**Contact:** Hazel Brinton
**Direct Dial:** 01275 884811
**E-mail:** hazel.brinton@n-somerset.gov.uk
**Date:** Wednesday, 19 January 2022

**** Physical Meeting**
This meeting will take place in person at the Town Hall. Should you wish to attend in person we ask that you notify the Contact Officer above at least 24 hours before the meeting as this will help us to manage the meeting safely.

Dear Sir or Madam

**The Audit Committee – Thursday, 27 January 2022, 10.30 am – New Council Chamber**

A meeting of the Audit Committee will take place as indicated above.

The agenda is set out overleaf.

Yours faithfully

Assistant Director Legal & Governance and Monitoring Officer

To: Members of the Audit Committee

Councillors:

John Cato (Chairman), Sandra Hearne (Vice-Chairman), Patrick Keating, Marcia Pepperall and Richard Tucker.

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

**Agenda**

1. **Public Participation (Standing Order 17)**

   To receive and hear any person who wishes to address the Committee. The Chairman will select the order of the matters to be heard. Each speaker will be limited to a period of five minutes (up to a maximum of 30 minutes).

   Requests to speak must be submitted in writing to the Head of Legal and Democratic Services, or the officer mentioned at the top of this agenda letter, by noon on 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**

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

   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 Chamber in respect of a declaration, he or she should ensure that the Chairman 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** (Pages 5 - 10)

   20 September 2021, to approve as a correct record (attached)

5. **Notes from Informal Meeting** (Pages 11 - 16)

   25 November 2021, to approve the formal notes as a correct record of the meeting and approve the adoption of the recommendations therein (attached)

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

7. **Audit Committee Annual Report 2020-21** (Pages 17 - 26)

   Report of the Chairman of the Audit Committee (attached)

8. **Value for Money Extension Letter - External Auditor** (Pages 27 - 28)

   Letter from Grant Thornton, External Auditor (attached)

9. **Annual Governance Statement Process 2021-22** (Pages 29 - 46)

   Report of Service Director – Commercial and Governance (One West) (attached)

**10.** **External Audit Procurement Options** (Pages 47 - 50)

Report of Head of Audit and Assurance, Audit West (attached)

**11.** **Internal Audit Plan - Audit Committee Consultation** (Pages 51 - 54)

Report of Head of Audit and Assurance, Audit West (attached)

**12.** **Treasury Management Strategy 2022-23** (Pages 55 - 86)

Report of Director of Corporate Services (attached)

**13.** **Accounts Update Report (Accounting Policies)** (Pages 87 - 96)

Report of Director of Corporate Services (attached)

**14.** **Urgent business permitted by the Local Government Act 1972 (if any)**

Any item of business which the Chairman 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 Chairman to rule that it be considered as urgent. Otherwise the matter cannot be considered urgent within the statutory provisions.

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**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**

# Minutes

of the Meeting of

# The Audit Committee
# Monday, 20 September 2021

New Council Chamber - Town Hall

Meeting Commenced: 10.30 am Meeting Concluded: 11.37 am

**Councillors:**

John Cato (Chair)

Patrick Keating
Marcia Pepperall
Richard Tucker

**Apologies:** Councillors: Sandra Hearne.

**Also in attendance:** Jon Roberts, External Auditor, Grant Thornton.

**Officers in attendance:** Amy Webb (Director of Corporate Services), Nicholas Brain (Assistant Director Legal & Governance and Monitoring Officer), Melanie Watts (Head of Finance), Steve Ballard (Principal Accountant (Closure and Systems)), Emma Diakou (Head of Business Insight, Policy and Partnerships), Peter Cann (Head of Audit and Assurance) and Hazel Brinton (Democratic Services Officer).

**AUD 7 Appointment of Vice Chairman for Municipal Year 2021-22**

**Resolved:** that Councillor Sandra Hearne be elected as Vice Chairman of the Audit Committee for the municipal year 2021-22.

**AUD 8 Declaration of Disclosable Pecuniary Interest (Standing Order 37)**

None.

**AUD 9 Minutes 23 April 2021**

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

**AUD 10 Constitution Review**

The Assistant Director Legal and Governance and Monitoring Officer presented his report on the review of the Constitution. In presenting his report, he noted four recommendations around the amended terms of reference for the Audit Committee; changes to the size of the Planning and Regulatory Committee and public participation arrangements; changes requested by officers to parts of the

Financial Regulations and Contract Standing Orders within the Constitution and the process for a further review of the Constitution.

Members asked questions on the anticipated size and number of the proposed working groups to be set up to consider the review of the Constitution and the process around the use of open framework agreements.

**Resolved:**

1. That Audit Committee note the update of the Constitution to reflect the amended terms of reference for the Audit Committee approved previously by the Committee and Council as shown in tracked changes in the Appendix to the report;

2. That Audit Committee agree the suggested changes to the Constitution to reflect the decision of Council in July 2021 regarding the size of Planning & Regulatory Committee and public participation arrangements for that committee when considering planning applications;

3. That Audit Committee note the requested changes from officers to parts of Financial Regulations and Contract Standing Orders within the Constitution and consider those requests as part of the working group review suggested in paragraph 3.4 of the report with a view to any recommended changes being brought back to Audit Committee for approval in time for recommendation to Council at the next Annual Meeting.

**AUD 11** **Risk Register Update**

The Head of Business Insight, Policy and Partnerships presented her report on the council's Business Planning Framework and Risk Register. She outlined the process followed in constructing the council's Strategic Risk Register using the five Annual Directorate Statements and specific operational risks and noted the use of a risk scoring matrix and the regular reviews of the register by the Corporate Leadership Team. She undertook to bring the Strategic Risk Register to the next Audit Committee meeting for review.

The Head of Business Insight, Policy and Partnerships highlighted areas covered by the Risk Register which included finance and resources; governance; transformation; the impact of Covid19, Adult and Children's social services and partnership working amongst others. She explained the elements that made up the risk register which included mitigating actions proposed by officers to reduce the inherent risk of a particular area.

In discussing the report, members noted that that they had received briefings on the risk register previously and that members' questions on the process of constructing the register had resulted in the production of a consistent and standardised framework. A question was asked on the inclusion of residents' views to which the officer responded that residents had been consulted on the Corporate Plan and their views had been incorporated via the "golden thread" that ran from the Corporate Plan down to the individual team plans via the directorate statements and service plans. In response to a further question, she added that the risk registers were published on the council's website.

**Resolved:** that the Audit Committee note the content of the report and the accompanying document in appendix 1 outlining the development of the 2021/22 risk registers.

**AUD 12** **Internal Audit Update**

The representative from Audit West presented his update report on the delivery of the 2021/22 Annual Audit Assurance Plan. He noted that no internal audit reports had so far been issued where it was considered that the systems of internal control were weak or poor.

In presenting his report, the representative drew members' attention to two investigations relating to suspected fraudulent Covid19 grant payments. Both had been referred to the National Investigation Service and the National Anti-Fraud Network and Audit West was working with Liberata to pursue recovery of the funds. The representative noted that the frauds were very sophisticated and were not as a result of the breakdown of controls. A further investigation related to the use of the council's email system the circumstances of which were being considered by the council's ICT department. The representative informed members that the new fraud/whistleblowing tool was now live on the council's website and receiving referrals and that a warning of a phishing attack had been received and notified to staff via the ICT department's warning system.

The representative from Audit West further commented on the progress of the Audit Plan and explained that whilst there were 43 items on the plan, 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.

The representative drew members' attention to Section 3 of his report on the implementation of recommendations and the risk profile of those recommendations as requested by committee members. He noted that of the 39 recommendations made during previous audits, confirmation of implementation was now only awaited on three of them.

Members asked questions which were answered by the representative on the following areas: the level and amount of the frauds in relation to the government Covid19 grants and in the event of recovery, to whom the funds would be payable, the council or central government; what progress other councils who had been subjected to the same fraud had made in the recovery of funds; which two areas of recommendation implementation were outstanding and a general question on Table 1 items relating to insight into a change of trends or direction and which if any were of particular concern.

**Resolved:** to note the progress in delivery of the 2021/22 Annual Audit Assurance Plan.

**AUD 13** **Informing the Risk Assessment**

The council's Head of Finance confirmed that the "Letter from Those Charged with Governance" to the council's external auditors would be considered alongside the Statement of Accounts and Audit Findings Report under the following agenda item.

**AUD 14** **Statement of Accounts 2020-21**

The council's Head of Finance confirmed that changes had been made to the Introduction to the Annual Governance Statement as a result of feedback and recommendations from the Audit Committee members.

The representative of the Corporate Services Director noted that the draft accounts had been published on the council's website and considered by the Audit Committee at a workshop on 29 July 2021. He added that the revised accounts were attached to the meeting papers and the amendments to date had been minimal. He noted there were no amendments which impacted the core statements or outturn for the year and that the audit was substantially complete save for a few items as set out in the Audit Findings Report. Reference was made to the workshop provided to support members in their role of considering and approving the Annual Statement of Accounts and the Annual Governance Statement. The officer highlighted areas of the workshop that supported members in their role notably a review of the core statements, explanations of significant variances and trends over previous years, the going concern concept and basis for preparing the accounts, critical judgements in applying the Council's accounting policies and significant accounting estimates and sources of estimation uncertainty. He added that members had provided feedback and challenge on the content of the accounts at the workshop.

In presenting his report, the representative of the Director of Corporate Services highlighted the appendices attached to his report namely the revised Statement of Accounts 2020/21; the letter of representation to the external auditors to be signed by the Chief Financial Officer and the Chairman of the Audit Committee; the sources of assurance available to members of the Audit Committee in reviewing and approving the Statement of Accounts and the letter referenced under item 9 on the agenda, the "Informing the Risk Assessment Letter" from those charged with governance to the external auditors.

The representative of the Director of Corporate Services noted that electronic signatures would be used by the Chairman and the Chief Financial Officer once the financial statements had been agreed.

Members asked questions on the following matters: the valuation bands of council tax and when they were dated from; the process and layout of the accounts and whether amendments to the process and layout would be for this year or next.

The Chairman expressed his thanks for the improvements in clarity to the documents that had been made by officers.

Jon Roberts of Grant Thornton thanked the council's officers for their work involved in arranging for the audit to be signed off by the published timetable. He noted that whilst there were improvements to be made in presentation and disclosure to aid readers of the statements and that this was to be expected, there were no unadjusted misstatements that needed to be brought to members' attention.

He summarised the main findings of the external auditors report and made particular reference to the formulaic nature of the Audit Findings Report which helped the external auditors demonstrate their compliance with their reporting responsibility to the Audit Committee and in turn helped committee members deliver their responsibility as "Those Charged with Governance" to consider and confirm the Annual Accounts and Annual Governance Statement.

He pointed out the list of outstanding items as per his report but noted that this list was subject to change between the draft report and the presentation of the report to members. Some tests were still outstanding notably the pension assurance from the Avon Pension Fund and further payroll testing around full-time equivalent numbers as it was proving difficult to obtain without considerable manual intervention.

The representative from Grant Thornton drew members' attention to the new issues and risks section of his report and noted in particular risks surrounding Covid 19 grants which had been well handled by the council and ICT risks for which there was an action plan with officers. Reference was also made to two improvement recommendations concerning related party disclosures as three disclosures had not been received by the time of the audit and the transfer of a school to academy status which had not been recognised in the accounts in the 2017/18 year when it took place. He further commented on two prior year recommendations. One related to journals for which the recommendation still needed to be implemented and the other to the retention of supporting documentation which was in the process of implementation.

Members asked questions and received answers on the following areas of the Accounting Statements and Annual Governance Statement; journal management and the comparison with other authorities; the outstanding area of valuation of the Sovereign Centre; the academy transfer in 2017/18 and the operating expenditure error identified in the report.

Members highlighted areas of the Annual Governance Statement which they wished to be considered for the future including a reference to the committee's contribution to the change of governance of major capital projects and the purpose of the Annual Governance Statement. It was confirmed that the Annual Governance Statement would not reference all changes that had occurred during the year; only those of significance would be reported and that not all risks would be referred to otherwise the Statement would become unmanageably long. It was noted that other authorities operated on a similar basis.

