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NOTTINGHAM CITY COUNCIL
AUDIT COMMITTEE

Date: Friday, 24 February 2017

Time: 10.30 am

Place: LB 32 – Loxley House, Station Street, Nottingham, NG2 3NG

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

Corporate Director for Strategy and Resources

Governance Officer: Kate Morris **Direct Dial:** 0115 876 4353

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 Loxley House, Station Street, NG2 3NG on 25 November 2016 from 9.30am to 10.45am

Membership
Present

Councillor Sarah Piper	(Chair)
Councillor Steve Young	(Vice-Chair)
Councillor Leslie Ayoola	
Councillor Michael Edwards	(substitute for Councillor Wood)
Councillor John Hartshorne	(for minutes 43 - 45 only)
Councillor Andrew Rule	

Absent
Councillor Dave Liversidge
Councillor Toby Neal
Councillor Anne Peach
Councillor Malcolm Wood

Colleagues, partners and others in attendance:

Tony Crawley	-	KPMG External Auditors
Shail Shah	-	Head of Audit and Risk
Amanda Wright	-	Customer Experience Lead
Sue Risdall	-	Finance Team Leader (Technical Accounting)
Elaine Fox	-	Corporate Policy Officer
Jane O'Leary	-	Insurance and Risk Manager
Mark Leavesley	-	Governance Officer
Paul Jordan	-	Team Leader, Corporate Counter Fraud
John Slater	-	Group Auditor, Internal Audit
	-	
	-	
	-	

36 APOLOGIES FOR ABSENCE

Councillor Liversidge	)	other Council business
Councillor Peach	)	
Councillor Wood	-	personal

37 DECLARATIONS OF INTERESTS

None.

38 MINUTES

The Committee agreed the minutes of the meeting held on 16 September 2016 as a correct record and they were signed by the Chair.

39 PARTNERSHIP GOVERNANCE ANNUAL HEALTH CHECKS OF NOTTINGHAM CITY COUNCIL'S SIGNIFICANT PARTNERSHIPS

Elaine Fox, Corporate Policy Team, presented the report, which detailed the key findings from the annual partnership governance health checks. The main points were as follows:

- the majority of partnerships scored either ‘good’ or ‘excellent’ in all areas;
- a sample check of three of these scores was undertaken, and verified, by Corporate Policy and Internal Audit;
- the Greater Nottingham Transport Partnership has been removed from the Partnership Register as it has ceased operating.

RESOLVED

(1) to note:

(a) the key findings from the Partnership Governance Health Checks and Register of Significant Partnerships, as detailed in appendices 1 and 2;

(b) the findings and recommendations from the verification of governance documentation of four of the partnerships (D2N2 Local Enterprise Partnership, Education Improvement Board, Safeguarding Children Board and Green Theme Partnership), as detailed in appendix 4;

(2) that the Corporate Policy and Data Protection Teams work to ensure compliance by all partnerships.

40 LOCAL GOVERNMENT OMBUDSMAN ANNUAL LETTER 2016

Amanda Wright, Customer Experience Lead, presented the report, which detailed complaints received by the Council, and decisions made by the Local Government Ombudsman (LGO) on complaints received by them about the Council, during the period April 2015 to March 2016. The main points were as follows:

- in 2015-16, the LGO received 19,702 complaints nationally, of which 112 were about the City Council, 27 of which were investigated, and 13 of those upheld (a 48% uphold rate). Compared to 2014-15, this is a slight increase for received (109), a slight decrease for investigated (26) but a large increase in upheld (6 - 23%);

- the largest increase was in regards to complaints about the Benefits and Tax Service, rising from none upheld out of 25 complaints in 2014-15 to 5 upheld out of 20 complaints. The LGO has yet to respond to a request for justification of this increase;

- the City is below the national average for upheld complaints, currently 51%, and 5th lowest when compared to the other core cities;

- overall, the Council's figures reflect the national trend for the main subjects of complaint, which are Adult Care, Benefits and Tax and School Admission / Appeal services.

RESOLVED

(1) to note the report;

(2) that Ms Wright forward to Councillors the LGO response in regard to the query about the increase in upheld Benefit and Tax complaints.

41 REVIEW OF ACCOUNTING POLICIES 2016-17

Susan Risdall, Technical Accounting, presented the report, which requested the Committee review the Accounting Policies of the Council. It was explained that Part 3 of the Annual Accounts and Audit Regulations 2015 requires Councils to produce an Annual Statement of Accounts, which must include a statement of accounting policies.

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

In addition, where International Financial Reporting Standards (IFRS) allows a degree of choice, Audit Committees should be aware of, and confirm, any choices made.

RESOLVED that the following is approved:

(1) inclusion of the Statement of Accounting Policies in the Annual Accounts 2016/17;

(2) the degree of choice proposals, as allowed under International Financial Reporting Standards.

42 STUDENT HOUSING STRATEGY

The Committee received an update on the ongoing work in relation to student housing, including HIMO licensing and enforcement, Council Tax billing and loss, counter fraud approach, build and developments and student numbers.

During discussion, the following comments were made:

- Councillors enquired whether council tax is paid to the Council by central government when a HIMO is exempt (zero rated) due to it being fully in use as student accommodation;

- if a property is declared as a 'void', but a landlord claims a student is in residence, the council must check the validity of that claim.

At this point, Councillor Hartshorne arrived.

RESOLVED that the update is noted, and that Paul Jordan be requested to organise a meeting with members of the Committee to discuss student-related issues in more detail.

43 INTERNAL AUDIT QUARTERLY REPORT 2016/17 (1ST AND 2ND QUARTERS)

Shail Shah, Head of Audit and Risk, presented the report, which outlined the work undertaken by the Internal Audit service during quarters 1 and 2 of 2016/17. The report included appendices detailing an analysis of:

- High Risk findings (appendix 1);
- final Audit reports, with recommendations / levels of assurance (appendix 2);
- a summary of the current position against the Internal Audit Plan 2015/16 (appendix 3).

RESOLVED to

(1) note the work undertaken by, and performance of, the Internal Audit service during quarters 1 and 2 of 2016/17, including the information / analysis contained in the appendices;

(2) note the principles contained in the Public Sector Internal Audit Standards (PSIAS), which is a requirement of the Account and Audit Regulations 2015 in respect of the provision of an internal audit service, and approve the proposals in regard to an external assessment of the City Council's Internal Audit Service by Birmingham City Council;

(3) select 'Automatic Number Plate Recognition (ANPR)' and 'Equality Impact Assessments' audits for examination at a future meeting of this Committee.

44 TERMS OF REFERENCE AND ANNUAL WORK PROGRAMME

RESOLVED to note the role and functions of the Audit Committee, as detailed in the report, and endorse the work programme and terms of reference, as detailed in the appendices.

45 TREASURY MANAGEMENT 2016/17 - HALF YEARLY UPDATE

RESOLVED to note the actions taken under delegated authority by the Chief Finance Officer during the first half of 2016/17, in line with currently adopted Treasury Management Code of Practice.

AUDIT COMMITTEE - 24 FEBRUARY 2017

Title of paper:	**TREASURY MANAGEMENT 2017/18 STRATEGY**	
Director(s)/ Corporate Director(s):	Geoff Walker, Director of Strategic Finance	**Wards affected: All**
Report author(s) and contact details:	Glyn Daykin, Senior Accountant - Treasury Management Tel: 0115 8763724	
Other colleagues who have provided input:	Members of Treasury Management Panel: Geoff Walker, Director of Strategic Finance Theresa Channell, Head of Corporate Finance Susan Risdall, Technical Team Leader Jo Worster, Strategic Finance Team Leader	

Recommendation(s):	
1	Audit Committee are asked to consider and comment on the proposed Treasury Management Strategy for 2017/18, attached as **Appendix 1**, and, in particular: **a.** the strategy for debt repayment (Minimum Revenue Provision) in 2017/18 (**Appendix 4**); **b.** the Investment and Borrowing Strategies for 2017/18 (within **Appendix 1**); **c.** the Prudential Indicators and limits for 2015/16 to 2019/20 (**Appendix 3**); **d.** the current Treasury Management Policy Statement (**Appendix 5**).

1 REASONS FOR RECOMMENDATIONS

1.1 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 Strategy by those charged with governance.

The approval of the proposed Treasury Management Strategy for 2017/18 is to be considered at the meeting of City Council on 6 March 2017.

2 BACKGROUND

2.1 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 STRATEGY 2017/18 (APPENDIX 1)

3.1 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 2017/18 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 9**)

3.2 Summary of the main issues

3.2.1 The Treasury Management budget for 2017/18 is £46.837m and is based on the financial implications of the various proposed strategies, as detailed in Appendix 1, and has been included within the Medium Term Financial Plan (MTFP).

3.2.2 The Treasury Management Strategy reflects the implications of capital schemes within the approved capital program and a number of schemes in development which will significantly increase this programme to reflect the potential investment in the City Centre. Further detail can be found within the Capital Strategy Report being considered by Executive Board on 21 February 2017.

3.2.3 The Council's level of net external debt is anticipated to be £945.903m including £225.719m of Private Finance Initiative (PFI) liabilities as at 31 March 2017. This is expected to increase to £1,017.2m including £215.8m PFI debt by 31 March 2018. The cost of interest payments on the debt are expected to increase by £0.728m in 17/18.

3.2.4 The 2017/18 strategy continues to be to fund the borrowing requirement from short term interest rates, balances and reserves whilst still allowing the Council to take advantage of longer term funding opportunities. The low interest rate funding environment is expected to continue for at least the next couple of years.
This strategy does increase the Council's exposure to changes in long term interest rates, however this exposure is considered manageable given that £578m of the

Council's long term loan portfolio is at fixed rates and funded at less than 3.8% with a good spread of maturities.

The treasury management budget assumes the anticipated borrowing requirement will be financed by long term loans, together with an element of short term loans in 2017/18 to take the opportunity afforded by the low interest rates.

The strategy balances the risk that future interest rates will rise, reducing the benefit accrued from this policy. For example the initial costs are up to £0.225m lower per £10m borrowed short term at 0.25% (Bank Rate) vs 25 year PWLB debt at 2.50%; this balanced against the financial impact of for each 0.25% rise there is an extra £0.025m per annum in interest cost. Should £40m be taken using short term loans it is anticipated that around £0.9m be released and transferred into the Treasury Management Reserve for 'Interest equalisation' subject to the prevailing economic conditions at the time.

This would mean the forecast level of net variable interest rate exposure would be c.£190m including existing debts maturing in 17/18, the remaining 16/17 financing requirements and £24m LOBO loans with options in 17/18, however these are unlikely to be exercised.

This strategy will be kept under regular review and will use the support of our external treasury advisors, the latest economic and interest rate forecasts and funds will be maintained within the Treasury Management Reserve to protect the MTFP from unanticipated interest cost increases. Appendix 2 shows Arlingclose's Economic and Interest Rate Forecast.

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

4.1 PWLB records, economic and interest rate forecasts and working papers.

5 PUBLISHED DOCUMENTS REFERRED TO IN COMPILING THIS REPORT

5.1 None.

Appendix 1

NOTTINGHAM CITY COUNCIL

TREASURY MANAGEMENT STRATEGY 2017/18

CONTENTS

TABLES

APPENDICES

Executive Board 21 February 2017
Audit Committee 24 February 2017
City Council 6 March 2017

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: The major external influence on the Authority's treasury management strategy for 2017/18 will be the UK's progress in negotiating a smooth exit from the European Union. Financial markets, wrong-footed by the referendum outcome, have since been weighed down by uncertainty over whether leaving the Union also means leaving the single market. Negotiations are expected to start once the UK formally triggers exit in early 2017 and last for at least two years. Uncertainty over future economic prospects will therefore remain throughout 2017/18.
The fall and continuing weakness in sterling and the near doubling in the price of oil in 2016 have combined to drive inflation expectations higher. The Bank of England is forecasting that Consumer Price Inflation will breach its 2% target in 2017, the first time since late 2013, but the Bank is expected to look through inflation overshoots over the course of 2017 when setting interest rates so as to avoid derailing the economy.

Credit outlook: Markets have expressed concern over the financial viability of a number of European banks recently. Sluggish economies and continuing fines for pre-crisis behaviour have weighed on bank profits, and any future slowdown will exacerbate concerns in this regard.
Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however continue to fall.

Interest rate forecast: The Authority's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.25% during 2017/18. The Bank of

England has, however, highlighted that excessive levels of inflation will not be tolerated for sustained periods. Given this view and the current inflation outlook, further falls in the Bank Rate look less likely. Negative Bank Rate is currently perceived by some policymakers to be counterproductive but, although a low probability, cannot be entirely ruled out in the medium term, particularly if the UK enters recession as a result of concerns over leaving the European Union.

Gilt yields have risen sharply, but remain at low levels. The Arlingclose central case is for yields to decline when the government triggers Article 50. Long-term economic fundamentals remain weak, and the quantitative easing (QE) stimulus provided by central banks globally has only delayed the fallout from the build-up of public and private sector debt. The Bank of England has defended QE as a monetary policy tool, and further QE in support of the UK economy in 2017/18 remains a distinct possibility, to keep long-term interest rates low. A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix A.

For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.30%, short-term loans will be borrowed at an average of 0.40% and that new long-term loans will be borrowed at an average rate of 3.00%.

Local Context

The Council currently has £745.4m of borrowing and £63.9m of investments. This is set out in further detail at Appendix 6. Forecast changes in these sums and the estimated future borrowing requirement are shown in the balance sheet analysis in table 1 below.

Table 1: Forecast Borrowing Requirement and Balance Sheet Summary

	31.3.16 Actual £m	31.3.17 Estimate £m	31.3.18 Estimate £m	31.3.19 Estimate £m	31.3.20 Estimate £m
General Fund CFR	915.1	977.3	1039.3	1112.3	1097.5
HRA CFR	280.8	280.3	280	279.3	278.8
Total CFR	**1195.9**	**1257.6**	**1319.3**	**1391.6**	**1376.3**
Less: Other debt liabilities *	-236.3	-225.7	-215.8	-208.7	-198.5
Borrowing CFR	**959.6**	**1031.9**	**1103.5**	**1182.9**	**1177.8**
Less: External borrowing **	-690.4	-694.1	-677.4	-642.1	-588.3
Internal borrowing	**269.2**	**337.8**	**426.1**	**540.8**	**589.5**
Less: Usable reserves	-252.5	-211.9	-201.9	-197.5	-203.8
Less: Working capital	-99.9	-99.9	-99.9	-99.9	-99.9
Investments or (New borrowing)	**83.2**	**-26.0**	**-124.3**	**-243.4**	**-285.8**

* 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 around £30m.
The Council has an increasing CFR due to the capital programme, but minimal investments and will therefore be required to borrow up to £286m over the forecast period..

