over third-party loans.

Table 1.4.1: Total investment exposure in £ millions

Total investment exposure	Actual Held as at 31/03/22 £m	Forecast Held as at 31/03/23 £m	Forecast Held as at 31/03/24 £m
Treasury management investments	177.0	150.0	130.0
Service investments: Loans	0.8	0.8	0.8
Commercial investments: Property*	32.6	32.6*	32.6*
TOTAL EXPOSURE	**210.4**	**183.4**	**163.4**

** Commercial investment properties are re-valued annually by the council's valuers - valuations as at 31/3/23 are not yet available and cannot be forecast with reasonable certainty.*

Significant uncertainty also applies to the valuation of commercial property investments during the current economic environment.

1.4.2 How investments are funded

Current government guidance is that these indicators should include how investments are funded. Since the council does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with.

In accordance with best professional practice, North Somerset Council does not associate its borrowing with particular items or types of expenditure. The council manages its treasury position, borrowings, and investments in accordance with its approved Treasury Management Strategy and practices. In day-to-day cash management, no distinction is made between revenue cash and capital cash. External borrowing arises because of all the financial transactions of the council, and not simply those arising from capital spending. The council may choose to finance capital expenditure from its existing operational cash resources, rather than undertaking external borrowing, to minimise interest costs.

1.4.3 Rate of return received on investments

This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

Table 1.4.3: Investment rate of return (net of all costs)

Investments net rate of return	**Actual 202122 %**	**Forecast 2022/23 %**	**Forecast 2023/24 %**
Treasury management investments	0.37	1.65	2.30
Service investments: Loans	2.36	4.29	5.64
Commercial investments: Property	-0.70	0.00	0.00
ALL INVESTMENTS	**0.35**	**1.23**	**1.70**

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Treasury management risk register

Appendix 3

Risk	Impact	Probability	Unmitigated risk	Mitigating arrangements:	Revised probability	Residual risk
Credit risk						
- Loss of principal and/or interest due to counter-parties not being able to meet principal / interest payments as they fall due. Includes losses due to 'bail in' requirements. - Potential delays in being able to access funds. - Emerging markets carry a higher risk of financial loss than more developed markets, as they may have less developed legal, political, economic or other systems.	5	4	20	- Measurement of risk (use of credit ratings, CDS spreads, balance sheet analysis). - Monitoring of TM advisor advice, news, discussions with brokers, and reacting to events (eg both trading and regulatory). - Setting appropriate lending limits per counter-party re amounts, period and country of investment. - Diversification between lenders, lender types, countries. - Exposure to equity and tradable debt instruments only through diversified funds.	3	15
Liquidity risk						
- Running out of accessible cash, leading to inability to make payments as they are due. - Needing to borrow at higher cost than otherwise available. - Needing to sell assets / investments at short notice / at lower prices. - Not having available counter-parties to invest in.	4	2	8	- Daily cash flow forecasting. - Overdraft facility agreed. - Ready access to sources of cash from eg PWLB, other local authorities and banks and building societies. - Holding investments that can be readily realised.	1	4
Interest rate risk						
- Increasing interest rates lead to increase in cost of fixed rate and variable rate borrowing. - Decreasing market value of tradable fixed income investments (e.g. bonds) when interest rates rise. - Falling interest rates lead to lower return - Re-financing risk - Falling borrowing interest rates mean opportunity to re-finance borrowing at lower cost missed. - The use of derivatives may increase overall risk, by magnifying the effect of both gains and losses, leading to large changes in value and potentially large financial loss.	4	5	20	- Monitoring of TM advisor advice, news, discussions with brokers re economic outlook, and expected interest rate movements. - Taking into account uncertainty in future outcomes. - Monitoring of available / emerging sources of borrowing. - Maintaining suitable mix of fixed and variable interest rates for borrowing and investments. - Maintaining mix of maturity dates. - Monitoring of cost of re-financing borrowing compared to potential savings - Diversification of investment types. - Exposure to tradable debt instruments only through diversified funds. - Restriction of use of derivatives to stand-alone instruments that can be clearly demonstrated to reduce overall risk.	4	16
Inflation risk						
- The value of cash balances is eroded over time due to inflation (notably when interest rates on investments are lower than inflation)	4	4	16	- Monitoring of TM advisor advice, news, discussions with brokers re economic outlook, and expected inflation and related interest rate movements. - Identify balances not likely to be needed in the short term for operational cash flows, and invest these balances in longer term to generate sufficient income to at least match inflation.	3	12
Currency risk						
- The risk of loss from fluctuating foreign exchange rates when an investor has exposure to foreign currency or in foreign-currency-traded investments	1	0	0	- Local authorities are not allowed to borrow or invest in foreign currencies. All transactions must be in sterling.	0	0
Regulatory and political risk						
Risk that changes in regulations or leglislation may have an adverse impact on the Council's finances, including: - Brexit - leads to uncertainty in the economic outlook, and hence uncertainty over future interest rates and economic growth, and hence inflation, and government expenditure. - Changes in PWLB / other borrowing rates impact on the Council's borrowing costs - Changes in PWLB regulations limit availability/criteria of borrowing. - Changes in MiFID 2 regulatory requirements may increase costs and decrease access to markets.	3	4	12	- Monitoring of TM advisor advice, news, discussions with brokers, and reacting to events (eg both trading and regulatory). - On-going professional training and development of treasury management officers. - On-going training and updates to members on Treasury Management. - Regular review and update of overall Treasury Management Strategy. - Regular review and update of mix of borrowing and investments held to ensure the portfolio continues to meet the objectives of the Treasury Management Strategy.	3	9