**Resolved:**

1. That the Audit Committee:
    a. considered the matter(s) raised in the Annual Governance Statement;
    b. took note of any adjustments to the financial statements set out in the

external auditor’s report;
c. approved the draft letter of representation; and

2. That subject to any comments under 1 above, the Audit Committee:
a. approves the Statement of Accounts for 2020/21, subject to, any amendments necessary upon quantification of the impact of any issues arising from on-going work by the external auditors.
b. arranges for the Chair of the Council’s Audit Committee and the Chief Financial Officer to electronically sign the Accounts for 2020/21 as representing a ‘true and fair view’ of the financial position as at 31 March 2021, following any amendments necessary upon quantification of the impact of any issues arising from on-going work by the external auditors; and
c. arranges for the Leader of the Council and the Chief Executive Officer to formally approve the Council’s Annual Governance Statement as part of the financial accounts and sign accordingly with electronic signatures.

The Director of Corporate Services thanked all those involved in the production of the annual accounts and to the external auditors for expediting the audit so that they may be signed off by the statutory deadline.

The Chairman added his thanks to the team for all the work involved in preparing the accounts and to the Audit Committee members for their commitment in engaging with the audit and governance process.

Chairman

# Draft notes
of the informal Virtual Meeting of the
# Audit Committee
# Thursday, 25th November 2021
held via Microsoft Teams.

Meeting Commenced: 10:30 Meeting Concluded: 12:05

**Councillors:**

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

P Marcia Pepperall
P Richard Tucker
P Patrick Keating

P: Present
A: Apologies for absence submitted

**Also in attendance:**

**Officers in attendance:** Amy Webb (Corporate Services), Mark Anderson (Corporate Services), Hazel Brinton (Corporate Services), Peter Cann (Audit West), Melanie Watts (Corporate Services), Jeff Wring (Audit West)

## 1 Chairman's Welcome

The Chairman welcomed everyone to this informal meeting of the Audit Committee.

## 2 Minutes of the meeting held 20 September 2021

No corrections or clarifications to the 20 September 2021 meeting minutes were noted. As this meeting was informal, the minutes would be formally adopted at the next formal meeting of the committee.

**Recommendation**: that the Audit Committee adopts the minutes of the meeting held 20 September 2021 as the next formal meeting of the committee.

## 3 Internal Audit half-yearly update report

The Head of Audit and Assurance at Audit West guided members through his report. He highlighted a number of elements of the report including progress on the completion of the work plan; assurance levels and significant risks; investigations and whistleblowing including investigations into two Covid 19 related grant payments and an independent review of the issues surrounding the roofing works commissioned at a North Somerset School; counter fraud including fraud prevention information issued to staff; completion of the audit plan including a deferred audit of Green Waste Charging and Income and the implementation of recommendations of which two remain outstanding at the time of the meeting.

Members asked questions around the increase in academy schools and a corresponding reduction in the need for council resources to support the remaining local authority-maintained schools; the use of procurement frameworks in relation to purchasing at schools to ensure best value for money and the use of time plans against the completion of the audit work plan.

The Head of Audit and Assurance would report back in more detail to the committee on the suspected Covid19 grant payments fraud and the roofing works matter in due course.

Members agreed a further discussion with the Head of Audit and Assurance as to the use of time plans in relation to the completion of the audit work plan.

**Recommendation:** that the Audit Committee notes the progress in delivery of the 2021/22 Annual Audit Assurance Plan.

**4 Risk Management and Business Planning Framework Update**

The Director of Corporate Services presented the report and noted that the North Somerset Council Business Planning Framework was designed to monitor progress and risks aligned to the council's Corporate Plan priorities and Corporate Vision (open, fairer, greener).

She explained that it was a live document reviewed quarterly by leadership directorate teams and how the document was constructed.  She noted the significant corporate risks to the organisation at the end of quarter 2 including more general risks faced by all organisations relating to finance, information governance and cyberattack and more specific risks relating to matters such as Covid19.

The Director of Corporate Services noted that risks are reviewed as they arise so may not yet be reflected in the report and gave examples of risks currently being discussed that quarter including fuel shortages.

Members asked questions on the reflection in the report of increased risk in some areas particularly the rise in fuel prices and the corporate impact of this; the risk to capital projects; the public availability of the risk management document and the possibility of assigning specific financial and reputational risk values to the red items on the register

The Director of Corporate Services noted the expectation of the ongoing disruption to supply chains and the impact on the council's ability to deliver services including an increase in costs to the council and explained that individual directorates took note of specific directorate risks and mitigations. She noted that whilst mitigations are identified, these may not be sufficient to reduce the residual risk to medium and that she would feed this concern back to the Corporate Leadership Team. Members noted that the Director of Corporate Services would report back on how the committee's recommendations from the North-South Link Road review were to be implemented. She would also consider the possibility and desirability of ranking the red risks going forwards.

**Recommendation:** that the Audit Committee notes the risks within Strategic Risk Register and the mitigating actions applied to them.

**5 Treasury Management Outturn Report 2020-21**

A representative of the Director of Corporate Services presented his report. He highlighted areas in the report notably the headline metrics for April 2020 to March 2021; the pressure on the interest budget due to short term investment of cash to allow for flexibility of use; the additional external borrowing and repayment of such and the treasury management performance which was within the agreed targets.

He further noted that the treasury management function is carried out by two teams with specialist advice from Airlingclose and a broker against whose returns the in-house teams are benchmarked. He added that 2021 was a conservative year in terms of yield due to ongoing uncertainty with the pandemic. He pointed out various sections of the report and Appendices to members including the Summary of Investment Returns and Activity; Borrowing Activity; Economic Impacts; Budget Implications and Commercial Activity which included cost and valuation, income compared to budget and yield/return on investment.

Members asked questions on the review process and how often this is carried out (the Corporate Services Director's representative noted that reviews were proactive monthly); the average yield on the various types of investments made by the council; high risk investments being conducted by a few local authorities and whether the council responded to consultations on revised codes.

The Corporate Services Director's representative undertook to clarify the investment review process to members. The Head of Finance noted that there was an escalation process to the relevant Executive Member should a review of financial and other performance measures indicate that this was necessary but that formal reporting to the Audit Committee of relevant measures took place at least three times a year.

The Corporate Services Director's representative noted that commercial investments being carried out by some authorities had been criticised by CIPFA (Chartered Institute of Public Finance Accountants) and the Treasury and a revised code after the end of the consultation period was awaited to modify this type of activity by local authorities.

**Recommendation:** that the Audit Committee notes the treasury management out-turn monitoring report to 31st March 2021 including performance, prudential indicators, and commercial investments.

## 6 Treasury Management Mid-Year Report 2021-22 and 2022-23 Treasury Management Considerations

A representative of the Director of Corporate Services presented the report.

He noted that this report unlike previous ones contained a look towards the strategy for the following year after early engagement with committee members.

In presenting his report, the Directors of Corporate Services' representative highlighted the headline metrics for April to September 2021 which included lower cash flows compared to the previous year, no new borrowings and performance indicators within target levels. He drew members' attention to the sections on Summary of Investment Returns and Activity including benchmarking of the in-house treasury management teams' returns; the performance of the pooled funds; borrowings; Economic Impact; Commercial Investments and advice on borrowing to invest. He noted that no material changes to the current over-arching Treasury Management Strategy for 2022-23 were being proposed but some changes may come out of current consultations on the draft 2021 Code and that Environmental, Social and Governance investment-based decisions (ESG) and / or increasing Greener investment opportunities would be introduced.

Members asked questions on CCLA fund values and the process for incorporating the committee's thoughts into the Treasury Management Strategy for the following year. The Head of Finance undertook to consult with members on the latter point.

**Recommendation:** that the Audit Committee notes:

- the treasury management in-year monitoring report to 30th September 2021 including performance, prudential indicators, and commercial investments and
- the proposed matters for inclusion in the Treasury Management Strategy 2022/23

## 7 Audit Committee Member Training Stage 1

The Director of Corporate Services updated members on the proposals for member training.

She and the Chairman had agreed a training needs analysis which would be sent out to members to help them self-assess priorities for their individual training.

After a question from a member, she agreed to consider using a survey instead of a spreadsheet to gather the information.

**8 Independent Members**

The Director of Corporate Services informed members that the person specification and advert for independent members had been refreshed and that issues around eligibility had been clarified with the council's solicitor.

She proposed that an advert would be issued in the next few weeks.

**9 Continuous Improvement**

The Director of Corporate Services updated members on how the council proposed to monitor its major change and business as usual activity and incorporate the incremental changes that are made.  She added that further work was being carried out on how to capture small improvements and assurance activities into the council's business planning framework for 2022-23 to identify areas for continuous improvement.

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Chairman

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# North Somerset Council

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| **REPORT TO THE** | **AUDIT COMMITTEE** |
| **DATE OF MEETING:** | **27TH JANUARY 2022** |
| **SUBJECT OF REPORT:** | **AUDIT COMMITTEE ANNUAL REPORT** |
| **TOWN OR PARISH:** | **NONE** |
| **OFFICER/PRESENTING:** | **COUNCILLOR JOHN CATO – CHAIR OF THE AUDIT COMMITTEE** |
| **KEY DECISION:** | **NO** |

## RECOMMENDATIONS:

The Audit Committee approves the Annual Report for 2020/21 at Appendix 1.

## SUMMARY OF REPORT

The Audit Committee has specific terms of reference given to it from Full Council and as such is required to report back annually to Council on its activities. Appendix 1 is the proposed summary report for approval by the Audit Committee.

The Committee is requested to consider the Annual Report and recommend its approval by Full Council.

## 1. POLICY

There is no statutory obligation to have an Audit Committee, however they are widely recognised as a core component of effective governance as laid out in best practice from a number of professional bodies. The Audit Committee therefore has a key role in advising the council on the adequacy of its financial governance and other management arrangements for achieving the organisation's objectives.

## 2. DETAILS

Appendix 1 sets out a report with details a high-level summary of the activities of the Committee. It provides a commentary over key areas of financial and corporate governance and associated assurance activities including:

- Internal audit
- External audit
- Risk management
- Governance
- Anti-fraud and corruption
- Audit Committee performance

The Annual Report also incorporates the Committee's outline work programme for 2021/22, as shown in Appendix 2. In noting this work programme, it should be acknowledged that the programme may change during the year to accommodate any emerging significant governance, internal control, or risk issues.

Benefits for Customers/ Residents

The committee's work is based around ensuring the council's systems of control and arrangements for the management of risk are effective. This effectiveness is central to the council achieving its corporate objectives. In addition, a strong control environment and effective risk and governance arrangements enable the council to secure its assets and ensure that they are used in the best interests of customers and residents of the council.

## 3. CONSULTATION

Prior to its production, this report has been discussed between the Chair and Vice-Chair of the Audit Committee, the S151 Officer, and the Head of Audit and Assurance.
Given the nature of the report, no further consultation and engagement was necessary beyond these interactions and those that there have been with the Committee over the period covered by the report. Committee Members will have the opportunity to comment and make suggestions in the meeting before it is approved.

## 4. FINANCIAL IMPLICATIONS

There are no direct financial implications in relation to this report.

## 5. LEGAL POWERS AND IMPLICATIONS

There are no direct legal implications from this report which is focussed on a high-level summary of the activities of the Committee.

## 6. CLIMATE CHANGE AND ENVIRONMENTAL IMPLICATIONS

There are no direct environmental implications from this report which is focussed on a high-level summary of the activities of the Committee.

## 7. RISK MANAGEMENT

The Audit Committee is tasked with ensuring that there are effective arrangements within the Council for managing significant risks. This responsibility is reflected in the Audit Committee's Terms of Reference. An effective Audit Committee demonstrates good governance in that democratically elected Members carry out an independent scrutiny role on behalf of the Community. This helps to ensure that the Council is delivering good value to its residents from its services and is managing its key risks appropriately.

## 8. EQUALITY IMPLICATIONS

There are no specific equality implications. The elected members serving on the Audit Committee are representative of the council's political balance.

## 9. CORPORATE IMPLICATIONS

Good Corporate Governance and Risk Management is the responsibility of all officers and Members of the Council.

## 10. OPTIONS CONSIDERED

None.

