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NOTTINGHAM CITY COUNCIL
AUDIT COMMITTEE

Date: Friday, 27 February 2015

Time: 10.30 am

Place: LB31 - Loxley House, Station Street, Nottingham, NG2 3NG

Councillors are requested to attend the above meeting to transact the following business

Acting Corporate Director for Resources

Governance Officer: Catherine Ziane-Pryor **Direct Dial:** 0115 8764298

AGENDA **Pages**

9	**INTERNAL AUDIT QUARTERLY REPORT 2014/15 (THIRD QUARTER) AND INTERNAL AUDIT PLAN 2015/16.** Report of Acting Director of Strategic Finance	103 - 114
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IF YOU NEED ANY ADVICE ON DECLARING AN INTEREST IN ANY ITEM ON THE AGENDA, PLEASE CONTACT THE GOVERNANCE OFFICER SHOWN ABOVE, IF POSSIBLE BEFORE THE DAY OF THE MEETING

CITIZENS ATTENDING MEETINGS ARE ASKED TO ARRIVE AT LEAST 15 MINUTES BEFORE THE START OF THE MEETING TO BE ISSUED WITH VISITOR BADGES

CITIZENS ARE ADVISED THAT THIS MEETING MAY BE RECORDED BY MEMBERS OF THE PUBLIC. ANY RECORDING OR REPORTING ON THIS MEETING SHOULD TAKE PLACE IN ACCORDANCE WITH THE COUNCIL'S POLICY ON RECORDING AND REPORTING ON PUBLIC MEETINGS, WHICH IS AVAILABLE AT WWW.NOTTINGHAMCITY.GOV.UK. INDIVIDUALS INTENDING TO RECORD THE MEETING ARE ASKED TO NOTIFY THE GOVERNANCE OFFICER SHOWN ABOVE IN ADVANCE.

NOTTINGHAM CITY COUNCIL

AUDIT COMMITTEE

MINUTES of the meeting held at LB31 - Loxley House, Station Street, Nottingham, NG2 3NG on 28 November 2014 from 10.30am – 11.52am

Membership

Present	Absent
Councillor Sarah Piper (Chair)	Councillor Georgina Culley
Councillor Thulani Molife (Vice Chair) (from minute 26)	Councillor Roger Steel
Councillor Mohammad Aslam	
Councillor Michael Edwards	
Councillor John Hartshorne	
Councillor Toby Neal	
Councillor Malcolm Wood	

Colleagues, partners and others in attendance:

Richard Walton	-	KPMG Auditors (External Auditors)
Jeff Abbott	-	Head of Strategic Finance
Laura Catchpole	-	Policy Officer
Chris Common	-	Organisational Planning and Performance Manager
Glyn Daykin	-	Finance Analyst, Treasury Management
Barry Dryden	-	Senior Finance Manager (Financial Reporting)
Mark Gannon	-	Director of Customer Access
Lynne North	-	Customer Liaison Officer, Have Your Say
Shail Shah	-	Head of Internal Audit
Catherine Ziane-Pryor	-	Governance Officer

22 APOLOGIES FOR ABSENCE

Councillor Georgina Culley (Health Issues)
Councillor Roger Steel (Other Council Business)

23 DECLARATIONS OF INTERESTS

None.

24 MINUTES

The minutes of the meeting held on 19 September 2014 were confirmed and signed by the Chair.

25 ANNUAL AUDIT LETTER

Further to the 'Statement of Accounts 2013/14' which was considered at the last meeting, Richard Walton, Audit Manager of KPMG, introduced the external auditors' report which summarised the key findings from the 2013/14 audit of the Council, including the financial statements and Value for Money conclusion.

The predicted rating of an 'Unqualified Opinion' is awarded.

RESOLVED to note the Annual Audit Letter 2013/14.

26 LOCAL GOVERNMENT OMBUDSMAN (LGO) ANNUAL REPORT

Lynne North, Customer Liaison Officer, was accompanied by Mark Gannon, Director of Customer Access, in presenting the report which sets out the number of complaints dealt with on behalf of the Authority for the year ending 31 March 2014. A breakdown of the complaints made to Service Areas and the decisions on those complaints, is contained within the Appendix to the report.

The following points were discussed:

(a) from now on, the LGO will send a copy of each annual review letter to the Leader of the Council as well as to the Chief Executive of the Authority. It is hoped that this will help to support greater democratic scrutiny of local complaint handling and ensure effective local accountability of public services;

(b) Nottingham is the second best performing Core City. This excludes Glasgow which has become a Core City but isn't regulated by LGO. Nottingham City received 115 complaints/enquiries during the year and only 14 complaints were upheld. Maladministration was found in 4 cases;

(c) the Authority continues to perform well and turn around enquiries/complaints in good time with an improvement year on year;

(d) the volume of complaints regarding School Admission Appeals is a national issue resulting from the national situation of there being more school aged children than school places;

(e) the 'Have Your Say' corporate system for recording compliments, comments and complaints has increased feedback from Nottingham's citizens and is giving invaluable information of how to improve services and responses to citizens

RESOLVED to note the report and the Ombudsman Annual Letter.

27 IMPLEMENTING THE PERFORMANCE MANAGEMENT FRAMEWORK

Chris Common, Organisational Planning and Performance Manager, presented the report of the Strategic Director Organisational Transformation, setting out progress made during the past 6 months in implementing the Performance Management Framework (PMF) which was approved for adoption by the Audit Committee on 28 February 2014.

The PMF was revised to reinforce a strong performance culture which is an integral part of the day-to-day activity of the Council. To date, nearly 100 managers have attended one of the performance management training workshops with nearly 2/3rds of attendees reporting their skills in performance management had improved by attending the course. Three months later, 63% said they have been able to use their skills to positively influence the performance culture of their service

Councillor’s questions were responded to as follows:

(a) to gauge the success of the promotional and support work, managers were directly consulted and overall there were good levels of the awareness and implementation of the PMF;
(b) there were some departments, such as Children and Adults where further work in key areas is necessary, including their use of ‘Covalent’ – the Council’s performance management software system;
(c) some of the points raised through the consultation have been addressed, including improving the PMF prominence on the intranet, but generally most colleagues how their activity links to the Council Plan objectives (‘the Golden Thread’);
(d) every Council Team should have a Service Plan as this, along with Performance Appraisals, identifies links from the service to the priorities of the Council Plan;
(e) by working with managers, who are organised and disciplined, the ‘ripple effect’ is relied upon for information to be progressed downwards. There is not the capacity within the Organisational Planning and Performance Team to check that this is the case in each team so their work focussed on developing the high directorate and departmental level plans;
(f) further work to maintain and accelerate progress will take place with regular workshops, targeted support and advice, improved access to the intranet and there will be further revisions to the business planning process to embed the PMF principles.

RESOLVED to note the progress made since the Performance Management Framework (PMF) was adopted in April 2014.

28 PARTNERSHIP GOVERNANCE HEALTH CHECKS AND UPDATE OF SIGNIFICANT PARTNERSHIPS

Laura Catchpole, Policy Officer, introduced the Strategic Director of Early Interventions’ report setting out the key findings from the Partnership Governance Health Checks and the updated Register of Significant Partnerships.

The Register of Significant Partnerships, as of November 2014 includes:

Children’s Partnership Board;
Crime and Drugs Partnership;
D2N2 Local Enterprise Partnership;
Economic Prosperity Committee;
N2 Skills and Employment Board;
Experience Nottinghamshire;
Greater Nottingham Growth Point Partnership;
Greater Nottingham Transport Partnership;
Green Nottingham;
Health & Wellbeing Board;
Housing Strategic Partnership;
Nottingham Regeneration Ltd;
One Nottingham;
Strategic Cultural Partnership;

The following areas were highlighted;

(a) the majority of partnerships scored good/excellent in all areas;
(b) the Economic Prosperity Committee is to be included in the Register of Significant partnerships;
(c) no partnerships have been removed from the Register this year.

RESOLVED to note the key findings from the Partnership Governance Health Checks and Register of Significant Partnerships.

29 TREASURY MANAGEMENT 2014/15 HALF YEARLY UPDATE

Glyn Daykin, Finance Analyst, introduced the Acting Corporate Director for Resources' report which set out Treasury Management actions and performance to 30 September 2014.

The following key points were drawn to the Committee's attention;

(a) the new borrowing strategy for 2-14/15 is to raise up to £24.6m to finance new capital expenditure and replace maturing long-term debt. To 30 September no new long term borrowing has taken place;
(b) the debt rescheduling strategy for 2014/15 is to consider any debt rescheduling or repayment opportunities which enable revenue savings to be generated in the year. To 30 September, no debt rescheduling had taken place;
(c) the investment strategy for 2014/15 is to ensure the security of funds invested through the application of restricted counterparty list and the imposition of limits on the period and levels of individual investments and within those confines to maximise the return on investments;
(d) the average return on investments from 1 April to 30 September was 0.64%. The 2014/15 budget assumed an average return of 0.68% for the period.
(e) a rise in interest rates is predicted during the first half of 2015.

Councillor's questions were responded to as follows by Finance Colleagues:

(f) debt rescheduling did not take place as although opportunities are monitored, none were identified as being suitable, especially when the cost of moving debt is taken into consideration;
(g) if interest rates were to change, the tools are in place, within the Treasury Management Strategy, to cope with this;
(h) it would be more appropriate for Geoff Walker, as Acting Director of Strategic Finance, to respond to the concern that other Local Authorities are predicting that they will experience significant financial issues within the next 2 or 3 years and how similar influences may affect Nottingham City Council although it must be noted that there has been no wholly reliable analysis to suggest that the Councils in question will be become bankrupt. Medium Term Financial Planning helps to ensures long term stability, added to which reserves are reassuring and KPMG do not have any particular concerns regarding the current strategy and future of the City Council;
(i) while some other Local Authorities, including Newcastle to which Nottingham is often compared, are predicting potential financial difficulties regarding some single issues, such as implementing safeguarding requirements for children and adults, which may demand more resources than those Councils are able to provide, this is potential risk for all Local Authorities and will be tacked if the issue arises in Nottingham;
(j) the Section 151 Officer for Finance is fully informed and endorses all financial strategies and statements prior to Committee consideration. Added to which, the constant monitoring of 'health indicators' ensures processes are monitored and compliant;

(k) Nottingham City does consider benchmarking against investment offers but as risk appetite varies, long term investments can skew the status of benchmarks.

RESOLVED

(1) to note the treasury management actions taken in 2014/15 to date;

(2) for the Acting Director of Strategic Finance, to respond directly to Members of the Audit Committee regarding the concern that other Local Authorities are predicting that they will experience significant financial issues within the next 2 or 3 years, and how Nottingham City Council may be affected;

(3) for the Head of Strategic Finance to provide Committee Members with a 'daily list' of responsibilities of the financial Section 151 Officer, and details of the limit of their responsibilities;

(4) for 'Performance Management' to be included within the future Member training schedule.

30 EAST MIDLANDS SHARED SERVICES (EMSS) UPDATE

Shail Shah, Head of Internal Audit, outlined the background to, and outturn against the Internal Audit of EMSS, the full details of which are contained in the report of the Acting Director of Strategic Finance.

Jeff Abbott, Head of Strategic Finance, informed the Committee of actions and progress against the recommendations of the audit.

Jeff Abbott highlighted the following points:

(a) Internal Audit had expressed concerns that the Oracle system was extremely complex and that the differences between Nottingham City and Leicestershire Councils had proved more significant than predicted;
(b) improvements are progressing and many control issues have been resolved but there are some areas of concern where in resolving some issues, inefficiencies have been built into the system which now need to be resolved;
(c) detailed plans are in place to improve EMSS, including slicker use of the Oracle system, improved staff training, and increasing the use of the self service portal;
(d) there is still work to be done around configuration on work flow for debt and accounts receivable.

Councillor's questions were responded to as follows:

(a) the partnership between the two authorities is reasonably balanced although each has very different needs and Leicestershire has initially contributed more resources than Nottingham;
(b) Leicestershire County Council has been using Oracle since the 1990s and so it is well embedded in the culture of the authority. Oracle is fairly new to Nottingham and although the initial indications were that Nottingham would experience little change to operations, this was not the case and by the time the partnership model of the

Oracle system ‘went live’ was not ready for Nottingham and Nottingham was not ready for it. As a result, some aspects were not fit for use at that point;

(c) Nottingham has benefited from the experience of Leicestershire’s officers who have always been helpful, but it appears that they had not realised the extent of pressure that they would be put under and it was difficult to progress the system due to the arrangements of the initial business case;

(d) while performance continues to improve, the Leicestershire Team are seeking further investment but funds are not available from Nottingham so an internal IT body is required to advise on alternative options;

(e) lessons have been learnt from the partnership and any further joint ventures must be with an Authority which is more similar to Nottingham. Partnerships of this sort can be very successful, as is seen in some areas of London where up to 5 boroughs have joined together.

RESOLVED;

(1) to note the outcome from 2013/14 audit work planned and completed to date;

(2) to note the updated EMSS 2014/15 Audit Plan.

31 COUNTER FRAUD POLICY

Shail Shah, Head of Internal Audit, introduced the Director of Strategic Finance’s report which detailed the Counter Fraud Strategy and the Counter Fraud Strategy for Schools.

Richard Walton of KPMG assured the Committee that KPMG did not have any concerns regarding the policy and that other Local Authorities are likely follow Nottingham’s example.

RESOLVED to endorse the City Council’s Counter Fraud Strategy, as detailed in Appendix 1 of the report, and the Counter Fraud Strategy for Schools, as detailed in Appendix 2 of the report.

32 INTERNAL AUDIT QUARTERLY REPORT 2014/15 - 2ND QUARTER

Shail Shah, Head of Internal Audit, presented the report which outlines the work of Internal Audit Service during the 2nd Quarter of 2014/15.

It is noted that while some Councillors requested further information on the sustainability of Local Authority schools which transfer to Academy status, it was not possible for the Internal Audit Team to investigate this issue as once a school has transferred, the overall responsibility including financial records, processes and liabilities, also transfers to the Academy.

RESOLVED:

(1) to note the performance of Internal Audit during Quarter 2;

(2) for the Audit of ‘Bank Reconciliation’ to be considered at the February 2015 meeting of the Audit Committee.

(3) to invite the Head of IT to a future meeting of this Committee to present, when completed, the external consultant's review of IT services.

33 AUDIT COMMITTEE ANNUAL WORK PROGRAMME UPDATE

Shail Shah, Head of Internal Audit, introduced the Director of Strategic Finance's report which outlined the core functions of the Committee, the benefits that will arise for the City Council and an outline annual work programme.

Councillors requested that that the Chief Finance Officer be invited to attend at least one Audit Committee meeting in a municipal year as this had been a practice many years ago which had proved very informative.

RESOLVED

(1) to note the functions of the Audit Committee and the benefits arising from its existence;

(2) to endorse the outline work programme at Appendix 1.

(4) for the Head of Internal Audit to invite the Chief Finance Officer to attend a future meeting of the Audit Committee.

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External Audit Plan 2014/15

Nottingham City Council

February 2015

Contents

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This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission has issued a document entitled *Statement of Responsibilities of Auditors and Audited Bodies*. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw your attention to this document which is available on the Audit Commission's website at www.audit-commission.gov.uk.

External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact **Sue Sunderland**, the appointed engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees on 0161 246 **4000, or by email to trevor.rees@kpmg.co.uk, who is the national contact partner for all of KPMG's work with the Audit Commission. After this, if you are still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure. Put your complaint in writing to the Complaints Unit Manager, Audit Commission, 1st Floor, Fry Building, 2 Marsham Street, London, SW1P 4DF or by email to complaints@audit-commission.gsi.gov.uk. Their telephone number is 03034448330.**

Introduction

This document describes how we will deliver our audit work for Nottingham City Council.

Scope of this report

This document supplements our *Audit Fee Letter 2014/15* presented to you in April 2014. It describes how we will deliver our financial statements audit work for Nottingham City Council ('the Authority'). It also sets out our approach to value for money (VFM) work for 2014/15.

We are required to satisfy ourselves that your accounts comply with statutory requirements and that proper practices have been observed in compiling them. We use a risk based audit approach.

The audit planning process and risk assessment is an on-going process and the assessment and fees in this plan will be kept under review and updated if necessary.

Statutory responsibilities

Our statutory responsibilities and powers are set out in the *Audit Commission Act 1998* and the Audit Commission's *Code of Audit Practice*.

The Audit Commission will close at 31 March 2015. However our audit responsibilities under the *Audit Commission Act 1998* and the *Code of Audit Practice* in respect of the 2014/15 financial year remain unchanged.

The *Code of Audit Practice* summarises our responsibilities into two objectives, requiring us to audit/review and report on your:

- *financial statements (including the Annual Governance Statement):* providing an opinion on your accounts; and
- *use of resources:* concluding on the arrangements in place for securing economy, efficiency and effectiveness in your use of resources (the value for money conclusion).

The Audit Commission's *Statement of Responsibilities of Auditors and Audited Bodies* sets out the respective responsibilities of the auditor and the Authority.

The Audit Commission will cease to exist on 31 March 2015. Details of the new arrangements are set out in Appendix 4. The Authority can expect further communication from the Audit Commission and its successor bodies as the new arrangements are established. This plan restricts itself to reference to the existing arrangements.

Structure of this report

This report is structured as follows:

- Section Two includes our headline messages, including any key risks identified this year for the financial statements audit and Value for Money arrangements Conclusion.
- Section Three describes the approach we take for the audit of the financial statements.
- Section Four provides further detail on the financial statements audit risks.
- Section Five explains our approach to VFM arrangements work.
- Section Six provides information on the audit team, our proposed deliverables, the timescales and fees for our work.

Acknowledgements

We would like to take this opportunity to thank officers and Members for their continuing help and co-operation throughout our audit work.

Headlines

This table summarises the headline messages. The remainder of this report provides further details on each area.

Audit approach	Our overall audit approach remains similar to last year with no fundamental changes . Our work is carried out in four stages and the timings for these, and specifically our on site work, have been agreed with the Acting Director for Strategic Finance and Senior Finance Manager. Our audit strategy and plan remain flexible as risks and issues change throughout the year. We will review the initial assessments presented in this document throughout the year and should any new risks emerge we will evaluate these and respond accordingly.
Key financial statements audit risks	We have completed our initial risk assessment for the financial statements audit and identified a number of significant risks for the audit: • The potential on-going impact of control weaknesses identified in 2013/14 if insufficient progress has been made in removing or mitigating the during 2014/15 • Full HRA revaluation • NET2 • Changes in accounting for schools • New Revenues & Benefits Company • Change in main bank account These are described in more detail on pages 11 - 13. We will assess these risks as part of our interim audit and conclude on them at year end.
VFM audit approach	We have completed our initial risk assessment for the VFM conclusion and have identified one risk in relation to the Authority's arrangements for securing financial resilience . This relates to the Authority's financial and savings plans to address the challenges of the financial climate in which it is currently operating. This is described in more detail on page 15. We will assess this risk area as part of our interim work and report on our findings at the conclusion of the audit.
Audit team, deliverables, timeline and fees	There has been a change to the audit team this year with a change of in charge. Our main year end audit is currently planned to commence in July. Upon conclusion of our work we will again present our findings to you in our *Report to Those Charged with Governance (ISA 260 Report)*. The planned fee for the 2014/15 audit is £229,490. This is £1,070 more than the fee set out in our *Audit Fee Letter 2014/15* and is due to the increase in work required in relation to NNDR following the removal of the certification requirement for the NNDR3 return.

Our audit approach

We undertake our work on your financial statements in four key stages during 2015:

- **Planning (January to February).**
- **Control Evaluation (February to April).**
- **Substantive Procedures (July to August).**
- **Completion (September).**

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We have summarised the four key stages of our financial statements audit process for you below:

Jan Feb Mar Apr May Jun Jul Aug Sep

1 Planning

- Hold initial planning meetings with officers and update our business understanding and risk assessment.
- Assess the organisational control environment.
- Determine our audit strategy and plan the audit approach.
- Issue our *Accounts Audit Protocol*.

2 Control evaluation

- Evaluate and test selected controls over key financial systems.
- Review the work undertaken by the internal audit on controls relevant to our risk assessment.
- Review the accounts production process.
- Review progress on critical accounting matters.

3 Substantive procedures

- Plan and perform substantive audit procedures.
- Conclude on critical accounting matters.
- Identify audit adjustments.
- Review the Annual Governance Statement.

4 Completion

- Declare our independence and objectivity.
- Obtain management representations.
- Report matters of governance interest.
- Form our audit opinion.

Our audit approach – planning (continued)

During January and February 2015 we complete our planning work.

We assess the key risks affecting the Authority's financial statements and discuss these with officers.

We assess if there are any weaknesses in respect of central processes that would impact on our audit.

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Our planning work takes place in January and February 2015. This involves the following aspects:

Planning

- Update our business understanding and risk assessment including fraud risk.
- Assess the organisational control environment.
- Determine our audit strategy and plan the audit approach.
- Issue our *Accounts Audit Protocol*.

Business understanding and risk assessment

We update our understanding of the Authority's operations and identify any areas that will require particular attention during our audit of the Authority's financial statements.

We identify the key risks including risk of fraud affecting the Authority's financial statements. These are based on our knowledge of the Authority, our sector experience and our ongoing dialogue with Authority staff. Any risks identified to date through our risk assessment process are set out in this document. Our audit strategy and plan will, however, remain flexible as the risks and issues change throughout the year. It is the Authority's responsibility to adequately address these issues. We encourage the Authority to raise any technical issues with us as early as possible so that we can agree the accounting treatment in advance of the audit visit.

We meet with the finance team to consider issues and how they are addressed during the financial year end closedown and accounts preparation.

Organisational control environment

Controls operated at an organisational level often have an impact on controls at an operational level and if there were weaknesses this would impact on our audit.

In particular risk management, internal control and ethics and conduct have implications for our financial statements audit. The scope of the relevant work of your internal auditors also informs our risk assessment.

Audit strategy and approach to materiality

Our audit is performed in accordance with International Standards on Auditing (ISAs) (UK and Ireland). The Engagement Lead sets the overall direction of the audit and decides the nature and extent of audit activities. We design audit procedures in response to the risk that the financial statements are materially misstated. The materiality level is a matter of professional judgement and is set by the Engagement Lead.

In accordance with ISA 320 (UK&I) '*Audit materiality*', we plan and perform our audit to provide reasonable assurance that the financial statements are free from material misstatement and give a true and fair view. Information is considered material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements.