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 2017/18.

Borrowing Strategy

The Council currently holds £745.4m of loans (excluding £225.7m PFI debt), an increase of £55.0m 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 £124.3m by the end of 2017/18 at which point external debt is forecast to be around £801.7m (£1,017.5 including PFI debt).

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 approved capital program providing this does not exceed the authorised limit for borrowing of £1,147 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.

The Council will look to fund the borrowing requirement from short term loans at low interest rates whilst still allowing flexibility to take advantage of longer term funding opportunities. Any borrowing will be subject to the Council's limits on the net exposure to fixed and variable interest rates shown in the Prudential Indicators shown in Appendix 3.

When borrowing, the Council usually pays a margin above prevailing central government funding costs (gilt yields). For PWLB loans, this margin is fixed at 0.80% for the majority of funding. However, when funding via the money markets, via short-term loans with a maturity date of than less than 1 year, little or no margin is applied by local authorities that are depositing surplus cash. In addition, short-term rates are based on prevailing Bank of England "Bank Rate", currently 0.25% while longer term loans will reflect longer-term trends and other market factors. Consequently, it is currently significantly cheaper to borrow short-term debt from other local authorities than borrow PWLB loans.

The saving against 25 year PWLB debt is currently (2.50% - 0.25%) = £225,000 per annum for every £10m borrowed; the impact of each 0.25% rise in Bank Rate is an £25,000 extra cost per annum. While there is the risk of not finding sufficient short term funding, local authorities currently have £37bn available to invest and the PWLB also provides a liquidity back stop.

In this way the Council will be able to reduce net borrowing costs and reduce overall treasury risk. The benefits of short-term 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 modestly. Our treasury advisors 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 2017/18 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

The Council may arrange forward starting loans during 2017/18, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

In addition, the Council may borrow further short-term loans to cover unplanned 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
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

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

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

The 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 the European Investment Bank (EIB), local authority loans and bank loans, that may be available at more favourable rates.

European Investment Bank (EIB): The EIB is the world's largest multilateral development bank. The Bank is a not for profit institution and has a relatively low cost of funding which now represents an attractive funding source for authorities with a sufficiently large capital programme. The product range allows a more sophisticated approach to risk management incorporating forward starting loans, sculpted repayment profiles and a mix of fixed and floating rate debt can be utilised to complement the existing debt portfolio.

Municipal Bond Agency: UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a joint and several guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report.

LOBOs: The Council holds £34m 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. £24m of these LOBOS have options during 2017/18, 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 commensurate to the financial impact of the deal.

Investment Strategy

The Council holds 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 £41m and £110m, but investment balances are expected to be maintained at a balance of around £30m in the forthcoming year.

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.

Negative Interest Rates: If the UK enters into a recession in 2017/18, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

Strategy: Given the increasing risk and continued low returns from short-term unsecured bank investments, the Council aims primarily to avoid credit risk by holding a minimum level of investments for cash flow liquidity purposes only. The majority of the Council's surplus cash is currently invested in highly liquid short-term unsecured bank deposits and money market funds.

Should investment balances increase for a sustained period the Council will aim to diversify further into secured asset classes.

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
UK Govt	n/a	n/a	£ Unlimited 50 years
AAA	£10m 5 years	£15m 20 years	£15m 50 years
AA+	£10m 5 years	£15m 10 years	£15m 25 years
AA	£10m 4 years	£15m 5 years	£15m 15 years
AA-	£10m 3 years	£15m 4 years	£15m 10 years
A+	£10m 2 years	£15m 3 years	£15m 5 years
A	£10m 13 months	£15m 2 years	£15m 5 years
A-	£10m 6 months	£15m 13 months	£15m 5 years
None	n/a	n/a	£15m 25 years
Pooled funds	£10m per fund		

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

Lloyds Bank: The Council's own bank, will be subject to the limits in table 2 for investment balances, but also accommodate necessary short-term cash management balances for periods of up to 4 days with no maximum sum.

Credit Rating: Investment limits are set 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. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

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.

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.

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.

Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

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. The limit for non-specified investments is shown in table 3 below.

Table 3: Non-Specified Investment Limit

	Cash limit
Total non-specified investments	£30m

Investment Limits: The Council's revenue reserves available to cover investment losses are forecast to be c.£160 million on 31st March 2017. 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. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 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	£10m per group
Any group of pooled funds under the same management	£20m per manager
Negotiable instruments held in a broker's nominee account	£50m per broker
Foreign countries	£10m per country
Money Market Funds	£50m in total

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.

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 prudent basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments.

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 and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

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 periodically attend training courses, seminars and conferences provided by our treasury advisors 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. The current contract is due to expire in March 2017 and so the council is to go through a re-tender exercise for future services commencing from April 2017.

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. 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 £1,147 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. Details of the specific risks identified in respect of treasury management within the Council are adopted to form a Risk Management Action Plan. This Plan is reviewed at regular intervals at meetings of the Treasury Management Panel and is reported to Audit Committee for scrutiny as part of the Treasury Management Strategy Report..

Arlingclose Economic & Interest Rate Forecast December 2016

Underlying assumptions: Underlying assumptions:

- The medium term outlook for the UK economy is dominated by the negotiations to leave the EU. The long-term position of the UK economy will be largely dependent on the agreements the government is able to secure with the EU and other countries.
- The global environment is also riddled with uncertainty, with repercussions for financial market volatility and long-term interest rates. Donald Trump's victory in the US general election and Brexit are symptomatic of the popular disaffection with globalisation trends. The potential rise in protectionism could dampen global growth prospects and therefore inflation. Financial market volatility will remain the norm for some time.
- However, following significant global fiscal and monetary stimulus, the short term outlook for the global economy is somewhat brighter than earlier in the year. US fiscal stimulus is also a possibility following Trump's victory.
- Recent data present a more positive picture for the post-Referendum UK economy than predicted due to continued strong household spending.
- Over the medium term, economic and political uncertainty will likely dampen investment intentions and tighten credit availability, prompting lower activity levels and potentially a rise in unemployment.
- The currency-led rise in CPI inflation (currently 1.0% year/year) will continue, breaching the target in 2017, which will act to slow real growth in household spending due to a sharp decline in real wage growth.
- The depreciation in sterling will, however, assist the economy to rebalance away from spending. The negative contribution from net trade to GDP growth is likely to diminish, largely due to weaker domestic demand. Export volumes will increase marginally.
- Given the pressure on household spending and business investment, the rise in inflation is highly unlikely to prompt monetary tightening by the Bank of England, with policymakers looking through import-led CPI spikes to the negative effects of Brexit on economic activity and, ultimately, inflation.
- Bank of England policymakers have, however, highlighted that excessive levels of inflation will not be tolerated for sustained periods. Given this view and the current inflation outlook, further monetary loosening looks less likely..

Forecast:

- Globally, the outlook is uncertain and risks remain weighted to the downside. The UK domestic outlook is uncertain, but likely to be weaker in the short term than previously expected.
- The likely path for Bank Rate is weighted to the downside. The Arlingclose central case is for Bank Rate to remain at 0.25%, but there is a 25% possibility of a drop to close to zero, with a very small chance of a reduction below zero.

- Gilt yields have risen sharply, but remain at low levels. The Arlingclose central case is for yields to decline when the government triggers Article 50.

	Dec -16	Mar-17	Jun-17	Sep-17	Dec -17	Mar-18	Jun-18	Sep-18	Dec -18	Mar-19	Jun-19	Sep-19	Dec -19
Official Bank Rate													
Upside risk	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**
Downside risk	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
3-month LIBID rate													
Upside risk	0.05	0.05	0.10	0.10	0.10	0.15	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	**0.25**	**0.25**	**0.25**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**
Downside risk	0.20	0.25	0.25	0.25	0.30	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
1-yr LIBID rate													
Upside risk	0.10	0.10	0.15	0.15	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	**0.60**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.60**	**0.70**	**0.85**	**0.90**	**0.90**	**0.90**
Downside risk	0.10	0.15	0.15	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30
5-yr gilt yield													
Upside risk	0.25	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	**0.50**	**0.40**	**0.35**	**0.35**	**0.35**	**0.40**	**0.40**	**0.40**	**0.45**	**0.50**	**0.55**	**0.60**	**0.65**
Downside risk	0.30	0.45	0.45	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
10-yr gilt yield													
Upside risk	0.30	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	**1.15**	**0.95**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.90**	**0.95**	**1.00**	**1.05**	**1.10**	**1.15**
Downside risk	0.30	0.45	0.45	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
20-yr gilt yield													
Upside risk	0.25	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	**1.70**	**1.50**	**1.40**	**1.40**	**1.40**	**1.40**	**1.40**	**1.45**	**1.50**	**1.55**	**1.60**	**1.65**	**1.70**
Downside risk	0.40	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60
50-yr gilt yield													
Upside risk	0.25	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	**1.60**	**1.40**	**1.30**	**1.30**	**1.30**	**1.30**	**1.30**	**1.35**	**1.40**	**1.45**	**1.50**	**1.55**	**1.60**
Downside risk	0.40	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60

PRUDENTIAL INDICATORS 2015/16 – 2019/20	2015/16 Act £m	2016/17 Est £m	2017/18 Est £m	2018/19 Est £m	2019/20 Est £m
1. PRUDENCE INDICATORS					
i) Capital Expenditure					
General Fund	201.2	178.5	167.7	160.3	50.8
HRA	51.0	57.9	63.3	43.5	34.6
	252.2	**236.4**	**231.0**	**203.8**	**85.4**
ii) CFR at 31 March					
General Fund	678.8	751.6	823.5	903.7	899.0
HRA	280.8	280.3	279.8	279.3	278.8
PFI-related debt	236.3	225.7	215.8	208.7	198.5
	1,195.9	**1,257.6**	**1,319.1**	**1,391.6**	**1376.3**
iii) External Debt at 31 March					
Borrowing	690.4	750.2	831.5	915.1	904.8
Other (PFI debt)	236.3	225.7	215.8	208.7	198.5
Gross Debt	**926.7**	**975.9**	**1,047.2**	**1,123.8**	**1,103.3**
Less Investments	-82.7	-30.0	-30.0	-30.0	-30.0
Net Debt	**844.0**	**945.9**	**1,017.2**	**1,093.8**	**1,073.3**
2. AFFORDABILITY INDICATORS					
i) Ratio of financing costs to net revenue stream					
General Fund		14.52%	15.44%	17.05%	18.48%
HRA		12.06%	12.29%	12.92%	13.27%
ii) Impact of capital investment decisions		**£**	**£**	**£**	**£**
Council Tax Band D (per annum)		36.18	48.11	12.74	25.66
HRA rent (per week)		0.00	0.00	0.10	0.40
		£m	**£m**	**£m**	**£m**
iii) Authorised limit for external debt		1,081.2	1,147.2	1,223.8	1,203.3
iv) Operational Boundary for ext. debt		1,041.2	1,107.2	1,183.8	1,163.3
v) HRA limit on indebtedness					
HRA CFR		280.3	279.8	279.3	278.8
HRA Debt Cap (CLG prescribed)		319.8	319.8	319.8	319.8
Difference - headroom		**39.5**	**40.0**	**40.5**	**40.0**
3. TREASURY MANAGEMENT INDICATORS					
i) Upper limit on NET variable interest rate exposure	22.0	250.0	300.0	300.0	300.0
ii) Upper limit on NET fixed interest rate exposure	585.6	800.0	900.0	900.0	900.0
iii) Fixed Debt maturity structure					
- under 12 months	8%	0-25%	0-25%	0-25%	0-25%
- 12 months to 2 years	3%	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	18%	0-25%	0-25%	0-25%	0-25%
- 10 to 25 years	32%	0-50%	0-50%	0-50%	0-50%
- 25 to 40 years	23%	0-50%	0-50%	0-50%	0-50%
- 40 years and above	6%	0-25%	0-25%	0-25%	0-25%
iv) Sums invested for >364 days					
- in-house limit	£0m	£50m	£20m	£20m	£20m
v) Adoption of the *CIPFA Code of Practice for Treasury Management*	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 existing and proposed capital expenditure.

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) **<u>Treasury Management Indicators</u>**

i) *'Upper limit on NET variable interest rate exposure'* - is set to control the Authority's exposure to interest rate risk. The upper limits on variable rate interest rate exposures, expressed as the amount of net principal borrowed 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) *'Upper limit on NET fixed interest rate exposure'* - is set to control the Authority's exposure to interest rate risk. The upper limits on fixed interest rate exposures, expressed as the amount of net principal borrowed for the next three financial years are required.

- Fixed rate borrowing provides certainty for future interest costs, regardless of movements in interest rates.

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 2017/18

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 as well as locally determined prudent methods.

- For capital expenditure incurred before 2007/08, and for supported capital expenditure incurred on or after that date, MRP policy will be to charge 2% of the balance at 31 March 2016 on a straight line basis so the whole debt is repaid after 50 years. This policy was introduced in 2016/17 and represents a prudent adaptation to Option 1 in the guidance.
- For unsupported capital expenditure incurred after 2007/08, 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 in the guidance)*
- 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.
- Where loans are made to other bodies for their capital expenditure, MRP will be charged or reduce the outstanding debt in line with the principal repayment profile in the 3rd party agreement .
- No MRP will be charged in respect of assets held within the Housing Revenue Account.
- Voluntary MRP may be made at the discretion of the Director of Finance.
- Capital receipts maybe voluntarily set-aside to clear debt and replace with future prudential borrowing to temporarily reduce the MRP charge. This use of capital receipts will be at the discretion of the Director of Finance.

Capital expenditure incurred during 2017/18 will not be subject to a MRP charge until 2018/19.