## AUTHORS

Councillor John Cato – Chairman of the Audit Committee
John.cato@n-somerset.gov.uk

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

## BACKGROUND PAPERS

Members requiring further information are requested to refer to the agenda, reports and minutes of the Committee meetings posted on the council's website.

https://n-somerset.moderngov.co.uk/ieListMeetings.aspx?CommitteeId=153

**Appendix 1**

## AUDIT COMMITTEE ANNUAL REPORT TO COUNCIL - 2020/21

## 1. INTRODUCTION

This is the fifteenth annual report of the Committee since it was established by the Council in July 2006. It covers the work undertaken from August 2020 to July 2021. The purpose of this report is to comply with the Constitution that requires the Full Council to receive a report from the Audit Committee, detailing its activities and effectiveness for the year and the proposed work programme for the following year. The Committee's annual report is one of the means by which the Council is assured that the Committee is carrying out its role effectively.

## 2. GENERAL APPROACH

The Audit Committee is committed to the principles of openness, effectiveness, and collaboration. The Committee is a key component of the Council's governance framework. Its function is to provide an independent and high-level resource to support good governance and strong public financial management. The purpose of the Committee is to provide to those charged with governance independent assurance on the adequacy of the risk management framework, the internal control environment and the integrity of the financial reporting and governance processes. By overseeing both internal and external audit activity it makes an important contribution to ensuring that effective assurance arrangements are in place.

To this end, in the last year the Audit Committee has held informal working group meetings once or twice a month over the year to keep abreast of issues which may be of concern to it and to receive appropriate briefings/ updates from officers. Discussions have given consideration to the following main areas:

- Internal Audit
- Risk Management
- Internal Control Frameworks
- Council Performance Improvement
- Information Management and Accessibility
- Climate Emergency Governance and Internal Control
- Audit Committee Training
- External Best Practice and Peer Education
- Asset and Treasury Management

And has:

- Promoted access to the Audit Committee and to Audit Committee meetings to all members and scrutiny committees
- Maintained dialogue with Audit Committees in other authorities in pursuit of best practice, continuous improvement and to understand lessons learned
- Identified gaps in Audit Committee skills and undertaken training
- Arranged Informal regular meetings with officers, auditors, and executive members to monitor performance, including monthly meetings with the Chief Executive and Director of Corporate Services/ S151
- Completed a 'deep dive' into the governance process over major projects

- Challenged the way that risks are presented to members to ensure that members are more aware when making decisions and caused action to be initiated on improving the council's Risk Management frameworks.
- Made active progress towards influencing Climate Emergency metrics.
- Established peer connections outside of North Somerset Council.

## 3. REVIEW OF WORK UNDERTAKEN IN 2020/21

### a. Financial Governance – Annual Accounts

Due to the COVID lockdown and impact the statutory date for sign off of the Annual Accounts had been delayed. Local authorities were required to commence the public inspection period on or before the first working day of September 2020.

### b. Financial Governance – Treasury Management

i. The Committee acts as a scrutiny function for the Council's Treasury Management arrangements as recommended by CIPFA.

ii. The Committee formally received reports on the outturn of performance for the year 2020/21 including a mid-year update on performance and the strategy for the year 2021/22. Members expressed their thanks to the officers and advisors on explaining the complexities and technical aspects of Treasury Management and were pleased to see that the Council was taking a balanced view in how to exploit opportunities in this area to deliver increased value back to the Council. The Chairman also noted that he wished to have further discussions to clarify his understanding around the reporting process of the Property Investment Board.

### c. Financial Governance - External Audit

i Alongside the audit of the accounts for 2019/20 which were examined during the last 12 months the external auditor also conducted work in relation to concluding a satisfactory VFM opinion for the Council following assessments of our financial resilience, economy, efficiency and effectiveness and a Satisfactory review of our main grant returns.

ii. The external auditor also presented their audit plans. No significant variances were proposed from the previous audit approach and update reports on their work continued to be presented to the Committee alongside references to key national reports and reviews which could impact on the governance framework.

iii. Information was also provided to the Committee around the updated Value for Money arrangements and the audit fees for 2020/21 which were to be agreed.

### d. **Corporate Governance** (Including Risk Management) –

i. The Accounts and Audit Regulations require the Council to carry out an annual review of its governance arrangements, and to produce an annual statement detailing the results of that review.

ii. Whilst there were no significant issues identified, the Committee did recognise through the Annual Governance Statement the state of the financial challenge facing the Council, not least due to COVID-19. The interim Director of Finance and Property also provided members with a verbal update on the Senior Management Review, which had been concluded by the Chief Executive.

iii. During the year the Committee received updates on the Councils key risks. This included a presentation on Corporate Risk Register, COVID-19 Risk Register, and the EU Transitions Risk Register. The Committee spent time discussing the scale of these risks along with progress against actions.

iv. The Committee have also engaged in further conversations with the Chief Executive, the Director of Corporate Services/ S151 and the Head of Business Insight, Policy and Partnerships who have brought a commitment to a standard model dashboard for risk assessment and reporting which has now been implemented.

v. The Audit Committee expressed interest in respect to the governance, transparency, and visibility to Councillors over major projects, and were wanting to learn lessons for the future for other major projects. A deep dive exercise was completed by the Committee, which followed with a range of recommendations being brought forward to the Chief Exec, S151 and appropriate Executive members. Implementation of these recommendations has already been partially implemented.

**e. Corporate Assurance -**

**Internal Audit & Counter Fraud**

i. The Committee was satisfied with the balance of the 2021/22 plan in relation to the Council's key corporate risks as well as the mix of its planned projects, unplanned commissions including COVID-19 related work, and follow-up of previous reports.

ii. In relation to performance the Committee reviewed the outcomes of the service against its key performance indicators for 2020/21, notably high-risk audits and the impacts of COVID-19 unplanned work and investigations, alongside a number of other key indicators.

iii. The committee noted the annual opinion on the internal control framework and that with increased pressure on budgets as well as a shift to homeworking, choices on the degree of internal control had to be made and there was therefore an imperceptible rise in the level of the risk being accepted.

iv. The Committee received a detailed briefing of the elements of Counter-Fraud work in reducing and eliminating fraud and corruption within the Council's activities and monitored progress.

**f. Audit and Assurance Annual Report**

This was the closing Internal Audit Annual Report to the Committee for the financial year 2020/21. Also included was a summary of audit performance and key issues, as well as the formal opinion on the internal control framework.

**g. Audit and Assurance Plan**

This report described the reasonable assurance model for internal audit and summarised the Audit and Assurance work plan as identified and prioritised by internal audit.

**h. Internal Audit Charter**

Internal Audit is an assurance function that primarily provides an independent and objective opinion to the Council on its control environment. Internal Audit helps the organisation to achieve its objectives through a systematic and disciplined approach to evaluate and improve the effectiveness of governance, risk management and control, processes. Its mission is to enhance and protect organisational value by providing risk based and objective assurance, advice and insight.

**I. Awareness & Briefings**

i. Updates and briefings continue to be a strong part of the Committee's approach to raising awareness of key governance issues with members and several briefings were given this year through the normal meeting cycle which included -

- Impact of COVID-19 on Council Finances
- COVID-19 Risk Register
- Role of the Committee
- External Audit
- Internal Audit
- Treasury Management
- Annual Accounts
- Fraud Prevention/ Counter-Fraud inc. Whistleblowing, Anti-Money laundering and Anti-Bribery and corruption
- Risk Management, Risk Assessment and Risk Registers

ii. This approach continues to be welcomed and has resulted in constructive and valuable debate of individual topic areas which will continue into 2021/22.

## 4. AUDIT COMMITTEE TRAINING

The Chair and Vice-Chair are keen that external formal training for all Audit Committee members is undertaken as a regular annual process.

As well as attending the briefings identified in this report, in addition some Audit Committee Training has been achieved by free courses identified by audit committee members and voluntarily completed, particularly Leadership Essentials for Audit Committee Chairs and Vice-Chairs 2 day residential by the Chair and Vice-Chair, and CfPS webinars and training.

The committee is looking to find ways to achieve more external training for all committee members in the forthcoming year.

## 5. WORK PLAN FOR 2021/22

The workplan is kept under review in the informal and formal meetings of the committee and in discussions with the officers and auditors. Planned subjects for 2021 – 2022 are shown in detail in Appendix 2, however it is acknowledged that it may not be possible to cover all of these areas within the financial year and thus the work plan will be update as necessary.

## 6. MEMBERSHIP AND SUPPORT

i. Councillor John Cato is the Chair of the Committee. The Vice Chair is Sandra Hearne, and the other members are Patrick Keating, Marcia Pepperall and Richard Tucker. There are currently no independent co-opted members. The make-up of the Committee will be kept under close review during the year.

ii. The Committee is supported by a range of officers, notably the Director of Corporate Services (S151 Officer), engagement leads from Audit West, the Head of Finance and Democratic Seri.

iii. The external auditors are currently represented by an Engagement Lead and Audit Manager from Grant Thornton.

iv. The Committee is in frequent contact with Audit committees from other authorities to exchange views, methods of working, and ideas.

Audit Committee Formal Meetings Work Plan - which set out provisional agendas for forthcoming meetings - Revised