Key: Scores: 1 (Lowest)-5 (Highest)

Considerations to support new framework for ESG investments **Appendix 4**

When developing a new investment policy and governance framework for any type of treasury investments there are a great many factors to consider. The council will ensure that the strategy for new ESG investments will ensure full compliance with complex legislation and also seek to mitigate the significant risks associated with investing taxpayers' money.

Some of the considerations that may feature in the formulation of the new ESG investment strategy are listed below, although the list is not intended to be comprehensive and may be expanded during later discussions as further suggestions are made, or may be refined if elements do not meet the councils' core objectives.

- **External governance**, e.g. legal requirements defined by statute, accounting requirements and government expectations, best practice, e.g.;
  - Refer to Section 6 of the main body of the report
  - Local Government Act 2003 (various)
  - CIPFA - Guidance, TM and Risk Management toolkits, TM frameworks and roadmaps
  - The UK Stewardship Code - Financial Reporting Council (FRC)
  - Task Force for Climate Related Disclosure - TCFD
  - UN Principles for Responsible Investment (UNPRI.org)

- **Setting clear objectives**
  - Investment limits – i.e. ESG investments will not exceed £6m
  - Net Real Total Return - i.e. > 0%
  - Security - i.e. no more than 4% total drawdown
  - Liquidity - i.e. ability to realise within 1 month
  - Yield - i.e. CIPFA / impact on revenue budge)
  - Statement of Responsible Investing (RI)
    - ESG – e.g. 5 star rating
    - Transparency - i.e. fund components specified and RI / ESG rated
  - Asset provider size, longevity, credit worthiness, fees
  - Counterparty selection criteria - i.e. credit rating triple A
  - Counterparty limit
  - Country limit
  - Regulations compliance measures - i.e conforms with criteria
  - Risks management, understanding and risks ranges willing to take
  - Define the entry strategy and criteria
  - Define the end game, strategy and criteria for getting out, de-risking

- **Investment strategy** – types of products / investments / assets
  - Cannot fall into definition of capital expenditure – must be a treasury investment
  - Asset strategy selection criteria and allocations
    - Protection, e.g. Bonds limited to % allocation
    - Diversifiers, e.g. could be infrastructure or property
    - Growth expectations
    - Geographic constraints
  - Markets and choice of assets, e.g. Funds, unit trusts, CCLA
  - Implementation strategy

- **Governance**
  - Risk management

  - Oversight and scrutiny
  - Framework
  - Monitoring and reporting
  - Knowledge, experience and training
  - Best practice
  - S151 responsibilities
  - Reporting framework – frequency, risks, returns, objectives

- **Risk assessment and management**
  - Interest rates
  - Counterparty
  - Country
  - Inflation
  - Market

Authorised Limit – the maximum amount of external debt at any one time in the financial year.