Further details on assessment of materiality is set out on page 6 of this document.

Our audit approach –planning (continued)

When we determine our audit strategy we set a monetary materiality level for planning purposes.

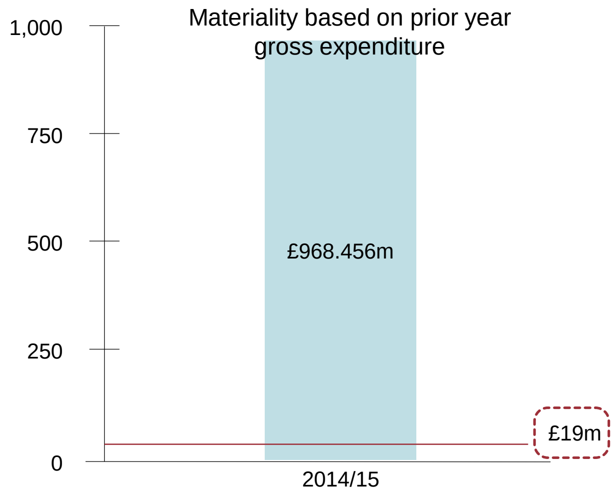
For 2014/15 we have set this at £19 million.

We will report all audit differences over £0.950 million to the Audit Committee.

Materiality

The assessment of what is material is a matter of professional judgment and includes consideration of three aspects: materiality by value, nature and context.

- Material errors by value are those which are simply of significant numerical size to distort the reader's perception of the financial statements. Our assessment of the threshold for this depends upon the size of key figures in the financial statements, as well as other factors such as the level of public interest in the financial statements.
- Errors which are material by nature may not be large in value, but may concern accounting disclosures of key importance and sensitivity, for example the salaries of senior staff.
- Errors that are material by context are those that would alter key figures in the financial statements from one result to another – for example, errors that change successful performance against a target to failure.



Materiality for planning purposes has been set at £19 million, which approximately equates to 2 percent of forecast gross expenditure (based on the prior year outturn less planned savings).

We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the Audit Committee

Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Audit Committee any misstatements of lesser amounts to the extent that these are identified by our audit work.

Under ISA 260(UK&I) *'Communication with those charged with governance'*, we are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 (UK&I) defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.

ISA 450 (UK&I), *'Evaluation of misstatements identified during the audit',* requires us to request that uncorrected misstatements are corrected.

In the context of the Authority, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £0.950 million.

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

Our audit approach – planning (continued)

We will issue our *Accounts audit protocol* following completion of our planning work.

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Accounts audit protocol

At the end of our planning work we will issue our *Accounts Audit Protocol*. This important document sets out our audit approach and timetable. It also summarises the working papers and other evidence we require the Authority to provide during our interim and final accounts visits.

We met with the Senior Finance Manager to discuss mutual learning points from the 2013/14 audit. These will be incorporated into our work plan for 2014/15. We revisit progress against areas identified for development as the audit progresses.

Our audit approach – control evaluation

During March to April 2015 we will complete our interim audit work.

We assess if controls over key financial systems were effective during 2014/15. We work with your internal audit team to avoid duplication.

We work with your finance team to enhance the efficiency of the accounts audit.

We will report any significant findings arising from our work to the Audit Committee.

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Our on site interim visit will be completed during March 2015. During this time we will complete work in the following areas:

Control Evaluation

- Evaluate and test controls over key financial systems identified as part of our risk assessment.
- Review the work undertaken by the internal audit function on controls relevant to our risk assessment.
- Review the accounts production process.
- Review progress on critical accounting matters.

Controls over key financial systems

We update our understanding of the Authority's key financial processes where our risk assessment has identified that these are relevant to our final accounts audit and where we have determined that this is the most efficient audit approach to take. We confirm our understanding by completing walkthroughs for these systems. We then test selected controls that address key risks within these systems. The strength of the control framework informs the substantive testing we complete during our final accounts visit.

In our ISA 260 report for 2013/14 we reported on control weaknesses in the East Midlands Shared Service identified by Internal Audit which had made a number of recommendations. We recommended that these recommendations were implemented as soon as possible. As part of our work, we will perform procedures to check that this had been done. In addition the new Oracle ledger system implementation resulted in issues over the production of the Trial Balance in 2013/14. We are assured these issues have been resolved but will review in 2014/15. Our Accounts Audit Protocol will request working papers to show the mapping of the ledger to the accounts as this is a key document in our audit work.

Liaising with internal audit

In order to maximise the effectiveness of the audit resources deployed on core financial systems and governance projects we have a joint working protocol in place and have had discussions with internal audit to understand our respective approaches and to ensure there will be no duplication of effort.

Critical accounting matters

We will discuss the work completed to address the specific risks we identified at the planning stage. Wherever possible, we seek to review relevant workings and evidence and agree the accounting treatment as part of our interim work.

If there are any significant findings arising from our interim work we will present these at the next available Audit Committee meeting.

Our audit approach – substantive procedures

During July 2015 we will be on site for our substantive work.

We complete detailed testing of accounts and disclosures and conclude on critical accounting matters, such as specific risk areas. We then agree any audit adjustments required to the financial statements.

We also review the Annual Governance Statement for consistency with our understanding.

We will present our *ISA 260 Report* to the Audit Committee in September 2015.

Our main final accounts visit on site has been provisionally scheduled for the period 29 June to 24 July 2015. During this time, we will complete the following work:

Substantive Procedures

- Plan and perform substantive audit procedures.
- Conclude on critical accounting matters.
- Identify and assess any audit adjustments.
- Review the Annual Governance Statement.

Substantive audit procedures

We complete detailed testing on significant balances and disclosures. The extent of our work is determined by the Engagement Lead based on various factors such as our overall assessment of the Authority's control environment, the effectiveness of controls over individual systems and the management of specific risk factors.

Critical accounting matters

We conclude our testing of key risk areas identified at the planning stage and any additional issues that may have emerged since.

We will discuss our early findings of the Authority's approach to address the key risk areas with the Senior Finance Manager in March/April 2015, prior to reporting to the Audit Committee in September 2015.

Audit adjustments

During our on site work, we will meet with the Senior Finance Manager on a weekly basis to discuss the progress of the audit, any differences found and any other issues emerging.

At the end of our on site work, we will hold a closure meeting, where we will provide a schedule of audit differences and agree a timetable for the completion stage and the accounts sign off.

To comply with auditing standards, we are required to report uncorrected audit differences to the Audit Committee. We also report any material misstatements which have been corrected and which we believe should be communicated to you to help you meet your governance responsibilities.

Annual Governance Statement

We are also required to satisfy ourselves that your Annual Governance Statement complies with the applicable framework and is consistent with our understanding of your operations. Our review of the work of internal audit and consideration of your risk management and governance arrangements are part of this.

We report the findings of our audit of the financial statements work in our *ISA 260 Report*, which we will issue in September 2015.

Our audit approach – other matters

In addition to the financial statements, we also review the Authority's Whole of Government Accounts pack.

We may need to undertake additional work if we receive objections to the accounts from local electors.

We will communicate with you throughout the year, both formally and informally.

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Whole of government accounts (WGA)

We are required to review your WGA consolidation and undertake the work specified under the approach that is agreed with HM Treasury and National Audit Office. Deadlines for production of the pack and the specified approach for 2014/15 have not yet been confirmed.

Elector challenge

The Audit Commission Act 1998 gives electors certain rights. These are:

- the right to inspect the accounts;
- the right to ask the auditor questions about the accounts; and
- the right to object to the accounts.

As a result of these rights, in particular the right to object to the accounts, we may need to undertake additional work to form our decision on the elector's objection. The additional work could range from a small piece of work where we interview an officer and review evidence to form our decision, to a more detailed piece of work, where we have to interview a range of officers, review significant amounts of evidence and seek legal representations on the issues raised.

The costs incurred in responding to specific questions or objections raised by electors is not part of the fee. This work will be charged in accordance with the Audit Commission's fee scales.

Reporting and communication

Reporting is a key part of the audit process, not only in communicating the audit findings for the year, but also in ensuring the audit team are accountable to you in addressing the issues identified as part of the audit strategy. Throughout the year we will communicate with you through meetings with the finance team and the Audit Committee. Our deliverables are included on page 19.

Independence and objectivity confirmation

Professional standards require auditors to communicate to those charged with governance, at least annually, all relationships that may bear on the firm's independence and the objectivity of the audit engagement partner and audit staff. The standards also place requirements on auditors in relation to integrity, objectivity and independence.

The standards define 'those charged with governance' as 'those persons entrusted with the supervision, control and direction of an entity'. In your case this is the General Purpose & Audit Committee.

KPMG LLP is committed to being and being seen to be independent. APB Ethical Standard 1 *Integrity, Objectivity and Independence* requires us to communicate to you in writing all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place, in our professional judgement, may reasonably be thought to bear on KPMG LLP's independence and the objectivity of the Engagement Lead and the audit team.

Appendix 1 provides further detail on auditors' responsibilities regarding independence and objectivity.

Confirmation statement

We confirm that as of February 2015 in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Engagement Lead and audit team is not impaired.

Key financial statements audit risks

In this section we set out our assessment of the significant risks or other key areas of audit focus of the Authority's financial statements for 2014/15.

For the key risk area we have outlined the impact on our audit plan.

Professional standards require us to consider two standard risks for all organisations. We are not elaborating on these standard risks in this plan but consider them as a matter of course in our audit and will include any findings arising from our work in our *ISA 260 Report*.

- Management override of controls – Management is typically in a powerful position to perpetrate fraud owing to its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Our audit methodology incorporates the risk of management override as a default significant risk. In line with our methodology, we carry out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business, or are otherwise unusual.
- Fraudulent revenue recognition – We do not consider this to be a significant risk for local authorities as there are limited incentives and opportunities to manipulate the way income is recognised. We therefore rebut this risk and do not incorporate specific work into our audit plan in this area over and above our standard fraud procedures.

Appendix 3 covers more details on our assessment of fraud risk.

The table below sets out the significant risks we have identified through our planning work that is specific to the audit of the Authority's financial statements for 2014/15.

We will revisit our assessment throughout the year and should any additional risks present themselves we will adjust our audit strategy as necessary.

Key audit risk	Impact on audit
Controls over transactions **Audit areas affected** - mapping of TB to the ledger - Payroll, accounts payable & accounts receivable	**Risk** That the weaknesses in control identified in 2013/14 have not be adequately addressed or mitigated throughout 2014/15 to enable us to have sufficient assurance over the material accuracy of the financial statements. **Our audit work** As discussed on page 8 of this document, we will perform procedures to check that Internal Audit's recommendations in respect of the East Midlands Shared Service have been implemented. We will also document and perform testing to ensure that controls within key systems operate effectively. Where controls were not operating throughout the period we will review mitigating controls in place. We will request and review working papers to demonstrate the mapping of the ledger to the accounts as this is a key document in our audit work.

Key financial statements audit risks (continued)

For each key risk area we have outlined the impact on our audit plan.

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Key audit risks		Impact on audit
HRA valuation	**Audit areas affected** ▪ PPE note and values of HRA valuation	**Risk** The HRA stock represents a very large balance in the PPE and a revaluation may have a material impact on this balance. **Our audit work** A full valuation of the HRA stock will be undertaken in the 2014/15 year. We will review the assumptions of the Valuer and his/her assessment. We will compare against key indicators eg BCIS indices.
Net2	**Audit areas affected** ▪ PFI disclosures ▪ Financial planning for PFI scheme	**Risk** The Net2 tram extension project is a major capital project for the council. As a PFI scheme the accounting and related disclosures are complex and so there is an inherent risk of material error related to this scheme. **Our audit work** We will review the current status of the scheme and consider the financial modelling of the Unitary payments.
Accounting for Schools	**Audit areas affected** ▪ PPE assets	**Risk** A new LAAP (Local Authority Accounting Panel) bulletin has been issued in relation to the accounting treatment for school assets within the Council's balance sheet. **Our audit work** We will liaise with officers to ensure the requirements of the LAAP bulletin are met and that school assets are correctly recognised in the balance sheet.

Key financial statements audit risks (continued)

For each key risk area we have outlined the impact on our audit plan.

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Key audit risks	Impact on audit
New Company for Revenues and Benefits **Audit areas affected** ▪ Payroll ▪ Group accounts	**Risk** A new company has been created for the administration of Revenues & Benefits and so is a new subsidiary of the Council. A number of staff have been transferred. **Our audit work** We will review the controls over the new company and the implications for the Council's group accounts as well as considering the status of the staff as part of our work on payroll.
New bank accounts **Audit areas affected** ▪ Cash	**Risk** The Authority is transferring its banking arrangements from the Co-operative Bank to Lloyds bank. **Our audit work** We will review the arrangements for the transfer of the bank accounts and that there has been no impact in the administering or receipt of transactions, for example, payments from the public.

VFM audit approach

Our approach to VFM work follows guidance provided by the Audit Commission.

Background to approach to VFM work

In meeting their statutory responsibilities relating to economy, efficiency and effectiveness, the Commission's *Code of Audit Practice* requires auditors to:

- plan their work based on consideration of the significant risks of giving a wrong conclusion (audit risk); and
- carry out only as much work as is appropriate to enable them to give a safe VFM conclusion.

To provide stability for auditors and audited bodies, the Audit Commission has kept the VFM audit methodology unchanged from last year. There are only relatively minor amendments to reflect the key issues facing the local government sector.

The approach is structured under two themes, as summarised below.

Specified criteria for VFM conclusion	Focus of the criteria	Sub-sections
The organisation has proper arrangements in place for securing **financial resilience**.	The organisation has robust systems and processes to: ■ manage effectively financial risks and opportunities; and ■ secure a stable financial position that enables it to continue to operate for the foreseeable future.	■ Financial governance ■ Financial planning ■ Financial control
The organisation has proper arrangements for challenging how it **secures economy, efficiency and effectiveness**.	The organisation is prioritising its resources within tighter budgets, for example by: ■ achieving cost reductions; and ■ improving efficiency and productivity.	■ Prioritising resources ■ Improving efficiency and productivity

We will report on the results of the VFM audit through our *ISA 260 Report*. This will summarise any specific matters arising, and the basis for our overall conclusion. The key output from the work will be the VFM conclusion (i.e. our opinion on the Authority's arrangements for securing VFM), which forms part of our audit report.

VFM audit approach (continued)

We have identified one VFM risk that we will consider as part of our detailed risk assessment.

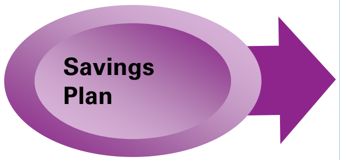
We will provide an update on how the Authority is managing this risk in our ISA 260 Report.

In line with the risk-based approach set out on the previous page, we have

- assessed the Authority's key business risks which are relevant to our VFM conclusion;
- identified the residual audit risks for our VFM conclusion, taking account of work undertaken in previous years or as part of our financial statements audit;
- considered the results of relevant work by the Authority, the Audit Commission, other inspectorates and review agencies in relation to these risk areas; and
- concluded to what extent we need to carry out additional risk-based work.

Below we set out our preliminary findings in respect of those areas where we have identified a residual audit risk for our VFM conclusion,

We will report our final conclusions in our *ISA 260 Report 2014/15*.

Key VFM risk	Risk description and link to VFM conclusion	Preliminary assessment
	The Council continues to face the requirement to reduce its spend as Central Government funding reduces. The Medium Term Financial Plan for 2014/15 to 2016/17 assumes a reduction in the spending power of the Council of 5.1% in 2014/15 and 5.3% in 2015/16. The plan forecasts a reduction in Revenue Support Grant of £21.9m in 2014/15 and a further £28.2m in 2015/16. The Council set a balanced budget for 2014/15, incorporating £22.6m of savings with a further requirement for £24.8m of savings planned for 2015/16. This is relevant to the financial resilience criteria.	Against a backdrop of continued demand pressures it will become more and more difficult to deliver savings in a way that secures longer term financial and operational sustainability. As part of our vfm risk assessment we will critically assess the controls the Authority has in place to ensure a sound financial standing and review how the Authority is planning and managing its savings plans.

Audit team

Your audit team has been drawn from our specialist public sector assurance department. Our audit team includes a new Assistant Manager but the Engagement Lead and Audit Manager remain as last year.

Contact details are shown on page one.

The audit team will be assisted by other KPMG specialists as necessary.

Sue Sunderland

Engagement Lead

"My role is to lead our team and ensure the delivery of a high quality external audit opinion. I will be the main point of contact for the Audit Committee and Executive Directors."

Richard Walton

Manager

"I am responsible for the management, review and delivery of the whole audit and providing quality assurance for any technical accounting areas. I will work closely with Sue Sunderland to ensure we add value. I will liaise with the Finance Team

Janet Dean

Assistant Manager

"I will be responsible for the on-site delivery of our work. I will liaise with the Senior Finance Manager, the Finance Team and Internal Audit. I will also supervise the work of our audit assistants."

Audit deliverables

Deliverable	Purpose	Committee dates
Planning		
External Audit Plan	■ Outlines our audit approach. ■ Identifies areas of audit focus and planned procedures.	**February 2015**
Control evaluation and Substantive procedures		
Report to Those Charged with Governance (ISA 260 Report)	■ Details control and process issues. ■ Details the resolution of key audit issues. ■ Communicates adjusted and unadjusted audit differences. ■ Highlights performance improvement recommendations identified during our audit. ■ Comments on the Authority's value for money arrangements.	**September 2015**
Completion		
Auditor's Report	■ Provides an opinion on your accounts (including the Annual Governance Statement). ■ Concludes on the arrangements in place for securing economy, efficiency and effectiveness in your use of resources (the VFM conclusion).	**September 2015**
Whole of Government Accounts	■ Provide our assurance statement on the Authority's WGA pack submission.	**September 2015**
Annual Audit Letter	■ Summarises the outcomes and the key issues arising from our audit work for the year.	**November 2015**

Audit timeline

We will be in continuous dialogue with you throughout the audit.

Key formal interactions with the Audit Committee are:

- **February – External Audit Plan;**
- **September – ISA 260 Report;**
- **November – Annual Audit Letter.**

We work with the finance team and internal audit throughout the year.

Our main work on site will be our:

- **Interim audit visits during March.**
- **Final accounts audit during July and August.**

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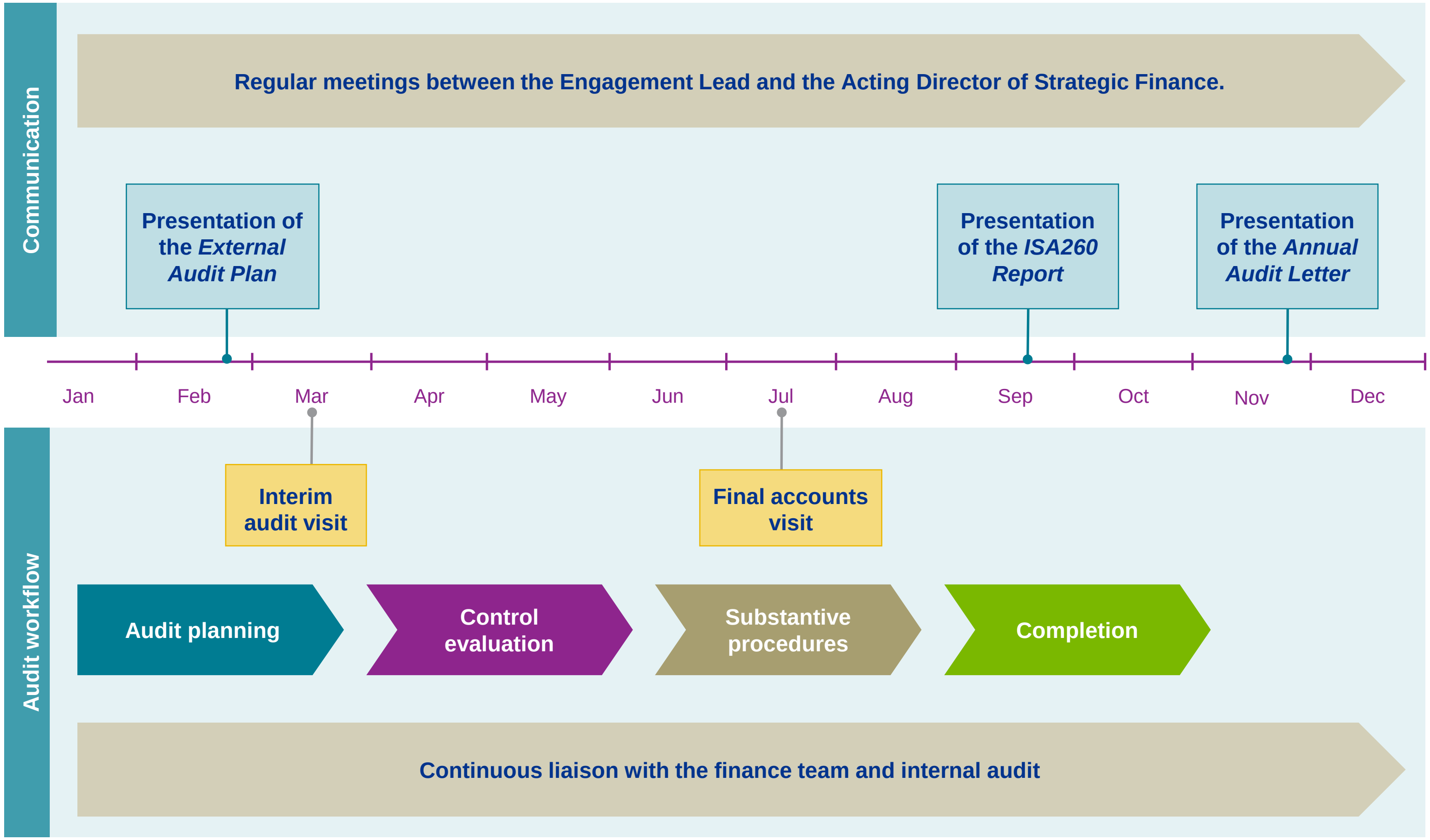

Key: ● Audit Committee meetings.

Audit fee

The fee for the 2014/15 audit of the Authority is £229,490.

Our audit fee remains indicative and based on you meeting our expectations of your support.

Meeting these expectations will help the delivery of our audit within the proposed audit fee.