| Title | Frequency | Lead Officer | Purpose of Report | Jan-21 | Apr-21 | Jul-21 informal | 20 Sept 21 | 25 Nov 21 | 27 Jan 22 | 28 Apr 22 | Jun-22 | Sep-22 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Standing items to cover statutory functions** | | | | | | | | | | | | |
| Internal Audit (IA) updates and Annual Report | Quarterly | Head of Internal Audit | Internal Audit Assurance | | | | | | | | | |
| Counter Fraud - Annual Anti-Bribery, Fraud and Corruption Pol | Annual | Head of Internal Audit | Fraud and corruption detection | | | | | | | | | |
| Adoption of minutes | Quarterly | Committee chair/ Dir Corporate | Review of actions and matters | | | | | | | | | |
| Risk Management - Internal Audit - covered in annual report | Annual | Head of Internal Audit | Reasonable Assurance model | | | | | | | | | |
| Risk Register updates - NSC | Quarterly | Head of Business Insight, Polic | Corporate Governance monitori | | | | | | | | | |
| External Auditor (EA), plan and progress update | Six monthly | External Auditors | To provide those charged with | | | | | | | | | |
| Risk Management Framework Update | Annual | Head of Business Insight, Polic | Risk Management Governance | | | | | | | | | |
| Annual Audit Letter (EA) | Annual | External Auditors | To provide those charged with | | | | | | | | | |
| Annual Governance Statement (Draft) | Annual | Director of Corporate Services | To present the draft AGS for co | | | | | | | | | |
| Annual Governance Statement (Final) | Annual | Director of Corporate Services | To present the AGS for conside | | | | | | | | | |
| Annual Letter of Representation | Annual | Committee chair/ Dir Corporate | Letter of Representation | | | | | | | | | |
| Annual Statutory Accounts (Draft) | Annual | Head of Finance | Draft Statement of Accounts | | | | | | | | | |
| Annual Statutory Accounts (Audited) | Annual | Head of Finance | Audited Statement of Accounts | | | | | | | | | |
| Audit Committee Workplan | Annual | Committee chair/ Dir Corporate | Member Information and Assura | | | | | | | | | |
| External Audit (EA) Findings Report/Audit Opinion | Annual | External Auditors/Head of Finar | To provide those charged with | | | | | | | | | |
| Grant Certification Report (EA) | Annual | External Auditors/Head of Finar | Financial Governance and Assu | | | | | | | | | |
| Report of Work Undertaken by Audit Committee | Annual | Committee Chair/ Head of Inter | Member Information and Assura | | | | | | | | | |
| Accounting Policies | Annual | Head of Finance | Finance Governance and Assu | | | | | | | | | |
| Internal Audit Plan - Draft | Annual | Head of Internal Audit | Draft plan for consultation | | | | | | | | | |
| Internal Audit Plan | Annual | Head of Internal Audit | Annual Internal Audit and Assu | | | | | | | | | |
| Treasury Management Strategy (Draft) | Annual | Head of Finance | Treasury Management Strategy | | | | | | | | | |
| Treasury Management Strategy | Annual | Head of Finance | Treasury Management Strategy | | | | | | | | | |
| Treasury Management (TM) performance/ outturn | Six monthly | Head of Finance | Annual Treasury Management | | | | | | | | | |
| Business Continuity Governance | Annual | To be confirmed | Risk Management Governance | | | | | | | | | |
| **Governance - ad hoc reports when changes happen, a risk arises which requires additional assurance or as a result of audit recommendations** | | | | | | | | | | | | |
| Major Projects Governance Strategy Update | When required | Head of Major Projects | Major Projects Governance | | | | | | | | | |
| Outsourced Services Governance Strategy Update | When required | Director of Corporate Services | Strategic Procurement Governa | | | | | | | | | |
| Procurement Governance Strategy Update | When required | Director of Corporate Services | Outsourced Services Governan | | | | | | | | | |
| Support Services Contract Governance Briefing | When required | Director of Corporate Services | Support Services Governance | | | | | | | | | |
| Critical Incident and Emergency Response Audit and Governan | When required | Director of Corporate Services | Corporate Governance monitori | | | | | | | | | |
| Information Technology Audit and Assurance | When required | Director of Corporate Services | IT Governance Assurance | | | | | | | | | |
| Procurement Processes Governance Assurance | When required | Director of Corporate Services | Procurement Governance Assu | | | | | | | | | |
| Information Security Audit and Assurance | When required | Director of Corporate Services | Security Gopvbernance Assura | | | | | | | | | |
| Third Party Outsourced Services Governance Assurance | When required | Director of Corporate Services | Delegated/Outsiourced Service | | | | | | | | | |
| Directorate Report on organisation and governance. | When required | As required | Directorate Governance and Int | | | | | | | | | |
| Constitution Review and Update briefing - informal | When required | Assistant Director - Legal and D | for recommendation of propose | | | | | | | | | |
| Significant Partnerships Governance Strategy Update | When required | Director of Corporate Services | Governance, Risk Management | | | | | | | | | |
| Contract Standing Orders | When required | Assistant Director - Legal and D | Principles and structure of gove | | | | | | | | | |
| Ethics and Standards | When required | Internal Audit? | Ethics and Standards Assuranc | | | | | | | | | |
| HR matters | When required | Director of Corporate Services | HR Governance | | | | | | | | | |
| Financial Regulations | When required | Head of Finance | Finance Governance and Assu | | | | | | | | | |
| **Annual Training - suggest that training needs analysis is completed to ensure focussed and proportiona** | | | | | | | | | | | | |
| AC Member Training - stage 1 - plan/specify/establish | | Director of Corporate Services/H | Redmond Review - Audit Comn | | | | | | | | | |
| AC Member Training - stage 2 - training commissioned | | Director of Corporate Services/H | Redmond Review - Audit Comn | | | | | | | | | |
| Principles of Governance, Assurance and Audit | | Director of Corporate Services/H | To ensure skills and knowledge | | | | | | | | | |
| Role of Audit Committee and deliverables | | Director of Corporate Services/H | To ensure skills and knowledge | | | | | | | | | |
| Role of External Audit and deliverables | | Director of Corporate Services/H | To ensure skills and knowledge | | | | | | | | | |
| Role of Internal Audit and deliverables | | Director of Corporate Services/H | To ensure skills and knowledge | | | | | | | | | |
| Role of S151/Finance | | Director of Corporate Services/H | To ensure skills and knowledge | | | | | | | | | |
| Role & Responsibilities of Senior Officers | | Director of Corporate Services/H | To ensure skills and knowledge | | | | | | | | | |
| Annual Accounts | | Director of Corporate Services/H | To ensure skills and knowledge | | | | | | | | | |
| Internal Controls | | Director of Corporate Services/H | To ensure skills and knowledge | | | | | | | | | |
| Risk Management | | Director of Corporate Services/H | To ensure skills and knowledge | | | | | | | | | |
| Business Performance | | Director of Corporate Services/H | To ensure skills and knowledge | | | | | | | | | |
| **Development work - items to be brought forward and planned in at later stage** | | | | | | | | | | | | |
| External Independent Members - stage 1 - plan/specify/review/recruit | | Head of Democratic Services/N | Redmond Review - Audit Comn | | | | | | | | | |
| External Independent Members - stage 2 - induction | | Head of Democratic Services/N | Redmond Review - Audit Comn | | | | | | | | | |
| Voice of the Customer Report? | | Customer Experience Officer/(V | Customer/Resident Experience | | | | | | | | | |
| Continuous Improvement | | | | | | | | | | | | |

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17 December 2021

Dear Councillor Cato

Under the 2020 Code of Audit Practice, for relevant authorities other than local NHS bodies we 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.

We wrote to you as part of our audit findings report in September to confirm that we expected to publish our Auditor's Annual Report, including our commentary on arrangements to secure value for money, no later than December 2021. We have not been able to issue our Auditor's Annual Report by this date because of the need to divert team resources to completing the audit opinions on the accounts of other local councils. We now expect to publish our Auditor's Annual Report on North Somerset Council by the end of February 2022.

For the purposes of compliance with the 2020 Code, this letter constitutes the required audit letter explaining the reasons for delay.

Yours faithfully

*JD Roberts*

Jon Roberts

Partner

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# North Somerset Council

**REPORT TO THE** **AUDIT COMMITTEE**

**DATE OF MEETING:** **27TH JANUARY 2022**

**SUBJECT OF REPORT:** **ANNUAL GOVERNANCE STATEMENT 2021/22**

**OFFICER PRESENTING:** **JEFF WRING - AUDIT WEST**

**RECOMMENDATION**

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 2021/22. 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

## 2. POLICY

2.1 The council has adopted a Local Code of Corporate Governance, 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/2021-10/statement%20of%20accounts%202020-21_0.pdf.

**3.2 Process for 2021/22 Statement**

An overview of the 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.

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 was one significant issue identified in the 2020/21 statement related to the impacts of the ongoing Coronavirus Pandemic (COVID-19) and consequent implications around; impact on public health, the local economy, managing financial pressures, organisational resilience, democracy and the safeguarding of vulnerable adults & children during lockdown.

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

At our next meeting in April we will update the position in relation to this issue and provide an opportunity for the committee to input any views they have on governance or significant issues.

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.

## 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

Jeff Wring - Audit West jeff_wring@bathnes.gov.uk

## BACKGROUND PAPERS

Council's Local Code of Corporate Governance

## Annex A. Outline Methodology for Preparing the Annual Governance Statement 2021/22

### 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 2021/22 | |
|---|---|
| Audit Committe | Annual |

| Review progress made against any significant issues included in the 2020/21 Annual Governance Statement | |
|---|---|
| Audit Committee | Ongoing |

| Consideration of significant issues for 2021/22 Annual Governance Statement | |
|---|---|
| Corporate Leadership Team, Statutory Officers & Finance Business Partners | Ongoing |

**Approval of 2021/22 Annual Governance Statement**

**Leader, Chief Executive and Audit Committee - September 2022**

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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<br>• 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)<br>• Leading by example and using the above standard operating principles or values as a framework for decision making and other actions<br>• 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<br>• Underpinning personal behaviour with ethical values and ensuring they permeate all aspects of the organisation's culture and operation<br>• Developing and maintaining robust policies and procedures which place emphasis on agreed ethical values<br>• 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<br>• 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<br>• Striving to optimise the use of the full powers available for the benefit of citizens, communities and other stakeholders<br>• Dealing with breaches of legal and regulatory provisions effectively<br>• 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<br>• 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<br>• 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<br>• 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<br>• Developing formal and informal partnerships to allow for resources to be used more efficiently and outcomes achieved more effectively<br>– Ensuring that partnerships are based on: trust<br>– a shared commitment to change<br>– 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<br>• Ensuring that communication methods are effective and that members and officers are clear about their roles with regard to community engagement<br>• Encouraging, collecting and evaluating the views and experiences of communities, citizens, service users and organisations of different backgrounds including reference to future needs<br>• Implementing effective feedback mechanisms in order to demonstrate how views have been taken into account<br>• Balancing feedback from more active stakeholder groups with other stakeholder groups to ensure inclusivity<br>• 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<br>• 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<br>• Delivering defined outcomes on a sustainable basis within the resources that will be available<br>• Identifying and managing risks to the achievement of outcomes<br>• 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<br>• 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<br>• 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<br>• 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<br>• 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<br>• Engaging with internal and external stakeholders in determining how services and other courses of action should be planned and delivered<br>• Considering and monitoring risks facing each partner when working collaboratively, including shared risks<br>• Ensuring arrangements are flexible and agile so that the mechanisms for delivering goods and services can be adapted to changing circumstances<br>• 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<br>• Ensuring capacity exists to generate the information required to review service quality regularly<br>• Preparing budgets in accordance with objectives, strategies and the medium term financial plan<br>• 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<br>• Ensuring the budgeting process is all-inclusive, taking into account the full cost of operations over the medium and longer term<br>• 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<br>• 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<br>• 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<br>Recognising the benefits of partnership working where added value can be achieved<br>• 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<br>• Publishing a statement that specifies the types of decisions that are delegated and those reserved for the collective decision making of the governing body<br>• 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<br>• 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<br>– 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<br>– ensuring personal, organisational and system-wide development through shared learning, including lessons learnt from governance weaknesses both internal and external<br>– Ensuring that there are structures in place to encourage public participation<br>– Taking steps to consider the leadership's own effectiveness and ensuring leaders are open to constructive feedback from peer review and inspections<br>– Holding staff to account through regular performance reviews which take account of training<br>– 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<br>• Implementing robust and integrated risk management arrangements and ensuring that they are working effectively<br>• 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<br>• 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<br>• 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<br>• Providing members and senior management with regular reports on service delivery plans and on progress towards outcome achievement<br>• 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<br>• Evaluating and monitoring risk management and internal control on a regular basis<br>• Ensuring effective counter fraud and anti-corruption arrangements are in place<br>• Ensuring additional assurance on the overall adequacy and effectiveness of the framework of governance, risk management and control is provided by the internal auditor<br>– 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<br>– 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<br>• Ensuring effective arrangements are in place and operating effectively when sharing data with other bodies<br>• 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<br>• 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<br>• 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<br>• Ensuring members and senior management own the results reported<br>• 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)<br>• Ensuring that this Framework is applied to jointly managed or shared service organisations as appropriate<br>• 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<br>• 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<br>• Welcoming peer challenge, reviews and inspections from regulatory bodies and implementing recommendations<br>• Gaining assurance on risks associated with delivering services through third parties and that this is evidenced in the annual governance statement<br>• 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:** **27TH JANUARY 2022**

**SUBJECT OF REPORT:** **PROCUREMENT OPTIONS – EXTERNAL AUDIT**

**TOWN OR PARISH:** **NONE**

**OFFICER/PRESENTING:** **JEFF WRING – AUDIT WEST**

**KEY DECISION:** **NO**

## RECOMMENDATIONS:

That the Audit Committee supports the recommended option for the future procurement of External Auditors to the Council by Public Sector Audit Appointments Limited (PSAA).

## SUMMARY OF REPORT

The report sets out the legislative background and options for the future provision and procurement options for the External Auditors to the Council. The report recommends we use a national sector led approach to maximise value for money and associated benefits on quality of service.

## 1. POLICY

There is a statutory obligation to have an external auditor of the council's accounts and an effective auditor is widely recognised as a core component of good governance as laid out in best practice from a number of professional bodies. The Audit Committee therefore has a key role in advising the council on the adequacy of its external audit arrangements and supporting the S151 Officer (Director of Corporate Services) in carrying out the Council's statutory duties in this area.

## 2. DETAILS

Background

2.1 The Local Audit & Accountability Act 2014 put in place the framework which allowed local authorities to appoint their own external auditors. Prior to 2010, the Audit Commission was responsible for appointments with the work either being undertaken by their in-house auditors or by a limited number of private firms.

2.2 In August 2010, it was announced that the Audit Commission would be abolished, with the stated aims being to reduce costs and improve local democratic accountability by allowing local authorities to appoint their own external auditors from a more competitive market.

2.3 As part of the transitional arrangements, the Audit Commission undertook a competitive exercise which resulted in a series of regional contracts being awarded to Grant Thornton, KPMG, Ernst & Young and Mazars. The contracts commenced in 2012 and saved over £25M nationally in audit fees each year.

2.4 The Audit Commission itself closed in March 2015 with responsibility for the existing appointments transferring to Public Sector Audit Appointments Limited (PSAA). PSAA is an independent company established by the Local Government Association. The transitional arrangements for principal authorities were extended for a further year until April 2018, however Health bodies and smaller local government bodies still needed to appoint their own external auditors from April 2017.

2.5 The government made a decision to allow councils to come together to continue to procure audit services through a sector led organisation (PSAA) or to appoint their own auditor. At the time it was envisaged that the majority of councils would procure jointly and avoid the need to establish an auditor panel and undertake their own procurement exercise.