Bank Rate – the Bank of England base rate.

Capital Financing Requirement – financing needs of the council – i.e., the requirement to borrow.

CIPFA - the Chartered Institute of Public Finance and Accountancy. The institute is one of the leading professional accountancy bodies in the UK and the only one which specialises in the public sector. It is responsible for the education and training of professional accountants and for their regulation through the setting and monitoring of professional standards. Uniquely among the professional accountancy bodies in the UK, CIPFA has responsibility for setting accounting standards for a significant part of the economy, namely local government. CIPFA's members work, in public service bodies, in the national audit agencies and major accountancy firms.

CLG – Communities and Local Government – see MHCLG.

Counterparty – the organisation the council is investing with.

Credit Rating – an assessment of the credit worthiness of an institution.

Creditworthiness – a measure of the ability to meet debt obligations.

ESG – Environmental, Social and Governance based investment decisions.

Finance Lease - a finance lease is a lease that is primarily a method of raising finance to pay for assets, rather than a genuine rental. The latter is an operating lease. The key difference between a finance lease and an operating lease is whether the lessor (the legal owner who rents out the assets) or lessee (who uses the asset) takes on the risks of ownership of the leased assets. The classification of a lease (as an operating or finance lease) also affects how it is reported in the accounts.

Gilts – long term fixed income debt security (bond) issued by the UK Government and traded on the London Stock Exchange.

LIBID – London Interbank BID Rate – the interest rate at which London banks are willing to borrow from one another.

MHCLG – Ministry of Housing, Communities and Local Government. The Government department that sets policy on supporting local government, communities and neighbourhoods, regeneration, housing, planning building and the environment and fire. The name for this Government department has recently changed and is now known as **DLUHC**, which is the **Department for Levelling Up, Housing and Communities**.

Minimum Revenue Provision - the minimum amount which must be charged to an authority's revenue account each year and set aside towards repaying borrowing.

Money Market - the market in which institutions borrow and lend.

Money Market Rates – interest rates on money market investments.

Ninety-One – one of the council's cash managers who invest in multi-asset funds. They were previously known as Investec.

Operational Boundary – the most likely, prudent but not worst-case scenario of external debt at any one time.

Pooled Funds – investments are made with an organisation who pool together investments from other organisations and apply the same investment strategy to the portfolio. Pooled fund investments benefit from economies of scale, which allows for lower trading costs per pound, diversification, and professional money management.

Prudential Code – a governance procedure for the setting and revising of prudential indicators. Its aim is to ensure, within a clear framework, that the capital investment plans of the council are affordable, prudent, and sustainable and that treasury management decisions are taken in accordance with good practice.

Prudential Indicators – indicators set out in the Prudential Code that calculates the financial impact and sets limits for treasury management activities and capital investment.

PWLB (Public Works Loans Board) - a central government agency which provides long and medium-term loans to local authorities at interest rates only slightly higher than those at which the Government itself can borrow. Local authorities can borrow to finance capital spending from this source.

Sovereign – the countries the council can invest in.

Tradition UK Ltd – is one of the council's cash managers who manage £10m of investments on our behalf. Tradition place funds in fixed term cash deposits with a range of financial institutions.

Treasury Management – the management of the council's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risk associated with those activities and the pursuit of optimum performance with those risks.

Treasury Management Practices – schedule of treasury management functions and how those functions will be carried out.

Variable Net Asset Value money market funds – the principal invested may fluctuate below that invested.