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Audit fee

Our *Audit Fee Letter 2014/15* presented to you in April 2014 first set out our fees for the 2014/15 audit. The Audit Commission has subsequently increased the scale fee by £1,070 to reflect the additional work required to gain assurance over business rates transactions now we are no longer required to audit the NNDR claim. We have not considered it necessary to make any changes to the agreed fees at this stage.

Our audit fee includes our work on the VFM conclusion and our audit of the Authority's financial statements.

The planned fee for the 2014/15 audit is £229,490.

Audit fee assumptions

The fee is based on a number of assumptions, including that you will provide us with complete and materially accurate financial statements, with good quality supporting working papers, within agreed timeframes. It is imperative that you achieve this. If this is not the case and we have to complete more work than was envisaged, we will need to charge additional fees for this work. In setting the fee, we have assumed:

- the level of risk in relation to the audit of the financial statements is not significantly different from that identified for 2014/15;
- you will inform us of any significant developments impacting on our audit;
- you will identify and implement any changes required under the *CIPFA Code of Practice on Local Authority Accounting in the UK 2014/15* within your 2014/15 financial statements;
- you will comply with the expectations set out in our *Accounts Audit Protocol*, including:
  - the financial statements are made available for audit in line with the agreed timescales;
  - good quality working papers and records will be provided at the start of the final accounts audit;
  - requested information will be provided within the agreed timescales;
  - prompt responses will be provided to queries and draft reports;
- internal audit meets appropriate professional standards;
- internal audit adheres to our joint working protocol and completes appropriate work on all systems that provide material figures for the financial statements and we can place reliance on them for our audit; and
- additional work will not be required to address questions or objections raised by local government electors or for special investigations such as those arising from disclosures under the Public Interest Disclosure Act 1998.

Meeting these expectations will help ensure the delivery of our audit within the agreed audit fee.

The Audit Commission requires us to inform you of specific actions you could take to keep the audit fee low. Future audit fees can be kept to a minimum if the Authority achieves an efficient and well-controlled financial closedown and accounts production process which complies with good practice and appropriately addresses new accounting developments and risk areas.

Changes to the audit plan

Changes to this plan and the audit fee may be necessary if:

- new significant audit risks emerge;
- additional work is required of us by the Audit Commission or other regulators; and
- additional work is required as a result of changes in legislation, professional standards or financial reporting requirements.

If changes to this plan and the audit fee are required, we will discuss and agree these initially with the Acting Corporate Director for Resources.

Appendix 1: Independence and objectivity requirements

This appendix summarises auditors' responsibilities regarding independence and objectivity.

Independence and objectivity

Auditors are required by the Code to:

- carry out their work with independence and objectivity;
- exercise their professional judgement and act independently of both the Commission and the audited body;
- maintain an objective attitude at all times and not act in any way that might give rise to, or be perceived to give rise to, a conflict of interest; and
- resist any improper attempt to influence their judgement in the conduct of the audit.

In addition, the Code specifies that auditors should not carry out work for an audited body that does not relate directly to the discharge of the auditors' functions under the Code. If the Authority invites us to carry out risk-based work in a particular area, which cannot otherwise be justified to support our audit conclusions, it will be clearly differentiated as work carried out under section 35 of the Audit Commission Act 1998.

The Code also states that the Commission issues guidance under its powers to appoint auditors and to determine their terms of appointment. The Standing Guidance for Auditors includes several references to arrangements designed to support and reinforce the requirements relating to independence, which auditors must comply with. These are as follows:

- Auditors and senior members of their staff who are directly involved in the management, supervision or delivery of Commission-related work, and senior members of their audit teams should not take part in political activity.
- No member or employee of the firm should accept or hold an appointment as a member of an audited body whose auditor is, or is proposed to be, from the same firm. In addition, no member or employee of the firm should accept or hold such appointments at related bodies, such as those linked to the audited body through a strategic partnership.
- Audit staff are expected not to accept appointments as Governors at certain types of schools within the local authority.
- Auditors and their staff should not be employed in any capacity (whether paid or unpaid) by an audited body or other organisation providing services to an audited body whilst being employed by the firm.
- Firms are expected to comply with the requirements of the Commission's protocols on provision of personal financial or tax advice to certain senior individuals at audited bodies, independence considerations in relation to procurement of services at audited bodies, and area wide internal audit work.
- Auditors appointed by the Commission should not accept engagements which involve commenting on the performance of other Commission auditors on Commission work without first consulting the Commission.
- Auditors are expected to comply with the Commission's policy for the Engagement Lead to be changed on a periodic basis.
- Audit suppliers are required to obtain the Commission's written approval prior to changing any Engagement Lead in respect of each audited body.
- Certain other staff changes or appointments require positive action to be taken by Firms as set out in the standing guidance.

Appendix 2: KPMG Audit Quality Framework

We continually focus on delivering a high quality audit.

This means building robust quality control procedures into the core audit process rather than bolting them on at the end, and embedding the right attitude and approaches into management and staff.

KPMG's Audit Quality Framework consists of seven key drivers combined with the commitment of each individual in KPMG.

The diagram summarises our approach and each level is expanded upon.

At KPMG we consider audit quality is not just about reaching the right opinion, but how we reach that opinion. KPMG views the outcome of a quality audit as the delivery of an appropriate and independent opinion in compliance with the auditing standards. It is about the processes, thought and integrity behind the audit report. This means, above all, being independent, compliant with our legal and professional requirements, and offering insight and impartial advice to you, our client.

KPMG's Audit Quality Framework consists of seven key drivers combined with the commitment of each individual in KPMG. We use our seven drivers of audit quality to articulate what audit quality means to KPMG.

We believe it is important to be transparent about the processes that sit behind a KPMG audit report, so you can have absolute confidence in us and in the quality of our audit.

Tone at the top: We make it clear that audit quality is part of our culture and values and therefore non-negotiable. Tone at the top is the umbrella that covers all the drives of quality through a focused and consistent voice. Sue Sunderland as the Engagement Lead sets the tone on the audit and leads by example with a clearly articulated audit strategy and commits a significant proportion of his time throughout the audit directing and supporting the team.

Association with right clients: We undertake rigorous client and engagement acceptance and continuance procedures which are vital to the ability of KPMG to provide high-quality professional services to our clients.

Clear standards and robust audit tools: We expect our audit professionals to adhere to the clear standards we set and we provide a range of tools to support them in meeting these expectations. The global rollout of KPMG's eAudIT application has significantly enhanced existing audit functionality. eAudIT enables KPMG to deliver a highly technically enabled audit. All of our staff have a searchable data base, Accounting Research Online, that includes all published accounting standards, the KPMG Audit Manual Guidance as well as other relevant sector specific publications, such as the Audit Commission's *Code of Audit Practice*.

Recruitment, development and assignment of appropriately qualified personnel: One of the key drivers of audit quality is assigning professionals appropriate to the Authority's risks. We take great care to assign the right people to the right clients based on a number of factors including their skill set, capacity and relevant experience.

We have a well developed technical infrastructure across the firm that puts us in a strong position to deal with any emerging issues. This includes:

- A national public sector technical director who has responsibility for co-ordinating our response to emerging accounting issues, influencing accounting bodies (such as CIPFA) as well as acting as a sounding board for our auditors.

- A national technical network of public sector audit professionals is established that meets on a monthly basis and is chaired by our national technical director.

- All of our staff have a searchable data base, Accounting Research Online, that includes all published accounting standards, the KPMG Audit Manual Guidance as well as other relevant sector specific publications, such as the Audit Commission's *Code of Audit Practice*.

- A dedicated Department of Professional Practice comprised of over 100 staff that provide support to our audit teams and deliver our web-based quarterly technical training.

Appendix 2: KPMG Audit Quality Framework

We continually focus on delivering a high quality audit.

This means building robust quality control procedures into the core audit process rather than bolting them on at the end, and embedding the right attitude and approaches into management and staff.

Quality must build on the foundations of well trained staff and a robust methodology.

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Commitment to technical excellence and quality service delivery: Our professionals bring you up- the-minute and accurate technical solutions and together with our specialists are capable of solving complex audit issues and delivering valued insights.

Our audit team draws upon specialist resources including Forensic, Corporate Finance, Transaction Services, Advisory, Taxation, Actuarial and IT. We promote technical excellence and quality service delivery through training and accreditation, developing business understanding and sector knowledge, investment in technical support, development of specialist networks and effective consultation processes.

Performance of effective and efficient audits: We understand that how an audit is conducted is as important as the final result. Our drivers of audit quality maximise the performance of the engagement team during the conduct of every audit. We expect our people to demonstrate certain key behaviors in the performance of effective and efficient audits. The key behaviors that our auditors apply throughout the audit process to deliver effective and efficient audits are outlined below:

- timely Engagement Lead and manager involvement;
- critical assessment of audit evidence;
- exercise of professional judgment and professional scepticism;
- ongoing mentoring and on the job coaching, supervision and review;
- appropriately supported and documented conclusions;
- if relevant, appropriate involvement of the Engagement Quality Control reviewer (EQC review);
- clear reporting of significant findings;
- insightful, open and honest two-way communication with those charged with governance; and
- client confidentiality, information security and data privacy.

Commitment to continuous improvement: We employ a broad range of mechanisms to monitor our performance, respond to feedback and understand our opportunities for improvement.

Our quality review results

We are able to evidence the quality of our audits through the results of Audit Commission reviews. The Audit Commission publishes information on the quality of work provided by KPMG (and all other firms) for audits undertaken on behalf of them (http://www.audit-commission.gov.uk/audit-regime/audit-quality-review-programme/principal-audits/kpmg-audit-quality).

The latest Annual Regulatory Compliance and Quality Report (issued June 2014) showed that we are meeting the Audit Commission's overall audit quality and regularity compliance requirements.

Appendix 3 : Assessment of fraud risk

We are required to consider fraud and the impact that this has on our audit approach.

We will update our risk assessment throughout the audit process and adapt our approach accordingly.

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Members /Officers responsibilities

- Adopt sound accounting policies.
- With oversight from those charged with governance, establish and maintain internal control, including controls to prevent, deter and detect fraud.
- Establish proper tone/culture/ethics.
- Require periodic confirmation by employees of their responsibilities.
- Take appropriate action in response to actual, suspected or alleged fraud.
- Disclose to the Audit Committee and auditors:
  - any significant deficiencies in internal controls.
  - any fraud involving those with a significant role in internal controls.

KPMG's identification of fraud risk factors

- Review of accounting policies.
- Results of analytical procedures.
- Procedures to identify fraud risk factors.
- Discussion amongst engagement personnel.
- Enquiries of management, Audit Committee, and others.
- Evaluate controls that prevent, deter, and detect fraud.

KPMG's response to identified fraud risk factors

- Accounting policy assessment.
- Evaluate design of mitigating controls.
- Test effectiveness of controls.
- Address management override of controls.
- Perform substantive audit procedures.
- Evaluate all audit evidence.
- Communicate to the Audit Committee and management/officers

KPMG's identified fraud risk factors

- We will monitor the following areas throughout the year and adapt our audit approach accordingly.
  - Revenue recognition.
  - Management override of controls.

Appendix 4: Transfer of Audit Commissions' functions

The Audit Commission will be writing to audited bodies and other stakeholders in the coming months with more information about the transfer of the Commissions' regulatory and other functions.

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From 1 April 2015 a transitional body, Public Sector Audit Appointments Limited (PSAA), established by the Local Government Association (LGA) as an independent company, will oversee the Commission's audit contracts until they end in 2017 (or 2020 if extended by DCLG). PSAA's responsibilities will include setting fees, appointing auditors and monitoring the quality of auditors' work. The responsibility for making arrangements for publishing the Commission's value for money profiles tool will also transfer to PSAA.

From 1 April 2015, the Commission's other functions will transfer to new organisations:

- responsibility for publishing the statutory Code of Audit Practice and guidance for auditors will transfer to the National Audit Office (NAO) for audits of the accounts from 2015/16;
- the Commission's responsibilities for local value for money studies will also transfer to the NAO; and
- the National Fraud Initiative (NFI) will transfer to the Cabinet Office.

cutting through complexity™

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Acting Director for Strategic Finance
Nottingham City Council
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Nottingham, NG2 3NG

Our ref SS/RW

17 February 2015

Dear Geoff,

Certification of claims and returns - annual report 2013/14

The Audit Commission requires its external auditors to prepare an annual report on the claims and returns it certifies for each client. This letter is our annual report for the certification work we have undertaken for 2013/14.

In 2013/14 we carried out certification work on the following claims/returns:

Claim/return	**Certified value (£)**
BEN01 – Housing Benefit subsidy claim	149,146,860
CFB06 – Pooling of Housing Capital Receipts	5,731,934
TRA11	3,085,000
Total	**157,963,794**

Matters arising

<u>BEN01 Housing Benefits Subsidy Claim</u>

As in previous years, our certification work in respect of the Housing Benefit subsidy claim identified a number of errors. It was possible to amend the claim for some of these errors and given the scale and complexity of this claim, the amendments were for relatively minor amounts. However, DWP rules require that all issues are reported or amended regardless of size.

Where it was not possible to calculate an amendment, these errors were reported in a qualification letter to the DWP. Generally items are included in qualification letters, rather than the claim form being amended, if the effect of the errors found can only be extrapolated from a sample of cases tested.

The reasons for the errors leading to qualification of the claim were varied and included:

- Incorrect calculation of earnings – extrapolated impact circa £515,000
- Incorrect tax credit values – extrapolated impact circa £90,000
- Incorrect calculation of childcare costs – extrapolated impact cica £50,000
- Non-dependent deductions omitted – extrapolated impact £9,000

The DWP use the information provided in the qualification letter to decide what if any further evidence the Council needs to provide and ultimately what adjustment will be made to grant payments. As in previous years, the Council can also undertake further work and make representations to DWP to reduce the extrapolated impact.

Going forward it is recommended that the Authority reviews the areas in question and ensures that these are communicated to staff and covered in future quality checks.

CFB06 - Pooling of Housing Capital Receipts

Our certification work did not identify any issues or errors with the Pooling of Housing Capital Receipts claim, and we certified this claim unqualified without amendment.

TRA11 – Local Transport Major Projects Grant

This grant is scheme rather than year specific and there was no comparable claim in 2012/13. Our certification work did not identify any issues with the claim, and we certified this claim without amendment or qualification.

Progress against last year’s recommendations

In our 2012/13 Certification Annual Report we raised five recommendations, three of which related to improving the accuracy of the Council’s Housing Benefits claim. Of these three, one related specifically to Council Tax benefit and is no longer covered by the Housing Benefit claim and for the other two we are satisfied from our testing that the Council has improved its arrangements and addressed the recommendations.

One recommendation related to the Pooling of Housing Capital Receipts and we are satisfied from our testing that this issue has been resolved.

One recommendation related to the Teachers’ Pensions Returns that is no longer certified within the Commission regime, and we have not included our follow up of the Council’s progress in implementing this recommendation within this report.

Full details are included in Appendix 2.

Certification work fees

The Audit Commission set an indicative fee for our certification work in 2013/14 of £19,779. We have requested a fee variation from the Audit Commission for the housing benefits claim. Despite the removal of council tax testing we have had to conduct additional testing to cover the issues arising from prior year's audits. This is still awaiting approval. The total estimated fee, therefore, in 2013/14 is £20,814.

The details are set out in the table below:

Claim	**2013/14 Indicative fee (£)**	**2013/14 Final fee (£)**	**2012/13 Final fee (£)**
BEN01 – Housing Benefit subsidy claim	16,496	17,531	16,610
CFB06 – Pooling of Housing Capital Receipts	1,035	1,035	1,910
TRA11 – Local Transport Major Projects Grant	2,248	2,248	-
Total	**19,779**	**20,814**	**18,520**

Yours sincerely

Sue Sunderland
Director

Appendix 1 – 2013/14 Certification of Claims and Returns Action Plan

Priority rating for recommendations		
❶ Issues that are fundamental and material to your overall arrangements for managing grants and returns or compliance with scheme requirements. We believe that these issues might mean that you do not meet a grant scheme requirement or reduce (mitigate) a risk.	❷ Issues that have an important effect on your arrangements for managing grants and returns or complying with scheme requirements, but do not need immediate action. You may still meet scheme requirements in full or in part or reduce (mitigate) a risk adequately but the weakness remains in the system.	❸ Issues that would, if corrected, improve your arrangements for managing grants and returns or compliance with scheme requirements in general, but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.

Number	Issue	Recommendation	Priority	Comment/Responsible officer/Due date
1	Errors were identified in the sample testing of housing benefit claims in the following areas at a level leading to an extrapolation of more than £10,000: • Incorrect calculation of earnings • Incorrect tax credit values • Incorrect calculation of childcare costs	The Authority should reinforce these areas when training staff and carry out specific quality checks to reduce the number of errors	❶	

Appendix 2 – Follow up of 2012/13 Certification of Claims and Returns Recommendations

Number	Prior year recommendation	Priority	Status in current year	Management comments
1	**Housing benefits claim** Put in place a timetable for completion of both initial and further testing required to support the certification of future Housing Benefit returns to meet certification deadlines.	❶	Complete Arrangements worked effectively in 2013/14	Agreed – this action is complete.
2	Carry out a rolling review of claimant assessments for rent allowance that include LHA to confirm accuracy of rates used. For future assessments, strengthen checks on LHA rates to confirm their accuracy.	❷	Recommendation implemented Testing in 2013/14 identified a significant reduction in error rate and a very low extrapolation error.	Agreed – this action is complete.
3	**Capital receipts pooling claim** Resolve uncertainty reported in our 2012/13 qualification letter re the basis for the calculation of capital allowances available to the Council .	2	Resolved	Agreed – this action is complete.

This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission has issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw your attention to this document.
External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Sue Sunderland, who is the engagement leader to the Authority (telephone 0115 945 4490, e-mail sue.sunderland@kpmg.co.uk who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees (telephone 0161 236 4000, e-mail trevor.rees@kpmg.co.uk) who is the national contact partner for all of KPMG's work with the Audit Commission. After this, if you are still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure. Put your complaint in writing to the Complaints Unit Manager, Audit Commission, 3rd Floor, Fry Building, 2 Marsham Street, London, SW1P 4DF or by email to complaints@audit-commission.gsi.gov.uk. Their telephone number is 0303 444 8330.

AUDIT COMMITTEE – 27 FEBRUARY 2015

Title of paper:	**TREASURY MANAGEMENT 2015/16 STRATEGY**	
Director(s)/ Corporate Director(s):	Glen O'Connell, Corporate Director, Resources	**Wards affected: All**
Report author(s) and contact details:	Geoff Walker, Director of Strategic Finance (Acting), 0115 8763740 geoff.walker@nottinghamcity.gov.uk	
Other colleagues who have provided input:	Glyn Daykin, Finance Analyst Treasury Management Tel: 0115 8763724 E-mail: glyn.daykin@nottinghamcity.gov.uk	
Recommendation(s):		
1	Audit Committee are asked to consider and comment on the proposed 2015/16 Treasury Management and Investment Strategies, attached as **Appendix 1,** prior to its consideration by City Council on 9 March 2015.	

1. REASONS FOR RECOMMENDATIONS

The Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Code of Practice and Prudential Code are both adopted by the Council. There is a requirement for authorities to nominate a body within the organisation to be responsible for scrutiny of treasury management activity. It is considered that the City Council's Audit Committee is the most appropriate body for this function.

In undertaking this function, the Audit Committee holds the responsibility to provide effective scrutiny of treasury management policies and practices, and to deliver this in advance of the associated annual strategies being formally approved by Council in March. This provides an opportunity for detailed scrutiny and analysis of the Treasury Management and Investment Strategy by those charged with governance.

2. BACKGROUND

Treasury management is the management of an organisation's borrowings and investments, the effective management of the associated risks and the pursuit of optimum performance or return consistent with those risks.

The treasury management function is governed by provisions set out under Part 1 of the Local Government Act 2003, whereby the City Council must have regard to the CIPFA Prudential Code and the CIPFA Code of Practice.

The City Council retains external advisors to provide additional input on treasury management matters. The service provided includes economic and interest rate forecasting, advice on strategy, portfolio structure, debt restructuring, investment policy, creditworthiness, credit ratings and other counterparty criteria and technical assistance on other related matters, as required.

3. PROPOSED TREASURY MANAGEMENT AND INVESTMENT STRATEGY 2015/16 (APPENDIX 1)

This document sets the strategic context, within the Council's planning cycle, for how treasury management activity will take place in the forthcoming year. Within this context, the objectives of the strategy are:

- To achieve the lowest net interest rate costs on the City Council's external debt, whilst recognising the risk management implications
- To protect the Medium Term Financial Strategy (MTFS) from fluctuations in interest rates and to prevent the need for excessive borrowing in future years, when rates may be unfavourable
- To maintain the security and liquidity of external investments, and within those parameters, to seek to maximise the return on such investments.

The main elements of the proposed strategy for 2015/16 are:

- Borrowing strategy (**Appendix 1, page 4**)
- Debt rescheduling (**Appendix 1, page 6**)
- Debt repayment (Minimum Revenue Provision statement (**Appendix 4**)
- Housing Revenue Account strategy (**Appendix 1**)
- Investment strategy (**Appendix 1, page 6**)
- Prudential indicators (**Appendix 3**)
- Risk Management Action Plan (**Appendix 6**)

4. BACKGROUND PAPERS OTHER THAN PUBLISHED WORKS OR THOSE DISCLOSING EXEMPT OR CONFIDENTIAL INFORMATION

None.

5. PUBLISHED DOCUMENTS REFERRED TO IN COMPILING THIS REPORT

None.

Appendix 1

NOTTINGHAM CITY COUNCIL

TREASURY MANAGEMENT STRATEGY 2015/16

Executive Board 24 February 2015
Audit Committee 27 February 2015
City Council 9 March 2015

Introduction

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

In addition, the Department for Communities and Local Government (CLG) issued revised *Guidance on Local Authority Investments* in March 2010 that requires the Council to approve an investment strategy before the start of each financial year.

This report fulfils the Council's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the CLG Guidance.

The 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 risk are therefore central to the Council's treasury management strategy.

External Context

Economic background: There is momentum in the UK economy, with a continued period of growth through domestically-driven activity and strong household consumption. There are signs that growth is becoming more balanced. The greater contribution from business investment should support continued, albeit slower, expansion of GDP. However, inflationary pressure is currently extremely benign and is likely to remain low in the short-term. There have been large falls in unemployment but levels of part-time working, self-employment and underemployment are significant and nominal earnings growth remains weak and below inflation.