Appointing Period 2018/19 – 2022/23

2.6 Within the local government sector the vast majority of Councils indeed expressed a preference to join a sector led procurement exercise from PSAA and at the September 2016 Audit Committee meeting, it was the recommendation of the S151 Officer and Head of Audit that North Somerset Council should also follow this option.

2.7 The main basis for this recommendation was that there were no resources available for the Council to carry this exercise out on their own and there were very clear financial and quality benefits by following the recommended option which would also help the major firms to also plan their resources and bids more effectively.

2.8 Full Council approved the recommendation to opt-in to PSAA at their meeting of January 2017 and Grant Thornton have been providing External Audit Services to the Council following this procurement exercise.

2.9 PSAA report that out of a total of 494 eligible bodies, at the time of the opt-in period in 2017, 484 took the decision to opt in.

Appointing Period 2023/24 – 2027/28

2.10 On 22 September 2021, PSAA invited all eligible bodies to become opted-in authorities for the audit years 2023/24 to 2027/28 in its role as a specified appointing person. The decision to become an opted in authority must again be made by Full Council and an acceptance notice has to be returned by 11th March 2022.

2.11 There are three ways that North Somerset Council can appoint its auditor for the five financial years from 2023/24, these being:

1. Undertake an individual auditor procurement and appointment exercise;
2. Undertake a joint audit procurement and appointing exercise with other bodies;
3. Join PSSA's sector led national scheme.

2.12 Given the current very challenging local audit market and the many advantages highlighted during the previous appointment, it is recommended that North Somerset Council once again join the PSAA scheme. By joining this scheme, the Council will:

- Avoid the need to establish an independent auditor panel;
- Avoid the need to manage their own auditor procurement;
- Benefit from PSAA's robust process in validating fee variation proposals; and
- Assume a high level of participation based on previous uptake levels which will support market sustainability and realistic prices in a challenging market

2.13 The Audit Committee are therefore asked to support the recommendation so that arrangements can be finalised in the next few months to confirm our approach to securing our involvement in the sector led exercise by PSAA.

## 3. CONSULTATION

The report has been issued to the S151 Officer (Director of Corporate Services).

## 4. FINANCIAL IMPLICATIONS

There are no direct charges from using PSAA Ltd and there are very clear financial and quality benefits by following the recommended option which should also help the major firms to also plan their resources and bids more effectively.

## 5. LEGAL POWERS AND IMPLICATIONS

There is a statutory obligation to have an external auditor of the council's accounts and the Local Audit and Accountability Act 2014 provided framework in which Local Authorities could appoint their external auditors.

## 6. CLIMATE CHANGE AND ENVIRONMENTAL IMPLICATIONS

There are no direct environmental implications from this report.

## 7. RISK MANAGEMENT

An effective external auditor demonstrates one aspect of good governance on behalf of the Council and the wider Community. This helps to ensure that the Council is delivering good value to its residents from its services and is managing its key risks appropriately.

## 8. EQUALITY IMPLICATIONS

There are no specific equality implications.

## 9. CORPORATE IMPLICATIONS

Good Corporate Governance and Risk Management is the responsibility of all officers and Members of the Council.

## 10. OPTIONS CONSIDERED

As laid out in the report section 2. Two other options have been considered, the first of which is to carry out the exercise ourselves or to partner with a group of neighbouring authorities. In both cases there are no available resources or expertise to carry out the exercise or any appetite from other councils in our region to use scarce capacity on this initiative. Almost all councils will be using the recommended option. As laid out in the report the rationale for the recommended option is that there are clear financial and quality benefits coupled with the continued ability to represent our views around the choice and suitability of potential suppliers.

## AUTHORS

Jeff Wring - Service Director – One West jeff_wring@bathnes.gov.uk

Peter Cann – Head of Audit and Assurance – Audit West peter_cann@bathnes.gov.uk

## BACKGROUND PAPERS

Members requiring further information are requested to refer to the agenda, reports and minutes of the Committee meetings posted on the council's website.

https://n-somerset.moderngov.co.uk/ieListMeetings.aspx?CommitteeId=153

# North Somerset Council

**REPORT TO THE AUDIT COMMITTEE**

**DATE OF MEETING: 27 JANUARY 2022**

**SUBJECT OF REPORT: AUDIT PLAN – AUDIT COMMITTEE CONSULTATION**

**TOWN OR PARISH: NONE**

**OFFICER 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 2022/23.
- Note the intention to keep the plan under constant review, including a six-month reassessment, 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 2022/23. It also outlines the intended approach towards COVID-19 activity.

## 2. POLICY

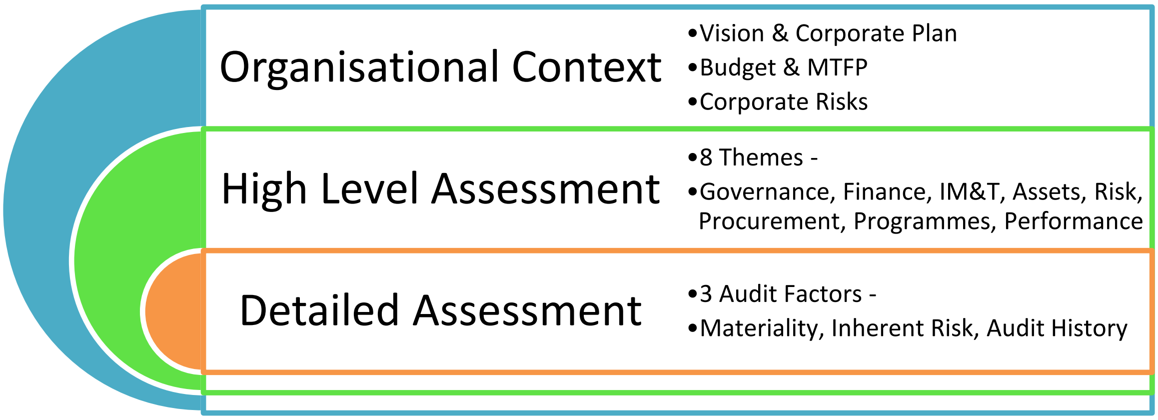
The work of the Internal Audit Service is to provide independent assurance to the council's senior officers and members that governance, risk management and controls are sufficient in ensuring delivery of the council's objectives.

## 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. The model we use – the Reasonable Assurance Model - has previously been reported to the Committee in detail.

3.2 It was created and adopted in conjunction with a number of other councils in the South West and indeed its approach won a Public Finance award in 2017.

3.3 The outline of the model is as follows with the key elements in the middle section which introduced 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 take place between December to March with the following officers/ groups:
- Section 151 Officer
- Finance Business Partners/ Head of Finance
- Directorate Leadership Teams
- Statutory Officers
- Audit Committee

**3.5 <u>COVID-19 and 6 Monthly Rolling Plan Review</u>**

3.5.1 During the financial year 2020/21, 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 November 2020 Audit Committee meeting.

3.5.2 Whilst only small adjustments were required to the subsequent year's plan (2021/22), given the ongoing uncertainty of COVID-19 and the possibility of more variants (such as Omicron) it is the intention of the Internal Audit Service to follow 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 2022 – 31st March 2023, the plan will be kept under constant 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. In addition to this, a COVID-19 contingency resource will continue to be held to help smooth any impact.

**3.6 <u>Consultation & Input – Audit Committee</u>**

3.6.1 The Audit Committee is a key stakeholder and ultimately approve the Audit Plan and 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 at the end of March.

3.6.2 In addition to Covid-19 factors around Financial Resilience, local economic impacts and ongoing financial assurance around the use of Covid-19 grants the Chartered Institute of Internal Auditors has drawn up ten key areas for 2022 which organisations should take account of in preparing their audit plans.

These are detailed below as a point of reference to help the committee in understanding where they feel audit coverage may be beneficial.

- IT security: response and recovery
- Rising sustainability regulations
- Accelerated digitisation and low-code adoption
- Workforce fatigue and cultural erosion
- Pandemic response: organisational and strategic resilience
- Financial risk and the looming insolvency wave
- Rising inflation and the global tax clampdown
- Climate change and sustainability is now a principal risk
- Supply chain strains and the race to flexibility
- Health and safety amid the continued COVID-19 threat

## 4. CONSULTATION

In developing and delivering the Annual Audit Assurance Plan the Internal Audit Service has consulted widely with officers and members. Ongoing consultation will continue with the Audit Committee, including at six-months into the year.

## 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 of risks arising from COVID-19. Internal Audit assists the council in identifying risks, improvement areas and recommending good practice.

## 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 would 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 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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## BACKGROUND PAPERS

Annual Audit Assurance Plan 2021/22 Audit Committee April 2021
Annual Audit Assurance Plan 2020/21 Audit Committee July 2020

# North Somerset Council

**REPORT TO THE AUDIT COMMITTEE**

**DATE OF MEETING: 27 JANUARY 2022**

**SUBJECT OF REPORT: TREASURY MANAGEMENT STRATEGY 2022/23**

**TOWN OR PARISH: ALL**

**OFFICER/MEMBER PRESENTING: AMY WEBB, DIRECTOR OF CORPORATE SERVICES**

**KEY DECISION: N/A**

**REASON:** Not an Executive decision

**RECOMMENDATIONS**

The Audit Committee is requested to note the contents of the report which summarise the Treasury Management Strategy for 2022/23 and its associated impacts.

## 1. SUMMARY OF REPORT

The purpose of the report is to present the council's draft annual ***treasury management strategy*** (TMS) for the 2022/23 financial year and builds on the previous report on this matter, which was considered by the Audit Committee at its meeting in November 2021.

To provide further training and support in this area, an informal workshop session held on 11 January 2022, which was jointly facilitated by Finance Officers and Arlingclose, who are the council's treasury management advisors. This approach is consistent with previous years when specialist information sessions have also been arranged.

The report contains details of;

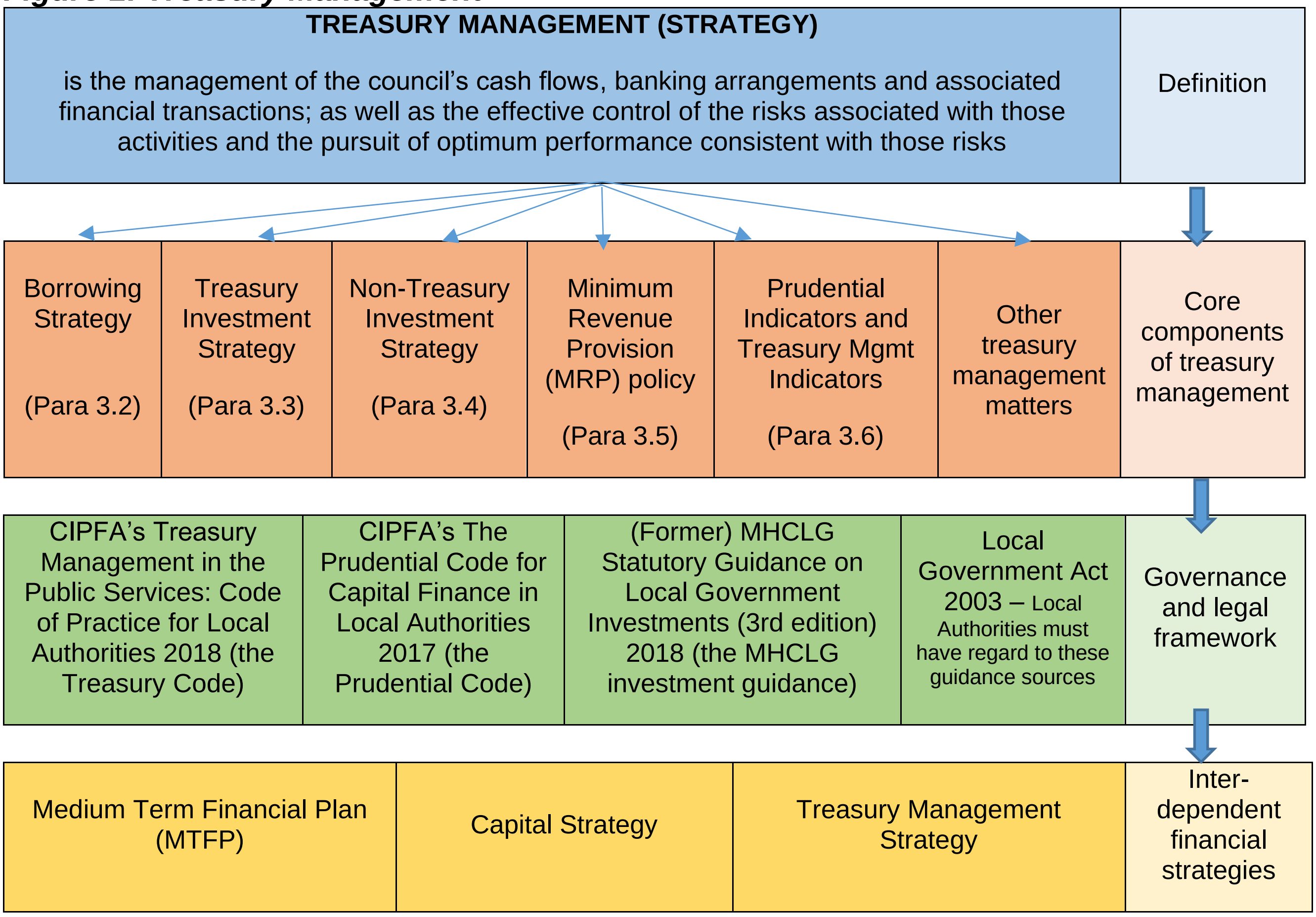
- how the council plans to manage its cash-flows and resources to ensure effective treasury management,
- the proposed Prudential Indicators for 2022/23, and
- the proposed policy for making Minimum Revenue Provision in respect of the repayment of the council's external debt, within the revenue budget.