North Somerset Council

Report to the Audit Committee

Date of Meeting: 26 January 2023

Subject of Report: Update on Annual Accounts

Town or Parish: All

Officer presenting: Steve Ballard - Principal Accountant (Closure and Systems)

1. Key Decision: N/A

Recommendations

The Audit Committee are requested to **note** the following:

a) the developments in the CIPFA Code of Practice for Local Government Accounts, including that there are limited changes to the Code for the 2022/23.

b) that officers are proposing one additional accounting policy, relating to the Community Infrastructure Levy, for inclusion in the accounts, with no significant changes to existing accounting policies in 2022/23.

c) that officers' initial assessment of the critical judgements made in applying the Council's accounting policies, and the major sources of estimation uncertainty identified in the preparation of the 2022/23 accounts.

d) the requirement for the Council's accounts to provide a 'true and fair' view of the Council's financial position and transactions, the concept of materiality, the initial assessment of materiality limits applied by officers in drawing up the accounts; and disclosures which, although not material due to their value, are considered material due to their nature.

1. Summary of Report

1. The purpose of this report is to provide Members with an update of the issues which impact on the annual accounts process. These include changes to the Code, and the annual review the Council's accounting policies.

2. The report also provides Members with a reminder of the concept of materiality, and outlines officers approach in applying materiality in preparing the draft financial statements.

2. Policy

3. Local authorities in the United Kingdom are required to prepare their accounts in accordance with primary legislation, such as the Accounts and Audit Regulations, as well as 'proper accounting practices', meaning compliance with the terms of the Code of Practice on Local Authority Accounting in the United Kingdom (the Code).

4. The Code specifies the principles and practices of accounting required to prepare a Statement of Accounts which gives a 'true and fair' view of the financial position and transactions of a local authority. The Code is updated annually, and may introduce new, or amended, accounting standards or reporting requirements which need to be complied with.

5. The Audit Committee is charged with overseeing the Authority's financial reporting process, and is required to consider and, under delegated powers from the full Council, to approve the Council's Statement of Accounts each year.

6. The Chair of the Audit Committee and the Chief Financial Officer are required to sign the Council's Statement of Accounts as representing a 'true and fair' view of the financial position of the Council and its income and expenditure for the year.

7. The Chief Financial Officer is responsible for:
   - the preparation of the Statement of Accounts in accordance with the Code,
   - selecting suitable accounting policies and then applying them consistently,
   - making judgements and estimates that are reasonable and prudent,
   - arrangements for internal control as she determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and
   - for being satisfied that the financial statements give a true and fair view of the financial position and transactions of the Council.

8. Audit Committee members therefore need to consider whether they receive adequate assurance over Council's arrangements for the preparation of the financial statements, including arrangements for making critical judgements in applying accounting policies, and for making accounting estimates, before approving the financial statements.

3. Update on the Council's Annual Accounts

Changes to the Code – 2022/23 and 2023/24

9. The Code of Practice is updated annually to reflect new or updated accounting standards. There are only minor changes to the Code for 2022/23. Following review, none are considered likely to have a significant impact on the Council's accounts.

10. The implementation of ‘IFRS16 – Leases’ into the Code has again been deferred until 2024/25. This change of accounting policy will require changes to the accounting treatment where the Council is the lessee of long-term assets, and revisions to the related disclosures. Although the implementation of the new standard will be only reflected in the 2024/25 accounts, disclosure of the likely impact of this change will need to be included in the 2023/24 accounts. Work is on-going to quantify the impact of these changes.

11. There is a consensus that the length and complexity of the accounts produced under the current Code can make the accounts impenetrable to many users. CIPFA consulted on changes to the Code for 2021/22, with the aim of delivering accounts that more clearly communicate the authority’s financial performance and future financial sustainability. However, no significant changes have yet been proposed in the Code. CIPFA is continuing to develop guidance on revised content for inclusion in the Code in future years.

12. As previously discussed, officers will be holding a workshop with members to update them on proposed changes to simplify and focus the Narrative Report on key messages in the 2022/23 financial statements.