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

Existing Investment & Debt Portfolio Position

	At 31 December 2016 **Actual Portfolio £m**	**Average Rate %**
External Borrowing:		
PWLB – Fixed Rate	570.576	4.16
PWLB – Variable Rate	54.295	0.65
Local Authorities	70.000	0.27
Market Loans inc LOBO's	49.000	4.35
Bonds/Stock	0.619	3.00
Other	0.895	0.25
Total External Borrowing	**745.385**	**3.55**
Other Long Term Liabilities: PFI & Finance Leases	225.700	
Total Gross External Debt	**971.085**	
Investments:		
Short-term investments		
- Banks	10.000	0.58
- Other LA's	10.000	1.40
Long-term investments	0.00	
Money Market/Pooled Funds	41.600	0.26
Total Investments	**61.600**	**0.50**
Net Debt	**827.428**	

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
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
Increased proportion of borrowing using 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
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
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

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 or Pooled Funds - 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.

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: January 2017	Next Review: April 2017
Prevailing Summary risk Threat Level (LxI)	5.04 (average) (1.86 x 2.71)	Target summary Risk Threat Level	3.47 (average) (1.43 x 2.43)
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 strategy (TMP 1.1, 1.2, 1.3, 1.8, 3, 4 & 11)	1 x 3 = 3	1 x 3 = 3
2	Inappropriate borrowing strategy (TMP 1.2, 1.3, 1.5 & 1.8)	3 x 3 = 9	3 x 1 = 3
3	Revenue implications of capital program not accurately reflected in the MTFP (TMP 7)	3 x 3 = 9	1 x 3 = 3
4	MRP Policy is Inappropriate (TMP 7)	1 x 3 = 3	1 x 3 = 3
5	Poor cash management (TMP 1.2, 1. 8)	1 x 3 = 3	1 x 3 = 3
6	Colleague fraud (TMP 1.7 & 5)	2 x 2 = 4	1 x 2 = 2
7	Failure to comply with CIPFA Code of Practice and/or respond to changes in relevant legislation (TMP 1.6)	2 x 2 = 4	2 x 2 = 4

Impact of UK referendum (Brexit) on the Treasury Management Risk Register	No change to risk ratings, but will review as situation developments

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 – Tender exercise in progress with contract to be awarded to commence from April '17 to March '21 • 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	EFFECTIVE	• Maintain equivalent arrangements • Internal audit plan includes 16 scheduled audit days per annum.	GO	GW	• Monthly check by S151 officer of current investments. • Latest Internal Audit report findings give "High assurance on controls" (May 16) • Weekly meetings with portfolio holder • TM Panel meets regularly to review the overall position. • Implementation of amendments to the	Ongoing Ongoing Ongoing Ongoing Ongoing	Ongoing As received Weekly Quarterly As required

	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. • Regular reviews of interest rate forecasts • Up to date knowledge of existing and developing investment products through regular attendance at seminars and workshops • CFO action under delegation (and in consultation with portfolio holder) to respond quickly to emerging issues.					investment strategy when appropriate • TM colleagues work with advisors and colleagues to keep abreast of wider economic conditions and respond accordingly.	Ongoing	Quarterly
2	• Identification and monitoring of annual borrowing requirement • Monitoring of PWLB	EFFECTIVE	• Capital programme review completed	GO	GW TC	• Sufficient resources identified to cover capital expenditure and	Ongoing	Quarterly

	borrowing rates • Monitor exposure to changes in long term interest rates • Use of alternative loan products as appropriate • Regular review of arrangements and possibilities • Review of capital programme, informing new capital strategy. • Retention of strong external advisors • Optimise debt levels by maintaining a CIPFA Liability Benchmark, to monitor Minimum Revenue Provision against debt and Capital Financing Requirement • Opportunities for rescheduling identified and implemented		• Maintain existing arrangements • Continued strong performance of external advisors			cash flows • Continued regular review by TM Panel.	Ongoing	Quarterly
3	• Treasury Costs in MTFP based on latest capital program and balance sheet forecasts • Regular review of capital program	ONGOING	• Continued support from external advisors • Continue to improve links between Capital and	GO	GW	• Continued regular review by TM Panel	At TM Panel meetings	Quarterly

	• Monitor Interest rate forecasts • Retention of strong external advisors • Support Corporate Finance Team to identify and monitor revenue impact of capital program		Treasury					
4	• Benchmark other Local Authorities MRP policies • Attendance of Treasury/Finance workshops on MRP policy reviews • Following full review in 15/16, annually review of MRP in the light of prevailing and forecast circumstances • Incorporate new changes to policy and financial implications into MTFP	ONGOING	• Compare policy plans at 6 monthly Core Cities meetings	GO GO	GW GW	• Continued regular review by TM Panel. • Changes to policy included in TM Strategy Report	At TM Panel meetings Annual TM strategy	At least Quarterly Annual

5	• Use of cash forecasting models, with regular monitoring and updates undertaken • Track record is sound • Continuous adaptation of model in the light of prevailing and forecast circumstances • Monitor availability new short term loans from other local authorities • Require to incorporate the cash implications of capital program	ONGOING	• Maintain existing arrangements	GO	GW	• Continued regular review by TM Panel	TM Panel meetings	Quarterly
6	• 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 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 s151 officer and system tests. • TM Panel review is robust	Internal audit reports Ongoing TM Panel meetings TM Panel meetings	Quarterly Ongoing Ongoing

7	• 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 • Provide councillor training to ensure adequate scrutiny of Treasury activities	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 Annual At least quarterly

AUDIT COMMITTEE - 24 February 2017

Title of paper:	**Changes to Arrangements for the Appointment of External Auditors**	
Director(s)/ Corporate Director(s):	Geoff Walker Director of Strategic Finance	**Wards affected:** All
Report author(s) and contact details:	Susan Risdall, Team Leader – Technical Accounting susan.risdall@nottinghamcity.gov.uk 0115 8763653	
Other colleagues who have provided input:		
Recommendation(s):		
1	To consider the options available for appointing external auditors following the conclusion of the 2017/18 audit as set out in the report and provide a recommendation to Council.	

1 REASONS FOR RECOMMENDATIONS

1.1 To summarise the changes to the arrangements for appointing external auditors following the closure of the Audit Commission and the end of transitional arrangements at the conclusion of the 2017/18 audit.

1.2 To update Audit Committee on the options available for appointing external auditors and the national arrangements being developed by Public Sector Audit Appointments Limited.

2 BACKGROUND

2.1 The Local Audit and Accountability Act 2014 abolished the Audit Commission and set up transitional arrangements for the appointment of auditors and setting of audit fees to cover the period up until the conclusion of the 2017/18 audit.

2.2 The Council’s current external auditor is KPMG under a contract managed by Public Sector Audit Appointments Ltd (PSAA Ltd). This was a transitional not for profit body set up by the Local Government Authority (LGA) with delegated authority from the Secretary of State at CLG.

2.3 When the current transitional arrangements come to an end on 31 March 2018 the Council will have a number of options available for the future appointment of external auditors. A report was brought to Audit Committee on 10 September 2014 to update them on this matter. The Local Audit (Appointing Person) Regulations 2015 require that if a decision is made to opt in to the appointing person arrangement (Option 3 of this report) then this decision must be made by full Council and formally notified to the PSAA by 9 March 2017.

3 SUMMARY OF OPTIONS

3.1 The scope of external audits will still be set by the National Audit Office who produces the Code of Audit Practice. To be eligible to compete for the audit work, accounting firms will need to demonstrate that they have the required skills and experience and be suitably registered with a body approved by the Financial Reporting Council.

3.2 There are three main options available for the future appointment of external auditors which summarised are:

Option 1 – the Council sets up its own separate and individual Auditor Panel to appoint an auditor. The Local Audit and Accountability Act 2014 stipulate that the panel must contain a majority of independent members and have an independent chair. Members and Officers of an Authority within the past five years are not deemed to be independent for this purpose. The LGA estimate the cost of recruiting and servicing the Auditor Panel, running the bidding exercise and negotiating the contract to be approximately £15,000 plus on going expenses and allowances.

Option 2 – Set up an Auditor Panel jointly with another authority/ have joint procurement arrangements. This involves setting up a joint Auditor panel which will also need to be made up of wholly or a majority of independent appointees. It will have the advantage of shared costs and possible economies of scale but the Panel will be further removed from the Council with potentially no input from elected members.

Option 3 – Opt in to the national scheme for Auditor appointments led by PSAA Ltd. The advantages of this option are that the Council would not have to set up an Auditor Panel, the administration and procurement exercise would be carried out by PSAA Ltd who are experienced in appointing auditors, managing audit contracts and setting audit fees. PSAA are advising that as at January 2017, approx. 250 authorities have or are intending to opt in to the scheme. This should result in economies of scale and should attract the best suppliers. The LGA support this approach as it believes that it offers the best value to Councils by reducing costs and having the ability to negotiate the lowest fees.

4 FINANCIAL IMPLICATIONS

4.1 Audit fees have reduced significantly over recent years; the cost for 2015/16 was £172,118. It is not yet known what the audit fees will be under the new contract but the PSAA scheme is likely to be able to secure a more competitive price than could be achieved by Nottingham City Council alone.

4.2 The PSAA has committed to minimising its own costs and audit fees, setting a fair scale of charges across the participating bodies and returning any surplus funds.

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

5.1 None

6 PUBLISHED DOCUMENTS REFERRED TO IN COMPILING THIS REPORT

6.1 Annual Accounts 2015/16
Local Audit and Accountability Act 2014
CIPFA’s Auditor Panels

KPMG

Audit Committee Progress Report

External Audit

Nottingham City Council

February 2017

Contents

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This report provides the audit committee with an overview on progress in delivering our responsibilities as your external auditors.

The report also highlights the main technical issues which are currently having an impact in local government.

If you require any additional information regarding the issues included within this report, please contact a member of the audit team.

We have flagged the articles that we believe will have an impact at the Authority and given our perspective on the issue:

High impact Medium impact Low impact For information

External audit progress report

This document provides the audit committee with a high level overview on progress in delivering our responsibilities as your external auditors.

At the end of each stage of the audit we issue certain deliverables, including reports and opinions. A summary of progress against these deliverable is provided in Appendix 1 of this report.

Area of responsibility	Commentary
Financial statements and Value for Money	Since the last Audit Committee in November we have; — undertaken our external audit risk assessment and wider planning, amongst other activities this has included planning meetings with the teams responsible for producing the financial statements, and overseeing the Authority's capital programme. We have also met with internal audit to discuss key risks facing the Authority . These meetings have helped inform our external audit plan; — finalised our 2016/17 External Audit Plan. The Plan is included as a separate document for discussion on the agenda for this meeting; — set-up our IT General Controls testing which is due to commence w/c 27 February. In line with last year, we will utilise our IT Specialist to review and test the design and operation of key controls underpinning the Authority's general ledger system (Oracle). For 2016/17 we have also brought the Northgate system into scope which will provide efficiencies at year-end, allowing us to rely on system generated reports underpinning key balances related to council tax and NNDR income; and — shared with the Authority our working paper requirement (PBC) for our interim audit visit which is due to commence w/c 27 February.
Certification of claims and returns	We have;. — finalised our Annual Report on grants and returns 2015/16. This is included as a separate document for discussion on the agenda for this meeting. — certified the Authority's DfT Local Transport Plan Major Projects S31 AUD return for the year-ending March 2016. We issued an unqualified report, with a minor reclassification of expenditure required for the final claim. — certified the Authority's Teachers' Pensions End of Year Certificate (EOYC) return for the year ending 31 March 2016. We issued an unqualified report, with minor amendments required to the EOYC.

Inspiring innovative government

@gov is a government-focused digital magazine hosted on kpmg.com. Fresh content is added to *@gov* on a monthly basis and printable digest versions are produced twice annually. Each edition examines a new theme, the first of which is *Transforming government in the age of technology*.

This first edition contains a range of articles, which include articles on:

- establishing digital identities for citizens;
- government data sharing;
- the public policy imperatives of autonomous vehicles; and
- innovations in human service delivery.

The magazine can be downloaded as a PDF from kpmg.com/atgov

Publication 'Value of Audit - Perspectives for Government'

What does this report address?

This report builds on the Global Audit campaign – *Value of Audit: Shaping the future of Corporate Reporting* – to look more closely at the issue of public trust in national governments and how the audit profession needs to adapt to rebuild this trust. Our objective is to articulate a clear opinion on the challenges and concepts critical to the value of audit in government today and in the future and how governments must respond in order to succeed.

Through interviews with KPMG partners from nine countries (Australia, Canada, France, Germany, Japan, the Netherlands, South Africa, the UK and the US) as well as some of our senior government audit clients from Canada, the Netherlands and the US, we have identified a number of challenges and concepts that are critical to the value of audit in government today and in the future.

What are the key issues?

— The lack of consistent accounting standards around the world and the impacts on the usefulness of government financial statements.

— The importance of trust and independence of government across different markets.

— How government audits can provide accountability thereby enhancing the government's controls and instigating decision-making.

— The importance of technology integration and the issues that need to be addressed for successful implementation

— The degree of reliance on government financial reports as a result of differing approaches to conducting government audits

The *Value of Audit: Perspectives for Government* report can be found on the KPMG website at https://home.kpmg.com/xx/en/home/insights.html

The *Value of Audit: Shaping the Future of Corporate Reporting* can be found on the KPMG website at www.kpmg.com/sg/en/topics/value-of-audit/Pages/default.aspx

Publication 'Reimagine - Local Government'

KPMG have published a number of reports under the headline of *Reimagine – Local Government*. These are summarised below:

Council cash crunch: New approach needed to find fresh income
— By 2020, councils must generate all revenue locally.
— More and more are looking towards diversifying income streams as an integral part of this.
— Councils have significant advantages in becoming a trusted, independent supplier.
— To succeed, they must invest in developing commercial capability and capacity.

Councils can save more than cash by sharing data
— Better data sharing in the public sector can save lives and money.
— The duty to share information can be as important as the duty to protect it.
— Local authorities are yet to realise the full value of their data and are wary of sharing information.
— Cross-sector structures and the right leadership is the first step to combating the problem.

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English devolution: Chancellor aims for faster and more radical change
— Experience of Greater Manchester has shown importance of strong leadership.
— Devolution in areas like criminal justice will help address complex social problems.
— Making councils responsible for raising budgets locally shows the radical nature of these changes.
— Cuts to business rates will stiffen the funding challenge, even for the most dynamic councils.