## 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***




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 taken into account 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 of 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 2022/23 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
- Treasury investment strategy – paragraph 3.3
- Non-treasury investment strategy – paragraph 3.4
- 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 2021, the council held £180m of borrowing which it has drawn down over a number of years to fund capital previous expenditure.

- £143m of this debt is held with the Public Works Loan Board (PWLB) at an average rate of 3.86%
- £ 12m of this debt relates to debt managed by Bristol City Council, in respect of the former Avon
- £ 25m of this debt relates to long-term leasing arrangements, the largest of which relates to the Sovereign Centre

The summary below details the estimated level of borrowing that are likely to be required over the next few years to fund the schemes that are included within the current capital programme, as well as those being requested for approval in the Capital Strategy report for 2022/23.

| **EXPENDITURE BUDGET** | **2021/22 £'000** | **2022/23 £'000** | **2023/24 £'000** | **2024/25 £'000** | **2025/26 £'000** | **TOTAL £'000** |
|---|---|---|---|---|---|---|
| **Approved Programme** | **94,624** | **94,799** | **99,181** | **17,977** | **0** | **306,581** |
| - Planned additions to the programme | 0 | 38,722 | 58,331 | 37,689 | 20,569 | **155,311** |
| **DRAFT CAPITAL PROGRAMME** | **94,624** | **133,521** | **157,512** | **55,666** | **20,569** | **461,892** |

| **FUNDING RESOURCES** | **2021/22 £'000** | **2022/23 £'000** | **2023/24 £'000** | **2024/25 £'000** | **2025/26 £'000** | **TOTAL £'000** |
|---|---|---|---|---|---|---|
| Earmarked Grants and contributions | 74,328 | 80,472 | 108,910 | 28,665 | 16,302 | **308,677** |
| Unsupported Borrowing | 14,216 | 48,969 | 43,263 | 27,274 | 4,267 | **137,989** |
| Capital Receipts | 1,510 | 1,621 | 1,500 | 1,562 | 0 | **6,193** |
| Revenue Contributions | 1,774 | 145 | 0 | 0 | 0 | **1,919** |
| Non Earmarked Receipts | 2,796 | 2,314 | 3,839 | -1,835 | 0 | **7,114** |
| | **94,624** | **133,521** | **157,512** | **55,666** | **20,569** | **461,892** |

As can be seen from the table above, the overall level of new borrowing required over the period to 2026 is currently estimated to be £137.989m, with approximately £63.185m of this new borrowing being required to finance capital expenditure before the end of March 2023.

The summary above and all the borrowing calculations in this report only reflect proposals which are to be included within the council's approved capital programme. Should any further increases in borrowing or forward funding decisions subsequently be made beyond these levels, then further council approval would be required to re-state prudential indicators, and additional revenue resources identified to fund debt repayment costs.

The council may also borrow additional sums to pre-fund future years' requirements, providing that this does not exceed the authorised limit for borrowing, which is currently set at £244m.

**3.2.2. Summary:**

The council currently holds £180m of long-term debt and this would increase by a further £64m should the council spend the amount of capital expenditure that it plans to approve. 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 this borrowing during 2022/23.

**3.2.3. Objectives:**

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

**3.2.4. Proposed Strategy for 2022/23:**

External borrowing decisions will be deferred in respect of the 2022/23 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 2022/23:**

Given the levels of planned investment the council recognises that it will be required to borrow externally over the period 2023-2026 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 the majority of its long-term borrowing from the PWLB it will consider long-term loans from other sources in the future, including banks, pensions and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order 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 is that they are no longer able to draw down loans from the PWLB if their 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 cash-flows, then it must be accepted that the council will make investment decisions on an almost daily basis in order 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 also the retention of monies within reserves, which are may be held to fund future spending or be held to manage risk.  It will be 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 current level of investment balances held and performance,
- market conditions, interest rates and future expectations,
- current regulatory framework and also future changes,
- annual cash-flow forecasts for the year ahead,
- planned profile of spending linked to capital receipts, grants and reserves,
- new investment plans, and
- any other strategic decisions that may have been taken elsewhere within the council's treasury management strategy (i.e. its borrowing strategy)

### 3.3.2. Summary:

In the past 12 months, the council's treasury investment balance has ranged between £112m and £190m which is significantly above levels in previous years. A review has been undertaken which show that this is, to a large extent, linked to the ongoing impacts of Covid-19, notably surrounding the cash flows related to the many support packages and intervention measures that the government has put in place over the past 2 years. Forecasts do indicate that these levels are expected to reduce by 31 March 2022 as sums are paid to businesses, providers and potentially returned to the government, and even further during 2022/23.

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 significantly reduced due to the current economic environment, the portfolio is providing returns in line with the risks being taken.

Market conditions currently show that interest rates are beginning to rise, initially driven by the recent bank of England base rate rise, it will therefore be important to consider interest rates before placing any long-term fixed rate investments as the council may inadvertently lock in funds and miss a potential opportunity. Arlingclose, as the council's appointed treasury advisors, provide on-going economic commentary and interest rate forecasts to assist the Council in formulating its treasury strategies. Key issues from the latest economic commentary are detailed in Appendix 1, Section 7.

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.

### 3.3.3. Objectives:

Both the CIPFA Code and the MHCLG Guidance require councils to have two underlying objectives, 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 does not 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 appetite to risk.

### 3.3.4. Treasury Investment Strategy for 2022/23:

A) The council continues to place short-term treasury investments in fixed and variable-term cash deposits with a range of counter-parties; this Strategy would reduce the risk of capital losses, ensure liquidity is maintained and also limits the council's exposure to interest rate risk losses as well as minimising exposure to credit risk through diversification. This will be achieved through the application of limits on the amount and period of its investments with individual counterparties, and in individual countries.

B) The council continues to place some medium to longer-term investments in alternative investment products; this Strategy would align some longer-term cash balances to longer term investment periods, provide further diversification of the portfolio in terms of product, counter-party / credit risk and inflationary risk. These types of investment will provide higher rates of return however, it must be accepted that they may potentially provide a capital loss should prices fall beyond the initial investment levels, which would need to be reflected within the annual revenue budget from April 2023.

C) The council will not use any of its surplus cash-flows to make non treasury related investments, as these would fall outside of the permissions of the treasury investment policies and guidance and they would also expose the council to the potential for further capital losses.

### 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.

| Sector | Overall Limit[1] | In-house Limit | Tradition Limit | Time Limit |
|---|---|---|---|---|
| UK Central Government | **no limit** | unlimited | unlimited | 50 years |
| UK Local Authorities[3] | **£15m** | £10m | £5m | 25 years |
| 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 |
| **AA+** | **£25m** | £25m | £0m | 5 years |
| **AA** | **£22m** | £22m | £0m | 4 years |
| **AA-** | **£20m** | £16m | £4m | 3 years |
| **A+** | **£18m** | £14m | £4m | 2 years |
| **A** | **£16m** | £12m | £4m | 13 months |
| **A-** | **£13m** | £9m | £4m | 13 months |
| UK building societies* whose lowest long-term rating is A- and societies without credit ratings, that have an asset size of more than **£0.4bn** | **£10m** | £6m | £4m | 6 months |
| UK building societies* whose lowest long-term rating is A- and societies without credit ratings, that have an asset size of more than **£1bn** | **£10m** | £6m | £4m | 13 months |
| Money market funds[2] and similar pooled vehicles whose lowest published credit rating is AAA* | **£15m** | £15m | £0m | N/A |
| Pooled Investment funds | **£5m per Fund Type** | *£5m per Fund type* | £0m | N/A |
| The Council's Bank accounts | **Net £9m** | Net £9m | £0m | 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*

This table must be read in conjunction with the notes 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 bank. A group of banks under the same ownership will be treated as a single organisation for limit purposes.

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.

#### 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 taken into account.

### 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**. No further 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 2022/23.

### 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 2022/23:

*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 2022 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 2022/23 will not be subject to an MRP charge until 2023/24.

**It should be noted that the MRP charge associated with current capital spending approvals has been included within the budget for 2022/23 and the planned spending for 2022/23 has been factored into the council's medium term financial plan for 2023/24.**

### 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 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 2021 and a further report will be considered at the meeting in January 2022.

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.

The meeting was 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.

## 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 2018 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 2018 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 & ENVIRONMENTAL IMPLICATIONS

The council will continue to avoid any direct treasury management investments in fossil fuel related companies and will engage with its advisors to explore and assess the potential for any future investment opportunities in funds with a Renewable Energy & Sustainability focus as these products continue to be developed by the market in response to the Climate & Nature Emergency agenda.

The council has maintained its 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.

It is also the intention to better understand the extent to which other investments held may contribute towards climate change, understand exposure to risks driven by climate change, and to keep abreast of potential investment opportunities that have regard to climate change. However, the primary considerations will remain security and liquidity, then yield.

## 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 as a result 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 in order 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 considers the strategy to be followed during 2022/23, for investment and borrowing, which have been aligned with the capital programme. It also sets out the council's expectation for interest rates and highlights the uncertainties and risks in the forecast due to market conditions.

Furthermore, 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 2022/23.

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.

The Prudential Code and Treasury Management Codes of Practice have been updated effective from December 2021. Due to the late publication, and that not all guidance has been published at the time of writing, full adoption of the reporting requirements has been deferred until 2023/24 as permitted by the Code.

**APPENDICES**

1. Treasury Management Strategy for 2022/23
2. Prudential Indicators for 2022/23
3. Treasury Risk Register
4. Glossary of Terms

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## BACKGROUND PAPERS

Other relevant guidance includes:

- CIPFA – The Prudential Code for Capital Finance in Local Authorities 2017
- MHCLG – Statutory Guidance on Local Government Investments (3rd edition) 2018
- CIPFA - Treasury Management in Public Services – Guidance notes for local authorities 2018

## 1 INTRODUCTION

Treasury management is the management of the council's cash flows, borrowing and investments, and the associated risks. The council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the council's prudent financial management.

The council maintains and operates a treasury management policy comprising the principles and practices to which the activity will comply. 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.

## 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 invests its money for three broad purposes:
- Treasury management investments – ie 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
- Commercial investments - to earn investment income, usually rental income, and to provide capital appreciation, from a portfolio of property investments.