Changes to regulatory requirements

13. Regulatory developments outside of the Code that are likely to impact on the 2022/23 financial statements include:
    - Minimum Revenue Provision (MRP) – The Minimum Revenue Provision is the minimum amount which must be charged to a Council’s revenue account each year and set aside as provision for repayment of debt, as required by the Local Government Act 2003. Government have issued further guidance on the calculation of the MRP. Officers believe that the Council already makes prudent provision for the repayment of its debt, and therefore does not expect this guidance to significantly impact on the charges the Council makes in its accounts.
    - IFRS 9 Statutory Override for pooled investments –the IFRS 9 statutory override in local government has been extended for another two years until 31 March 2025. This provides permission for gains and losses on pooled investments, such as those held by the Council, to continue to be held in Balance Sheet reserves, rather than impacting on the Council’s surplus or deficit for the year each year.
    - Dedicated Schools Grants deficits – Similarly, the statutory override for Dedicated Schools Grant (DSG) deficits has been extended for the next three years, from 2023-24 to 2025-26.

14. Officers are due to attend update training in the next few weeks and will continue to keep Members informed of any significant changes in Code requirements for the content and format of the Council’s accounts.

Review of accounting policies

15. Accounting policies are the specific principles and practices applied by an authority in preparing and presenting its financial statements. The finance team has developed a ‘library’ of the Council’s accounting policies. Of these, only those with significant impact are disclosed within the Council’s accounts.

16. It is good practice for ‘those charged with governance’ (i.e. the members of the Audit Committee) to review the policies on an annual basis and approve any changes proposed.

17. Officers have reviewed the Council's library of accounting policies. Changes made to the Council's accounting policies in 2021/22, regarding the preparation of group accounts and the disclosure of the value of Infrastructure assets, have been included in the library of policies, and will be included in the Council's accounts on an on-going basis.

18. One existing accounting policy is now proposed for inclusion in the statement of accounts. It relates to the accounting treatment of Community Infrastructure Levy (CIL) funding. Balances and cumulative transactions in relation to CIL are expected to near materiality levels in the near future.

19. The accounting policy proposed for inclusion is shown at Appendix A.

20. No significant changes are proposed to existing accounting policies over those included in the previous year's statement of accounts.

Accounts which provide a 'true and fair' view of the Council's financial position and transactions, and the concept of materiality

21. Detailed consideration of the assessment of appropriate materiality levels for the Council's preparation of the accounts is set out in Appendix B.

22. Officers consider that it is appropriate to set an indicative materiality level in preparing the Council's accounts at approximately one third of the external auditor's materiality, i.e. based on 2 % of gross revenue expenditure at 'Cost of services' level in the previous years' audited accounts. This equates to around £7.86m.

23. Disclosures which, although not material due to their value, are considered material by their nature, due to their potential impact on the decisions of likely users of the accounts, are:
    a) disclosures of officers' remuneration, salary bandings and exit packages
    b) disclosure of members' allowances
    c) disclosure of related party transactions

Critical judgements made in applying the Council's accounting policies, and major sources of estimation uncertainty in the preparation of the accounts

24. Officers have completed an initial assessment of the critical judgements made in applying the Council's accounting policies, and the major sources of estimation uncertainty identified in the preparation of the 2022/23 accounts. These issues impact on whether the accounts provide a 'true and fair' view of the Council's financial position. These are listed in Appendix C and D respectively.

25. The judgements proposed remain as detailed in the 2021/22 statement of accounts, except that the judgement in relation to whether group accounts need to be prepared to account for the transactions undertaken by the Council's subsidiary company, North Somerset Environment Company Ltd, is likely to be removed from the disclosure. This is considered to no longer require significant judgement due to the clear materiality of the company's transactions on the group accounts.

26. Each year, members of the Audit Committee participate in a workshop session to review the draft annual financial statements. This provides an opportunity for officers to explain the accounting estimates used in preparing the accounts, and for members to question

officers on the adequacy of the Council's arrangements for making accounting estimates.

27. Papers will be submitted to the Audit Committee later in the year setting out the detail of these issues, and the sources of assurance that members can use in making their assessment of the adequacy of the Council's arrangements to produce 'true and fair' financial statements.

4. Consultation

28. Officers continue to undertake discussions with external audit regarding key issues impacting on the preparation of the accounts, including significant accounting estimates and judgements. Officers will continue to liaise with external audit on emerging issues as the accounts are finalised.