Senior public sector pensions
— Recent changes to pensions taxation have particularly affected the public sector, with fears senior staff may quit as pension allowances bite.
— 'Analyse, control, engage' is the bedrock of an effective strategy.

Time for the *Care Act* to deliver
— Momentum behind last year's *Care Act* risks stalling.
— Councils are struggling to create an accessible care market with well-informed consumers.
— Local authorities must improve digital presence and engage providers.
— Austerity need not be an impediment to progress. It could be an enabler.

The publications can be found on the KPMG website https://home.kpmg.com/uk/en/home/insights/2016/04/reimagine-local-government.html

Publication 'The future of cities'

We are delighted to share *The future of cities*, a report that helps local government leaders build and evaluate sustainable cities for their current and future generations.

What is *The future of cities*?

The future of cities is a global report that follows from the UK firm's thought leadership partnership with the City of Bristol and the work surrounding its European Green Capital 2015 designation. The report is broken into two modules that draw on the expertise of KPMG practitioners around the world and includes a range of case studies to ensure you find approaches relevant to your context.

The first module, *The future of cities: creating a vision*, explains the central role of vision in the success of second cities, identifying seven guiding principles to make cities more attractive. Examples are provided of various cities around the globe that are putting some of these principles into action.

The second, *The future of cities: measuring sustainability*, discusses some of the ways in which cities are being measured and how these metrics could evolve. More important, it provides practical examples of what leading cities are doing, the lessons to be learned and how these can be applied to other cities.

This content is now featured on kpmg.com/futurecities where readers can access a broader collection of reports and shorter opinion pieces from KPMG's leading thinkers on different aspects on how to create better, more sustainable places to live and work.

Disruptive trends: Technology

Disruption on multiple fronts is putting audit committees on high alert

Audit Committee Institute

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Technological disruption continues to appear on the audit committee agenda. With many audit committees looking to ensure risk management and internal control systems are addressing the full range of existing and emerging risks, ensuring that the technological expertise on the committee is appropriate is an increasing challenge.

With cyberattacks on corporate networks and systems becoming more advanced, cyber security remains a major oversight concern for audit committees (and boards). Years ago, retail and financial services organisations were most at risk due to the processing of credit card data. Today, personal information is frequently targeted over credit card data, placing a much broader range of organisations at risk. The cyber security challenge can be broken into five more granular topics:

1.Data protection Data protection, while clearly connected to cyber security, actually falls into a larger business security category, as data loss can occur in many ways. When considering data protection, audit committees often receive from management a list of security programs that are currently in place; however, the first step should really be making sure the right information has been identified and data sets clearly defined. This can be a challenge as what is considered relevant continues to change. Today, things like user names, passwords, awards program profiles and social media accounts are being targeted. Given that this list will continually evolve, audit committees should regularly confirm that the definition and protection of alternative data sets - beyond standard credit card information - is being carried out. To augment the information they have at hand, audit committees can also request relevant data directly from IT, for example, testing results, reviews of key data and hacking reports.

2.Social engineering Social engineering is a broad term for any kind of psychological deception or exploitation of the "human factor" to gain access to information. Email phishing is one form, but attacks can be much more complex, employing phone calls, physical impersonation or any scenario that plays on the target's sympathy, fear, greed, etc. Proper oversight should involve social media acceptable use policies and organisational workflows detailing proper account usage.

Disruptive trends: Technology (Cont.)

3. Auditing of third-parties Many organisations are relying more and more on third parties as part of their business model. The audit committee should ensure that management has considered and evaluated whether appropriate controls are in place to prevent misuse of any confidential customer information aggregated by third-party vendors. To be more certain that the organisation is not creating additional liabilities, third-party audits are becoming more common.

4. Cyber insurance Cyber insurance addresses an organisation's liability when faced with cyber-based risks, such as a data breach or data destruction resulting in the loss of sensitive information. Organisations are beginning to purchase these types of policies, but there remains some confusion over exactly what is and isn't covered. The audit committee should have oversight over whether such policies appropriately address the organisation's significant financial exposures.

5. Remediation procedures Too often, audit committees look at a cyber breach, ensure an established process is being followed, then move on. More and more, however, we see audit committees getting involved in post-mortem follow-up reviews, sometimes even going beyond the standard oversight role in order to understand what went wrong, ensure remediation compliance and probe for other areas of vulnerability to help combat future attacks.

Business model risk

When an organisation effectively implements an industry changing technological innovation, one major effect is that their competitors' business models - and possibly a business model that has been an industry standard - can be disrupted. Consider the effect ride sharing has had on the way the taxi industry has been operating for decades or how internet-based streaming services have changed the way television is purchased and consumed. Going forward, audit committees will need to pay greater attention to how, and which, disruptive technologies could potentially put the organisation's business model at risk

Technology project risk

Despite the impact of the current economy on some sectors, organisations continue to undertake IT and strategic transformation projects. This can be a concern if organisations lack proper IT experience on the board. Is significant expenditure being incurred on big transformation projects without the proper governance to protect or maximize the investment? At the same time, regulators are raising the bar in the area of IT risks and controls, signalling the fact that it's time for boards, and potentially audit committees, to address this as part of their risk portfolio.

Data & Analytics privacy risk

D&A is changing business significantly and the organisations that are best leveraging it are seeing dramatic results. However, like all disruptive technologies there are corresponding risks, including increased privacy risk.

Customers and other stakeholders entrust information to organisations for specific purposes, but those organisations may exploit that information in other ways using D&A. This creates significant privacy oversight challenges that boards and audit committees need to be aware of and address.

Disruptive trends: Technology (Cont.)

Putting the audit committee on high alert

Virtually no strategic conversation proceeds without someone citing the need to either be disruptive or to respond quickly to disruptive market and industry trends - trends that have typically been connected to technology in one way or another. We don't, however, generally think about the concept of disruption when talking about the audit committee, even when we're discussing its changing role and responsibilities.

However, the concept of disruption is broadening its meaning beyond its current association with the interaction between technology, business and market forces. It is being applied in other areas and to other, broader trends. One might talk, for example, about the disruptive impact of demographic or regulatory trends, rather than just technological ones. To that end, a high-level concept of disruption provides a valuable framework for discussing many of the changes and challenges currently facing the audit committee. And there are, without question, a range of audit trends (auditor rotation, reporting, D&A, etc.), that can only be seen as disruptive, given the kind of substantive change they are driving and their potential to transform the way audit committees do what they do - and what they are increasingly being asked to do.

Disruption can affect audit committees in different ways. In some cases - for example, cyber security - audit committees might need to become more knowledgeable and more vigilant in their oversight due to the rapid, ongoing evolution of the field. In other areas, such as oversight of reporting and compliance, it is their own approaches and processes that are changing, as complex standards up the regulatory ante.

Going forward, managing inevitable change will be both an audit committee priority and a challenge and one that all audit stakeholders - directors, management, auditors, regulators, shareholders and even the public - have an interest in facilitating.

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Technical developments

PSAA's Value For Money Tool

Level of impact: ● (Low)	KPMG perspective
The PSAA's Value for Money Profiles tool (VFM Profiles) was updated on 3 October 2016. The VFM profiles have been updated with the latest available data. The adult social care section has been re-designed based on the new adult social care financial return (ASC-FR). Data is available from 2014/15 onwards with no comparable data from earlier years. The VFM profiles have also been updated with the latest available data from the following sources: — General fund revenue account budget (RA) (2016/17) — Child and working tax credit statistics (2014/15) — Children in low-income families local measure (2015) — Chlamydia testing activity dataset (CTAD) (2015) — Climate change statistics: CO2 emissions (2014) — Collection rates for council tax and non-domestic rates in England (2015/ 16) — Council tax demands and precepts statistics (2016/17) — Fuel poverty sub-regional statistics (2014) — Homelessness statistical release (P1E) (2015/16) — Housing benefit speed of processing (2015/16) — Mid-year population estimates (2015) — NHS health check data (2015/16) — Planning applications (2015/16) — Schools, pupils and their characteristics (2015/16) — Young people from low income backgrounds progressing to higher education (2013/14) The Value For Money Profiles can be accessed via the PSAA website at http://vfm.psaa.co.uk/nativeviewer.aspx?Report=/profiles/VFM_Landing	*The Committee may wish to seek further understanding for areas where their Authority appears to be an outlier.*

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NAO report: Children in need of help or protection

Level of impact: ● (For Information)

The NAO has published a report entitled *Children in need of help or protection*.

The report finds that the actions taken by the Department for Education since 2010 to improve the quality of help and protection services delivered by local authorities for children have not yet resulted in services being of good enough quality. NAO analysis found that spending on children's social work, including on child protection, varies widely across England and is not related to quality.

Neither the Department for Education nor authorities understand why spending varies.

The report finds that nationally the quality of help and protection for children is unsatisfactory and inconsistent, suggesting systemic rather than just local failure. Ofsted has found that almost 80% of authorities it has inspected since 2013 are not yet providing services rated as Good to help or protect children. Good performance is not related to levels of deprivation, region, numbers of children or the amount spent on children in need. Ofsted will not complete the current inspection cycle until the end of 2017, a year later than originally planned. The Department does not therefore have up-to-date assurance on the quality of services for 32% of local authorities.

The report also notes that children in different parts of the country do not get the same access to help or protection, finding that thresholds for accessing services were not always well understood or applied by local partners such as the police and health services. In Ofsted's view some local thresholds were set too high or low, leading to inappropriate referrals or children left at risk. In the year ending 31 March 2015 there were very wide variations between local authorities in the rates of referrals accepted, re-referrals, children in need and repeat child protection plans.

The report is available from the NAO website at www.nao.org.uk/report/children-in-need-of-help-or-protection

Consultation on 2017/18 work programme and scales of fees

Level of impact: (For Information)

Public Sector Audit Appointments Ltd (PSAA) has published its consultation on the 2017/18 work programme and scales of fees.

The consultation sets out the work that auditors will undertake at principal local government and police bodies for 2017/18, with the associated scales of fees. The consultation document, and the lists of individual scale fees, are available on the 2017/18 work programme and scales of fees consultation page of the PSAA website: www.psaa.co.uk/audit-and-certification-fees/201718-work-programme-and-scales-of-fees

There are no planned changes to the overall work programme for 2017/18. It is therefore proposed that scale fees are set at the same level as the scale fees applicable for 2016/17.

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The work that auditors will carry out on the 2017/18 accounts will be completed based on the requirements set out in the *Local Audit and Accountability Act 2014* and under the *Code of Audit Practice*.

The consultation closed on Thursday 12 January 2017. PSAA will publish the final work programme and scales of fees for 2017/18 in March 2017.

This is the final year for which PSAA will set fees under the current transitional arrangements. The Secretary of State for Communities and Local Government has specified PSAA as an appointing person for principal local government and police bodies, under the provisions of the *Local Audit and Accountability Act 2014* and the requirements of the *Local Audit (Appointing Person) Regulations 2015*.

This means that PSAA will make auditor appointments under new audit contracts to bodies that choose to opt into the national scheme the company is developing, for audits of the accounts from 2018/19.

Further information is available on the appointing person page of the PSAA website: www.psaa.co.uk/supporting-the-transition/appointing-person

Overview of Local Government

Level of impact: ● (For Information)
The NAO has recently published an Overview of Local Government The overview looks at the local government landscape and summarises both matters of likely interest to Parliament and the National Audit Office's (NAO's) work with local authorities. These include Local Government Responsibilities, Funding and Service Spending and the findings from the NAOs work on Local Government. The overview is available from the NAO website at www.nao.org.uk/report/overview-local-government

Local government licensing fees

Level of impact: (Low)	KPMG perspective
Following referral from the Supreme Court of the United Kingdom, Advocate General Wathelet has given his opinion on the lawfulness of licence fees in a case involving Westminster City Council. The fee, which was for the grant or renewal of a 'sex establishment' licence in the City of Westminster, was made up of two parts: — Part A related to the administration of the application (which is nonreturnable if the application is refused); and — Part B (much higher) related to the management and enforcement of the licensing regime, which is refundable if the application is refused. The Supreme Court had asked the Court of Justice of the European Union (CJEU) whether Part B constituted a "charge", which was therefore prohibited by Directive 2006/123/EC of the European Parliament and of the Council of 12 December 2006 on services in the internal market ("the Services Directive"). Advocate General Wathelet recommended a finding to the CJEU that the Services Directive must be interpreted as precluding Westminster from taking into account, when calculating the fee due for the grant or renewal of an authorisation, the cost of managing and enforcing the authorisation scheme (part B), even if the part corresponding to that cost is refundable where the application for the grant or renewal of the authorisation in question is refused.	The Committee may wish to seek assurance that the Authority has considered this judgement and has taken action to ensure that its licencing fees are calculated in an appropriate manner.

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CIPFA publication on understanding the financial statements

Level of impact: 🟢 (Low)	KPMG perspective
CIPFA has published a new report titled *Understanding Local Authority Financial Statements*. This is an update of its previous publication *How to Tell the Story*. The report can be found on the CIPFA/LASAAC pages of the CIPFA website at www.cipfa.org/policy-and-guidance/technical-panels-and-boards/cipfa-lasaac-local-authority-code-board/simplification-and-streamlining-the-presentation-of-local-authority-financial-statements Further to this report, CIPFA/LASAAC undertook a consultation on proposals for the 2017/18 Code of Practice on Local Authority Accounting in the United Kingdom. The headline changes were: — a new principles-based approach to narrative reporting. — a review of the Code's provisions on going concern reporting. — a review of accounting policies provisions in the Code. — new disclosure on transaction costs for pension fund investments. — narrow scope amendments to International Financial Reporting Standards. — legislative changes. — a new appendix including the provisions for the Code’s adoption of IFRS 9 Financial Instruments (note this new appendix will apply to the 2018/19 financial statements). — a new appendix including provisions for the Code’s adoption of IFRS 15 Revenue from Contracts with Customers (note this new appendix will apply to the 2018/19 financial statements). The details of the consultation can be found at www.cipfa.org/policy-and-guidance/consultations-archive/201718-code-of-practice-on-local-authority-accounting-in-the-united-kingdom-invitation-to-comment	*The Committee may ask whether their Authority have provided their views in the consultation.*

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Appendix

Appendix 1

2016/17 audit deliverables

Deliverable	Purpose	Timing	Status
Planning			
Fee letter	Communicate indicative fee for the audit year	April 2016	Complete
External audit plan	Outline our audit strategy and planned approach Identify areas of audit focus and planned procedures	February 2017	Complete
Interim			
Interim report	Details and resolution of control and process issues. Identify improvements required prior to the issue of the draft financial statements and the year-end audit. Initial VFM assessment on the Council's arrangements for securing value for money in the use of its resources.	April 2017	In progress
Substantive procedures			
Report to those charged with governance (ISA 260 report)	Details the resolution of key audit issues. Communication of adjusted and unadjusted audit differences. Performance improvement recommendations identified during our audit. Commentary on the Council’s value for money arrangements.	September 2017	TBC

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Appendix 1

2016/17 audit deliverables (cont.)