The MPC's focus is on both the degree of spare capacity in the economy and the rate at which this will be used up, factors prompting some debate on the Committee. Despite two MPC members having voted for an 0.25% increase in rates at each of the meetings between August and December 2014, the minutes of the January 2015 meeting showed unanimity in maintaining the Bank Rate at 0.5% as there was sufficient risk that low inflation could become entrenched and the MPC became more concerned about the economic outlook.

Credit outlook: The transposition of two European Union directives into UK legislation in the coming months will place the burden of rescuing failing EU banks disproportionately onto unsecured local authority investors. The *Bank Recovery and Resolution Directive* promotes the interests of individual and small businesses covered by the Financial Services Compensation Scheme and similar European schemes, while the recast *Deposit Guarantee Schemes Directive* includes large companies into these schemes. The combined effect of these two changes is to leave public authorities and financial organisations (including pension funds) as the only senior creditors likely to incur losses in a failing bank after July 2015.

The continued global economic recovery has led to a general improvement in credit conditions since last year. This is evidenced by a fall in the credit default swap spreads of banks and companies around the world. However, due to the above legislative changes, **the credit risk associated with making unsecured bank deposits will increase** relative to the risk of other investment options available to the Council.

Interest rate forecast: The Council's treasury management advisor Arlingclose forecasts the first rise in official interest rates in August 2015 and a gradual pace of increases thereafter, with the average for 2015/16 being around 0.75%. Arlingclose believes the normalised level of the Bank Rate post-crisis to range between 2.5% and 3.5%. The risk to the upside (i.e. interest rates being higher) is weighted more towards the end of the forecast horizon. On the downside, Eurozone weakness and the threat of deflation have increased the risks to the durability of UK growth. If the negative indicators from the Eurozone become more entrenched, the Bank of England will likely defer rate rises to later in the year. Arlingclose projects gilt yields on an upward path in the medium term, taking the forecast average 10 year PWLB loan rate for 2015/16 to 2.70%.
A more detailed economic and interest rate forecast provided by the Arlingclose is attached at Appendix 2.

For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.80%, and that new long-term loans will be borrowed at an average rate of 4.00%.

Local Context

The Council currently has £695.9m of borrowing and £160.0m of investments. This is set out in further detail at Appendix 3. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance Sheet Summary and Forecast

	31.3.14 Actual £m	**31.3.15 Estimate £m**	**31.3.16 Estimate £m**	**31.3.17 Estimate £m**	**31.3.18 Estimate £m**
General Fund CFR	635	661	904	884	847
HRA CFR	282	281	289	294	300
Total CFR	**917**	**942**	**1193**	**1178**	**1147**
Less: Other debt liabilities *	-92	-103	-239	-230	-220
Borrowing CFR	**825**	**839**	**954**	**948**	**927**
Less: External borrowing **	-710	-688	-671	-666	-644
Internal borrowing	**115**	**151**	**283**	**282**	**283**
Less: Usable reserves	-238	-224	-205	-196	-193
Less: Working capital	-93	-93	-93	-93	-93
Investments or (New borrowing)	**216**	**166**	**15**	**7**	**3**

* finance leases and PFI liabilities that form part of the Council's debt
** shows only loans to which the Council is committed and excludes optional refinancing

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, subject to holding a minimum investment balance of £30m.
The Council has an increasing CFR due to the capital programme, and a reducing amount of investments and will therefore be required to borrow up to £27m over the forecast period. Further borrowing in this period will be required if additional regeneration schemes are approved and added to the capital program.

The 2013/14 investments include £100m raised from the Public Works Loan Board (PWLB) in 2012/13 to finance a required capital contribution for the Nottingham Express Transit (NET) Phase 2 scheme. This borrowing was raised in advance of need, to take advantage of low interest rates and the cash is expected be expended in early 2015/16.

CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council expects to comply with this recommendation during 2015/16.

Borrowing Strategy

The Council currently holds £696 million of loans (excluding £103m PFI debt), a decrease of £14 million on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Council expects to borrow up to £15m plus a further £137m PFI debt in 2015/16. The Council may also commit to borrow additional sums at fixed rates to pre-fund future years' requirements, to reduce its level of internal borrowing or for additional capital schemes that are not yet in the capital program approval providing this does not exceed the authorised limit for borrowing of £1,050 million.

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

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

By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Arlingclose will assist the Council with

this ‘cost of carry’ and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2015/16 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.
In addition, the Council may borrow short-term loans (normally for up to one month) to cover unexpected cash flow shortages.

Sources: The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB) and its successor body
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except Nottinghamshire County Council Pension Fund)
- capital market bond investors
- Local Capital Finance Company and other special purpose companies created to enable local authority bond issues

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

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

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

LGA Bond Agency: Local Capital Finance Company was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for three reasons: borrowing authorities may be required to provide bond investors with a joint and several guarantee over the very small risk that other local authority borrowers default on their loans; there will be a lead time of several months between committing to borrow and knowing the interest rate payable; and up to 5% of the loan proceeds will be withheld from the Authority and used to bolster the Agency’s capital strength instead.

LOBOs: The Council holds £49m of LOBO (Lender’s Option Borrower’s Option) loans where the lender has the option to propose an increase in the interest rate as set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. £34m of these LOBOS have options during 2015/16, and although the Council understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Council will take the option to repay LOBO loans at no cost if it has the opportunity to do so.

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

Debt Rescheduling: The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. 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.

Forward Starting Loans: In order to minimise the risk of the uncertainty of future interest rates, we will consider the use of 'Forward Starting loans' to fix the rate of interest for a specific loan where the cash will be taken at a set future date. These will be considered where it clearly demonstrates a reduction in the overall financial risk the council is exposed to.

Investment Strategy

The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's investment balance has ranged between £160 and £301 million, but investment balances are expected to reduce significantly in the forthcoming year as surplus cash will continue to be used to meet borrowing requirements.

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

Strategy: Given the increasing risk and continued low returns from short-term unsecured bank investments, the Council aims to further diversify into more secure and higher yielding asset classes during 2015/16. The majority of the Authorities surplus cash is currently invested in short-term unsecured bank deposits, certificates of deposit and money market funds. This diversification will therefore represent a substantial change in strategy over the coming year.

Approved Counterparties: The Council may invest its surplus funds with any of the counterparty types in table 2 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 2: Approved Investment Counterparties and Limits

Credit Rating	Banks Unsecured	Banks Secured	Government	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a
AAA	£15m 5 years	£15m 20 years	£15m 50 years	£10m 20 years
AA+	£15m 5 years	£15m 10 years	£15m 25 years	£10m 10 years
AA	£15m 4 years	£15m 5 years	£15m 15 years	£10m 10 years
AA-	£15m 3 years	£15m 4 years	£15m 10 years	£10m 10 years
A+	£15m 2 years	£15m 3 years	£15m 5 years	£10m 5 years
A	£15m 13 months	£15m 2 years	£15m 5 years	£10m 5 years
A-	£15m 6 months	£15m 13 months	£15m 5 years	£10m 5 years
BBB+	£10m Overnight	£10m 6 months	£5m 2 years	£5m 2 years
None	n/a	n/a	£15m 25 years	n/a
Pooled funds	£10m per fund			

This table must be read in conjunction with the notes below:-

Credit Rating: Investment decisions are made by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used.

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

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

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

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

Pooled Funds: Shares in diversified investment vehicles consisting of the any of the above investment types, plus corporate bonds, commercial paper, equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Money Market Funds that offer same-day liquidity and aim for a constant net asset value will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the 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.

Risk Assessment and Credit Ratings: Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

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

Other Information on the Security of Investments: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

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

Specified Investments: The CLG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
    - the UK Government,
    - a UK local authority, parish council or community council, or
    - a body or investment scheme of "high credit quality".

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

Non-specified Investments: Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in table 3 below.

Table 3: Non-Specified Investment Limits

	Cash limit
Total long-term investments	£50m
Total investments without credit ratings or rated below A-	£50m
Total investments with institutions domiciled in foreign countries rated below AA+	£30m
Total non-specified investments	£50m

Investment Limits: The Council's revenue reserves available to cover investment losses are forecast to be c.£224 million on 31st March 2015. In order that no more than 10% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £15 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below:

Table 4: Investment Limits

	Cash limit
Any single organisation, except the UK Central Government	£15m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£15m per group
Any group of pooled funds under the same management	£40m per manager
Negotiable instruments held in a broker's nominee account	£100m per broker
Foreign countries	£20m per country
Registered Providers	£50m in total
Unsecured investments with Building Societies	£30m in total
Money Market Funds	£100m in total

Liquidity Management: The Council uses purpose-built cash flow forecasting software to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a pessimistic basis, with receipts under-estimated and payments over-estimated to minimise the risk of the 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.

Other Items

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

Policy on Use of Financial Derivatives: Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds, will not

be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.
Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

Policy on Apportioning Interest to the HRA: On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/ credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured and interest transferred between the General Fund and HRA at the average 3 month UK Government Treasury Bill interest rate to reflect a credit risk free return.

Investment Training: The needs of the Council's treasury management staff for training in investment management are assessed as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.
Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.

Investment Advisers: The Council has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues.

Investment of Money Borrowed in Advance of Need: The Council may, from time to time, borrow in advance of need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. Consideration will be given to the use of forward starting loans as an alternative where appropriate. These risks will be managed as part of the Council's overall management of its treasury risks. The total amount borrowed will not exceed the authorised borrowing limit of £1050 million. The maximum period between borrowing and expenditure is expected to be two years, although the Council is not required to link particular loans with particular items of expenditure.

Management of Risk: Risk management plays a fundamental role in treasury activities, due to the value and nature of transactions involved. Appendix 6 details the specific risks identified in respect of treasury management within the Council and the adopted Risk Management Action Plan. This Plan is reviewed at regular intervals at meetings of the Treasury Management Panel.

Arlingclose Economic & Interest Rate Forecast January 2015

Underlying assumptions:

- The UK economic recovery slowed towards the end of 2014, with economic and political uncertainty weighing on business investment. However, the Q3 growth rate of 0.7% remains slightly above the long run average, suggesting the recovery remains robust.
- Household consumption is key to the recovery in 2015. While we expect consumption growth to slow, given softening housing market activity and slower employment growth, the fall in inflation and resulting rise in both real (and nominal) wage growth and disposable income should support spending.
- Inflationary pressure is currently low (annual CPI is currently 0.5%) and is likely to remain so in the short-term. The fall in oil prices has yet to feed fully into the prices of motor fuel and retail energy and CPI is expected to fall further. Supermarket price wars are also expected to bear down on food price inflation.
- The MPC's focus is on both the degree of spare capacity in the economy and the rate at which this will be used up, factors prompting some debate on the Committee.
- Nominal earnings growth is strengthening, but remains relatively weak in historical terms, despite large falls in unemployment. Our view is that spare capacity remains extensive. The levels of part-time, self-employment and underemployment are significant and indicate capacity within the employed workforce, in addition to the still large unemployed pool. Productivity growth can therefore remain weak in the short term without creating undue inflationary pressure.
- However, we also expect employment growth to slow as economic growth decelerates. This is likely to boost productivity, which will bear down on unit labour costs and inflationary pressure.
- In addition to the lack of wage and inflationary pressures, policymakers are evidently concerned about the bleak prospects for the Eurozone. These factors will maintain the dovish stance of the MPC in the medium term. The MPC clearly believes the appropriate level for Bank Rate for the post-crisis UK economy is significantly lower than the previous norm. We would suggest this is between 2.5 and 3.5%.
- The ECB has introduced outright QE as expected. While this may alleviate some of the anxiety about the economic potential of the Eurozone, political risk remains significant (e.g. Greek election). Therefore fears for the Eurozone are likely to maintain a safe haven bid for UK government debt.

Forecast:

- We continue to forecast the first rise in official interest rates in Q3 2015, but the risks to this forecast are very much weighted to the downside. The February Inflation Report will be key to our review of the possible path for Bank Rate.

- We project a slow rise in Bank Rate. The pace of interest rate rises will be gradual and the extent of rises limited; we believe the normalised level of Bank Rate post-crisis to range between 2.5% and 3.5%.
- Market sentiment (derived from forward curves) has shifted significantly lower in the past three months; market expectations are now for a later increase in interest rates and a more muted increase in gilt yields.
- The short run path for gilt yields has flattened due to the sharp decline in inflation expectations. We project gilt yields on an upward path in the medium term.
- The short run path for gilt yields is flatter due to the deteriorating Eurozone situation. We project gilt yields on an upward path in the medium term.

	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Official Bank Rate													
Upside risk				0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	**0.50**	**0.50**	**0.75**	**0.75**	**1.00**	**1.00**	**1.25**	**1.25**	**1.50**	**1.50**	**1.75**	**1.75**	**1.75**
Downside risk			0.25	0.25	0.50	0.50	0.75	0.75	1.00	1.00	1.00	1.00	1.00
3-month LIBID rate													
Upside risk	0.10	0.20	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	**0.55**	**0.60**	**0.80**	**0.90**	**1.05**	**1.15**	**1.30**	**1.40**	**1.55**	**1.65**	**1.80**	**1.95**	**2.00**
Downside risk	0.15	0.20	0.30	0.40	0.55	0.65	0.75	0.85	0.95	0.95	0.95	0.95	1.00
1-yr LIBID rate													
Upside risk	0.10	0.20	0.20	0.30	0.30	0.30	0.30	0.30	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	**0.95**	**1.00**	**1.20**	**1.30**	**1.45**	**1.55**	**1.70**	**1.80**	**1.95**	**2.05**	**2.20**	**2.35**	**2.40**
Downside risk	0.15	0.20	0.30	0.50	0.55	0.60	0.65	0.70	0.75	0.80	0.80	0.80	0.80
5-yr gilt yield													
Upside risk	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.45	0.45	0.45	0.45	0.50	0.50
Arlingclose Central Case	**1.10**	**1.20**	**1.30**	**1.40**	**1.50**	**1.65**	**1.80**	**1.95**	**2.10**	**2.20**	**2.35**	**2.40**	**2.50**
Downside risk	0.35	0.35	0.40	0.45	0.50	0.50	0.55	0.60	0.65	0.70	0.70	0.70	0.75
10-yr gilt yield													
Upside risk	0.35	0.40	0.40	0.40	0.40	0.45	0.45	0.45	0.45	0.50	0.50	0.55	0.55
Arlingclose Central Case	**1.60**	**1.70**	**1.80**	**1.90**	**2.00**	**2.15**	**2.30**	**2.45**	**2.60**	**2.70**	**2.85**	**2.90**	**3.00**
Downside risk	0.35	0.35	0.40	0.45	0.50	0.50	0.55	0.60	0.65	0.70	0.70	0.75	0.80
20-yr gilt yield													
Upside risk	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55	0.55
Arlingclose Central Case	**2.10**	**2.20**	**2.30**	**2.35**	**2.45**	**2.50**	**2.65**	**2.75**	**2.90**	**3.00**	**3.15**	**3.20**	**3.30**
Downside risk	0.35	0.40	0.50	0.60	0.70	0.75	0.75	0.75	0.80	0.85	0.85	0.90	0.90
50-yr gilt yield													
Upside risk	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55	0.55
Arlingclose Central Case	**2.15**	**2.25**	**2.35**	**2.40**	**2.50**	**2.55**	**2.70**	**2.80**	**2.95**	**3.05**	**3.20**	**3.25**	**3.35**
Downside risk	0.35	0.40	0.50	0.60	0.70	0.75	0.75	0.75	0.80	0.85	0.85	0.90	0.90

PRUDENTIAL INDICATORS 2014/15 – 2017/18					
	2013/14 Act £m	**2014/15 Est £m**	**2015/16 Est £m**	**2016/17 Est £m**	**2017/18 Est £m**
1. PRUDENCE INDICATORS					
i) Capital Expenditure					
General Fund	69.8	111.6	207.4	55.9	28.3
HRA	52.4	65.0	67.0	64.8	51.4
	122.2	**176.6**	**274.4**	**120.7**	**79.7**
ii) CFR at 31 March					
General Fund	542.9	557.5	664.3	654.4	627.0
HRA	282.3	281.3	289.3	294.1	300.0
PFI-related debt	91.8	103.2	239.5	229.7	219.7
	917.0	**942.0**	**1193.1**	**1178.2**	**1146.7**
iii) External Debt at 31 March					
Borrowing	710.2	688.1	671.0	665.8	644.4
Other (PFI debt)	91.8	103.2	239.5	229.8	219.7
Gross debt	**802.0**	**791.3**	**910.5**	**895.6**	**864.1**
2. AFFORDABILITY INDICATORS					
i) Ratio of financing costs to net revenue stream					
General Fund	16.15%	14.19%	13.92%	14.71%	14.92%
HRA	12.23%	13.03%	12.31%	12.05%	11.79%
ii) Impact of capital investment decisions			**£s**	**£s**	**£s**
Council Tax Band D (per annum)	-	-	1.38	6.49	4.28
HRA rent (per week)	-	-	-	-	-
	£m	**£m**	**£m**	**£m**	**£m**
iii) Authorised limit for external debt	882.3	1091.6	1050.5	1044.6	968.1
iv) Operational Boundary for ext. debt	842.3	1041.6	1030.5	1024.6	948.1
v) HRA limit on indebtedness					
HRA CFR	282.3	281.3	289.3	294.1	300.1
HRA Debt Cap (CLG prescribed)	319.8	319.8	319.8	319.8	319.8
Difference - headroom	**37.5**	**38.5**	**30.5**	**25.7**	**19.7**
3. TREASURY MANAGEMENT INDICATORS					
i) Limit on variable interest rates- debt	8%	0-50%	0-50%	0-50%	0-50%
ii) Limit on fixed interest rates- debt	92%	50-100%	50-100%	50-100%	50-100%
iii) Fixed Debt maturity structure					
- under 12 months	4%	0-25%	0-25%	0-25%	0-25%
- 12 months to 2 years	2%	0-25%	0-25%	0-25%	0-25%
- 2 to 5 years	12%	0-25%	0-25%	0-25%	0-25%
- 5 to 10 years	19%	0-50%	0-50%	0-50%	0-50%
- 10 to 25 years	33%	0-50%	0-50%	0-50%	0-50%
- 25 to 40 years	21%	0-25%	0-25%	0-25%	0-25%
- 40 years and above	9%	0-75%	0-75%	0-75%	0-75%
iv) Sums invested for >364 days - in-house limit	£15.0m	£50m	£50m	£50m	£50m
v) Adoption of the *CIPFA Code of Practice for Treasury Management in the Public Services*	YES				
vi) Credit risk	Provided in Appendix 1,				

NOTES TO THE SCHEDULE OF PRUDENTIAL INDICATORS

1) **Prudence Indicators**

i) *'Estimate of total capital expenditure'* – a "reasonable" estimate of total capital expenditure to be incurred in the next 3 financial years, split between the General Fund and the HRA.

- This estimate takes into account the current approved asset management and capital investment strategies.

ii) *'Capital financing requirement' (CFR)* – this figure constitutes the aggregate amount of capital spending which has not yet been financed by capital receipts, capital grants or contributions from revenue, and represents the underlying need to borrow money long-term. An actual figure at 31 March each year is required, together with estimates for the next three financial years.

- This approximates to the previous Credit Ceiling calculation and provides an indication of the total long-term debt requirement.
- The figure includes an estimation of the total debt brought 'on-balance sheet' in respect of PFI schemes and finance leases.

iii) *'External debt'* - the actual level of gross borrowing (plus other long-term liabilities, including the notional debt relating to on-balance sheet PFI schemes and leases) calculated from the balance sheet, with estimates for the next three financial years.

2) **Affordability Indicators**

i) '*Ratio of financing costs to net revenue stream'* – expresses the revenue costs of the Council's borrowing (interest payments and provision for repayment) as a percentage of the total sum to be raised from government grants, business rates, council and other taxes (General Fund) and rent income (HRA). From 1 April 2012, the General fund income figure includes revenue raised from the Workplace Parking Levy.

- These indicators show the impact of borrowing on the revenue accounts and enable a comparison between years to be made. The increase in the General Fund ratio reflects the falling grant from government and the impact of the extension of the NET capital scheme, funded from specific Government grant and the Workplace Parking Levy income streams.

ii) *'Incremental impact of capital investment decisions'* – expresses the revenue consequences of future capital spending plans to be met from unsupported borrowing and not financed from existing budget provision, on both the level of council tax and weekly housing rents.

- This is a key indicator, which provides a direct link between the capital programme and revenue budget and enables the revenue impact of additional unsupported capital investment to be understood.

iii) *'Authorised limit for external debt'* – this represents the maximum amount that may be borrowed at any point during the year. An estimate for the next three financial years is required.

- This figure allows for the possibility that borrowing for capital purposes may be undertaken early in the year, with a further sum to reflect any temporary borrowing as a result of adverse cash flow. This represents a 'worst case' scenario.

iv) *'Operating boundary for external debt'* – this indicator is a working limit and represents the highest level of borrowing is expected to be reached at any time during the year - It is recognised that this operational boundary may be breached in exceptional circumstances.

v) *'HRA limit on indebtedness'* – from 1 April 2012, a separate debt portfolio has been established for the HRA. The CLG have imposed a 'cap' on the maximum level of debt for individual authorities and the difference between this limit and the actual HRA CFR represents the headroom available for future new borrowing.

3) **Treasury Management Indicators**

i) *'The amount of net borrowing which is at a variable rate of interest'* - expressed either as an absolute amount or a percentage. Upper and lower limits for the next three financial years are required.

- A high level of variable rate debt presents a risk from increases in interest rates. This figure represents the maximum permitted exposure to such debt.

ii) *'The amount of net borrowing which is at fixed rate of interest'* - expressed either as an absolute amount or a percentage. Upper and lower limits for the next three financial years are required.

- Fixed rate borrowing provides certainty for future interest costs, regardless of movements in interest rates. The lower limit is effectively the counterpart to the upper limit for variable rate borrowing.

iii) *'Upper and lower limits with respect to the maturity structure of the Council's borrowing'* – this shows the amount of fixed rate borrowing maturing in each period, expressed as a percentage of total fixed rate borrowing.

- This indicator is designed to be a control over having large amounts of fixed rate debt falling to be replaced at the same time.

iv) *'Total sums invested for periods of greater than 364 days* – a limit on investments for periods longer than 1 year. A three-year estimate is required.

- This indicator is designed to protect the liquidity of investments, ensuring that large proportions of the cash reserves are not invested for long periods.

v) *The adoption of the CIPFA Code of Practice for Treasury Management in the Public Services'.* This is not a numerical indicator, but a statement of good practice.