The strategy for 2022/23 in respect of the following aspects of the treasury management function is based upon the treasury 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 2021 is as follows:

***Table 5: Current portfolio of borrowing and investment balances***

| **LONG-TERM DEBT** | **Principal £m** | | **Average rate** | **Average term** |
|---|---|---|---|---|
| Fixed rate – PWLB | £142.9 | £142.9 | 3.86% | 1-36 years |
| Other long-term liabilities;<br>- Ex-Avon loan debt<br>- Other (incl leasing)* | <br>£12.0<br>£24.7 | <br><br>£36.7 | <br>4.82%<br>4.60% | <br>1-30 years<br>1-40 years |
| **TOTAL DEBT** | | **£179.6m** | | |
| **SHORT-TERM TREASURY INVESTMENTS** | **Principal £m** | | **Average rate** | **Average term** |
| Managed in-house;<br>- UK banks<br>- UK building societies<br>- Local authority/ DMO | <br>£13.0<br>£22.0<br>£116.0 | <br><br><br>£151.0 | <br>0.15%<br>0.17%<br>0.10% | <br>12 months<br>6 months<br>8 months |
| Cash managed by Tradition;<br>- Local authority/ DMO | <br>£10.0 | <br>£10.0 | <br>0.10% | <br>10 months |
| **LONG-TERM TREASURY INVESTMENTS** | **Principal £m** | | **Average rate** | **Average term** |
| Managed in-house;<br>- CCLA<br>- UBS Multi Asset Income Fund<br>- Ninety-One Diversified Income Fund | <br>£5.0<br>£1.0<br>£4.0 | <br><br><br>£10.0 | <br>4.63%<br>4.69%<br>3.59% | <br>3-5 years<br>3-5 years<br>3-5 years |
| **TOTAL TREASURY INVESTMENTS** | | **£171.0m** | | |
| **TOTAL NET DEBT** | | **£8.6m** | | |

**The lease principal, rate and term as at the previous year end (31st March 2021) - 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 6: maturity profile of the Council's PWLB borrowing and investments***

| **MATURITY PROFILE** | **PWLB LONG TERM DEBT £m** | **SHORT TERM INVESTMENTS £m** | **NET DEBT / (INVESTMENT) £m** |
|---|---|---|---|
| Maturing Jan to March 2022 | £2.5 | £36.0 | (£33.5) |
| Maturing 2022/23 & 2023/24 | £6.0 | £125.0 | (£119.0) |
| Maturing 2024/25 to 2026/27 | £28.3 | £0 | £28.3 |
| Maturing 2027/28 to 2031/32 | £31.1 | £0 | £31.1 |
| Maturing 2032/33 to 2036/37 | £33.0 | £0 | £33.0 |
| Maturing 2037/38 to 2041/42 | £22.0 | £0 | £22.0 |
| Maturing after 2041/42 | £20.0 | £0 | £20.0 |
| **TOTALS** | **£142.9** | **£161.0** | **(£18.1)** |

## 4 TREASURY INVESTMENT STRATEGY

4.1 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.

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

4.3 **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.

4.4 **Negative interest rates:** The COVID-19 pandemic has increased the risk that the Bank of England will set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. Since investments cannot pay negative income, negative rates will be applied by reducing the value of investments. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

4.5 **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.

4.6 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

4.7 **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.

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

4.9 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.

4.10 **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.

4.11 **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.

4.12 **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.

4.13 **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.

4.14 **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.

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

4.16 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.

4.17 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.

4.18 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.

4.19 **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.

4.20 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.

**4.21 Foreign countries**

4.22 Investments in foreign countries will be limited to those that hold a AAA, AA+ or AA sovereign credit rating from all three major credit rating agencies, and to a maximum of **£12 million per country**, this limit to be divided between the in-house team (£8m) and cash manager Tradition (£4m). There is no limit on investments in the UK whatever the sovereign credit rating.

4.23 Banks that are domiciled in one country but are owned in another country will need to meet the rating criteria and will count against the limit for both countries. Overseas subsidiaries of foreign banking groups will normally be assessed according to the country of domicile of the parent organisation. However, Santander UK plc (a subsidiary of Spain's Banco Santander) will be classed as a UK bank due to its substantial UK franchises and the arms-length nature of the parent-subsidiary relationship.

4.24 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.

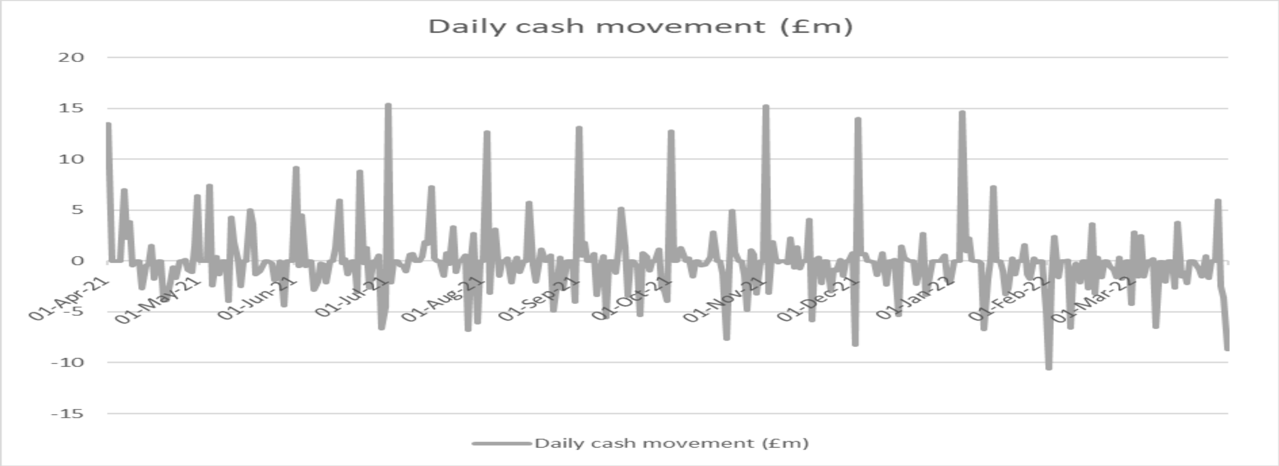
**4.25 Liquidity management**

4.26 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.

4.27 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.

**4.28 Management of cash-flows**

Annual cash-flow forecasts can be seen in the table below.




4.29 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;

- <u>Significant inflows</u> 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 stake-holders 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 councils bank accounts.

- <u>Significant outflows</u> 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.

4.30 Over the past two years the councils cash-flows have been significantly impacted by Covid 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.

4.31 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.

4.32 The intended borrowing strategy for 2022/23 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.

## 5 NON-TREASURY INVESTMENT STRATEGY

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

### 5.2 Service investments: Loans

5.3 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.

5.4 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.

### 5.5 Commercial investments: Property

5.6 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.

5.7 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.

5.8 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).

5.9 After servicing costs, fees and borrowing costs, these assets are budgeted to generate an annual net return to the revenue budget of £0.3m (2021/22 £0.1m).

5.10 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.

5.11 The council has no plans to dispose of its commercial investment properties at this time.

## 6 BORROWING STRATEGY

### 6.1 <u>Local context</u>

6.2 Forecast changes to the capital financing requirement and borrowing forecasts are shown in the balance sheet analysis in the table below.

***Capital Financing Requirement vs forecast borrowing***

*

| | Actual 31/3/21 £m | Forecast 31/3/22 £m | Estimate 31/3/23 £m | Estimate 31/3/24 £m | Estimate 31/3/25 £m |
|---|---|---|---|---|---|
| **Overall CFR** | 184.9 | 193.1 | 236.7 | 270.8 | 286.8 |
| Less: CFR re finance leases and Ex Avon loan debt* | -34.7 | -33.9 | -33.0 | -32.1 | -31.3 |
| **CFR re loan debt** | 150.2 | 159.2 | 203.7 | 238.7 | 255.5 |
| Less: External borrowing ** | -150.6 | -143.4 | -200.9 | -170.6 | -142.6 |
| **Implies:** **Internal borrowing** | -0.4 | 15.8 | 2.8 | 68.1 | 112.9 |

*finance leases and Ex-Avon loan debt that form part of the Council's total debt*
*** includes capital expenditure included in the Capital Strategy, but not yet approved*

6.3 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

6.4 The council's Capital Strategy forecasts indicate that it is likely to need to borrow to finance its planned capital expenditure. The decision of whether, and when, to take external borrowing will be made considering current and forecast interest rates. The council may choose to finance this borrowing requirement from its operational cash resources, known as 'internal borrowing'. This reduces interest costs and exposure to other risks.

6.5 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. The table in para 6.2 above shows that the Authority expects to comply with this recommendation during 2022/23.

6.6 **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

6.7 **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

6.8 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.

6.9 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.

6.10 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

7.1 **Economic background:** The ongoing impact on the UK from coronavirus, together with higher inflation, higher interest rates, and the country's trade position post-Brexit, will be major influences on the council's treasury management strategy for 2022/23.

7.2 The Bank of England (BoE) increased Bank Rate to 0.25% in December 2021 while maintaining its Quantitative Easing programme at £895 billion. The Monetary Policy Committee (MPC) voted 8-1 in favour of raising rates, and unanimously to maintain the asset purchase programme.

7.3 Within the announcement the MPC noted that the pace of the global recovery was broadly in line with its November Monetary Policy Report. Prior to the emergence of the Omicron coronavirus variant, the Bank also considered the UK economy to be evolving in line with expectations, however the increased uncertainty and risk to activity the new variant presents, the Bank revised down its estimates for Q4 GDP growth to 0.6% from 1.0%. Inflation was projected to be higher than previously forecast, with CPI likely to remain above 5% throughout the winter and peak at 6% in April 2022. The labour market was generally performing better than previously forecast and the BoE now expects the unemployment rate to fall to 4% compared to 4.5% forecast previously, but notes that Omicron could weaken the demand for labour.

7.4 UK CPI for November 2021 registered 5.1% year on year, up from 4.2% in the previous month. Core inflation, which excludes the more volatile components, rose to 4.0% y/y from 3.4%. The most recent labour market data for the three months to October 2021 showed the unemployment rate fell to 4.2% while the employment rate rose to 75.5%.

7.5 **Credit outlook:** Since the start of 2021, relatively benign credit conditions have led to credit default swap (CDS) prices for the larger UK banks to remain low and had steadily edged down throughout the year up until mid-November when the emergence of Omicron has caused them to rise modestly. However, the generally improved economic outlook during 2021 helped bank profitability and reduced the level of impairments many had made as provisions for bad loans. However, the relatively recent removal of coronavirus-related business support measures by the government means the full impact on bank balance sheets may not be known for some time.

7.6 The improved economic picture during 2021 led the credit rating agencies to reflect this in their assessment of the outlook for the UK sovereign as well as several financial institutions, revising them from negative to stable and even making a handful of rating upgrades.

7.7 Looking ahead, while there is still the chance of bank losses from bad loans as government and central bank support is removed, the institutions on the council's counterparty list are well-capitalised and general credit conditions across the sector are expected to remain benign. Duration limits for counterparties on the council's lending list are under regular review and will continue to reflect economic conditions and the credit outlook.

7.8 **Interest rate forecast:** The council's treasury management adviser Arlingclose is forecasting that Bank Rate will continue to rise in calendar Q1 2022 to subdue inflationary pressures and the perceived desire by the BoE to move away from emergency levels of interest rates.

7.9 Investors continue to price in multiple rises in Bank Rate over the next forecast horizon, and Arlingclose believes that although interest rates will rise again, the increases will not be to the extent predicted by financial markets. In the near-term, the risks around Arlingclose's central case are to the upside while over the medium-term the risks become more balanced.

## 8 OTHER TREASURY MANAGEMENT MATTERS

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

8.2 **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).

8.3 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 2022/23.

8.4 **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 also 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 Prudential Code aims to improve the transparency of investment decisions. The Code include the requirement to produce a Capital Strategy, and the inclusion of prudential indicators within the report to allow the reader to understand the forecast the council's overall debt levels, in conjunction with the capital programme and investment decisions, and how this external borrowing will be repaid.

### 1.2.1 Authorised borrowing limit and Operational limit

The council is required to set an 'affordable borrowing limit' (also termed the 'authorised limit for external debt') each year. In line with statutory guidance, a, lower, "operational boundary" is also set, as a warning level should debt approach the affordable borrowing limit.

The **authorised limit** is the 'affordable borrowing limit' which the council is required to set in section 3 of the Local Government Act 2003 and cannot be exceeded without acting ultra vires. The authorised limit is set at a higher level than the operational boundary to provide headroom for unexpected borrowing requirements.

The **operational boundary/ limit** should be the council's best estimate of the most likely, prudent, maximum levels of debt to be held during the years in question. The boundary can be exceeded in the short-term should the council need to undertake temporary borrowing, or debt rescheduling, but should not be exceeded for new long-term borrowing proposals.