Deliverable	Purpose	Timing	Status
Completion			
Auditor's report	Providing an opinion on your accounts (including the Annual Governance Statement). Concluding on the arrangements in place for securing economy, efficiency and effectiveness in your use of resources (the VFM conclusion).	September 2017	TBC
WGA	Concluding on the Whole of Government Accounts consolidation pack in accordance with guidance issued by the National Audit Office.	September 2017	TBC
Annual audit letter	Summarise the outcomes and the key issues arising from our audit work for the year.	November 2017	TBC
Certification of claims and returns			
Certification of claims and returns report	Summarise the outcomes of certification work on your claims and returns for Government departments.	December 2017	TBC

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KPMG

Annual Report on grants and returns 2015/16

Nottingham City Council

—

February 2017

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. Public Sector Audit Appointments issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies summarising where the responsibilities of auditors begin and end and what is expected from audited bodies. We draw your attention to this document which is available on Public Sector Audit Appointment's website (www.psaa.co.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.

We are committed to providing you with a high quality service. If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Tony Crawley, the engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact the national lead partner for all of KPMG's work under our contract with Public Sector Audit Appointments Limited, Andrew Sayers (andrew.sayers@kpmg.co.uk). After this, in relation to the certification of the Housing Benefit Subsidy grant claim, if you are still dissatisfied with how your complaint has been handled you can access PSAA's complaints procedure by emailing generalenquiries@psaa.co.uk, by telephoning 020 7072 7445 or by writing to Public Sector Audit Appointments Limited, 3rd Floor, Local Government House, Smith Square, London, SW1P 3HZ.

Headlines

Introduction and background

This report summarises the results of work we have carried out on the Authority's 2015/16 grant claims and returns.

This includes the work we have completed under the Public Sector Audit Appointment (PSAA) certification arrangements, as well as the work we have completed on other grants/returns under separate engagement terms. The PSAA work completed in 2015/16 relates solely to the Authority's 2015/16 Housing Benefit Subsidy claim which had a value of £148.236 million.

Under separate assurance engagements we have also certified four claims/returns as listed below.

- DCLG Pooling of Housing Capital Receipts return – y/e 31 March 2016 – claim value of £13.757 million
- DfT Local Transport Plan Major Projects S31 AUD return – y/e 31 March 2016 – claim value of £3.141 million
- Teachers' Pensions End of Year Certificate (EOYC) return – y/e 31 March 2016 – claim value of £33.497 million
- SFA Sub-contracting return – period ending 31 July 2016

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Certification and assurance results (Pages 5-6)

Our certification work on Housing Subsidy Benefit claim included:

- agreeing standard rates, such as for allowances and benefit incomes, to the DWP Circular communicating the value of each rate for the year;
- sample testing of benefit claims to confirm that the entitlement had been correctly calculated and was supported by appropriate evidence;
- undertaking an analytical review of the claim form considering year-on-year variances and key ratios;
- confirming that the subsidy claim had been prepared using the correct benefits system version; and
- completing testing in relation to modified schemes payments, uncashed cheques and verifying the accurate completion of the claim form.

Following the completion of our work, a qualification letter was required, due to a number of recurring errors, mainly the inclusion of incorrect earnings and tax credits in benefit entitlement calculations. We noted that for four of the 13 prior year errors followed up as part of this year's work, the error rate was over 30%, an increase from the previous year. Overall 606 cases were tested, of which 116 contained errors. We have subsequently raised a recommendation within this report to support the Authority in reducing this going forward.

Our work on the other grant assurance engagements resulted in issuing a Reporting Accountant's independent reasonable assurance report in connection with the below returns for the year ended 31 March 2016:

- DCLG Pooling of Housing Capital Receipts return;
- Local Transport Plan Major Projects S31 AUD return; and
- Teachers' Pensions EOYCa return.

We also issued a report in regards to the arrangements the Authority has in place to manage and control its subcontractors as described within the SFA guidance.

Adjustments were necessary to three of the Authority's grants and returns as a result of our certification work this year.

- Housing Benefit Subsidy claim – minor amendment of £832;
- Teachers' Pension EOYC – minor amendments were made to the EOYC presented for certification (see page 6); and
- Local Transport Return – inter project reclassification of c£243k expenditure was required, however this did not impact on the amount of grant that the Authority claimed.

Recommendations (Pages 8)

We have made one recommendations to the Authority from our work this year and agreed an action plan with officers.

Fees (Page 7)

Our proposed fee for certifying the Authority's 2015/16 Housing Benefit Subsidy grant is £18,458 which is still subject to determination by PSAA. This is more than the indicative fee set by PSAA and reflects the additional work we have undertaken in year. Our fees for the other 'assurance' engagements were subject to agreement directly with the Authority and are set out on page 7.

Summary of reporting outcomes

Overall, we carried out work on 5 grants and returns:

- **2 were unqualified with no amendment;**
- **2 were unqualified but required some amendment to the final figures; and**
- **1 required a qualification to our audit certificate and a minor adjustment.**

Detailed comments are provided overleaf.

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Detailed below is a summary of the reporting outcomes from our work on the Authority's 2015/16 grants and returns, showing where either audit amendments were made as a result of our work or where we had to qualify our audit certificate or assurance report.

A qualification means that issues were identified concerning the Council's compliance with a scheme's requirements that could not be resolved through adjustment. In these circumstances, it is likely that the relevant grant paying body will require further information from the Authority to satisfy itself that the full amounts of grant claimed are appropriate.

	Comments overleaf	Qualified	Significant adjustment	Minor adjustment	Unqualified
Public Sector Audit Appointments regime					
— Housing Benefit Subsidy	1	●		●	
Other assurance engagements					
— Pooling of capital receipts	2				●
— Transport Grant	3			●	●
— Teachers Pension	4			●	●
— SFA Sub-contracting	5				●
		1	**-**	**3**	**4**

Summary of certification work outcomes

This table summarises the key issues behind each of the adjustments or qualifications that were identified on the previous page.

Ref	Summary observations	Amendment
1	**Housing Benefits** We issued a qualification letter and agreed one minor amendment to the claim of £832. The Housing Benefits audit approach is mandated by the Department for Work and Pensions. Testing involves a 'discovery sample' of 20 cases for each benefit type (total 40 cases), with further testing of 40 cases required for each type of error found, either in the current year's discovery testing or errors identified from the previous year. For our 2015/16 audit, there were 13 types of errors from the previous year, each required further testing of 40 cases. The testing undertaken did not identify any further errors for two the 13 error types. However, further errors were identified for the remaining 11, and for four of them the error rate was over 30%. These four error types related to inaccuracies within benefit calculations for earned income, tax credits, child care costs, and statutory maternity pay. While individual errors were typically minor, some as low as £1 (resulting in underpayments and overpayments), the frequency of errors found has increased from the previous year. Our initial discovery testing also identified two new error types, which both resulted in further testing. Overall 606 cases were tested, of which 116 cases contained errors. While the error rate for the Authority is not inconsistent with other large unitary Authority's where we undertake housing benefits work, it is important that the Authority continues to take action to address the causes. This requires continuous commitment to training and quality to minimise the number of recurring errors. We acknowledge that the Quality Assurance team are proactive in correcting the errors that they discover, and that housing benefits regulations are complex by their nature, which when combined with a varied claimant mix within Nottingham, poses an inherent risk to the Authority in accurately processing housing benefit claims.	**- £832**
2	**Pooling of capital receipts** — We issued an unqualified audit report. — There were no issues or amendments arising from our review.	**£0**
3	**Local transport grant** — We issued an unqualified audit report. — As part of our review we identified the that an inter project correction had not been accurately reflected within the claim, this resulted an a reclassification of c.£243k between two components of the transport project. There was no impact on the bottom line eligible grant funding.	**£0**

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Summary of certification work outcomes (cont.)

This table summarises the key issues behind each of the adjustments or qualifications that were identified on the previous page.

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Ref	Summary observations	Amendment
4	**Teachers' pensions** — We issued an unqualified audit report. — From our initial review we identified two minor issues for which the Authority amended the End Of Year Certificate (EOYC). These included £152 of Career Average Flexibilities misclassified on the EOYC. Along with, £2,358.12 underpayment of contributions resulting from an element of a teachers salary not being accounted for. — The EOYC was returned to the Authority with minor discrepancies identified by Teachers' Pensions, we also reviewed the revised EOYC before it was re-submitted.	**+£2,510**

5	**SFA Sub-contracting**
	— In the year ending 31 July 2016, the Authority had subcontracting arrangements which were funded through an agreements with the Skills Funding Agency (the "SFA"). The terms of the funding agreement require the Authority to obtain a report on an annual basis from an independent accountant on the arrangements that the Authority has in place to manage and control its subcontractors as described in the SFA guidance.
	— The Authority is required to complete and submit a certificate to the SFA confirming that the report identified no recommendations, or that any recommendations identified have been actioned in the form of an implementation plan with dates agreed.
	— We evaluated the design and operational effectiveness of the policies and procedures in place intended to achieve compliance with the subcontracting requirements set out within the Funding Agreements and the funding rules 2015/2016.
	— Our review highlighted four recommendations all of which were agreed by the Authority and we agreed an action plan to address them. The recommendations included:
	    — the completeness of the register of training operations;
	    — having in place a contingency plan for delivery of education and training should a subcontractor fail to deliver;
	    — updating the subcontracting clauses within the model contract; and
	    — publishing supply chain fees and charges in the format required by the SFA.
		N/A

Fees

Our fees for the Housing Benefit Subsidy claim are set by Public Sector Audit Appointments.

Our fees for other assurance engagements on grants/returns are agreed directly with the Authority.

The overall fees we propose to charge for carrying out all our work on grants/returns in 2015/16 was £31,658.

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Public Sector Audit Appointments certification arrangements

Public Sector Audit Appointments set an indicative fee for our work on the Authority's Housing Benefit Subsidy claim in 2015/16 of £12,372 fee. Our proposed fee of £18,458 is still subject to determination by PSAA. This is higher than the indicative fee, and compares to the 2014/15 fee for this claim of £14,620.

The main reasons for the fee exceeding the original estimate was the work required to address the additional errors identified as part our testing.

Grants subject to other assurance engagements

The fees for our assurance work on other grants/returns are agreed directly with the Authority. Our fees for 2015/16 were broadly in line with those in 2014/15.

Breakdown of fees for grants and returns work

Breakdown of fee by grant/return		
	2015/16 (£)	**2014/15 (£)**
Housing Benefit Subsidy claim	£18,458*	£14,620
Pooling of capital receipts	£4,000	£3,000
Local transport grant	£3,000	£3,000
Teachers pension	£3,200*	£3,500
SFA subcontracting	£3,000	-
Decent Homes Backlog Funding**	-	£3,400
Total fee	**£31,658**	**£27,520**

* Fees subject to final approval

**This funding ceased in 2014/15 and so no certification was required for 2015/16.

Recommendations

We have given each recommendation a risk rating and agreed what action management will need to take.

Priority rating for recommendations		
1 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.	2 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.	3 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.

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Issue	Implication		Recommendation	Priority	Comment	Responsible officer and target date
Housing Benefits						
Housing benefits errors For our 2015/16 audit, there were 13 types of errors from the previous year, each required further testing of 40 cases. Our testing did not identify any further errors for two the 13 error types. However, further errors were identified for the remaining 11, four of which the error rate was over 30%. These four error types related to inaccuracies within benefit calculations for earned income, tax credits, child care costs, and statutory maternity pay. While individual errors were typically minor, some as low as £1, the frequency of errors found has increased from the previous year.	Claimants receive incorrect benefits Financial penalties for the Authority from the DWP as a result of the housing benefits audit.	1	It is important that the Authority takes action to address the causes of the errors found. This will require continuous commitment to training and quality to minimise the number of recurring errors.	2	**TBC**	**TBC**

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External Audit Plan 2016/2017

Nottingham City Council

February 2017

Headlines

Financial Statement Audit

There are no significant changes to the Code of Practice on Local Authority Accounting in 2016/17, which provides stability in terms of the accounting standards the Authority need to comply with.

Materiality

Materiality for planning purposes has been based on last year's expenditure and set at £13 million.

We are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance and this has been set at £0.65 million.

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Significant risks

Those risks requiring specific audit attention and procedures to address the likelihood of a material financial statement error have been identified as:

- Significant changes in the pension liability due to LGPS Triennial Valuation.

Other areas of audit focus

Those risks with less likelihood of giving rise to a material error but which are nevertheless worthy of audit understanding have been identified as:

- Disclosure associated with retrospective restatement of CIES, EFA and MiRS;
- PPE Valuation; and
- Group Accounts.

See pages 2 to 6 for more details.

Value for Money Arrangements work

The National Audit Office sets the framework for our VFM audit which is unchanged from the previous year. Our approach is underpinned by an overall criterion in which we consider whether the Authority has, all significant respects, had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

We have identified one specific area of focus;

- Financial sustainability, including medium term financial planning and the delivery of savings plans. This is relevant to the sustainable resource deployment sub-criterion of the VFM conclusion.

We will update our risk assessment throughout the year and report in our ISA 260

See pages 7 to 11 for more details.

Logistics

Our team is:

- Tony Crawley – Director
- Thomas Tandy – Manager
- Alastair Cowen – Assistant Manager

More details are on **page 14.**

Our work will be completed in four phases from December to September and our key deliverables are this Audit Plan and a Report to those charged with Governance as outlined on **page 13.**

Our fee for the audit is £172,118 (£177,118 2015/2016) see **page 12.**

Introduction

Background and Statutory responsibilities

This document supplements our Audit Fee Letter 2016/17 presented to you in April 2016, which also sets out details of our appointment by Public Sector Audit Appointments Ltd (PSAA).