- The Council adopted the Code on 18 February 2002. Revised Codes, issued in 2009 and 2011, have subsequently been incorporated within the Council's strategy and procedures.

vi) *Credit risk* – The Council monitors a range of factors to manage credit risk, detailed in its annual Treasury Management Strategy.

Annual Minimum Revenue Provision Statement 2015/16

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

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

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

- For capital expenditure incurred before 1st April 2008, and for supported capital expenditure incurred on or after that date, MRP will be determined in accordance with the former regulations that applied on 31st March 2008, incorporating an "Adjustment A" of £5.095m. *(Option 1)*

- For unsupported capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant assets in equal instalments *or* as the principal repayment on an annuity, starting in the year after the asset becomes operational. MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 20 years. *(Option 3)*

- For assets acquired by finance leases or the Private Finance Initiative, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.

- No MRP will be charged in respect of assets held within the Housing Revenue Account.

Capital expenditure incurred during 2015/16 will not be subject to a MRP charge until 2016/17.

NOTTINGHAM CITY COUNCIL TREASURY MANAGEMENT POLICY STATEMENT

The following treasury management policy statement was formally adopted by the City Council on 5 March 2012*.*

1. INTRODUCTION AND BACKGROUND

1.1 The Council adopts the key recommendations of CIPFA's Treasury Management in the Public Services: Code of Practice (the Code), as described in Section 5 of the Code.

1.2 Accordingly, the Council will create and maintain, as the cornerstones for effective treasury management:-

- A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities

- Suitable treasury management practices (TMPs), setting out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

1.3 The Council (i.e. full Council) will receive reports on its treasury management policies, practices and activities including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.

1.4 The Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to Executive Board and for the execution and administration of treasury management decisions to the Chief Financial Officer, who will act in accordance with the organisation's policy statement and TMPs and CIPFA's Standard of Professional Practice on Treasury Management.

1.5 The Council nominates Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

2. POLICIES AND OBJECTIVES OF TREASURY MANAGEMENT ACTIVITIES

2.1 The Council defines its treasury management activities as:

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

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

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

2.4 The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken and the type of borrowing should allow the Council transparency and control over its debt.

2.5 The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Council's investments followed by the yield earned on investments remain important but are secondary considerations.

Appendix 6

Risk Management Action Plan (RMAP)

Likelihood	
1	Remote
2	Unlikely
3	Possible
4	Likely
5	Almost Certain

Likelihood (L)					
5	**5**	**10**	**15**	**20**	**25**
4	**4**	**8**	**12**	**16**	**20**
3	**3**	**6**	**9**	**12**	**15**
2	**2**	**4**	**6**	**8**	**10**
1	**1**	**2**	**3**	**4**	**5**
	1	**2**	**3**	**4**	**5**
	Impact (I)				

Impact	
1	Negligible
2	Minor
3	Moderate
4	Major
5	Catastrophic

Low Seriousness	Medium Seriousness	High Seriousness

Summary Business Risk: SRR17 – Failure to protect the Council's investments			
Owned by: DCEX/CD - Resources	Completed by: DCEX/CD – Resources and Treasury Management Panel	Completed: Dec 2014	Next Review: Mar 2015
Prevailing Summary risk Threat Level (LxI)	4.22 (average) (1.78 x 2.67)	Target summary Risk Threat Level	3.44 (average) (1.56 x 2.44)
Summary risk mitigation effectiveness (Effective, yet to secure improvement, may not be enough)		Effective	
Risks under risk management:			

Risk Ref:	**Description**	**Current Risk Rating Score (LxI)**	**Target Risk Rating Score (LxI)**
1	Inappropriate investment of monies with counterparties (TMP 1.1)	1 x 4 = 4	1 x 3 = 3
2	Failure to maximise recovery of Icelandic bank deposits (TMP 1.1, 1.2, 1.8)	3 x 1 = 3	3 x 1 = 3
3	Inappropriate investment strategy (TMP 1.1, 1.2, 1.3, 1.8, 3, 4 & 11)	2 x 3 = 6	2 x 3 = 6
4	Inappropriate borrowing strategy (TMP 1.2, 1.3, 1.5 & 1.8)	1 x 3 = 3	1 x 3 = 3
5	Inappropriate management of debt portfolio (TMP 1.2, 1.3, 1.5 & 1.8)	1 x 3 = 3	1 x 3 = 3
6	Banking contract transition failure (TMP 1.1, 1.2, 1.8)	3 x 2 = 6	1 x 2 = 2
7	Poor cash management (TMP 1.2, 1. 8)	2 x 2 = 4	2 x 2 = 4
8	Colleague fraud (TMP 1.7 & 5)	2 x 3 = 6	2 x 2 = 4
9	Failure to comply with CIPFA Code of Practice and/or respond to changes in relevant legislation (TMP 1.6)	1 x 3 = 3	1 x 3 = 3

Current Management Action / Controls Acting on Risk?
Delete as applicable: Some

Risk Ref.	Current Management/actions in place	Adequacy of action/control to mitigate risk	Additional management action/ controls	Responsibility for additional action		Critical success factors of additional actions	Key Dates	
				CD	D/ HoS		Additional controls complete	Progress review frequency
1	• Continued use of external advisors – Arlingclose contract renewed from April '13 to March '17 • Use of counterparties list based on range of formal credit ratings and wider market intelligence and advice • Limits set for amounts and time periods with individual institutions • Counterparty limits amended as and when required and future investments suspended if deemed appropriate • TM and investment strategy reviewed and amended as required • Quarterly review of the investment portfolio carried out at TM Panel meetings. • Monitoring of wider economic environment provided by advisors, with amendments to the existing strategy, as required.	EFFECTIVE	• Maintain current arrangements • Internal audit plan includes 16 scheduled audit days per annum.	GO	GW	• Weekly check by Deputy S151 officer of current investments. • Latest Internal Audit report findings give "significant assurance on controls" (Feb 15) • TM Panel meets regularly to review the overall position. • Implementation of amendments to the investment strategy when appropriate	Ongoing Ongoing Ongoing Ongoing	Ongoing As received Quarterly As required

2	• Co-ordination of action, through the LGA, to ensure maximisation of recovery of sums deposited in Icelandic Banks • Membership of LGA Icelandic Banks Steering Committee. • Retention of legal advisors, in UK and Iceland, through LGA • Regular updates provided on proposed actions, latest recovery levels and forecasts for future receipts	EFFECTIVE	• TM Panel meets regularly to review the overall position.	GO	GW	• Heritable Bank final recovery at 94% • Landsbanki final recovery at 91% • Glitnir Bank deposits as priority creditors, with recoveries of around 97% forecasted • c. £2.4m of Glitnir Bank recoveries in ISK in escrow subject to currency controls	Ongoing	Quarterly
3	• Retention of external advisors. • Regular reviews of interest rate forecasts • Up to date knowledge of existing and developing investment products through regular attendance at seminars and workshops • Regular review of the investment strategy • Monitoring of wider economic activity and prompt response • CFO action under delegation (and in consultation with portfolio holder) to respond quickly to emerging issues. • Regular reviews (at least	EFFECTIVE		GO	GW	• TM colleagues work with advisors and colleagues to keep abreast of wider economic conditions and respond accordingly. • TM Panel meets regularly to review the overall position. • Weekly meetings with portfolio holder	Ongoing Ongoing Ongoing	Quarterly At least quarterly and as required Weekly

	quarterly) with formal changes implemented as req'd							
4	• Identification and monitoring of annual borrowing requirement • Monitoring of PWLB borrowing rates • Use of alternative loan products as appropriate • Regular review of arrangements and possibilities • Review of capital programme, informing new capital strategy.	EFFECTIVE	• Capital programme review completed	GO	GW TC	• Sufficient resources identified to cover capital expenditure and cash flows • Continued regular review by TM Panel.	Ongoing Ongoing	Quarterly Quarterly
5	• Retention of strong external advisors • Regular monitoring of debt maturity profile • Establishment and maintenance of a liability benchmark, to monitor Minimum Revenue Provision against debt and Capital Financing Requirement • Opportunities for rescheduling identified and implemented	EFFECTIVE	• Maintain existing arrangements • Continued strong performance of external advisors	GO	GW	• Continued regular review by TM Panel	At TM Panel meetings	Quarterly
6	• Project team in place to ensure smooth transition from Co-Op Bank to Lloyds Bank w.e.f. 1 January 2015	EFFECTIVE	• Extension of exiting bank contract agreed with Co-Op, on a quarterly basis	GO	GW	• Completion of transition to new bank	March 2015	Monthly
7	• Use of cash forecasting models, with regular	EFFECTIVE	• Maintain existing	GO	GW	• Regular review by TM Panel	At TM Panel meetings	At least Quarterly

	monitoring and updates undertaken • Track record is sound • Continuous adaptation of model in the light of prevailing and forecast circumstances		arrangements					
8	• System of delegation and approved processes • Separation of duties between treasury management dealing and accounting • Use of professional indemnity insurance • Governance checks in place – e.g.: review by deputy s151 officer and TM Panel in place and satisfactory outcomes to date	EFFECTIVE	• Periodic system tests • Maintain existing arrangements – to be changed if testing identifies any issues • Maintenance of an updated Treasury Management Manual of Procedures and Practices	GO	GW	• Satisfactory outcome of internal audit review • Continuing satisfactory outcome of checks by deputy s151 officer and system tests. • TM Panel review is robust	Internal audit reports Ongoing TM Panel meetings TM Panel meetings	Quarterly Ongoing Ongoing
9	• Formal adoption of Code in place since inception. • Updates are reflected in annual review of TM and Investment Strategies • Review of requirements to take place as early as possible • Training on accounting issues • Regular attendance at treasury management workshops and seminars	EFFECTIVE	• Existing arrangements to continue • LAAP bulletin updates to be identified through specific closedown action note	GO	GW	• Continued application of current arrangements • Revisions are promptly and accurately reflected • Satisfactory internal audit review outcome • Robust appraisal by TM Panel	Ongoing Annual TM and investment strategy Audit report TM Panel meetings	Ongoing Annual At least quarterly

Other Options Considered

The CLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer, having consulted the portfolio holder, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

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

GLOSSARY OF TREASURY MANAGEMENT TECHNICAL TERMS	
TERM	**DEFINITION**
Bank Rate	The official interest rate set by the Bank of England's Monetary Policy Committee and what is generally termed at the "base rate".
Capital Expenditure	Expenditure on the acquisition, creation or enhancement of capital assets.
Capital Financing Requirement (CFR)	The Council's underlying need to borrow for capital purposes representing the cumulative capital expenditure of the local authority that has not been financed.
Certainty Rate (PWLB)	A 0.20% discount offered on new loans from PWLB in return for submission of information on future borrowing requirements.
Certificates of Deposit	Tradeable debt instrument issued by financial institution with fixed interest rate and maturity.
CNAV	See Money Market Funds
Credit Default Swaps	A financial instrument for swapping the risk of debt default; the buyer effectively pays an insurance premium against the risk of default.
Credit Rating	A formal opinion issued by a registered rating agency of a counterparty's (or a country's) future ability to meet its financial liabilities; these are opinions only and not guarantees.
Debt maturity	The date when an investment or loan is scheduled to be repaid.
Debt maturity profile	An analysis of the maturity dates of a range of loans/investments.
Diversification	The spreading of investments among different types of assets or between markets in order to reduce risk.
European Investment Bank (EIB)	A non-profit bank created by the European Union principally to make or guarantee loans to EU members for projects contributing to regional development within the Union. Funding is raised through the issuance of bonds, guaranteed by member states.
Funding For Lending Scheme	A Government/Bank of England scheme to provide banks with cheaper funding with the aim of increasing banks' overall net lending activity.
Government Gilts	Bonds issued by the UK Government. They take their name from 'gilt-edged': being issued by the UK government, they are deemed to be very secure as the investor expects to receive the full face value of the bond to be repaid on maturity.
Int. Financial Accounting Standards (IFRS)	Guidelines and rules set by the International Accounting Standards Board that companies and organisations follow when compiling financial statements.
Minimum Revenue Provision	An annual provision that the Council is statutorily required to set aside and charge to the Revenue Account for the repayment of debt associated with expenditure incurred on capital assets
Money Market Funds (MMF)	Pooled funds which invest in a range of short term assets providing high credit quality and high liquidity.
MMFs - CNAV	Constant Net Asset Value - a term used in relation to the value of a unit share in a pooled fund. The value of a share is always £1.
MMFs - VNAV	Variable Net Asset Value - a term used in relation to the value of a unit share in a pooled fund. A proportion of the assets may be valued at market value, rather than purchase price, reducing the value of the share on a temporary basis.
Negotiable Instruments	Term used for instruments such as Certificates of Deposits, Covered Bonds, Medium Term Notes and Corporate Bonds, where it is possible to realise the investment on the secondary market before maturity.
Non-Specified Investments	Term used in the CLG guidance. It includes any investment for periods greater than one year or those with bodies that do not have a high credit rating, use of which must be justified.

Pooled funds	Funds in which several investors collectively hold units or shares. The assets in the fund are held as part of a pool.
Premiums and Discounts	A penalty or payment arising from the premature repayment of debt. The calculation is dependant on the relative level of interest rates for the existing loan and current market rates.
Private Finance Initiative	A way of funding major capital investments, without immediate recourse to the public purse. Private consortia are contracted to design, build, and in some cases manage new projects. Contracts can typically last for 30 years, during which time the asset is leased by a public authority.
Prudential Code	Developed by CIPFA as a professional code of practice to support local authority capital investment planning within a clear, affordable, prudent and sustainable framework and in accordance with good professional practice.
Prudential Indicators	Indicators determined by the local authority to define its capital expenditure and asset management framework. They are designed to support and record local decision making in a manner that is publicly accountable; they are not intended to be comparative performance indicators.
PWLB	Public Works Loans Board. A statutory body operating within the United Kingdom Debt Management Office, an Executive Agency of HM Treasury. The PWLB's function is to lend money from the National Loans Fund to local authorities and other prescribed bodies, and to collect the repayments.
Quantitative Easing	The process used by the Bank of England to directly increase the quantity of money in the economy. The Bank buys assets from private sector institutions and credits the seller’s bank account. The seller has more money in their bank account, while their bank holds a claim against the Bank of England (known as reserves). The end result is more money out in the wider economy.
Revenue Expenditure	Expenditure to meet the continuing cost of delivery of services including salaries and wages, the purchase of materials and capital financing charges.
Specified Investments	Term used in the CLG Guidance for Local Authority Investments. Investments that offer high security and high liquidity, in sterling and for no more than 1 year. UK government, local authorities and bodies that have a high credit rating.
Supranational Bonds	Debt issued by international organisations such as the World Bank, the Council of Europe and the European Investment Bank
Term Deposits	Deposits of cash with terms attached relating to maturity and rate of return (interest).
Treasury Bills	Government-issued short-term loan instrument
Treasury Management Code	CIPFA’s Code of Practice for Treasury Management in the Public Services.
Unsupported Borrowing	Borrowing which is self-financed by the local authority. This is also sometimes referred to as Prudential Borrowing.

Proposed Forward Starting Loans

The policy of using forward starting loans is covered within the Borrowing Strategy section page, 4 and the Policy on Use of Financial Derivatives section, page 10 of the Treasury Management Strategy.

There is still a significant amount of capital investment in NET Phase 2 to be funded by the Council, including land acquisitions. In order to minimise the risk of the uncertainty of future interest rates, we have considered forward starting loans. As the land acquisitions will be taking place over a long period discussions have been held with a German bank (PBB) by our Treasury Management advisors, with a view to us entering into a contract for two forward starting loans totalling £24.5m which would finance a significant element of the future NET Phase 2 land acquisition costs and which would be required over the next 2 -3 years.

Based on the projections provided, there would be a small cash benefit in pursuing this, but the main benefits of entering into such a deal, as opposed to taking a loan now from PWLB to fix the interest rate, are:

- Securing interest rate certainty now as interest rates are extremely low, but not increasing current cash balances and the associated credit risk, and
- Reduced 'near term' revenue costs through delaying the start of the loans.

PBB is a leading European specialist lender for Real Estate and Public Investment finance.

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AUDIT COMMITTEE – 27 FEBRUARY 2015

Title of paper:	**REVIEW OF ACCOUNTING POLICIES**	
Director(s)/ Corporate Director(s):	Glen O'Connell Acting Corporate Director for Resources	**Wards affected:** All
Report author(s) and contact details:	Barry Dryden, Senior Finance Manager, Financial Reporting barry.dryden@nottinghamcity.gov.uk 0115 876 2799	
Other colleagues who have provided input:	None	
Recommendation(s):		
1	Review and agree the Statement of Accounting Policies for inclusion in the 2014/15 annual accounts.	
2	Review and agree the proposals where International Financial Reporting Standards (IFRS) allow a degree of choice.	

1. REASONS FOR RECOMMENDATIONS

1.1 Part 3 of the Annual Accounts and Audit Regulations 2011 (the Regulations) require the City Council to produce an annual Statement of Accounts. In accordance with IFRS, the Statement of Accounts must include a statement of accounting policies.

1.2 The Regulations also require a draft of the Statement of Accounts to be prepared and certified by the responsible financial officer by 30 June. In accordance with best practice for local authorities, the draft accounting policies should be reviewed by Audit Committee before the draft 2014/15 Statement of Accounts is produced.

1.3 In addition, where IFRS allows a degree of choice, Audit Committee should be aware of, and confirm the choices made.

2. BACKGROUND

2.1 The draft 2014/15 accounting policies are included in Appendix A. There are no significant changes to the accounting policies from 2013/14. The policies are reviewed annually to identify any which should be removed as they are no longer relevant or have no material effect to the Statement of Accounts and for 2014/15. Following this review the treatment of Foreign Currency translation has been added to the list of Accounting Policies not relevant or material to the statement (see Point 10.6 of Appendix A). In order to give the main focus to the core financial statements, only the critical Accounting Policies will be included in the body of the Statement of Accounts with a full version shown as an appendix.

2.2 Critical Accounting Policies

The critical accounting policies provide the fundamental bases for producing the Statement of Accounts and warrant particular consideration. These policies have therefore been reproduced below:

Accruals of Expenditure and Income

The revenue and capital accounts of the Council are maintained on an accrual basis. This means that income and expenditure are recognised in the accounts in the period in which they are earned or incurred and not when money is received or paid. Where income and expenditure has been recognised but cash has not been received or paid, a debtor or creditor is recorded in the Balance Sheet

Government Grants and Contributions

Government Grants and contributions are credited to income in the CIES only when there is reasonable assurance that any attached conditions will be met. Specific grants are credited to the relevant service line, while non-ring fenced and capital grants are credited to Taxation and Non-specific grant income.

Any grants received where conditions have not been met are carried in the Balance Sheet as creditors.

Charges to Revenue for Non-Current Assets
Service revenue accounts, support services and trading accounts are debited with the following amounts to record the real cost of holding non-current assets during the year:

- Depreciation attributable to the assets used by the relevant service.
- Revaluation and impairment losses attributable to the clear consumption of economic benefits on tangible fixed assets used by the service, and other losses where there are no accumulated gains in the Revaluation Reserve against which the losses can be written off.
- Amortisation of intangible fixed assets attributable to the service.

Valuation of Non-Current Assets
Generally non-current assets are valued initially at cost and subsequently revalued at fair value; the amount that would be paid for the asset in its existing use. The main exceptions are infrastructure, which is generally valued at depreciated historical cost, council dwellings, which are valued at Existing Use Value for Social Housing and heritage assets, which are valued at market value by an external valuer.

Interests in Companies and Other Entities
Inclusion in the Council's Group Accounts is, in accordance with the Code, dependent upon the extent of the Council’s interest and control over an entity. In the Council's single-entity accounts, the interests in companies and other entities are shown as investments and valued at cost less any provision for losses

2.3 Choices made under IFRS
For some policies the IFRS provides different options that can be used. The choices made in these instances have been applied consistently over the years, however, it would be prudent for Audit Committee to reaffirm the choices made. The key proposals are detailed below:

De Minimus Capital Expenditure
All assets acquired can be included in the Balance Sheet, regardless of their cost. However where the current value is less than the following amounts the Council may choose to exclude the asset from the Balance Sheet:

	£m
Vehicles and Plant	0.003
Computer Equipment	0.005
Land & Buildings	0.010

Componentisation
Where an asset consists of significant components that have different useful lives and / or depreciation methods to the remainder of asset, these components are separately identified and depreciated accordingly. The Council has chosen to only apply componentisation where the value of the asset is in excess of £3m.

Depreciation (including amortisation of intangible assets)
Certain Property Plant and Equipment components and Intangible Assets are written down over time and charged to revenue. International Financial Reporting Standards allow the Council to assess the period as well as the depreciation method. The following assets are depreciated on a straight line basis over their individually assessed useful life, unless otherwise stated:

- Dwellings, buildings, vehicles, plant, furniture and equipment
- Infrastructure and Community are depreciated over 25 years
- Intangible assets are depreciated over 5 years

2.4 The draft accounting polices will also be reviewed by the external auditors, KPMG, and therefore are still subject to change. Any major changes will be highlighted to Audit Committee at a future meeting.

3. BACKGROUND PAPERS OTHER THAN PUBLISHED WORKS OR THOSE DISCLOSING EXEMPT OR CONFIDENTIAL INFORMATION

None

4. PUBLISHED DOCUMENTS REFERRED TO IN COMPILING THIS REPORT

Annual Accounts 2013/14
Accounting and Audit Regulations 2014
Code of Practice on Local Authority Accounting in the United Kingdom 2014/15

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(Appendix A)
Accounting Policies

This section explains the accounting policies applied in producing the Statement of Accounts.

1.1 General Principles

1.1.1 Statutory Guidance and Accounting Standards used

The Statement of Accounts summarises the Council’s transactions for the 2014/15 financial year and its position at the year end of 31 March 2015. It provides the reader with information about the Council's financial position and its stewardship of public funds. The Statement of Accounts is a legal requirement under the Accounts and Audit Regulations 2011 and must comply with proper accounting practices. These practices are set out in the Code of Practice on Local Authority Accounting in the United Kingdom 2014/15 (the Code) which is based on approved accounting standards. In addition to compliance with the Code, the Council's accounts also comply with the Service Reporting Code of Practice 2014/15. This Code sets out proper practice for financial reporting to ensure consistency and comparability across Councils. The accounts are supported by IFRS and statutory guidance issued under section 7 of the 2011 Act.