5. Financial Implications

29. Updates to the Code, and the proposed changes to the Council's accounting policies, are expected to have minimal impact on the Council's financial out-turn or balances.

30. As noted in Appendices B and C, critical judgements made in applying the Council's accounting policies, and accounting estimates used in the valuation of the Council's assets and liabilities will have a material impact on the Council's financial statements.

6. Legal Powers and Implications

31. The CIPFA Code of Practice determines 'proper accounting practice' in relation to the Council's statement of accounts. The Council's accounts are a key requirement of its operational responsibilities. Their accuracy and adherence to legislation and relevant guidance are important to ensure the Chief Financial Officer and Audit Committee can discharge their statutory obligations.

7. Climate Change and Environmental Implications

32. None

8. Risk management

33. Failure to apply appropriate accounting policies, or to adequately assess materiality in relation to the Council's accounts, could result in the accounts not providing a 'true and fair view' of the Council's financial position, financial performance and cash flows, and leave the Council open to criticism by external audit, and potential qualification of their audit opinion on the accounts.

9. Equality Implications

34. None

10. Corporate Implications

35. None, other than as highlighted above

11. Options Considered

36. Options considered in the update of accounting policies, and in setting materiality levels, are detailed in the body of the report above.

Author

Melanie Watts, Head of Finance   Tel: 01934 634618
melanie.watts@n-somerset.gov.uk

Steve Ballard, Principal Accountant (Closure and Systems)   Tel: 01275 884037
steve.ballard@n-somerset.gov.uk

Appendices

Appendix A   Accounting policy – Community Infrastructure Levy
Appendix B   Assessment of materiality
Appendix B   Critical judgements in applying the Council's accounting policies
Appendix C   Significant accounting estimates and sources of estimation uncertainty

Background Papers

CIPFA Code of Practice on Local Authority Accounting 2022/23
CIPFA Guidance Notes for Practitioners 2022/23
Statement of Accounts 2021/22
Grant Thornton Audit Findings Report 2021/22

Appendix A

Accounting Policy - Community Infrastructure Levy

The authority has elected to charge a Community Infrastructure Levy (CIL). The levy will be charged on new builds (chargeable developments for the authority) with appropriate planning consent. The council charges for and collects the levy, which is a planning charge. The income from the levy will be used to fund a number of infrastructure projects (these include transport, flood defences and schools) to support the development of the area.

CIL is received without outstanding conditions; it is therefore recognised at the commencement date of the chargeable development in the Comprehensive Income and Expenditure Statement in accordance with the accounting policy for government grants and contributions set out above. CIL charges will be largely used to fund capital expenditure. However, a proportion of the charges may be used to fund revenue expenditure.

Income received by the Council in relation to CIL is classified as follows;

- CIL Administration – The collecting authority may apply up to 5% towards administration expenses incurred. The Council recognises 5% of CIL income towards these costs. This element has been recognised as revenue in the year in which receipts are due.
- CIL Infrastructure - CIL income applied to infrastructure is treated as a capital financing contribution.
- CIL Local Council element – CIL income to be passed to local councils (parishes) is treated as a Balance Sheet liability.
- CIL Surcharges – Any surcharges received have been treated as revenue in the year in which they are due.

Appendix B

Assessment of materiality

1. Introduction

The CIPFA Code of Practice for Local Government accounting specifies the accounting practices required for the Council's Statement of Accounts to give a 'true and fair' view. However, 'true and fair' does not mean 100% accurate, but 'materially correct'.

The Code provides a definition of materiality, which is applied to information and disclosures in the Council's financial statements: "information is material if omitting, misstating or obscuring it could reasonably be expected to influence decisions that users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific local authority."

The assessment of materiality helps officers to ensure that the accounts focus on key messages, notably in relation to the Council's performance, financial resilience and accountability for use of public funds.

2. Users of the accounts

The assessment of materiality is affected by the financial information needs of users of the financial statements.