Our statutory responsibilities and powers are set out in the Local Audit and Accountability Act 2014 and the National Audit Office's Code of Audit Practice.

Our audit has two key 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 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.

Approach

Our approach to the audit is based on understanding and assessing the Authority's structures and processes for decision-making, accountability, control and behaviours. In addition, we identify and assess potential weaknesses and those risks that can affect the financial statements. We then carry out audit procedures to address any identified risks and weaknesses. We assess where is the greatest risk for misstatement and how effective internal controls are at mitigating these risks.

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 is accountable to you in addressing the issues identified as part of the audit strategy.

Our key formal interactions with management and the Audit Committee are summarised in Appendix 1. Throughout the year we will communicate with you through meetings with the Finance Department, Senior Management and Audit Committee.

If any significant issues arise we will report to management and the Audit Committee at the earliest opportunity.

Financial Statements Audit

Our financial statements audit work follows a four stage audit process which is identified below. Appendix 1 provides more detail on the activities that this includes. This report concentrates on the Financial Statements Audit Planning stage of the Financial Statements Audit.

Financial Statements Audit Planning → Control Evaluation → Substantive Procedures → Completion

Value for Money Arrangements Work

Our Value for Money (VFM) Arrangements Work follows a five stage process which is identified below. Page 8 provides more detail on the activities that this includes. This report concentrates on explaining the VFM approach for the 2016/17 and the findings of our VFM risk assessment.

Risk Assessment → Identification of significant VFM risks → VFM audit work → Conclude → Reporting

Acknowledgements

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

Financial statements audit planning

Financial Statements Audit Planning

Our planning work takes place during December 2016 to February 2017. This involves the following key aspects:

— Risk assessment;

— Determining our materiality level; and

— Issuing this audit plan to communicate our audit strategy.

Risk assessment

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

The diagram opposite identifies, significant risks and other areas of audit focus, which we expand on overleaf. The diagram also identifies a range of other areas considered by our audit approach.

Keys: ● Significant risk ● Other area of audit focus ● Example other areas considered by our approach

KPMG

Financial statements audit planning (cont.)

Significant Audit Risks

Those risks requiring specific audit attention and procedures to address the likelihood of a material financial statement error.

Risk: Significant changes in the pension liability due to LGPS Triennial Valuation

During the year, the Local Government Pension Scheme for Nottinghamshire County (the Pension Fund) has undergone a triennial valuation with an effective date of 31 March 2016 in line with the Local Government Pension Scheme (Administration) Regulations 2013. The Authority's share of pensions assets and liabilities is determined in detail, and a large volume of data is provided to the actuary in order to carry out this triennial valuation.

The pension liability numbers to be included in the financial statements for 2016/17 will be based on the output of the triennial valuation rolled forward to 31 March 2017. For 2017/18 and 2018/19 the actuary will then roll forward the valuation for accounting purposes based on more limited data.

There is a risk that the data provided to the actuary for the valuation exercise is inaccurate and that these inaccuracies affect the actuarial figures in the accounts. Most of the data is provided to the actuary by Nottinghamshire County Council, who administer the Pension Fund.

Approach:

As part of our audit, we will agree any data provided by the Authority to the actuary, back to the relevant systems and reports from which it was derived, in addition to checking the accuracy of this data.

We will also liaise with the KPMG Audit Team that audits, the Pension Fund, with regard to the data provided to the Actuaries on the Authority's behalf to check the completeness and accuracy such data.

Financial statements audit planning (cont.)

Other areas of audit focus

These are those risks with less likelihood of giving rise to a material error but which are nevertheless worthy of audit understanding.

Disclosure associated with retrospective restatement of CIES, EFA and MiRS

CIPFA has been working with stakeholders to develop better accountability through the financial statements as part of its 'telling the whole story' project. The key objective of this project was to make Local Government accounts more understandable and transparent to the reader in terms of how councils are funded and how they use the funding to serve the local population. The outcome of this project has resulted in two main changes in respect of the 2016-17 Local Government Accounting Code (the Code) as follows:

— Allowing local authorities to report on the same basis as they are organised by removing the requirement for the Service Reporting Code of Practice (SeRCOP) to be applied to the Comprehensive Income and Expenditure Statement (CIES); and

— Introducing an Expenditure and Funding Analysis (EFA) which provides a direct reconciliation between the way local authorities are funded and prepare their budget and the CIES. This analysis is supported by a streamlined Movement in Reserves Statement (MIRS) and replaces the current segmental reporting note.

As a result of these changes, retrospective restatement of the CIES (cost of services), EFA and MIRS is required from 1 April 2016 in the Statement of Accounts. The new disclosure requirements and the restatement of the accounts require compliance with relevant guidance and the correct application of applicable Accounting Standards.
Though less likely to give rise to a material error in the financial statements, this is an important material disclosure change in this year's accounts that we will need to review.

Approach

We will liaise with the Authority's finance team regarding the new requirements and agree the new disclosures, including the restatement of the prior year comparators.

Other areas of audit focus

These are those risks with less likelihood of giving rise to a material error but which are nevertheless worthy of audit understanding.

Property Plant and Equipment (PPE) Valuation

The Authority is responsible for ensuring the valuation of their PPE is correct, and for conducting impairment reviews that confirm the condition of these assets. As a result of the Council's accounting policies, this is achieved by performing an annual review for impairment, and a rolling valuation programme. The asset valuation and impairment review processes are both estimates and therefore present a higher level of risk to the audit. Due to the inherent risk associated with the estimation of assets, we consider this to be an issue for review.

Approach

As part of our audit, we will review the terms of engagement with the valuer to ensure compliance with the Authority's accounting policies.

In addition, we will review the revaluation basis and consider its appropriateness with CIPFA Code of Practice and the underlying IFRS accounting standards.

We will also undertake appropriate work to understand the basis upon which any impairments have been calculated.

Group Accounts

Due to the group structure, the Authority will need to ensure its group accounts are complete and intra group transactions correctly identified and removed.

Approach

We will review proposed consolidation procedures as part of our interim work.

Financial statements audit planning (cont.)

Materiality

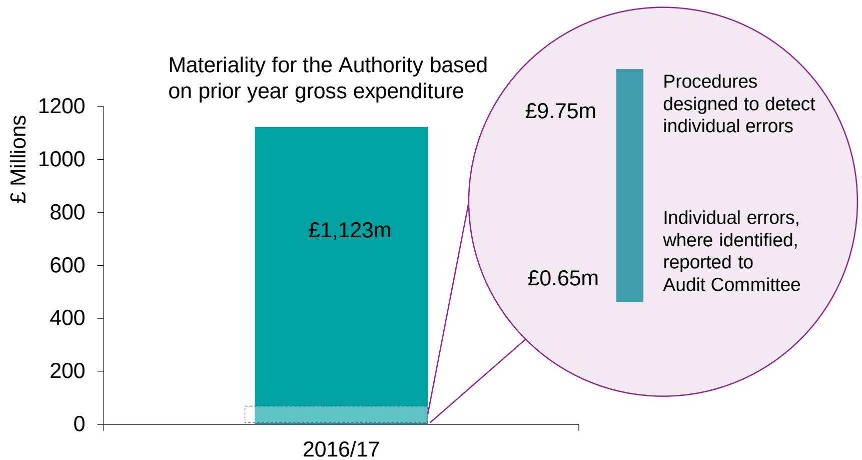
We are required to plan our audit to determine with reasonable confidence whether or not the financial statements are free from material misstatement. An omission or misstatement is regarded as material if it would reasonably influence the user of financial statements. This therefore involves an assessment of the qualitative and quantitative nature of omissions and misstatements.

Generally, we would not consider differences in opinion in respect of areas of judgement to represent 'misstatements' unless the application of that judgement results in a financial amount falling outside of a range which we consider to be acceptable.

Materiality for planning purposes has been set at £13 million (£12 million 15/16) for the Authority's standalone accounts and group accounts. This equates to 1.2% of gross expenditure. 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 unadjusted 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.

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 £0.65 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.

Group audit

The expectation is still that individually none of the subsidiaries constitute a significant component on the grounds of materiality, however as part of our audit work we will understand the consolidation process, and how the Authority correctly identifies and accounts for intra-group transactions.

Value for money arrangements work

Background to approach to VFM work

The Local Audit and Accountability Act 2014 requires auditors of local government bodies to be satisfied that the authority 'has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources'.

This is supported by the Code of Audit Practice, published by the NAO in April 2015, which requires auditors to 'take into account their knowledge of the relevant local sector as a whole, and the audited body specifically, to identify any risks that, in the auditor's judgement, have the potential to cause the auditor to reach an inappropriate conclusion on the audited body's arrangements.'

The VFM approach is fundamentally unchanged from that adopted in 2015/2016 and the process is shown in the diagram below. The diagram overleaf shows the details of the criteria for our VFM work.

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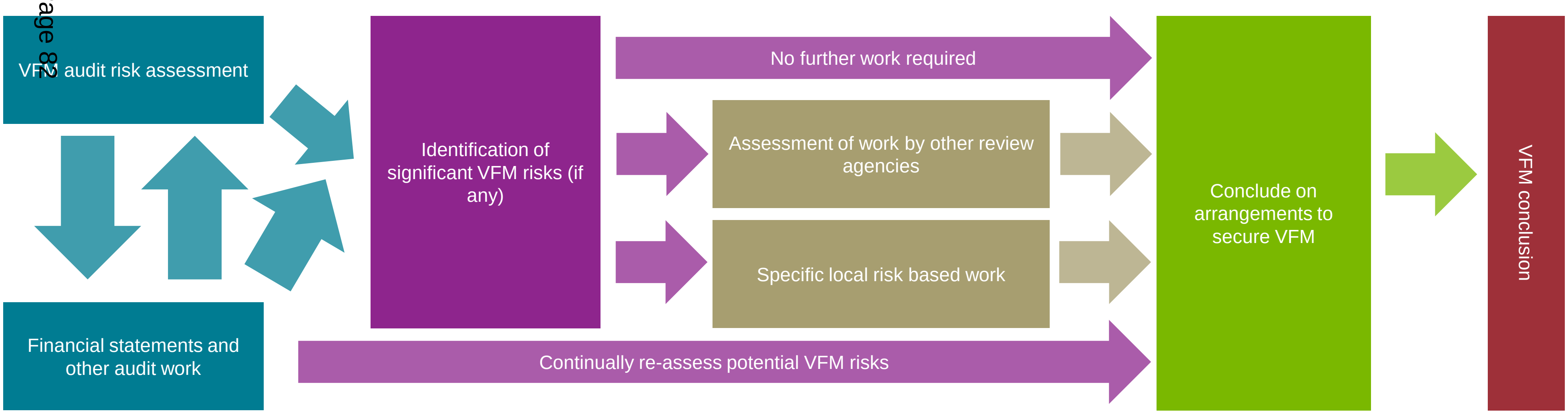

Value for money arrangements work (cont.)

Overall criterion

In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

Informed decision making

Proper arrangements:

- Acting in the public interest, through demonstrating and applying the principles and values of sound governance.
- Understanding and using appropriate and reliable financial and performance information to support informed decision making and performance management.
- Reliable and timely financial reporting that supports the delivery of strategic priorities.
- Managing risks effectively and maintaining a sound system of internal control.

Sustainable resource deployment

Proper arrangements:

- Planning finances effectively to support the sustainable delivery of strategic priorities and maintain statutory functions.
- Managing and utilising assets to support the delivery of strategic priorities.
- Planning, organising and developing the workforce effectively to deliver strategic priorities.

Working with partners and third parties

Proper arrangements:

- Working with third parties effectively to deliver strategic priorities.
- Commissioning services effectively to support the delivery of strategic priorities.
- Procuring supplies and services effectively to support the delivery of strategic priorities.

Value for money arrangements work (cont.)

VFM audit stage	Audit approach
VFM audit risk assessment	We consider the relevance and significance of the potential business risks faced by all local authorities, and other risks that apply specifically to the Authority. These are the significant operational and financial risks in achieving statutory functions and objectives, which are relevant to auditors' responsibilities under the *Code of Audit Practice.* In doing so we consider: ■ The Authority's own assessment of the risks it faces, and its arrangements to manage and address its risks; ■ Information from the Public Sector Auditor Appointments Limited VFM profile tool; ■ Evidence gained from previous audit work, including the response to that work; and ■ The work of other inspectorates and review agencies.
Linkages with financial statements and other audit work	There is a degree of overlap between the work we do as part of the VFM audit and our financial statements audit. For example, our financial statements audit includes an assessment and testing of the Authority's organisational control environment, including the Authority's financial management and governance arrangements, many aspects of which are relevant to our VFM audit responsibilities. We have always sought to avoid duplication of audit effort by integrating our financial statements and VFM work, and this will continue. We will therefore draw upon relevant aspects of our financial statements audit work to inform the VFM audit.
Identification of significant risks	The Code identifies a matter as significant *'if, in the auditor's professional view, it is reasonable to conclude that the matter would be of interest to the audited body or the wider public. Significance has both qualitative and quantitative aspects.'* If we identify significant VFM risks, then we will highlight the risk to the Authority and consider the most appropriate audit response in each case, including: ■ Considering the results of work by the Authority, inspectorates and other review agencies; and ■ Carrying out local risk-based work to form a view on the adequacy of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources.

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Value for money arrangements work (cont.)

VFM audit stage	Audit approach
Assessment of work by other review agencies and **Delivery of local risk based work**	Depending on the nature of the significant VFM risk identified, we may be able to draw on the work of other inspectorates, review agencies and other relevant bodies to provide us with the necessary evidence to reach our conclusion on the risk. If such evidence is not available, we will instead need to consider what additional work we will be required to undertake to satisfy ourselves that we have reasonable evidence to support the conclusion that we will draw. Such work may include: ■ Meeting with senior managers across the Authority; ■ Review of minutes and internal reports; ■ Examination of financial models for reasonableness, using our own experience and benchmarking data from within and without the sector.
Concluding on VFM arrangements	At the conclusion of the VFM audit we will consider the results of the work undertaken and assess the assurance obtained against each of the VFM themes regarding the adequacy of the Authority's arrangements for securing economy, efficiency and effectiveness in the use of resources. If any issues are identified that may be significant to this assessment, and in particular if there are issues that indicate we may need to consider qualifying our VFM conclusion, we will discuss these with management as soon as possible. Such issues will also be considered more widely as part of KPMG's quality control processes, to help ensure the consistency of auditors' decisions.
Reporting	On the following page, we report the results of our initial risk assessment. 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.