1.1.2 Accounting Convention

The accounting convention adopted in the Statement of Accounts is principally historical cost, modified by the revaluation of certain categories of non-current assets and financial instruments.

1.1.3 Prior Period Adjustments, Changes in Accounting Policies and Estimates and Errors

A prior period adjustment will be made to the accounts as a result of a change in accounting policies. Changes in accounting estimates will be accounted for prospectively. Material errors in prior periods are corrected retrospectively by amending opening balances and comparative amounts. A full disclosure as to the nature, circumstance and value of the adjustment will be disclosed in the notes to the accounts.

1.1.4 Events After the Balance Sheet Date

Events after the Balance Sheet date are those events, both favourable and unfavourable, that occur between the Balance Sheet date of 31 March and the date when the Statement of Accounts is authorised forissue. The two types of events and the accounting treatment are given below:

- For any material events after the balance sheet date which provide additional evidence regarding conditions existing at the balance sheet date, an adjustment has been made to the Statement of Accounts.

- Material events after the balance sheet date which concerned conditions not existing at 31 March have been disclosed as a separate note to the accounts.

1.1.5 Accruals of Expenditure and Income

The revenue and capital accounts of the Council are maintained on an accrual basis. This means that income and expenditure are recognised in the accounts in the period in which they are earned or incurred and not when money is received or paid. Further details are given below:

- Where income and expenditure has been recognised but cash has not been received or paid, a debtor or creditor for the relevant amount is recorded in the Balance Sheet. Cash received or paid and not yet recognised as income or expenditure is shown as a creditor (receipt in advance) or debtor (payment in advance) in the Balance Sheet and the Comprehensive Income and Expenditure Statement(CIES) adjusted accordingly. Where it is doubtful that debts will be settled, the balance of debtors is written down and a charge made to revenue for the income that might not be collected.
- Fees, charges and rents due from customers are accounted for as income at the date that the Council provides the associated goods or services.
- Supplies are recorded as expenditure in the period during which they are consumed. Where there is a gap between the date supplies are received and their consumption, they are carried as inventories on the Balance Sheet. For some quarterly payments including gas and electricity, expenditure is recorded at the date of meter reading rather than being apportioned between financial years. This practice is consistently applied each year and therefore does not have a material effect on the year's accounts.
- Works are charged as expenditure,once complete, prior to completionthey are carried as 'works in progress' on the Balance Sheet.
- For significant accruals such as pay awards, estimates are made based on the best information available at the time. Cost of pay awards not yet settled but likely to apply to part of the financial year to which the accounts relate are based on forecasted cost.
- Interest payable on borrowings and interest receivable on investments is accounted for as income and expenditure based on the effective interest rate for the relevant financial instrument rather than the cash flows fixed or determined by the contract.
- Income and expenditure are credited and debited to the relevant service revenue account in the CIES. Capital expenditure creates a fixed asset which is shown on the Balance Sheet.

  Accruals have been made on the basis of the known value of the transaction wherever possible. Where estimates have been required to be made, they are based on appropriate and consistently applied methods. In the case of highways and building works, the related assets or liabilities will be valued at the year-end by colleagues working in the relevant service. Where there has been a change to an estimation method from that applied in previous years and the effect is material, a description of the change and if practicable, the effect on the results for the current period is separately disclosed.

1.2 Policies primarily affecting the CIES

1.2.1 Government Grants and Contributions

Government grants and other contributions are recognised as due to the Council when the attached conditions have been satisfied and there is reasonable assurance that the grant or contribution will be received.

Grants and contributions are credited to income when there is reasonable assurance that the attached conditions will be met. Any grants received where conditions have not been met are carried in the Balance Sheet as creditors. When all conditions are satisfied, the grant is credited to the relevant service line and non-ring fenced grants and capital grants are credited to Taxation and Non-specific grant income in the CIES.

1.2.2 Business Improvement Districts (BID)

A BID scheme applies across the whole of the Council. The scheme is funded by a BID levy paid by non-domestic ratepayers. The Council acts as principal under the scheme, and accounts for income received and expenditure incurred (including contributions to the BID project) within the relevant services within the CIES.

1.2.3 Operating Leases

Receivable (Council as lessor)

Where the Council has granted an operating lease over a property or an item of plant or equipment, the asset is retained in the Balance Sheet. Rental income is credited to the Other Operating Expenditure line in the CIES. Credits are made on a straight line basis over the life of the lease and any direct costs incurred in negotiating and arranging the lease are added to the carrying amount and charged as an expense over the lease term on the same basis as rental income.

Payable (Council as lessee)

Rentals paid under operating leases are charged to the service benefiting from use of the leased asset in theCIES. Charges are made on a straight-line basis over the life of the lease, regardless of the pattern of payments.

1.2.4 Employee Benefits

Benefits Payable During Employment

Wages and salaries, paid annual leave and paid sick leave are recognised as an expense for services in the year in which employees render service to the Council.

An accrual is made for the cost of the holiday entitlements or for any form of leave, e.g. time off in lieu, which employees have earned during the year but are able to carry forward into the next financial year.

Termination Benefits

Termination benefits are amounts payable as a result of a decision by the Council to terminate an employee’s employment before the normal retirement date or an employee’s decision to accept voluntary redundancy. They are charged on an accruals basis to the Non Distributed Costs line in the CIES when the Council is demonstrably committed to the termination of the employment of an employee or group of employees or are making an offer to encourage voluntary redundancy.

Teachers Pension Scheme

Pension costs relating to Teachers' Pension Scheme have been treated as defined contribution schemes and the costs are charged to Children's and Education in the CIES.

Defined Benefit Schemes (Local Government Pension Scheme)

Within the CIES, service revenue accounts have been charged with their current service cost, which represents the extent to which the pension liability has increased as a result of employee service during the year. Past service costs, settlements and curtailments have been charged to non-distributable costs.

Discretionary Benefits

The Council also has restricted powers to make discretionary awards of retirement benefits in the event of early retirements. Any liabilities estimated to arise as a result of an award to any member of staff (including teachers) are accrued in the year of the decision to make the award and accounted for using the same policies as are applied to the Local Government Pension Scheme.

1.2.5 Charges to Service Revenue Accounts for Non-Current Assets

Service revenue accounts, support services and trading accounts are debited with the following amounts to record the real cost of holding non-current assets during the year:

- Depreciation attributable to the assets used by the relevant service.
- Revaluation and impairment losses attributable to the clear consumption of economic benefits on tangible fixed assets used by the service, and other losses where there are no accumulated gains in the Revaluation Reserve against which the losses can be written off.
- Amortisation of intangible fixed assets attributable to the service.

1.2.6 Financing and Investment

The financing an investment line of the CIES is charged or credited for the following amounts relating to investments:

- Gain or loss on the difference between net sale proceeds and carrying value of investment properties.
- Rental income from investment properties
- Gains and losses on the repurchase or early settlement of borrowing.
- Interest costs and expected return on Defined Benefit pension schemes.

1.2.7 Other Operating Expenditure

Other operating expenditure includes charges for:

- The proportion of receipts relating to HRA disposals payable to the Government

- Gains or losses on sale and derecognition of non-current assets (excluding investment properties)
- Actuarial gains or losses of Defined Benefit Pension Schemes, which are charged to the Pension Reserve

1.2.8 Overheads and Support Services

Overheads and support services are charged to service revenue accounts, trading undertakings and other support services in accordance with the Service Reporting Code of Practice. The basis for apportionment is generally time spent by colleagues on relevant tasks although other bases are used where more appropriate. The costs of Corporate and Democratic and Non-Distributable costs are not charged to service revenue accounts but are shown as separate lines on the CIES.

1.2.9 Carbon Reduction Commitment Scheme

As energy is used and carbon dioxide is emitted, an expense is charged to services in the CIES based on the current market price of allowances, together with a corresponding liability being created on the Balance Sheet. The expense is apportioned to services on the basis of energy consumption. The liability is subsequently discharged when the allowances are purchased retrospectively.

1.2.10 Landfill Allowance Schemes

When landfill is used an expense is charged to the CIES. This expense is matched by treating the use of landfill allowances allocated by DEFRA as government grants. Landfill used in excess of the allowances will appear as an expense in the form of allowances purchased from other Waste Disposal Authorities or a cash penalty paid to DEFRA.

Any residual allowances are measured at the lower of cost or net realisable value. However, due to the significant level of surplus landfill allowances available and trading being minimal, any surplus landfill allowances are judged to have no value

1.2.11 Exceptional Items

Normally any material exceptional items are separately identified on the face of the CIES, in order to give a fair presentation of the accounts. Where these items are less significant they are included within the cost of the relevant service, however, details of all exceptional items are given in the Explanatory Foreword.

1.2.12 Value Added Tax

Income and expenditure excludes any amounts related to VAT, as all VAT collected is payable to HM Revenue & Customs and all VAT paid is recoverable from it.

1.3 Policies primarily affecting the Balance Sheet

1.3.1 Property, Plant and Equipment (PPE), Heritage Assets and Intangible Assets

PPE - Recognition

All expenditure on the acquisition, creation or enhancement of PPE is capitalised on an accruals basis, provided that it brings benefits to the Council for more than one financial year. Expenditure that maintains but does not extend the previously assessed standards of performance of an asset (e.g. repairs and maintenance) is charged to revenue as an expense when it is incurred.

PPE - Surplus Assets

Assets that are surplus to service needs but that do not meet the classification of Investment Property or Assets Held for Sale are classified as PPE 'Surplus', pending a decision on the future use of the asset.

PPE - Private Finance Initiative (PFI) and Similar Contracts

In accordance with the code, the Council accounts for its PFI contracts in accordance with IFRC 12 Service Concession Agreements. The Council is deemed to control the services that are provided under its PFI schemes and ownership will pass to the Council at the end of the contracts for no additional charge (with the exception of LIFT Joint Service Centres for which there is an option to purchase). Therefore, the Council carries the assets used under the contracts, on its Balance Sheet as PPE, where they are accounted for in the same way as the other assets. The original recognition of assets is at fair value with a corresponding liability for the amounts due to the scheme operator.

The amounts payable to the PFI operators is comprised of 5 elements. The Fair Value of Services received during the year, Finance Cost, Contingent Rent, and Lifecycle replacement costs are posted to the CIES. The final element is a payment towards the outstanding liability on the balance sheet.

PPE - Finance Leases

Leases are classified as finance leases where substantially all of the risks and rewards incidental to ownership of the PPE transfer from the lessor to the lessee. All other leases are classified as operating leases.

Where a lease covers both land and buildings, the land and buildings elements are considered separately for classification.

Finance Leases – where the Council is Lessee

The asset is matched by a liability for the obligation to pay the lessor. Any initial direct costs of the Council are added to the carrying amount of the asset.

Lease payments are apportioned between:

- A charge for the acquisition of the interest in the PPE – applied to write down the lease liability and
- A finance charge which is debited to the Financing and Investment Income and Expenditure line in theCIES.

Finance Leases – the Council as Lessor

Where the Council grants a finance lease over a property or an item of plant or equipment, the carrying amount of the asset is written off and a long term debtor raised in the Balance Sheet.

Lease rentals receivable are apportioned between the principal repayment which reduces the debtor balance and interest which is credited to the Financing and Investment Income and Expenditure line in the CIES.

Heritage Assets – Recognition

Acquisitions are either purchased by the City Council or donated by a third party. Purchases are initially recorded at cost while donations are held at nil value until the assets related collection is externally valued within the heritage asset valuation cycle.

Items are omitted from the Balance Sheet where the Council is unable to obtain the valuations at a cost which is commensurate with the benefits it would provide to users of thefinancial statements.

Intangible Assets – Recognition

Intangible assets where the Council has control of the asset through either custody or legal protection for e.g. software licences, are capitalised at cost.

Measurement

Assets are initially measured at cost, i.e. purchase price plus any costs incurred in bringing the asset into working condition for its intended use. The Council does not capitalise borrowing costs. Assets are then carried in the Balance Sheet using the following measurement bases:

- Infrastructure for e.g. roads and bridges and community assets for e.g. parks and land used for cemeteries and crematoria are generally valued at depreciated historical cost.
- Council dwellings are valued at Existing Use Value for Social Housing as defined in the Royal Institute of Chartered Surveyors valuation manual. The valuation exercise was carried out in accordance with guidance issued by the Department for Communities and Local Government in 2009/10 based on a full valuation of beacon properties by Chartered Surveyors Herbert Button & Partners and Freeman and Mitchell.
- Other land and buildings are valued at fair value, the amount that would be paid for the asset in its existing use. Where insufficient market based evidence of fair value is available because an asset is specialised in nature, Depreciated Replacement Cost has been applied.
- Finance leases are recognised at fair value or the present value of the minimum lease payments if lower.
- Heritage assets are reported in the Balance Sheet at market value and have been valued by an external valuer, the valuation dates range from 2001 to 2008. These external valuations have been carried out by a variety of qualified experts in the relevant field. These external valuations are adjusted annually by the Council to provide an internal valuation which is used until the collection is periodically externally revalued.
- All other assets are valued at fair value.

Assets included in the Balance Sheet at fair value are revalued, as a minimum, every 5 years. However,if there is evidence that there have been material changes in the valuea further valuation will be undertaken.

Increases in valuations are credited toservices withinthe CIES where they arise from the reversal of a revaluation or an impairment loss previously charged on the same asset. Any gains in excess of previous revaluation losses are matched by credits to the Revaluation Reserve.

Any revaluation losses are firstly written down against any previous revaluation gains held in the Revaluation Reserve. Where there are no previous revaluation gains, the losses are charged to the relevant service line of the CIES.

The Revaluation Reserve contains revaluation gains recognised since 1 April 2007 only, the date of its formal implementation. Gains arising before that date have been consolidated into the Capital Adjustment Account.

De Minimis Levels

All assets acquired can be included in the Balance Sheet, regardless of their cost. However where the current value is less than the followingamounts the Council may choose to exclude the asset from the Balance Sheet.

Description	£m
Vehicles and Plant	0.003
Computer Equipment	0.005
Land & Buildings	0.010

Impairment

Asset values are assessed at the end of each financial year for evidence of reductions in value. If identified either as part of this review or as a result of a valuation exercise, they are accounted for as follows:

- Where there is a balance of revaluation gains on the Revaluation Reserve for the relevant asset the impairment loss is charged against that balance until it is used up. Thereafter, or if there is no balance of revaluation gains the impairment loss is charged to the relevant service line of the CIES.
- For intangible assets there will be no Revaluation Reserve balance, so impairment losses areis charged to the relevant service line of the CIES only.

Depreciation and Amortisation

Depreciation is provided for on all PPE assets. The annual charge to the CIESis calculated by dividing the value less any residual value of the asset by the estimated asset life. There is no depreciation on the assets in the year of acquisition, although a full year of depreciation is charged in the year of disposal. In accordance with recommended accounting practice, depreciation is not provided for in respect of freehold land, Heritage Assets, certain Community Assets and assets under construction.

Depreciation is calculated on the following bases:

- Dwellings – straight line allocation over the useful life on the building major components.
- Buildings – straight-line allocation over the useful life of the property as estimated by the valuer.
- Vehicles, plant, furniture and equipment – straight line allocation over the useful life.

- Infrastructure and Community – straight-line allocation generally over 25 years.
- Finance leases - over the lease term.If the lease term is shorter than the asset's estimated useful life and ownership of the asset does not transfer to the authority at the end of the lease period.
- Intangible assets –amortised on a straight line basis over the economic life, which is generally assessed to be 5 years.

Where an item of PPE asset has major components whose cost is significant in relation to the total cost of the item, the components are depreciated separately.

Componentisation

Where an asset consists of significant components that have different useful lives and / or depreciation methods to the remainder of asset, these components are separately identified and depreciated accordingly. A component value must be at least 20% of the whole asset. Where there is more than one significant part of the same asset which has the same useful life and depreciation method, the parts have been grouped to determine the depreciation charge. Componentisation only applies to enhancement and acquisition expenditure and revaluations carried out from 1st April 2010 with a de-minimis level of £3m.

1.3.2 Investment Property

Investment properties are those used solely to earn rentals and/or for capital appreciation and does not apply to properties which are being used to deliver services for the Council.

Investment properties are measured initially at cost. They are not depreciated but are revalued annually according to market conditions.

1.3.3 Long Term Investments

Interests in Companies and Other Entities

Inclusion in the Council's Group Accounts is, in accordance with the Code, dependent upon the extent of the Council's interest and control over an entity. In the Council's single-entity accounts, the interests in companies and other entities are shown as investments and valued at cost less any provision for losses.

Available-for-sale Financial Assets

Available-for-sale assets are valued at fair value. Where available-for-sale assets are quoted in an active market, the quoted market price is taken as fair value.

1.3.4 PPE Assets Held for Sale

When it becomes probable that the carrying amount of an asset will be recovered principally through a sale transaction rather than through its continuing use, it is reclassified as an Asset Held for Sale. Assets held for sale are carried at the lower of carrying value and fair value less costs to sell.

If assets no longer meet the criteria to be classified as Assets Held for Sale, they are reclassified back to non-current assets and valued at the lower of their carrying amount before they were classified as held for sale, adjusted for depreciation, amortisation or revaluations that would have been recognised had they not been classified as Held for Sale, and their recoverable amount at the date of the decision not to sell.

1.3.5 Inventories and Work in Progress

Stocks are largely valued at latest purchase price and any difference between this and actual cost is not considered to be material. Other less significant stocks are valued at average or actual cost.

1.3.6 Financial Liabilities

Financial liabilities are recognised on the Balance Sheet initially at fair value and carried at their amortised cost. Interest payable is charged to the Financing and Investment Income and Expenditure line of the CIES. The amount shown in the Balance Sheet is the carrying amount of the loan at 31st March.

1.3.7 Loans and Receivables

Loans and receivables are recognised on the Balance Sheet, initially at fair value and carried at their amortised cost. Annual credits to the Financing and Investment Income and Expenditure line in the CIES for interest receivable are based on the carrying amount of the asset multiplied by the effective rate of interest for the instrument.

1.3.8 Provisions

Provisions have only been recognised in the accounts where there is a legal or constructive obligation to transfer economic benefits as a result of a past event and where such an amount can be reliably estimated. Provisions are charged to the CIES and, depending on their materiality, are either disclosed as a separate item on the Balance Sheet or added to the carrying balance of an appropriate current liability. When expenditure is eventually incurred, it is charged to the provision set up in the Balance Sheet. Estimated settlements are reviewed at the end of each financial year. Where it is apparent that the provision is not required or is lower than originally anticipated, the provision is reversed and credited back to the relevant service

Where some or all of the payment required to settle a provision is expected to be recovered from another party, for e.g. from an insurance claim, this is only recognised as income for the relevant service if it is virtually certain that reimbursement will be received if the Council settles the obligation.

Provisions are also set up for bad and doubtful debts, but are offset against the debtor balance on the balance sheet, rather than being included in the provisions figure.

1.3.9 Contingent Liabilities

Where a material contingent loss cannot be accurately estimated or an event is not considered sufficiently certain, it has not been included in the accounts but is disclosed in the Explanatory Foreword/notes.

1.3.10 Contingent Assets

Contingent assets are not recognised in the Balance Sheet but disclosed in a note to the accounts.

1.3.11 Defined Benefit Schemes (Local Government Pension Scheme)

For defined benefit schemes, pension fund assets are accounted for at fair value as follows:

- Quoted and unitised securities - current bid price
- Unquoted securities - professional estimate
- Property - market value.

Pension liabilities are measured on anactuarial basis, using an assessment of the future payments that will be made for retirement benefits earned to date by employees. This assessment includes assumptions about mortality rates, employee turnover rates and projections of projected earnings for current employees.

Liabilities are discounted at the Balance Sheet date using a discount rate that takes into account the duration of the employer’s liabilities and the requirements of IAS19. The discount rate chosen is the annualised yield at the 21 year point on the Merrill Lynch AA rated corporate bond curve.

1.3.12 Reserves

The Council sets aside specific amounts as reserves for future policy purposes or to cover contingencies. Transfers to and from reserves are shown in the MIRS and not within services. Expenditure is charged to the CIES and not directly to any reserve. Certain reserves are kept to manage the accounting processes for non-current assets, financial instruments, retirement, and employee benefits and are not usable resources for the Council

1.4 Policies Affecting the Cash Flow Statement

1.4.1 Cash and Cash Equivalents

The Council's Cash Flow Statement reflects the movements in cash and cash equivalents during the year and is shown net of bank overdrafts that are repayable on demand. Cash is represented by cash in hand and deposits with the Council's own bank. Cash equivalents are deposits with financial institutions repayable without penalty on notice of not more than 24 hours. This includes Council deposits in other UK bank call accounts and Money Market Funds

1.5 Policies used to account on a Funding Basis

In a number of areas statutory provisions require the Council to account for transactions relating to the General Fund (and subsequently the amount to be raised from Council Tax) differently from the treatment required by IFRS. In each case the adjustment required is offset by a transfer to a specific reserve. The adjustments are shown within the MIRS as Adjustments between accounting basis and funding basis under regulations.

1.5.1 Depreciation, amortisation, revaluation gains and losses and impairment

Instead of these charges the Council is required to make an annual provision from revenue to contribute towards the reduction in its borrowing requirement (at least 4% of the adjusted Capital Financing Requirement, excluding amounts attributable to HRA). The difference between the two transactions is adjusted with the Capital Adjustment Account.

For the HRA, depreciation is replaced by a contribution to the Major Repairs Reserve.

1.5.2 Gains and Losses on Sale of Assets

Where sale proceeds are in excess of £10k, the gain or loss on sale or disposal (including finance leases) is removed from the CIES and adjusted with the Usable Capital Receipts Reserve (sale proceeds) and the Capital Adjustment Account (carrying value in the Balance Sheet).

A proportion of receipts relating to HRA disposals is payable to the Government and a corresponding sum is therefore transferred back from the Capital Receipts Reserve to the General Fund.

1.5.3 Capital grants

Capital Grants are reversed out of the General Fund to the Capital Grants Unapplied Account. When the grant is applied to fund capital expenditure, it is posted to the Capital Adjustment Account.

1.5.4 Revenue Expenditure Funded from Capital under Statute (REFCUS)

Certain items of expenditure and related grant funding charged to the CIES under IFRS may be treated as capital for funding purposes. A transfer is made between the General Fund and the Capital Adjustment Account reserve for these items.