The Code defines the primary users of local authority financial statements as 'service recipients and their representatives, and resource providers and their representatives'.

'Service recipients and their representatives' are likely to consist of local residents and their locally elected representatives. 'Resource providers and their representatives' are likely to mean central government, and local Council Tax and Non-domestic rates payers.

Other users are likely to include existing and potential lenders, credit ratings agencies, financial advisors, the media, trade unions, statisticians, analysts and academics, and businesses considering entering contracts with the Council.

In the public sector, providing information that allows for an assessment of the stewardship and accountability of elected members and management for the resources entrusted to them is of paramount importance.

Ensuring that the Council's audited financial statements focus on the needs of key users of the accounts is challenging, as different stakeholder groups will be interested in different information, have differing expectations of whether a particular transaction is material, and will have differing levels of financial literacy.

Hence, engagement with members, through the Audit Committee, provides a useful opportunity of officers to gain an understanding of the content of the financial statements which are likely to influence the decisions of members as users of the accounts.

3. Benchmarks for determining overall materiality

Determining a value for materiality involves the exercise of judgement. A percentage of a chosen benchmark in the accounts is often applied as a starting point. Appropriate benchmarks might include the total assets, liabilities, income, or expenditure in the accounts. As a public sector entity, other benchmarks used in the private sector such as profit before tax, gross profit, revenue and equity, are of limited relevance.

As the Council has custody of public assets to deliver services, the value of long-term assets might be considered an appropriate benchmark. Similarly, the Council holds long-term borrowing to finance its long-term assets. However, a materiality based on these measures alone would not be considered relevant to the wider financial performance of the Council reflected in the financial statements.

Council budgets are set and monitored based on net revenue expenditure (ie gross expenditure less gross income). However, use of net expenditure does not fully reflect the income and expenditure transactions, and hence is considered to lead to too low a materiality level to be meaningful.

The overall benchmark considered to be most relevant to users of the accounts is gross revenue expenditure, as it reflects both the revenue expenditure and income for the year, and can meaningfully be applied when considering entries in the Council’s Balance Sheet.

4. External auditor’s assessment of materiality

In conducting their audit of financial statements, the Council’s external auditor seeks to obtain reasonable assurance about whether the financial statements are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

Auditors are required to determine their assessment of materiality for the financial statements as a whole.

In their Audit Findings Report for 2021-22, the Council’s external auditors quantified their **overall materiality at £7.75 million** (being 2% of gross revenue expenditure at ‘Cost of services’ level in the audited 2020-21 accounts).

Note that this provides a lower measure of materiality than that based on a similar percentage of gross revenue expenditure at ‘Surplus / deficit on provision of services’ level, which includes the impact of financing expenditure and one-off expenditure on losses on disposal of non-current assets. It can be argued that the inclusion of such expenditure might mask the reflection of the cost of the provision of the Council’s services in the accounts.

The external auditor’s assessment of materiality is a key benchmark in determining the Council’s overall materiality level when preparing the draft accounts.

There is a risk that more than one non-material error or omission could be material to the accounts when considered in aggregate. Hence external auditors also set a ‘performance materiality’, at a level less than the overall materiality, to reduce to an appropriately low level the probability that the aggregate of uncorrected errors and omissions exceeds materiality for the financial statements as a whole.

External auditors typically quantify 'performance materiality' in the range of 50-75% of overall materiality to direct their audit testing. The assessment of performance materiality is typically based on a risk assessment, including:

- an assessment of the past experience of errors identified in the Council's accounts
- the knowledge, experience and continuity of the Council's financial reporting team
- the strength of the Council's overall control environment, including anti-fraud arrangements, and wider IT environment
- the strength of the Council's key financial reporting systems

In their Audit Findings Report for 2021-22, the Council's external auditors quantified their **'performance' materiality at £5.8 million**, being 75% of their overall materiality level.

5. Council's assessment of materiality

The Council needs to provide sufficient assurance to the external auditors that the financial statements are materially correct. Hence it is appropriate for the Council to take in to account the auditor's assessment of materiality when setting its own materiality in preparing the draft accounts.