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Value for money arrangements work (cont.)

Significant VFM Risks

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

Risk: Financial sustainability, including medium term financial planning and the delivery of savings plans.

As reported in the Authority's medium term financial plan in February 2016, central government's settlement funding for the Authority has reduced by £119m since 2010/11, however further financial challenges lie ahead. On the back of the Local Government Settlement, there will be future funding impacts, for example on the New Homes Bonus. The Authority forecasts further savings will need to be found as the Authority faces further expenditure pressures and a continued reduction in resources includes proposed savings of £19.8m 2016/17. Therefore we consider this as a significant risk.

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Approach:

We will undertake the following procedures over this significant risk:

- Review the delivery of the Authority's savings programme;
- Review the delivery of the saving plans including any actions taken by the Authority where savings are achieved in line with the plan;
- Consider the Authority's main income streams and the impact the December Local Government Settlement has on these, and how the Authority is working to mitigate the corresponding risks to service delivery; and
- Evaluate the arrangements the Authority has in place in identifying further savings for future years.

Other matters

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 the National Audit Office. Deadlines for production of the pack and the specified approach for 2016/17 have not yet been confirmed.

Elector challenge

The Local Audit and Accountability Act 2014 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 PSAA's fee scales.

Our audit team

Our audit team will be led by Tony Crawley, providing continuity. Appendix 2 provides more details on specific roles and contact details of the team.

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 communication outputs are included in Appendix 1.

Independence and Objectivity

Auditors are also required to be independent and objective. Appendix 3 provides more details of our confirmation of independence and objectivity.

Audit fee

Our Audit Fee Letter 2016/2017 presented to you in April 2016 first set out our fees for the 2016/2017 audit. This letter also sets out our assumptions. We have not considered it necessary to make any changes to the agreed fees at this stage.

The planned audit fee for 2016/17 is £172,118. This is lower than the fee in 2015/16 which was £177,118.

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

Appendix 1: Key elements of our financial statements audit approach

Communication

Continuous communication involving regular meetings between Audit Committee, Senior Management and audit team

- Audit strategy and plan (Feb)
- Interim report (if required) (Apr/May)
- ISA 260 (UK&I) Report (Sep)
- Annual Audit Letter (Oct/Nov)

Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec

Audit workflow

- Initial planning meetings and risk assessment
- Interim audit
- Year end audit of financial statements and annual report
- Sign audit opinion

Planning

- Perform risk assessment procedures and identify risks
- Determine audit strategy
- Determine planned audit approach

Control evaluation

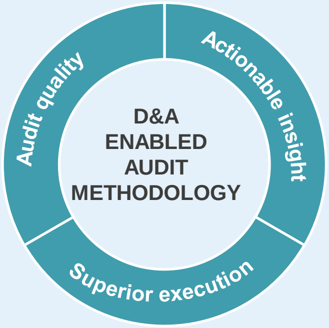
- Understand accounting and reporting activities
- Evaluate design and implementation of selected controls
- Test operating effectiveness of selected controls
- Assess control risk and risk of the accounts being misstated

Substantive testing

- Plan substantive procedures
- Perform substantive procedures
- Consider if audit evidence is sufficient and appropriate

Completion

- Perform completion procedures
- Perform overall evaluation
- Form an audit opinion
- Audit Committee reporting



Driving more value from the audit through data and analytics

Technology is embedded throughout our audit approach to deliver a high quality audit opinion. Use of Data and Analytics (D&A) to analyse large populations of transactions in order to identify key areas for our audit focus is just one element. We strive to deliver new quality insight into your operations that enhances our and your preparedness and improves your collective 'business intelligence.' Data and Analytics allows us to:

- Obtain greater understanding of your processes, to automatically extract control configurations and to obtain higher levels assurance.
- Focus manual procedures on key areas of risk and on transactional exceptions.
- Identify data patterns and the root cause of issues to increase forward-looking insight.

We anticipate using data and analytics in our work around key areas such as accounts payable, payroll and journals. We also expect to provide insights from our analysis of these tranches of data in our reporting to add further value from our audit.

Appendix 2: Audit team

Your audit team has been drawn from our specialist public sector assurance department.

Name	Tony Crawley
Position	Director
	‘My role is to lead our team and ensure the delivery of a high quality, valued added external audit opinion. I will be the main point of contact for the Audit Committee and Chief Executive.’

Tony Crawley

Director

+44 116 256 6067

tony.crawley@kpmg.co.uk

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Name	Thomas Tandy
Position	Manager
	‘I provide quality assurance for the audit work and specifically any technical accounting and risk areas. I will work closely with Tony and the team to ensure we add value. I will liaise with the Strategic Director of Finance and Corporate Directors.

Thomas Tandy

Manager

+44 115 945 4480

thomas.tandy@kpmg.co.uk

Name	Alastair Cowen
Position	Assistant Manager
	‘I will be responsible for the on-site delivery of our work and will supervise the work of our audit assistants.’

Alastair Cowen

Assistant Manager

+44 121 609 5810

alastair.cowen@kpmg.co.uk

Appendix 3: Independence and objectivity requirements

Independence and objectivity

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 Audit Committee.

KPMG LLP is committed to being and being seen to be independent. APB Ethical Standards require 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.

Further to this auditors are required by the National Audit Office's Code of Audit Practice to:

- Carry out their work with integrity, independence and objectivity;
- Be transparent and report publicly as required;
- Be professional and proportional in conducting work;
- Be mindful of the activities of inspectorates to prevent duplication;
- Take a constructive and positive approach to their work;
- Comply with data statutory and other relevant requirements relating to the security, transfer, holding, disclosure and disposal of information.

PSAA's Terms of Appointment 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 PSAA audit work 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.
- Auditors appointed by the PSAA should not accept engagements which involve commenting on the performance of other PSAA auditors on PSAA work without first consulting PSAA.
- Auditors are expected to comply with the Terms of Appointment policy for the Engagement Lead to be changed on a periodic basis.
- Audit suppliers are required to obtain the PSAA'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 Terms of Appointment.

Confirmation statement

We confirm that as of February 2017 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.

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. We draw your attention to the Statement of Responsibilities of auditors and audited bodies, which is available on Public Sector Audit Appointment's website (www.psaa.co.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.

We are committed to providing you with a high quality service. If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Tony Crawley, the engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact the national lead partner for all of KPMG's work under our contract with Public Sector Audit Appointments Limited, Andrew Sayers, by email to andrew.sayers@kpmg.co.uk. After this, if you are still dissatisfied with how your complaint has been handled you can access PSAA's complaints procedure by emailing generalenquiries@psaa.co.uk by telephoning 020 7072 7445 or by writing to Public Sector Audit Appointments Limited, 3rd Floor, Local Government House, Smith Square, London, SW1P 3HZ.

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AUDIT COMMITTEE – 24 February 2017

Title of paper:	**ANNUAL GOVERNANCE STATEMENT – PROGRESS MADE TO DATE ON ISSUES REPORTED 2015/16 AND PROCESS FOR PRODUCING 2016/17 STATEMENT**	
Director(s)/ Corporate Director(s):	Geoff Walker Director of Strategic Finance	**Wards affected: All**
Report author(s) and contact details:	Shail Shah Head of Audit & Risk ☎ 0115-8764245 ✉ shail.shah@nottinghamcity.gov.uk	
Other colleagues who have provided input:		

Recommendation(s):

1	Adopt the principles of good governance included in the CIPFA/SOLACE - Delivering Good Governance in Local Government Framework, 2016 as the City Council's Local Code of Corporate Governance.
2	Note the progress made to date in addressing the issues reported in the 2015/16 AGS, as detailed in this report.
3	Note the process and timetable for compiling and completing the 2016/17 AGS, as detailed in **Appendix 1.**

1. REASONS FOR RECOMMENDATIONS

1.1 This report sets out the current position in respect of those issues reported in the 2015/16 Annual Governance Statement (AGS), and the process for compiling the 2016/17 AGS.

1.2 The guidance for implementing good governance has been updated in 2016 by CIPFA / SOLACE to reflect a revision to the international framework in 2014 (see below). It places the attainment of sustainable economic, societal and environmental outcomes as a key focus of the governance structures and processes, and stresses the importance of taking account of the impact of current decisions and actions on future generations.

1.3 The International Framework: Good Governance in the Public Sector (CIPFA/IFAC, 2014) defines governance as follows:

Governance comprises the arrangements put in place to ensure that the intended outcomes for stakeholders are defined and achieved.

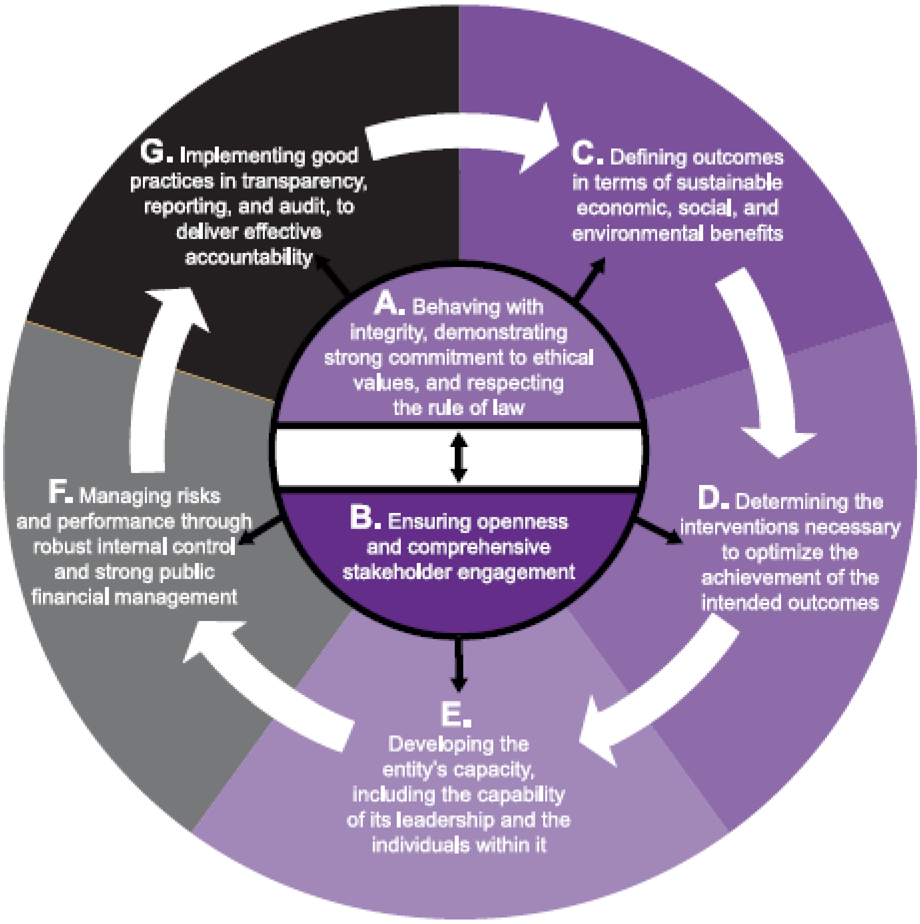
1.4 It states that:

To deliver good governance in the public sector, both governing bodies and individuals working for public sector entities must try to achieve their entity's objectives while acting in the public interest at all times.

Acting in the public interest implies primary consideration of the benefits for society, which should result in positive outcomes for service users and other stakeholders.

1.5 The diagram below, taken from the International Framework, illustrates the various principles of good governance in the public sector and how they relate to each other.

Achieving the Intended Outcomes While Acting in the Public Interest at all Times



1.6 The International Framework notes that:
Principles A and B permeate implementation of principles C to G. The diagram also illustrates that good governance is dynamic, and that an entity as a whole should be committed to improving governance on a continuing basis through a process of evaluation and review. The International Framework takes these core principles and identifies sub-principles which have been interpreted for a local government context by CIPFA / SOLACE in their 2016 guidance.

1.7 **<u>Update of Issues Reported</u>**
Issues identified in the 2015/16 AGS have been revisited and an update of the latest position established. In summary:

1.8 **EMSS:** The Council's Accountancy and Audit services continue to closely monitor the activity and performance closely. Issues have been faced in terms of financial management since the implementation and delays have been experienced in making payments. The causes of this issue have been addressed and the resulting payment backlog has been cleared. To provide clarity of responsibilities, a service level agreement has been set up between NCC and EMSS.

1.9 The restructure of Strategic Finance within NCC has seen the creation of a dedicated transactional team. This team will work closely with EMSS on improvement activity within Accounts Payable and Accounts receivable functions with the development of clear key performance indicators.

1.10 **Central Government Review of Local Government Funding and Balancing the Councils Budget:** The Government has implemented a rapid and extensive programme of policy change, accompanied by significantly reduced funding for the public sector. In response, service and financial planning processes have changed to:

- take account of the priorities within the Council Plan 2015-2019;
- 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 the Council's determination to be efficient, improve performance and modernise the organisation;
- recognise the very challenging financial landscape and future outlook and the impact on all sectors, including the Public Sector;
- continue to focus on regeneration and growth through capital investment

1.11 In addition, the Council's approach to setting recent budgets has, where possible, been guided by the following principles:

- to pursue commercialisation opportunities to generate income for the Council and help offset a proportion of the impact of grant reductions;
- reducing demand and reviewing the way we commission our services;
- redesigning and modernising our service provision / identifying efficiencies;
- to protect frontline services and minimise the impact of service reductions and changes on vulnerable citizens.

1.12 **Children in Care:** The cost of funding children in care arrangements and associated budget pressures are key issues facing the service. We are making some improvements with reduction of agency staffing; for the first time in two years the three managers in fostering, adoption, and post order are substantive Nottingham City staff recruitment of carers continues to be a challenge, but we are continuing to meet and discuss our two key strands one related to recruitment and the other retention of carers on a fortnightly basis. A reward scheme has been put in place to incentivise our existing carers to nominate friends and family to foster with the Council.