1.5.5 Termination Benefits - Pension Enhancements

Pension costs calculated according to IAS 19 are replacedby the actualpension payment for the year. The difference between the two transactions is transferred between the General Fund and the Pensions Reserve

1.5.6 Financial Liabilities

Where premiums and discounts have been charged to the CIES, regulations allow the impact on the General Fund to be spread over future years. The gain or loss is spread over the term that was remaining on the loan against which the premium was payable or discount receivable when it was repaid. The difference between the two approaches is transferred between the General Fund and the Financial Instruments Adjustment Account.

1.5.7 Loans and Receivables

Statutory provisions allow the General Fund to be charged with the actual interest receivable for the financial year. The adjustment to the CIES for soft loans is therefore removed and adjusted with the Financial Instruments Adjustment Account.

1.6 Accounting Policies not relevant or not material

The accounting policies are reviewed each year to assess whether it is appropriate for individual policies to be included. There are a number of accounting policies that have not been included above, because the statements are not materially affected by their implementation. These policies include:

- Use of capital receipts to fund disposal proceeds
- Intangible Assets – Recognition of website development and other internally generated assets
- Derecognition or impairment of available for sale financial assets, loans and receivables
- Valuation of available for sale financial assets other than at quoted market price
- Restructuring of loan portfolios and treatment of bonds
- Treatment of soft loans
- Changes to accounting policies
- Community Infrastructure Levy
- Subsequent revaluation of assets held for sale
- Jointly controlled assets
- Provision for backpay arising from unequal pay claims
- Treatment of foreign currency translations

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AUDIT COMMITTEE – 27 February 2015

Title of paper:	**ANNUAL GOVERNANCE STATEMENT – PROGRESS MADE TO DATE ON ISSUES REPORTED 2013/14 AND PROCESS FOR PRODUCING 2014/15 STATEMENT**	
Director(s)/ Corporate Director(s):	Geoff Walker Acting Director of Strategic Finance	**Wards affected: All**
Report author(s) and contact details:	Shail Shah Head of Internal Audit ☎ 0115-8764245 ✉ shail.shah@nottinghamcity.gov.uk	
Other colleagues who have provided input:		

Recommendation(s):	
1	Note the progress made to date in addressing the issues reported in the 2013/14 AGS, as detailed in **Appendix 1**
2	Note the process and timetable for compiling and completing the 2014/15 AGS, as detailed in **Appendix 2**

1. REASONS FOR RECOMMENDATIONS

This report sets out the current position in respect of those issues reported in the 2013/14 Annual Governance Statement (AGS), and the process for compiling the 2014/15 AGS.

1.1 Update of Issues Reported

Issues identified in the AGS have been revisited and an update of the latest position established. Issues not resolved are shown at **Appendix 1**.

1.1.1 Central Government Review of Local Government Funding & Balancing the Council's Budget

The Government has implemented a rapid and extensive programme of policy change, accompanied by significantly reduced funding for the public sector. On current projections the Government's settlement funding for the Council will have reduced by circa £100m between 2010/11 and 2015/16 and in response, service and financial planning process has once again facilitated significant proposed movements in resources

1.1.2 Children in Care

A plan is in place to reduce the numbers of children who remain in care over the forthcoming year. The renewed focus is the subject of a Big Ticket Project regarding reducing the numbers of children in care and speeding up the adoption process by tackling delay. There is strong collaboration between partners in Nottingham city, most notably between Health, LA, Police, Foster Carers and providers of residential accommodation. The Council has created a 'permanence team' which is the Children in

Care Team. The Council has also developed a The Edge of Care initiative to reduce the numbers of children coming into care.

Performance against children in care targets is strongly monitored and in some areas out performs against statistical neighbours. The Targeted Support Team continues to offer the effective delivery of services to children, young people and their families/carers, The reconfiguration of Nottingham City Council's Residential Services into Small Group Homes has served to support children and young people to be better placed, have improved outcomes in a cost effective manner and ensure young people receive a quality service that keeps them safe. All homes have met and exceeded minimum standards with one home receiving an OFSTED rating of outstanding and two homes receiving good with outstanding features.

1.1.3 EMSS

No major concerns have yet arisen in this regard. Some issues have been faced in terms of financial management since the implementation, and delays have been experienced in making payments to certain suppliers. The causes of this issue have been addressed and the resulting payment backlog is being cleared.

1.1.4 Nottingham Express Transit (NET)

Construction of NET Phase Two is underway. The NET concession contract, including project risks remaining with the City Council, is being managed by an experienced in-house project team and overseen by a dedicated Project Board.

1.1.5 Workplace Parking Levy (WPL)

The WPL income projections will be continually updated to reflect the latest information available from the WPL team. In the event that over the life of the NET Phase 2 contract, insufficient WPL income is generated, decisions may be made in respect of the ongoing contributions to the Link Bus network and/or extending the WPL scheme beyond the life of the NET Phase 2 contract.

1.1.6 Icelandic Banks

In October 2008, as a consequence of the global financial crisis, the Icelandic banking system collapsed, with four of its banks going into administration. This impacted directly on the Council, which had a total of £41.6m deposited. More than 120 local authorities had similar deposits with Icelandic banks, totalling some £920m. All these authorities joined forces through the Local Government Association to co-ordinate the recovery of the monies. The latest claim administration reports state no further repayments are expected.

<u>Process for the Production of the AGS 2014/15</u>

1.1.7 It is intended that the production of the AGS 2014/15 will closely follow the process of previous years noted by this committee, and the timetable is given at **Appendix 2**. The process will be managed by the Corporate Governance Steering Group (CGSG) as endorsed by the Executive Board on 20 May 2008 and which consists of senior colleagues representing Council services. A set of assurances will be obtained from the Leader of the Council, key colleagues including Corporate Directors, individuals with statutory roles, significant groups and significant partnerships

1.1.8 The assurance will come from a self assessment based on customised questionnaires targeted at the appropriate assurance givers, together with other information provided in support of the AGS. The questionnaires will be based on the Council's Code of Corporate Governance. Support throughout the process will be given by Internal Audit and the Head of Internal Audit who will visit all departmental management teams to discuss audit plans and introduce the 2014/15AGS.

1.1.9 The questionnaires will be supported by a comprehensive guidance document provided by Internal Audit. Completed questionnaires will be supplemented by other governance related information extracted from Council policies and strategies, internal and external assurance providers, Council, Board and committee minutes, and the annual review of governance arrangements in significant partnerships.

1.1.10 The final AGS will be an account of the Council's governance arrangements in a format addressing the principle embodied in the Local Code of Corporate Governance. It will reflect the failings identified and note actions put in place to address them. This will be discussed by members of the CGSG and will be presented to the Audit Committee for approval, and the document when approved will be published with the City Council's Statement of Accounts.

2. BACKGROUND

2.1 The Council's governance arrangements aim to ensure that objectives and responsibilities are set out and met in a timely, open, inclusive, and honest manner. The governance framework comprises the systems, processes, cultures and values by which it is directed and controlled, and through which it engages with and leads the community to which it is accountable. Every council and large organisation operates within a similar framework, which brings together an underlying set of legislative requirements, good practice principles and management processes.

2.2 The publication of an AGS is required by the Accounts & Audit Regulations 2011. The Council is required to conduct a review, at least annually, of the effectiveness of its internal control and prepare a statement in accordance with proper practices. The 2007 CIPFA/SOLACE (updated 2012) publication "Delivering Good Governance in Local Government Framework" provided the principles by which good governance should be measured. This was adopted as the Council's Local Code of Corporate Governance at the Executive Board meeting of 20 May 2008.

2.3 Included in this Committee's terms of reference is the core function that it should be "satisfied that the Authority's assurance statements, including the AGS, properly reflect the risk environment and any actions required to improve it."

2.4 In order to produce the AGS an annual timetable is required to ensure key tasks are undertaken in time to deliver it alongside the Council's Statement of Accounts. The timetable (**Appendix 2**) will be used to monitor the progress of the AGS.

2.5 The Committee has delegated authority for the formal approval of the AGS and approved the AGS for 2013/14 on 19 September 2014. It was signed by the Leader of the Council and Chief Executive and was published alongside the Statement of Accounts.

2.6 The AGS reflects the governance framework operating within the Council and its significant partnerships. The issues identified and the consequent plans for their mitigation are used to direct corporate resources, including those of Internal Audit.

2.7 Part of the 2013/14 AGS reported on significant control issues affecting the Council and the action plans put in place to address them. In ascertaining the significance of the control issues, CIPFA defines a series of factors to be considered, as follows:

- The issue has seriously prejudiced or prevented achievement of a principal objective
- The issue has resulted in a need to seek additional funding to allow it to be resolved, or has resulted in significant diversion of resources from another aspect of the business
- The issue has led to a material impact on the accounts.
- The Audit Committee, or equivalent, has advised that it should be considered significant for this purpose.
- The Head of Internal Audit has reported on it as significant, for this purpose, in the annual opinion on the internal control environment.
- The issue, or its impact, has attracted significant public interest or has seriously damaged the reputation of the organisation.
- The issue has resulted in formal action being taken by the Chief Financial Officer and/or the Monitoring Officer.
- The 2013/14 AGS also reported on issues of note which do not merit categorising as significant but require attention and monitoring to maintain and improve the system of internal control. As with significant issues these may have been brought forward from previous statements if the issues have not been finally resolved.

3. BACKGROUND PAPERS OTHER THAN PUBLISHED WORKS OR THOSE DISCLOSING EXEMPT OR CONFIDENTIAL INFORMATION

None

4. PUBLISHED DOCUMENTS REFERRED TO IN COMPILING THIS REPORT

Accounts & Audit Regulations 2011
CIPFA/SOLACE - Delivering Good Governance in Local Government Framework, 2007
CIPFA/SOLACE - Delivering Good Governance in Local Government Guidance Note, 2012
Executive Board 20 May 2008 - Local Code of Corporate Governance
Nottingham City Council - Statement of Accounts 2013/14
Annual Governance Statement 2013/14

AUDIT COMMITTEE – FEBRUARY 2015 – ITEMS TO FOLLOW UP.

Central Government Review of Local Government Funding & Balancing the Council's Budget

As the coalition Government has undertaken a fundamental review of public spending which has reduced the level of funding available to the Council from 2010/11 onwards. The combination of the impact of the global recession and the need for a significant investment in some services placed severe pressure on the Council's financial resources. The budget process, through the in depth analysis of spending requirements and the opportunities to generate income, highlighted the need to reduce net expenditure across the City Council.

Latest Position

The Government has implemented a rapid and extensive programme of policy change, accompanied by significantly reduced funding for the public sector. On current projections the Government's settlement funding for the Council will have reduced by circa £100m between 2010/11 and 2015/16 and in response, service and financial planning process has once again facilitated significant proposed movements in resources. Such changes include to:

- take account of the Council's priorities within the Council Plan:
- address demographic and service pressures through investment;
- reflect the significant reductions in external funding (especially general and specific Government grants) by reducing expenditure on those activities;
- support our determination to be efficient, improve performance and modernise our organisation;
- recognise the very challenging financial landscape and future outlook and the impact on all sectors including the public sector.

Budgets have been redirected to enable some resources to be targeted on the Council's current focus of supporting the most vulnerable, local jobs, and enjoying Nottingham. Resources are proposed to be redirected by:

- reducing demand and reviewing the way we commission our services:
- reviewing and optimising income streams of all kinds;
- redesigning and modernising our service provision / identifying efficiencies.

In addition the Council will continue its focus on regeneration and growth through its Capital Investment Strategy.

Children in Care

The Children in Care service exists primarily to ensure that children have permanent plans for where they live. Nottingham's priority for its children in care is to ensure that where possible, children live with their birth families. If that is not achievable then adoption and fostering are the next preferred options.

Children in care arrangements and associated budget pressures are key issues facing the service. There is a need to recruit and retain Social Workers to maintain stable safeguarding arrangements. Nottingham has seen, as in other areas across the country, a significant increase in the number of children in care over the past two years.

Latest Position

A plan is in place to reduce the numbers of children who remain in care over the forthcoming year. Part of this work involves systematic use of tools to help return young people to their birth families, having detailed exit plans for each young person, benchmarking all data against our statistical neighbours and ensuring a full complement of staff to deliver the business. Work is underway to match children and young people to adopters at an earlier point in the adoption process to ensure a stable and permanent family home for all our children in care. The renewed focus is the subject of a Big Ticket Project regarding reducing the numbers of children in care and speeding up the adoption process by tackling delay. Work in 2012 was undertaken to realign the children in care placements budget and to ensure that the use of a regional framework for all care registered and 16 plus accommodation was robust. This has resulted in some continued net savings on placement costs. Performance against placement stability and recording the wishes and feelings of children and young people continues to be strong.

There is strong collaboration between partners in Nottingham city, most notably between Health, LA, Police, Foster Carers and providers of residential accommodation. The Council has created a 'permanence team' which is the Children in Care Team. This became operational in April 2012. Further resources have since been agreed to support the effectiveness of the team to place children in permanency placements in a more timely way, and ensure delays are kept to a minimum. This is central to the strategy of ensuring better outcomes for our children in care population.

Performance against children in care targets is strongly monitored and in some areas out performs against statistical neighbours. An area for growth and development against key performance targets is in ensuring the health of children in care is robustly monitored and action taken where appropriate. Speeding up adoptions and tackling delay is the second priority area. NCC does better than its statistical neighbours (with the exception of Middlesbrough) in the recently published adoption scorecard. There was a significant increase in the number of adoptions in 2012/13 compared with the previous year. Resources have been realigned to build on that progress, based on evidence of what works well. The authority secured 43 adoptions and 43 Special Guardianship Orders for the financial year 2013/2014.

The Targeted Support Team continues to offer the effective delivery of services to children, young people and their families/carers, The reconfiguration of Nottingham City Council’s Residential Services into Small Group Homes has served to support children and young people to be better placed, have improved outcomes in a cost effective manner and ensure young people receive a quality service that keeps them safe. All homes have met and exceeded minimum standards with one home receiving an OFSTED rating of outstanding and two homes receiving good with outstanding features.

The Council has embarked on a further strategy to reduce the numbers of children coming into care. The Edge of Care Intervention Hub was launched in September 2013 which was for an initial 6 month pilot project, located and managed within the Targeted Support Team that has now been extended. To date, the Hub has supported 33 families that include 92 children. Of those 92, the Hub has worked directly with 70, of which it is felt that 65 have been directly at risk of being accommodated. 12 children have been accommodated. This amounts to an estimated budget relief of more than £1.2 million (based on placement type) over the 12 month period.

East Midlands Shared Service (EMSS)

Leicestershire County Council (LCC) and Nottingham City Council (NCC) have been working in partnership to develop and implement an East Midlands Shared Service to support both transactional finance and HR administration/payroll processes. The shared service is supported by an implementation of the Oracle E-Business Suite. As is usual with this type of extensive system implementation, a great deal of focus has been applied to the financial control processes requiring review and redesign. Much of the risk for NCC has been mitigated by the fact that the Council was migrating to an existing LCC platform.

Latest Position

The Council's Accountancy and Audit services continue to closely monitor the activity and performance of the Oracle system closely. No major concerns have yet arisen in this regard. Issues have been faced in terms of financial management since the implementation on 2 April 2013, and delays have been experienced in making payments to certain suppliers. The causes of this issue have been addressed and the resulting payment backlog is being cleared.

Nottingham Express Transit (NET)

Nottingham City Council entered into a 22 year Private Finance Initiative concession contract with Tramlink Nottingham Limited ("Tramlink") in December 2011 to extend and operate Nottingham's tram network. The concession contract passes the key design, build and construction risks, to Tramlink, the private sector concession company.

Latest Position

Construction of NET Phase Two is underway with an anticipated opening to passenger services during 2015. The NET concession contract, including project risks remaining with the City Council, is being managed by an experienced in-house project team and overseen by a dedicated Project Board.

Workplace Parking Levy (WPL)

The WPL is a levy which applies to all employers within the Nottingham City Council administrative boundary. Employers that provide any workplace parking places are required to get a WPL licence and those with 11 or more chargeable places, to pay a charge, from 1 April 2012. An important issue focuses on the ability of WPL to raise revenue to meet the Council's contribution to the NET Phase 2, the HUB and Link Bus network. The scheme was introduced on 1st October 2011 and charging commenced in April 2012.

Latest Position

There has been concern regarding the ability of WPL to meet funding requirements. The WPL income projections will be continually updated to reflect the latest information available from the WPL team as the income collection is still in its infancy. In the event that over the 23 year life of the NET Phase 2 contract, insufficient WPL income is generated, decisions may be made in respect of the ongoing contributions to the Link Bus network and/or extending the WPL scheme beyond the life of the NET Phase 2 contract.

SIGNIFICANT ISSUES REPORTED

Icelandic Banks

In October 2008, as a consequence of the global financial crisis, the Icelandic banking system collapsed, with four of its banks going into administration. This impacted directly on the Council, which had a total of £41.6m deposited with three of the banks involved (Heritable, Landsbanki and Glitnir), at the time of the collapse.

Latest Position

More than 120 local authorities had similar deposits with Icelandic banks at that time, totalling some £920m. All these authorities joined forces through the Local Government Association to co-ordinate the recovery of the monies. The latest claim administration reports state no further repayments are expected.

AGS Process 2014 / 2015

APPENDIX 2

Action	Feb 2015	Mar 2015	Apr 2015	May 2015	Jun 2015	Jul 2015	Sept 2015	Oct 2015	Feb 2016	Mar 2016
Head of Internal Audit to meet Departmental Management Teams										
Plan the process for obtaining assurances from Corporate Directors and other significant partners										
Review 2013/14 AGS and take update to Audit Committee										
Update to Corporate Governance Steering Group										
Confirm significant partners and groups										
Revise and circulate questionnaires to obtain assurance										
Produce Internal Audit Annual Report with Head of Audit opinion										
Review extent to which the Council complies with the Local Code										
Review of Assurance sources available: • Partnership arrangements • Corporate Director Assurance Statements • Statutory Officers - 151 Officer, Monitoring Officer, Head of Paid Service • Other sources of assurance including: ○ Key Officers, including those with responsibility Internal Audit, Performance, Risk and HR ○ External Assurances including external inspections										

Action	Feb 2015	Mar 2015	Apr 2015	May 2015	Jun 2015	Jul 2015	Sept 2015	Oct 2015	Feb 2016	Mar 2016
Draft AGS, outlining the governance environment and any significant governance issues that need to be disclosed										
Take report to Audit Committee as the committee responsible for monitoring compliance with the Local Code										
Consider Issues from External Audit Annual Letter										
Report Final AGS to Audit Committee with Statement of Accounts										
Prepare / follow-up mid year report to Audit Committee for first meeting of new year										

AUDIT COMMITTEE – 27 February 2015

Title of paper:	**INTERNAL AUDIT QUARTERLY REPORT 2014/15 (THIRD QUARTER) AND INTERNAL AUDIT PLAN 2015/16.**	
Director(s)/ Corporate Director(s):	Geoff Walker Acting Director of Strategic Finance	**Wards affected: All**
Report author(s) and contact details:	**Author and contact officer** Shail Shah – Head of Internal Audit Tel: 0115 8764245 Email: shail.shah@nottinghamcity.gov.uk	
Other colleagues who have provided input:		

Recommendation(s):	
1	Note and gives views on the performance of IA during the period.
2	Select up to two audits from **Appendix 2** for examination at the Committee's next meeting.
3	Approve the Internal Audit Plan for 2015/16 (**Appendix 3**).

1. REASONS FOR RECOMMENDATIONS

This report outlines the work of the Internal Audit service (IA) for the third quarter of 2014/15, and the proposed Internal Audit Plan 2015/16.

- **Appendix 1 -** Analysis of High Risk findings in Final Audit Reports issued in the period
- **Appendix 2** - List of final audit reports with high risk recommendations issued in the year with scope, analysis of recommendations, details of high risk recommendations and level of assurance
- **Appendix 3** - Summary of Proposed Audit Plan 2015/16.

1.1 Standards

The service works to a Charter endorsed by the Audit Committee. This Charter governs the work undertaken by the service, the standards it adopts and the way it interfaces with the Council. IA colleagues are required to adhere to the code of ethics, standards and guidelines of their relevant professional institutes and the relevant professional auditing standards. It has adopted, and substantially complied with the principles contained in the PSIAS, and has fulfilled the requirements of the Account and Audit Regulations 2011, and associated regulations, in respect of the provision of an IA service. The service has internal quality procedures and is ISO9001:2008 accredited.

Local Performance Indicators (PIs)

Performance against all PIs is illustrated in **Table 1**.

Table 1 : Performance v PI Targets					
Indicator		**Target**	**Period**	**Actual Year**	**Comments**
1	% of all recommendations accepted.	95%	100%	100%	Above Target
2	% of high recommendations accepted.	100%	100%	100%	On Target
3	Average number of working days from draft agreed to the issue of the final report	8	3	4	Above Target
4	Number of key / high risk systems reviewed.	15	4	4	Work underway and on target
5	% of staff receiving at least three days training per year.	100%	22%	22%	On Target
6	% of customer feedback indicating good or excellent service.	85%	100%	89%	Above Target

1.2 Activity

Table 2 shows that actual days achieved are in line with planned days set out in the updated Audit Plan. In summary, after allowance for seasonal work patterns, the plan is on target.

TABLE 2: ACTUAL v PLANNED AUDIT DAYS		
Total Planned Days	**Actual to date**	**Comments**
1849	1153	Audit Plan on track for year end completion.

Table 3 shows that in the year to date, acceptance of recommendations is above the target of 95% for all recommendations and is in accordance with the 100% target for high recommendations.

TABLE 3: RECOMMENDATIONS ACCEPTED				
	To Date		**Period**	
	All	**High**	**All**	**High**
Total recommendations made	163	51	25	11
Rejected	0	0	0	0
Total recommendations accepted	163	51	25	11
% accepted	100%	100%	100%	100%

1.4 Internal Audit Plan 2015/16

Appendix 3 summarises the internal audit plan for 2015/16. The IA Plan is produced annually and allocates audit resources throughout the year to review risks to the Council's vision, values and strategic priorities. The construction of the plan is informed by consideration of a range of factors including the Council Plan, the Council's Risk Register, previous internal and external audit activity, emerging themes and priorities, professional networks, the Council's transformation and improvement activity, and changes to national, local and regional policy. The Annual Plan contains capacity to adapt to accommodate new and unforeseen work as risks and priorities change and develop throughout the year, which will be reported to this Committee as part of the normal reporting cycle.