Setting a materiality limit too high could lead to a risk of omission of information which might influence the user of the accounts, which could lead to the Council's accounts being qualified by their auditors. As the Council's accounts have previously been given unqualified audit opinions by the auditor, it is reasonable to assert that officers' assessment of materiality has not been too high in previous years.

Setting too low a materiality limit would not lead to a risk of qualification, but could lead to:

- excessive detail and 'clutter' being included in the accounts, detracting from the clarity of the key messages being communicated, and
- additional officer and auditor time being required to prepare and audit the accounts when deadlines are already tight.

The Council has a history of producing high quality, accurate draft financial statements. The Council's financial reporting team have strong knowledge and experience of local government accounting, and accounts closure issues. The Council's overall control environment is considered strong, with no significant internal control weaknesses, including in relation to the Council's key financial systems, reported by the external auditors in their Audit Findings Reports, or by Internal Audit in the Annual Governance Statements, in recent years.

It is therefore considered appropriate to set the Council's performance materiality level in preparing the accounts at one third of the external auditor's materiality (based on 2 % of gross revenue expenditure at 'Cost of services' level in the previous years' audited accounts), such that three such errors, impacting in the same direction, would be needed to lead to a misstatement material to the external auditor's opinion.

This gives a value of overall materiality to be used as a guideline by officers in drafting the Council's 2022/23 accounts of **£7.75m**, and a performance materiality estimated at **£2.58m.**

6. Items which are material by nature

Officers drawing up the accounts, and auditors undertaking the audit of the accounts, may identify classes of transactions, account balance or disclosures which are considered more likely to influence the user of the accounts, and hence where it may be appropriate to set a lower materiality level than for the financial statements as a whole.

Officers have reviewed the statement of accounts, including the associated disclosures, for other items which would be most likely to impact on the decisions of likely users of the accounts, notably local residents. Disclosures identified as ‘material by nature’ are:

- Officers' remuneration, salary bandings and exit packages
- Members’ allowances - as of interest to local residents, and
- Related party transactions –to ensure transparency of the Council’s transactions with bodies or individuals who have control or influence over the Council.

Hence these disclosures will be retained in future statement of accounts, despite being below the numerical value of the materiality for the accounts as a whole.

Other disclosures below the Council’s materiality threshold, and which are not considered material by nature, will be considered for removal to ‘de-clutter’ the accounts, and allow better focus on the key messages in the accounts.

Appendix C

Critical judgements in applying the Council's accounting policies

In applying its accounting policies, the Council has had to make judgements about complex accounting transactions.

The critical judgements currently identified by officers are:

- the accounting treatment of Covid-19 response funding,
- the accounting treatment of Better Care Funding,
- the accounting treatment of schools' non-current assets, and
- the classification of the Council's commercial investment property.

The judgement disclosed in the 2021/22 accounts in relation to whether group accounts need to be prepared to account for the transactions undertaken by the Council's subsidiary company, North Somerset Environment Company Ltd, is likely to be removed from the disclosure of critical judgements. This is considered to no longer require significant judgement due to the clear materiality of the company's transactions on the group accounts.

Appendix D

Significant accounting estimates and sources of estimation uncertainty

The Statement of Accounts contains estimated figures that are based on assumptions made by the Council about the future or that are otherwise uncertain. Estimates are made considering historical experience, current trends and other relevant factors.

There have been no significant changes to the basis of these estimates compared to the previous year.

The areas of the accounts which are subject to material accounting estimates, or significant estimation uncertainty are currently assessed as follows:

- investment property valuations, including impairments,
- property, plant and equipment valuations, including impairments, and
- the pension fund (LGPS) net liability valuation, and actuarial gains and losses. Note that a triennial revaluation of the pension fund assets and liabilities is due to be undertaken by the actuary in 2022/23.

Other areas where accounting estimates are used, but considered less likely to have a material impact include:

- estimated remaining useful lives of PPE / depreciation and amortisation,
- measurement of financial instruments,
- bad debt provisions / credit loss allowances,
- provisions for liabilities, and
- accruals.