***Table 1.2.1:*** *PI: Authorised limit and operational boundary for external debt*

| Authorised limit and operational boundary for external debt | 2021/22 limit £m | 2022/23 limit £m | 2023/24 limit £m | 2024/25 limit £m |
|---|---|---|---|---|
| Authorised limit – total external debt | 234 | 243 | 283 | 254 |
| Operational boundary – total external debt | 224 | 238 | 260 | 229 |

It is currently estimated that long-term borrowing at the end of 2022/23 will be **£169.7m** (PWLB debt £134.4m, Salix £2.3m, Ex Avon loan debt £11.3m, and finance leases £21.7m).

The council's Treasury Management Strategy aims to keep sufficient, but not excessive, cash available to meet the council's spending needs, while managing the associated risks. Surplus cash is invested until required to produce a return, while shortages of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account.

The council is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. Due to decisions taken in the past, the council currently has £179.6m external borrowing, charging an average interest rate of 4.0%, and £171m treasury investments, earning an average rate of 0.35%.

### 1.2.2 Capital Expenditure

This indicator details the Capital Expenditure to be incurred by the council. The actual spend for 2020/21, the revised programme for 2021/22 and totals for the proposed programmes for 2022/23 to 2024/25, as set out in the Capital Strategy, are shown below.

***Table 1.2.2**: PI: Capital expenditure*

| **Capital Expenditure** | **Actual 2020/21 £m** | **Forecast 2021/22 £m** | **Estimate 2022/23 £m** | **Estimate 2023/24 £m** | **Estimate 2024/25 £m** |
|---|---|---|---|---|---|
| Total Capital Expenditure | 41.9 | 94.6 | 133.5 | 157.7 | 55.7 |

### 1.2.3 Actual external debt and the Capital Financing Requirement

In this indicator, projected levels of the council's total outstanding external debt (which comprises borrowing and leases) are compared with the Capital Financing Requirement. The Capital Financing Requirement measures the council's underlying need to borrow for a capital purpose for the current and future year. The actual Capital Financing Requirement as at the year-end is included in each year's statutory accounts.

***Table 1.2.3:** PI: Gross external debt and the Capital Financing Requirement*

| **Gross external debt and the Capital Financing Requirement** | **Actual as at 31/3/21 £m** | **Forecast as at 31/3/22 £m** | **Estimate as at 31/3/23 £m** | **Estimate as at 31/3/24 £m** | **Estimate as at 31/3/25 £m** |
|---|---|---|---|---|---|
| Capital Financing Requirement | 184.9 | 193.1 | 235.7 | 270.6 | 286.5 |
| Total Debt (incl leases ex-Avon) | 185.3 | 177.2 | 232.9 | 203.9 | 175.5 |

Statutory guidance is that total debt should remain below the Capital Financing Requirement, except in the short-term. As can be seen from the table above, the council expects to comply with this requirement in the medium-term.

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, in order to minimise interest costs.

In contrast, the Capital Financing Requirement reflects the council's underlying need to borrow for a capital purpose. The capital financing requirement indicators shown above reflect the totality of the capital expenditure contained within the proposed capital programme.

1.2.4 Affordability - Ratio of Financing Costs to Net Revenue Stream

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans, the MRP, and loans fund repayments are charged to revenue, offset by any investment income receivable. The net annual charge is known as the council's financing costs. In this indicator, financing costs are compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants, to provide a measure of the affordability of the council's forecast borrowing.

***Table 1.2.4****: PI: Proportion of financing costs to net revenue stream*

| | Actual 2020/21 | Forecast 2021/22 | Estimate 2022/23 | Estimate 202324 | Estimate 2024/25 |
|---|---|---|---|---|---|
| Net Financing costs (£m) | £10.3m | £10.7m | £11.5m | £12.6m | £13.6m |
| Proportion of net revenue (%) | 6.4% | 6.0% | 6.1% | 6.6% | 7.0% |

1.2.5 Maturity structure of borrowing

Refinancing risk is the risk that a borrower cannot refinance by borrowing to repay existing debt. In order 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 1.2.5****: PI: 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.

1.2.6 Principal sums invested for periods longer than a year

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.

*Table 1.2.6: PI: The limits on the total principal sum invested with final maturities longer than 365 days beyond the period end:*

| Investments longer than 365 Days | 2022/23 | 2023/24 | 2024/25 |
|---|---|---|---|
| Limit on principal invested with maturities longer than 365 days beyond year end | £60m | £50m | £50m |

## 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 Interest rate exposures

The treasury management team has an active strategy for assessing interest rate exposure that feeds into the setting of the annual budget, and which is used to update the budget quarterly during the year. This allows any adverse changes to be identified and accommodated. The analysis also informs whether new borrowing is taken out at fixed or variable interest rates.

### 1.3.2 Total value exposure to risk

The first indicator below shows the council's total exposure to potential investment losses.

***Table 1.3.2**: Total investment exposure in £millions*

| **Total investment exposure** | **Actual Held as at 31/03/21 £m** | **Forecast Held as at 31/03/22 £m** | **Forecast Held as at 31/03/23 £m** |
|---|---|---|---|
| Treasury management investments | 143.0 | 127.0 | 107.0 |
| Service investments: Loans | 0.8 | 0.8 | 0.8 |
| Commercial investments: Property* | 32.6 | 32.6* | 32.6* |
| **TOTAL EXPOSURE** | **176.4** | **160.4** | **140.4** |

** Commercial investment properties are re-valued annually by the council's valuers - valuations as at 31/3/22 are not yet available and cannot be forecast with reasonable certainty.*

As noted above, there are significant uncertainties over the timing and amounts of cash balances available for investment during the Covid pandemic. Significant uncertainty also applies to the valuation of commercial property investments during the current economic environment.

### 1.3.3 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 1.3.3**: Investment rate of return (net of all costs)*

| **Investments net rate of return** | **Actual 2020/21 %** | **Forecast 2021/22 %** | **Forecast 2022/23 %** |
|---|---|---|---|
| Treasury management investments | 0.56 | 0.37 | 0.53 |
| Service investments: Loans | 2.38 | 2.36 | 2.36 |
| Commercial investments: Property | 0.10 | 0.27 | -0.10 |
| **ALL INVESTMENTS** | **0.42** | **0.35** | **0.35** |

## 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.<br>- Potential delays in being able to access funds.<br>- 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).<br>- Monitoring of TM advisor advice, news, discussions with brokers, and reacting to events (eg both trading and regulatory).<br>- Setting appropriate lending limits per counter-party re amounts, period and country of investment.<br>- Diversification between lenders, lender types, countries.<br>- 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.<br>- Needing to borrow at higher cost than otherwise available.<br>- Needing to sell assets / investments at short notice / at lower prices.<br>- Not having available counter-parties to invest in. | 4 | 2 | 8 | - Daily cash flow forecasting.<br>- Overdraft facility agreed.<br>- Ready access to sources of cash from eg PWLB, other local authorities and banks and building societies.<br>- 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.<br>- Decreasing market value of tradable fixed income investments (e.g. bonds) when interest rates rise.<br>- Falling interest rates lead to lower return<br>- Re-financing risk - Falling borrowing interest rates mean opportunity to re-finance borrowing at lower cost missed.<br>- 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.<br>- Taking into account uncertainty in future outcomes.<br>- Monitoring of available / emerging sources of borrowing.<br>- Maintaining suitable mix of fixed and variable interest rates for borrowing and investments.<br>- Maintaining mix of maturity dates.<br>- Monitoring of cost of re-financing borrowing compared to potential savings<br>- Diversification of investment types.<br>- Exposure to tradable debt instruments only through diversified funds.<br>- 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.<br>- 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:<br>- Brexit - leads to uncertainty in the economic outlook, and hence uncertainty over future interest rates and economic growth, and hence inflation, and government expenditure.<br>- Changes in PWLB / other borrowing rates impact on the Council's borrowing costs<br>- Changes in PWLB regulations limit availability/criteria of borrowing.<br>- 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).<br>- On-going professional training and development of treasury management officers.<br>- On-going training and updates to members on Treasury Management.<br>- Regular review and update of overall Treasury Management Strategy.<br>- 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)

**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.

**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 **DLUCH**, which is the **Department for Levelling Up, Communities and Housing**.

**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: 27 JANUARY 2022**

**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:

   i. that there are limited changes to the Code for the 2021/22,
   ii. that significant work continues to be required to quantify the impact of the implementation of 'IFRS16 – Leases' in 2021/22 for implementation in the 2022/23 accounts

b) that officers expect to include group accounts, in addition to the North Somerset Council single entity accounts, in the 2021/22 financial statements, in order to reflect the material transactions undertaken by the Council's new subsidiary company, North Somerset Environment Company Ltd (NSEC)

c) that officers are proposing no significant changes to existing accounting policies in 2021/22 but will recognise additional policies to be applied in the preparation of the new group accounts in the draft financial statements.

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.

e) 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 2021/22 accounts.

## 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, e.g. the Accounts and Audit Regulations 2015, 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. 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.

6. 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 he 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.

7. 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 – 2021/22 and 2022/23**

8. The Code of Practice is updated annually to reflect new or updated accounting standards. There are only minor changes to the Code for 2021/22, none of which are likely to have a significant impact on the Council's accounts.

9. 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.

10. In the event, no significant changes have been proposed in the 2021/22 Code. CIPFA is continuing to develop guidance for inclusion in the Code in future years. 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.

11. 'IFRS16 – Leases' is due to be implemented within the Code for 2022/23. 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 2022/23 accounts, disclosure of the likely impact of this change will need to be included in the 2021/22 accounts. Significant work is still required by officers to quantify this impact, and detailed disclosure of the future impact may not be possible in the 2021/22 accounts.

**Review of accounting policies**

12. 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.

13. 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.

14. Officers have reviewed the Council's library of accounting policies. Only minor changes to existing policies have been made, notably in relation to the Council's new subsidiary, North Somerset Environment Company Ltd. However, additional policies will be applied in the preparation of the new group accounts, notably in relation to the identification of the group boundary, and accounting entries made in NSEC's accounts but not made in the council's single entity accounts, such as accounting for Corporation tax. As NSEC have yet to finalise these accounting policies, these group policies will be finalised and highlighted for members attention when the draft accounts are presented for audit later in the year.

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

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

16. 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 £7.75m.

17. 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**

18. 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 2021/22 accounts. These are listed in Appendix B and C respectively.

19. 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.

20. 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

21. 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

22. 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.

23. 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

24. 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 can discharge their statutory obligations.

## 7. CLIMATE CHANGE AND ENVIRONMENTAL IMPLICATIONS

25. None

## 8. RISK MANAGEMENT

26. 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

27. None

## 10. CORPORATE IMPLICATIONS

28. None, other than as highlighted above

## 11. OPTIONS CONSIDERED

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

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## APPENDICES

Appendix A   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 2021/22
CIPFA Guidance Notes for Practitioners 2021/22
Statement of Accounts 2020/21
Grant Thornton Audit Findings Report 2020/21

## 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, Members should note that '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 it or misstating it could influence decisions that users make on the basis of financial information about a specific reporting authority".

The assessment of materiality in drawing up accounts helps them to focus on the key messages of the accounts, 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 Council's perception of the financial information needs of users of the financial statements.

The Code currently 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.

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 judgment. 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 as a whole 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 2020-21, the Council's external auditors quantified their **overall materiality at £7.27 million** (being 2% of gross revenue expenditure at 'Cost of services' level in the audited 2019-20 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 clearly 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 as a whole 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 2020-21, the Council's external auditors quantified their **'performance' materiality at £5.46 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 2021/22 accounts of **£7.76m**, 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 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 from the accounts, to ‘de-clutter’ the accounts, and allow better focus on the key messages in the accounts.

## Appendix B

### 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,
- the classification of the Council’s commercial investment property, and
- whether group accounts need to be prepared in 2021/22 to account for the increased value of transactions undertaken by the Council’s new subsidiary company, North Somerset Environment Company Ltd.

## Appendix C

### 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 taking into account 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,
- property, plant and equipment valuations, and
- pension fund (LGPS) actuarial gains/losses.

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,
- impairments of PPE,
- measurement of financial instruments,
- bad debt provisions / credit loss allowances,
- provisions for liabilities, and
- accruals.