2. BACKGROUND

The Audit Committee's terms of reference include responsibility for receiving reports on the work undertaken by IA and for monitoring its performance. The Public Sector Internal Audit Standards (PSIAS) set the responsibility for the management of Internal Audit with the Board. In practical terms this Board responsibility is vested in the Audit Committee and Section 151 Officer who exercise their Board responsibility via the Constitution and the associated policies and procedures of the City Council. This report is one of the regular updates on work planned and undertaken by the service.

3. BACKGROUND PAPERS OTHER THAN PUBLISHED WORKS OR THOSE DISCLOSING EXEMPT OR CONFIDENTIAL INFORMATION

None

4. PUBLISHED DOCUMENTS REFERRED TO IN COMPILING THIS REPORT

- Accounts and Audit Regulations 2011
- Audit Plan 2014/15
- Public Sector Internal Audit Standards 2012

Reports issued in Q3 with High Risk Recommendations

Audit	Scope	Level of Assurance	Recommendations				
			High	Medium	Low	Report ref	
Fleet Maintenance	The agreed scope covered the following: • Contract / SLA Management • Pricing methodology used to determine the contract rates • Charging mechanism for completed work against the contracts. • Management Information systems, recording and reporting of work undertaken • IT controls over access to MIS • Income reconciliations against work performed • Budget and transactional reporting	Limited	10	7	2	R1	The business needs to review its current and future business needs in order that it can draw up a new specification for a fleet management system that addresses: 1) The management of Fleet Maintenance Contracts 2) Private MOT's, servicing and taxi testing 3) Production of real time invoices linked with point of sale systems 4) Linkages with NCC Financial management systems 5) Simplification of work categorisation by adopting nationally recognised coding. 6) Meets or exceeds NCC IT Security Standards 7) Allows for flexible reporting arrangements, including the generation of exception reports 8) Holds scanned images

Audit	Scope	Level of Assurance	Recommendations				
			High	Medium	Low	Report ref	
							of documentation relating to contract or vehicles or has links to other systems, such as Castle, where documentation could be held corporately. A complete record of changes to data in respect of adjustments to customer invoices.
						R4 R6	All work performed should have a job card in order that the time and parts utilised can be recorded and costs recovered, where appropriate. As far as taxi licencing work is concerned this would aid the recovery process as a report could be run from Tranman and used for recharge purposes. A system of review and charging should be established to ensure all work is promptly charged for. One solution may be for all job sheets to be scanned and held appropriately in order that they can be reviewed and the appropriate level of charge made.

Audit	Scope	Level of Assurance	Recommendations				
			High	Medium	Low	Report ref	
						R10	There is a need to have an agreed, consistent, up to date pricing policy adopted by both sites that is reviewed periodically and reinforced by the use of an EPOS system, which links both sites.
						R12	There is a need to have an agreed, consistent, up to date pricing policy adopted by both sites that is reviewed periodically and reinforced by the use of an EPOS system, which links both sites.
						R13	There is a need to have an agreed, consistent, up to date pricing policy adopted by both sites that is reviewed periodically and reinforced by the use of an EPOS system, which links both sites.
						R14	There is a need to have an agreed, consistent, up to date pricing policy adopted by both sites that is reviewed periodically and reinforced by the use of an EPOS system, which links both sites.
						R15	There is a need to have an agreed, consistent, up to date pricing policy adopted by both sites that is reviewed

Audit	Scope	Level of Assurance	Recommendations				
			High	Medium	Low	Report ref	
							periodically and reinforced by the use of an EPOS system, which links both sites.
						R17	Milometer reading should be accurate and complete for all vehicles to enable driver abuse and excessive mileages to be identified This is especially important where mileage is a factor in any SLA or contractual arrangement, such as NCH where mileage above 8,000 miles p.a. has to be reviewed as part of the charging arrangements.
						R18	Milometer reading should be accurate and complete for all vehicles to enable driver abuse and excessive mileages to be identified This is especially important where mileage is a factor in any SLA or contractual arrangement, such as NCH where mileage above 8,000 miles p.a. has to be reviewed as part of the charging arrangements.
Business Strategy & Support 2015	The agreed scope covered the following: • Review the process and payments for Section 17 – ensuring that all payments are appropriately documented and that,	Limited	1	4	1	R3	All keys for the safe should be removed at night.

Audit	Scope	Level of Assurance	Recommendations				
			High	Medium	Low	Report ref	
	where appropriate, clients sign for the cash received. • Review the management and recording of petty cash payments at a sample of remote establishments						

APPENDIX 2

Final Audit Reports issued 1st April to 31st December 2014

Department	Division	Activity Title	Assurance	Accepted recommendations			Reported quarter
				High	Medium	Low	
Children and Adults	Adult Assessment	Personal Budgets - 2014 - Follow-up	Significant Assurance	5	6	0	2
		Adult Assessment Total		**5**	**6**	**0**	
	School	Brocklewood Primary School	Significant Assurance	1	3	1	1
		Jubilee Primary School	Significant Assurance	0	0	0	1
		Nottingham Nursery	Significant Assurance	2	1	2	1
		Westglade Primary School	Significant Assurance	0	3	0	1
		Cantrell Primary and Nursery	Significant Assurance	1	4	4	2
		Ellis Guilford Comprehensive	Limited Assurance	8	8	3	2
		Glade Hill Primary and Nursery	High Assurance	0	2	4	1
		Oak Field School and Specialist Sports College	Significant Assurance	0	2	4	1
		Scotholme Primary and Nursery	High Assurance	0	1	3	1
		South Wilford Endowed CE Primary	Significant Assurance	1	2	1	2
		Walter Halls Primary and Early Years	Significant Assurance	0	3	3	2
		Schools Total		**13**	**29**	**25**	
	Quality and Commissioning	Housing Related Support Payments	High Assurance	0	0	0	1
		Quality and Commissioning Total		**0**	**0**	**0**	
Children and Adults Total				**18**	**35**	**25**	
Communities	Neighbourhood Services	Fleet Maintenance		10	7	2	3
		Neighbourhood Services Total		**10**	**7**	**2**	
Communities Total				**10**	**7**	**2**	
Development	**Planning and Transport**	Green Bus Funding	**Grant**	0	0	0	2
		Planning and Transport Total		**0**	**0**	**0**	
	Housing Strategy	Housing rents	**Limited**	7	6	1	1
		Housing Strategy Total		**7**	**6**	**1**	

Department	Division	Activity Title	Assurance	Accepted recommendations			Reported quarter
				High	Medium	Low	
	Economic Development	Economic Development - Funding Streams 2014	Significant Assurance	0	2	2	2
		Woodfield Industries 2014	Significant Assurance	0	6	0	2
		Economic Development Total		**0**	**8**	**2**	
Development Total				**7**	**14**	**3**	
Charities		Hanley & Gellestrope	**Charity Account**	0	0	0	1
Charities Total				**0**	**0**	**0**	
Resources	Information Technology	IT Asset Management	Limited Assurance	2	6	1	1
		IT Security 2014	Limited Assurance	5	2	1	1
		Information Technology Total		**7**	**8**	**2**	
	Strategic Finance	Housing Benefits 2014	Limited Assurance	2	1	0	1
		Troubled families Grant 2013 14 Qtr 4	Grant	0	0	0	1
		Troubled families Grant 2014 15 Qtr 1	Grant	0	0	0	2
		Growth Point 2013-14	Grant	0	0	0	1
		Adoption Reform Grant 2013 14 Part B	Grant	0	0	0	1
		Bank Reconciliation 2014	Limited Assurance	1	0	0	2
		Fairer Charging 2014	Significant Assurance	2	0	2	1
		Contracts audit	Significant Assurance	1	1	0	1
		AR - NCC Testing (Oracle)	Limited Assurance	0	5	0	1
		Budgetary Control	Significant Assurance	0	0	0	1
		Main Acc - NCC Testing (Oracle)	Limited Assurance	2	2	0	1
		Business Strategy & Support 2015	Limited Assurance	1	4	1	3
		Strategic Finance Total		**9**	**13**	**3**	
	Legal & Democratic Services	A3 forms Hardware Requirements Grant (One-off grant)	Grant	0	0	0	1
		Legal & Democratic Services Total		**0**	**0**	**0**	
Resources Total				**16**	**21**	**5**	
Grand Totals				**51**	**77**	**35**	**163**

APPENDIX 3

SUMMARY OF PROPOSED INTERNAL AUDIT PLAN 2015/16

Audit Area	Planned Days
Strategic Risk	50
Fraud / Counter Fraud	909
Consultancy, Advice and Support	180
Companies / Other Bodies	333
Corporate Audits	305
Development	110
Communities	110
Children & Families	160
Chief Executive	90
Resources	118
Developments / Other	80
Total Days	2445

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AUDIT COMMITTEE – 27 February 2014

Title of paper:	**INTERNAL AUDIT REPORT SELECTED FOR EXAMINATION**	
Director(s)/ Corporate Director(s):	Geoff Walker Acting Director of Strategic Finance	**Wards affected: All**
Report author(s) and contact details:	Shail Shah Head of Internal Audit ☎ 0115-8764245 ✉ shail.shah@nottinghamcity.gov.uk	
Other colleagues who have provided input:		

Recommendation(s):

1	To critically appraise the Internal Audit report at **Appendix 1** to:- • Determine whether the audit work was of an appropriate quality and scope; • Determine whether the service's response was sufficiently proportionate, robust and prompt; • Make any further observations and/or comments considered relevant; • Determine any further action.

1. REASONS FOR RECOMMENDATIONS

This report presents the Bank Reconciliation report selected for detailed examination, at the Committees' November 2014 meeting. The Audit Committee's role is to appraise the quality and scope of the Internal Audit work and determine whether the action taken by the audited service was sufficiently robust and prompt in response to the audit findings. Colleagues from Internal Audit and the reviewed service will be present at the meeting to assist this activity.

1.1. **Appendix 1** is the selected Bank Reconciliation report selected by the Committee at its November 2014 meeting**.**

1.2. **Table A** below summarise summarises key issues found.

TABLE A – Bank Reconciliation					
Reason for audit: The Audit selected was performed as part of the planned Internal Audit coverage. **Appendix 1** contains the latest position as reported as part of the 2014/15 Internal Audit Plan.					
Latest Assurance level:	High				
Key findings					
The 2013/14 Audit gave limited assurance based upon the failure to perform regular reconciliations throughout the year on the main bank accounts used by the council to receive income and pay citizens and businesses. This weakness was found to be addressed in our 2014/15 review which found reconciliations being completed on a regular basis and being given to a Senior Finance Manager for approval in accordance with our previous recommendations. Consequently a high level of assurance was judged to be appropriate.					
Recommendations Update					
Total:	0	**High Priority:**	0	**Medium Priority:**	0
The ownership of Internal Audit recommendations is the responsibility of the audit client and an update of progress has been included in the report.					

2. BACKGROUND

The critical appraisal of selected Internal Audit reports by Audit Committee is an important aspect of the Council's governance framework. This helps the Committee to fulfil its responsibility to receive reports on the work undertaken by Internal Audit and to critically appraise its performance. In doing this, the Committee is testing the robustness of and contributing to the organisation's audit and other governance arrangements. This also aids development of a deep understanding of the Council's internal control environment and Internal Audit working practices. Issues to consider are:

- How the audit was selected – for example the risk assessment, the potential for fraud, previous track record of the service, frequency of the audit;
- Whether the audit coverage was appropriate, adequate and correctly focussed;
- The time spent on the audit against the outcomes and findings;
- The quality of the internal audit report;
- The actual findings and the impact on the service and the council overall;
- The service's response to the audit recommendations;
- The speed and robustness of the actions taken to address the recommendations;
- Whether there are any learning points or principles that could be applied in future audit or governance work.

This list is for guidance only and the Committee is at liberty to explore other governance issues.

3. BACKGROUND PAPERS OTHER THAN PUBLISHED WORKS OR THOSE DISCLOSING EXEMPT OR CONFIDENTIAL INFORMATION

None

4. PUBLISHED DOCUMENTS REFERRED TO IN COMPILING THIS REPORT

None

Appendix 1

Nottingham City Council
Internal Audit

FINAL INTERNAL AUDIT REPORT
Bank Reconciliation 2014-15

Contents **Page**

Distribution List

Issue Date:	2 February 2015
Issued to:	Theresa Channell
Copied to:	Geoff Walker

Contact Details:

Head of Internal Audit	Shail Shah	64245
Audit Manager	Simon Parsons	64246
Principal Auditor	Peter Thompson	64244
Auditor	Thomas Loftus	64289

Executive Summary

Introduction and Background

1.1 We have reviewed the operation of Bank Reconciliations as part of the 2014/15 Audit Plan.

The scope of this audit consisted of the following:

- The reconciliation of the General Account
- The reconciliation of the Drawings Account

Key Findings

1.2 All figures used in the General Account and Drawings reconciliations matched their source (e.g. bank balances).

1.3 Each month a number of transactions occur through the General Account bank account (such as the addition of interest) that are not processed through Oracle. This results in variances between the bank balances and Oracle records. Journal entries are used to rectify these variances. In testing it was found that all necessary journal entries had been created.

1.4 One of the main factors in creating these variances every month is that appropriate radius rules cannot be put in place to automatically account for the transfers and other transactions. This is as a result of restrictions put in place by the bank. With the transfer of banking services to the new provider this should be rectified as new radius rules can be put in place.

1.5 All calculations and formulas used in the reconciliations were found to be correct.

1.6 We are pleased to see an improvement since we last reviewed this area and can report the fact that reconciliations are now being completed on a regular basis and are being passed to the Senior Finance Manager for approval.

Opinion

1.7 We are required to provide an opinion on the adequacy and effectiveness of internal controls in relation to the area under review. Our opinion is based on the work performed as set out in the agreed Audit Brief. We are able to give **High Assurance** on the controls in this area.

Added Value

1.8 There has been an improvement in the level of control, since this area was last reviewed with last year's recommendation being implemented.

Responsibilities

1.9 The City Council's Audit Committee review summary Internal Audit reports and the main issues arising, and seek assurance that action has been taken where necessary. As a consequence we provide details of each final audit and recommendations made. Management may be required to attend Committee or respond to it in relation to actions agreed and taken.

Appendix A – Definitions of Audit Opinion

Levels of Assurance

We use four categories to classify Internal Audit assurance over the processes examined, these are defined as follows:

High Assurance	High assurance that the system of internal control is designed to meet the organisation's objectives and controls are consistently applied in all the areas reviewed. Our work found some low impact control weaknesses which, if addressed, would improve overall control. These weaknesses are unlikely to impair the achievement of the objectives of the system.
Significant Assurance	Significant assurance that there is a generally sound system of control designed to meet the organisation's objectives and that controls are generally being applied consistently in the areas reviewed. However, some weakness in the design or inconsistent application of controls put the achievement of particular objectives at risk.
Limited Assurance	Limited assurance as weaknesses in the design or inconsistent application of controls put the achievement of the organisation's objectives at risk in the areas reviewed.
No Assurance	No assurance as weaknesses in control, or consistent non-compliance with key controls, could result in failure to achieve the organisation's objectives in the areas reviewed.

Where appropriate we may also comment on the level of assurance we can give that objectives will be met. This may apply when there are risks either partially or wholly outside of the control of management.

Categorisation of Recommendations

The recommendations within this report have been categorised by Internal Audit as:

High Priority	A fundamental weakness which presents material risk to the audited body and requires urgent attention by management.
Medium Priority	A significant weakness whose impact or frequency presents an unacceptable risk to the audited body that should be addressed by management.
Low Priority	The audited body is not exposed to any significant risk, but the recommendation merits attention.

In all cases Internal Audit will follow up implementation of the recommendations by the agreed date.

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AUDIT COMMITTEE - 27 February 2015

Title of paper:	**AUDIT COMMITTEE TERMS OF REFERENCE AND ANNUAL WORK PROGRAMME**	
Director(s)/ Corporate Director(s):	Geoff Walker Acting Director of Strategic Finance	**Wards affected: All**
Report author(s) and contact details:	Shail Shah - Head of Internal Audit ☎ 0115-8764245 ✉ shail.shah@nottinghamcity.gov.uk	
Other colleagues who have provided input:		
Recommendation(s):		
1	Note the functions of the Audit Committee and the benefits arising from its existence	
2	Endorse the outline work programme at **Appendix 1** and the terms of reference at **Appendix 2**.	

1. REASONS FOR RECOMMENDATIONS

Although an Audit Committee is not a legal requirement it reflects best practice reinforces the importance of probity, and performance and risk management. This report outlines the core functions of the Audit Committee, the benefits that will arise for the City Council and an outline annual work programme.

Role of the Audit Committee

The purpose of an Audit Committee is to provide independent assurance on the adequacy of the governance and control environment, effectiveness of the Risk Management Framework, and to oversee the annual financial reporting process.

Benefits of the Audit Committee

The benefits to be gained from operating an effective Audit Committee are that it:

- Raises greater awareness of the need for internal control and the implementation of audit recommendations;
- Increases public confidence in the objectivity and fairness of financial and other reporting;
- Reinforces the importance and independence of internal and external audit and any other similar review process eg providing a view on the annual governance statement;
- Provides additional assurance through a process of independent and objective review.

Governance Role

The Audit Committee aims to improve corporate focus on governance by:

- Providing assurance on the adequacy of the Risk Management Framework and the associated control environment;
- Scrutinising the Council's financial and non-financial performance to the extent that it affects the Council's exposure to risk and weakens the control environment;
- Overseeing the financial reporting process
- Approving the Council's Statement of Accounts;
- Commenting on the scope and nature of external audit;
- Overseeing proposed and actual changes to the Council's policies and procedures pertaining to governance

2. BACKGROUND

3.1 An Audit Committee is central to the provision of effective corporate governance, which partly depends on a systematic strategy, clear framework and processes for managing risk. Good governance also maintains and increases public confidence in the objectivity and fairness of financial and other reporting as well as helping to deliver improved services. It is important that local authorities have independent assurance about the mechanisms underpinning these aspects of governance.

3.2 It is recognised that high performing councils develop effective financial and non-financial control mechanisms. The development of expertise made available by the establishment of an Audit Committee, meeting on a regular cycle, and with Terms of Reference focussed on the key audit control and risk management areas critical to the Council's performance is a key part of these mechanisms.

3.3 The Committee's outline work programme is attached as **Appendix 1**. The work programme supports the Council's aim to improve its efficiency and effectiveness and has been developed to address the Terms of Reference for the Committee approved by the City Council included as **Appendix 2**. In accordance with CIPFA guidance, the Committee is politically balanced and will not have Executive membership.

Membership will continue to be reviewed in accordance with guidance from the Department of Communities & Local Government (DCLG).

3. BACKGROUND PAPERS OTHER THAN PUBLISHED WORKS OR THOSE DISCLOSING EXEMPT OR CONFIDENTIAL INFORMATION

None

4. PUBLISHED DOCUMENTS REFERRED TO IN COMPILING THIS REPORT

Advice note from CIPFA Technical Audit Committees – Practical Guidance for Local Authorities (CIPFA)

Appendix 1

Audit Committee Programme of work 2015 / 2016

REPORT TITLE	DATE ▷ LEAD ▽	26.06.15	31.07.15	18.09.15	27.11.15	26.02.16	29.04.16
Annual Governance Statement Interim Report	GW/SS						
Annual Governance Statement	GW/SS						
Internal Audit Plan	GW/SS						
Annual Governance Statement Mid Year Update	GW/SS						
Audit Committee Annual Report	Cllr P						
Audit Committee Role & Annual Work Programme	GW/SS						
Audit Committee Training Activity	GW/SS						
Counter Fraud Strategy	GW/SS						
EMSS Update	GW/SS						
Internal Audit Annual Report & Audit Charter	GW/SS						
Internal Audit Performance Report	GW/SS						
Internal Audit Reports Selected for Examination	GW/SS						
KPMG – External Audit Protocol	KPMG						
KPMG – Annual Audit Letter	KPMG						
KPMG – Certification of Claims & Returns Annual Report	KPMG						
KPMG – Report to Those Charged with Governance	KPMG						
KPMG – Regular update/statement progress	KPMG						
KPMG – External Audit Plan	KPMG						
LGO Annual Report	LN						
Partnership Governance Framework	LC						
Risk Management Annual Report	GW/R						
Risk Management Quarterly Report	GW/R						
Risk Management Strategy/Framework	GW/R						
Risk Management Training	GW/R						
Statements of Accounts	GW/JA						
Treasury Management Annual Report	GW/JA						
Treasury Management Strategy & Key Issues Update	GW/JA						
Performance Management Framework	AP/CC						

KEY : PEOPLE	
Cllr P	Councillor Piper
JA	Jeff Abbott
KPMG	External Auditor
LC	Laura Catchpoloe
LN	Lynne North
R	Risk Manager
SS	Shail Shah
GW	Geoff Walker
CC	Chris Common

KEY : PURPOSE	
	As required
	For approval
	Reviewing performance

Appendix 2
Audit Committee Terms of Reference

TITLE	**AUDIT COMMITTEE**
POWERS / REMIT	

(a) <u>Main Purposes</u>:

1. Provide assurance of the adequacy of the risk management framework and the associated control environment;
2. Scrutinise the council's financial and non-financial performance to the extent that it affects the council's exposure to risk and weakens the control environment;
3. Oversee the financial reporting process;
4. Approve the council's Statement of Accounts;
5. Comment on the scope and nature of external audit;
6. Oversee proposed and actual changes to the council's policies and procedures pertaining to governance.

(B) <u>Main Functions</u>:

1. Reviewing the mechanisms for the assessment and management of risk;
2. Approving the council's statement of accounts;
3. Receiving the council's reports on the Statement on the Annual Governance Statement and recommending their adoption;
4. Approving Internal Audit's strategy, planning and monitoring performance;
5. Receiving the Annual Report and other reports on the work of Internal Audit;
6. Considering the external auditor's annual letter, relevant reports and the report to those charged with governance and the council's responses to them;
7. Considering arrangements for and the merits of operating quality assurance and performance management processes;
8. Considering the exercise of officers' statutory responsibilities and of functions delegated to officers;
9. To recommend external audit arrangements for the council;
10. To receive and consider the results of reports from external inspectors, ombudsman and similar bodies and from statutory officers;
11. Overseeing the Partnership Governance Framework, including annual health checks and the Register of Significant Partnerships.

ACCOUNTABLE TO: Council

MEETINGS: Normally six per annum plus specials where required

MEMBERSHIP: 9 non-executive members (politically balanced) plus 1 independent member.

ESTABLISHED SUB COMMITTEES: None.