1.13 Plans have been put in place to manage the numbers of children who remain in care. In January 2017 we have 605 children in our care, an increase of 17 from April 2016. This is 92.5 per 10,000 child population, similar Councils had 96.3 per 10,000 child population in April 2016.

1.14 Over the last three years the number of unaccompanied asylum seeking children in our care has increased from 8 to 23, Home Office grant supports the placement cost of these children. The number of care leavers who were former unaccompanied children is currently 30. Many of this older group are in various processes post 18 relating to their right to remain in the UK.

1.15 In the 2017/18 financial year our recruitment of fosters carers will be further strengthened with the additional capacity to ensure we respond promptly to prospective carers and support them through the process. Local Authorities continue to face aggressive competition from independent private sector agencies in the foster carer recruitment arena.

1.16 A parliamentary select committee is examining the challenge of foster carer recruitment nationally. A member of that committee Lillian Greenwood MP has met with our foster carers and managers as part of the committee's evidence gathering process.

1.17 82.5% of our supported care leavers are aged 19-21 which is equal to national average and slightly higher than similar Councils average of 81.1%. Nottingham's has 56.1% of care leavers in employment, education or training greater than the national average of 49.3% and the similar council average of 47.7%.

1.18 The local CCG have just announced Department of Health funding for a new post to drive performance in relation to children in care health attainment.

1.19 In this financial year we are on track to meet our targets for adoption and other permanence outcomes for our children. The Department for Education have examined our adoption performance, and we had positive feedback regarding finding adopters for hard to place children such as a large sibling group of six who we managed to place together, and children with special needs.

1.20 Involvement in the criminal justice process of children in care aged 10-17 has fallen significantly in recent years from 16% to 5% and is now in line with similar Councils. Our part funding of a Police Officer post to work with children in care at risk of going missing or sexual exploitation, or other crime has received increasing recognition from other local authorities. South Yorkshire Police recently visited to look at this model. Mental Health Services and Education representatives continue to attend our weekly panel to review complex cases. A quality assurance officer based in the placements service monitors the quality of purchased placements, and visits external residential provision.

1.21 Our residential Children's homes continue to perform strongly when visited unannounced for inspection by Ofsted. Over the last 18 months our 7 Ofsted registered homes have been inspected unannounced by Inspectors on 21 occasions twenty of those visits have been judged as good or outstanding, on one occasion we received a requires improvement outcome. Our five semi-independent homes continue to provide excellent transition to independence for our young people.

1.22 A team of four HMI Ofsted inspectors visited the Councils children's services between 23rd January and 3 February 2017 to pilot a new inspection framework. Feedback was very positive overall with improvements noted in children in care social work fostering and adoption.

1.23 **Nottingham Express Transit (NET):** Construction of NET Phase Two is complete. A reliable operational service is now being delivered across an expanded tram network. 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. and overseen through a robust governance structure.

1.24 **Workplace Parking Levy (WPL)**: The overall NET/WPL financial model is regularly updated to reflect the actual WPL income received each financial year together with the latest projections of future income. Should forecasts indicate that insufficient WPL income may be generated over the life of the NET Phase 2 contract to achieve a balanced position by 2033/34, decisions may be made in respect of the ongoing contributions to the Green Bus network and/or extending the WPL scheme beyond the life of the NET Phase 2 contract.

1.25 **Information Governance:** The role and responsibilities of the Senior Information Risk Owner (SIRO) have been expanded to include; overall ownership of information risk management across the council, acting as champion for information management activities in order to mitigate against potential risks, and realising greater operational efficiencies and improved customer services. An Information Management Assurance Board is being established, led by the SIRO to ensure information is managed in an holistic manner across the whole organisation with a focus on compliance, transparency, and efficiency.

1.26 Performance associated with requests under Freedom of Information and Environmental Information Regulations continue to remain above the recently increased statutory target. Previous challenges associated with managing and processing personal information requests under the Data Protection Act (DPA) have been addressed and performance is now routinely in line with statutory expectations. Focussed activity around establishing sustainable operating models to ensure continued compliance in responding to all types of information requests is ongoing.

1.27 The council is compliant with the Department of Communities and Local Government's Transparency Code 2015, and continues to lead in proactively making datasets available for re-use, via the Open Data Nottingham portal, thereby providing continued commitment to the council's value of being open and transparent. A recent internal audit identified a positive direction of travel in terms of how the Information Rights & Insight Team review and make non-personal information available.

1.28 The Information Commissioners Office (ICO) has recently concluded its review of the consensual Data Protection Audit carried out in 2014. The ICO reported that she found it encouraging to see a significant improvement since the last review and now considers this review closed. However, the ICO does expect that the commitment demonstrated by NCC in improving its compliance with the DPA to be maintained.

1.29 In May 2018, the EU General Data Protection Regulation (GDPR) will replace the Data Protection Act 1998. The GDPR imposes new, and significantly more stringent, requirements for the handling of personal data. Although the position regarding the GDPR is not wholly clear, it is recognised that new procedures will need to be put in place to deal with the provisions of the GDPR associated with transparency and individuals' rights. Internal Audit were commissioned to carry out a gap analysis as part of the Council’s ongoing preparations for the implementation of the GDPR, focusing on actions required to ensure compliance and to identify areas where additional work is required before May 2018. In addition, the GDPR places greater emphasis on the explicit design of organisational and technical measures to secure compliance with its principles (privacy by default and design). It is recognised there could be significant associated budgetary, I.T., personnel, governance and communications implications. The internal audit report findings, and the ICO’s 12 step GDPR checklist, are being used to develop the Council’s GDPR action plan.

1.30 **Information Technology:** The Council commissioned a report considering several key areas where the Council’s IT Service has run installed infrastructure to the end of its useful life, with the view of identifying where investment is required to enable the Council to operate a technical environment that is fit for purpose. An improvement programme has been put in place to ensure that a continuing high level of IT service will be delivered.

1.31 **Robin Hood Energy:** The Council wholly own this private limited company licensed to supply gas and electricity to domestic and non-domestic customers in England, Scotland and Wales. It is a not-for-profit company and began offering credit tariffs in May 2015 followed by prepayment tariffs and commercial tariffs. Governance arrangements are now established including weekly management meetings and bi-monthly Board meetings. The Board comprises five Directors (all Councillors).

1.32 **Enviroenergy:** The Council wholly own this private limited company which both generates heat and power and sells heat and power to commercial and domestic customers in Nottingham. The company has launched additional commercial services, billing provision for a number of housing associations outside Nottingham and the development and sale of a heat monitor. The Board comprises 5 Directors (all Councillors) and meets on a bi-monthly basis.

1.33 The new appointment to Head of Enviroenergy, together with other key managerial appointments, is delivering new focus on infrastructure, investment and expansion with noticeable benefits in the following business performance areas necessary to sustain a heat network for the next 30 years :-

- Asset Care, Engineering Risk, Statutory Maintenance, Environmental Compliance, Capital and Revenue expenditure, Income enhancement, Budget Control, Health & Safety, Training and Development, Operational Efficiency, Customer Services and Private Wire and District Heating Expansion and Strategic planning.

1.34 **Nottingham Revenues and Benefits (NRB):** The Council has entered into a partnership with Northgate Information Solutions for the provision of Revenues & Benefits Services. A unique element of the partnership is that Northgate are contractually-bound to sub-contract the work to Nottingham Revenues & Benefits Limited, a wholly-owned Nottingham City Council company. Governance arrangements established incorporate monthly Operations Board meetings which have been held continuously throughout 2016/17 as have quarterly Partnership Boards. Transformation Board meetings were held on 6 dates in the first 3 quarters of 2016/17 and having delivered the Service Improvement Plan have now ceased. The company's Board comprises 4 Directors (3 councillors and 1 officer) and meets on a quarterly basis with technical representation where required.

1.35 **Blueprint Partnership Limited / Blueprint (General Partner) Limited:** The Council and its partner Igloo Regeneration Fund each have two Directors on the Blueprint Board with equal voting rights. Any decisions relating to the business, including investment of funds into the vehicle, have to be jointly agreed. Failure to reach agreement would lead to a deadlock situation being invoked. Any decision affecting or requiring resources from the Council are reported to the Council's executive board/portfolio holder for a decision to be made where there is an impact on the MTFP.

1.36 Process for the Production of the AGS 2016/17

- It is intended that the production of the AGS 2016/17 will closely follow the process of previous years noted by this committee, and the timetable is given at **Appendix 1**. 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.
- 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 and will be based on the relevant best practice developed produced by CIPFA/SOLACE.
- 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 2016/17 AGS.
- 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.

- 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 2015. 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 2016 (effective for 2016/17 statement)) 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 In 2012 CIPFA/SOLACE produced an updated guidance note covering the delivery of good governance in local government and how an authority's arrangements can be reflected in the AGS. The City Council has incorporated this guidance in both the evaluation of its governance arrangements and in the production of its AGS

2.4 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."

2.5 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 1**) will be used to monitor the progress of the AGS.

2.6 The Committee has delegated authority for the formal approval of the AGS and approved the AGS for 2015/16 on 18 September 2015. It was signed by the Leader of the Council and Chief Executive and was published alongside the Statement of Accounts.

2.7 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.

2.8 Part of the 2015/16 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 2015/16 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 2015
  CIPFA/SOLACE - Delivering Good Governance in Local Government Framework, 2016

- Executive Board 20 May 2008 - Local Code of Corporate Governance
  Nottingham City Council - Statement of Accounts 2015/16
  Annual Governance Statement 2015/16

AGS 2016 / 2017 Process APPENDIX 1

Action	Feb 2016	Mar 2016	Apr 2016	May 2016	Jun 2016	Jul 2016	Sept 2016	Oct 2016	Feb 2017	Mar 2017
Head of Internal Audit to meet Departmental Management Teams										
Plan the process for obtaining assurances from Corporate Directors and other significant partners										
Review 2015/16 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 2016	Mar 2016	Apr 2016	May 2016	Jun 2016	Jul 2016	Sept 2016	Oct 2016	Feb 2017	Mar 2017
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										

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AUDIT COMMITTEE – 24 February 2017

Title of paper:	**INTERNAL AUDIT QUARTERLY REPORT (3rd QUARTER 2016/17)**	
Director(s)/ Corporate Director(s):	Geoff Walker Director of Strategic Finance	**Wards affected:**
Report author(s) and contact details:	Shail Shah – Head of Audit and Risk Tel: 0115 8764245 Email: shail.shah@nottinghamcity.gov.uk	
Other colleagues who have provided input:		
Recommendation(s):		
1	To note the performance of Internal Audit during the period.	

1 REASONS FOR RECOMMENDATIONS

This report outlines the work of the Internal Audit service (IA) for the third quarter of 2016/17.

- **Appendix 1 -** Analysis of High Risk findings in Final Audit Reports issued in the period
- **Appendix 2** - List of final audit reports issued in the period with analysis of recommendations and level of assurance
- **Appendix 3** - Summary of position against updated Internal Audit Plan 2016/17

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 at the last assessment in 2015 was found to substantially comply with the principles contained in the Public Sector Internal Audit Standards (PSIAS), which is a requirement of the Account and Audit Regulations 2015, and associated regulations, in respect of the provision of an IA service. The service has internal quality procedures and is ISO9001:2008 accredited.

1.2 **Local Performance Indicators (PIs)**

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

Table 1 : Performance v PI Targets

	Indicator	Target	Period	Actual Year	Comments
1	% of all recommendations accepted.	95%	98%	98%	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 days	3	2	Above Target
4	% of staff receiving at least three days training per year.	100%	cumulative	73%	On Target
5	% of customer feedback indicating good or excellent service.	85%	cumulative	99%	Above Target
6	Number of key / high risk systems reviewed	11	9	9	Ongoing see below

1.3 **Activity**

Appendix 3 summarises the internal audit plan for 2016/17. NCC Internal Audit also provides an internal audit service for other organisations. 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, by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes. 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. It is also informed by consultation with stakeholders. The Plan is regularly reviewed and adapted as risks and priorities change and develop through the year.

1.4 The Internal Audit section incorporated the Corporate Counter Fraud Team during 2015/16 with a view to identifying additional income and savings for the Council. This new approach has been successful to date with the agreed income target for 2016/17 of £400,000 being exceeded in the first six months, and totalling £648,000 at the end of quarter 3. The team also helps the council to make savings which total £390,000 at the end of quarter 3.

1.5 **Summary of Activity**

A summary of reports issued within the last 3 months is included in Appendix 2. The following sections highlight any key issues and outcomes.

- **Key Financial Systems**: Work on the 2016/17 systems has been taking place during quarter 3 and will continue during this last quarter. We currently have 9 Audits at the reporting or fieldwork stage. We continue to assist East Midlands Shared Services with data analysis of payments to suppliers with a view to highlighting and reclaiming any duplicated payments.
- **Schools:** Our schools audits are planned to coincide with the school terms with the majority taking place in spring and summer terms. We have completed the audits programmed for summer 2016 and we have scheduled in the remainder for quarter 4. We will perform the responsible officer role at 3 academies during this last quarter
- **Compliance and Risk-Based Audits:** We have completed compliance and risk based audits across all departments in the first part of the year, including a review of Performance Indicators which will support the Human resources and Organisational Transformation division in ensuring the existence of effective organisational performance management and accountability. We intend to provide further support in this area during within the 2017/18 Annual Audit Plan. We have completed the majority of programmed grants audits in the first part of the year. These are generally necessary because government departments require the Head of Internal Audit to confirm compliance with grant conditions and that claimed expenditure is eligible for grant
- **Governance and Ethics**: During quarter 4 we have undertaken a process to update the Annual Governance Statement for 2016/17. We provide advice to departmental colleagues which supports them in making good decisions and setting up procedures which comply with the organisation's values, policies and processes. Included in the work plan is an audit of Councillors allowances which provided a high level of assurance. We have undertaken a review of colleague expenses which we will be reporting on in quarter 4. We plan to expand our work in this area to include organisational culture and behavioural insights in 2017/18.
- **Fraud and Investigations:** We have implemented a Corporate Counter Fraud plan that projects the scope of our activities over the next 2 years. This year we have concentrated efforts on Council Tax and Non-Domestic Rates. We continue to assist in identifying and investigating fraud in Right To Buy and tenancies, and work with colleagues in Nottingham City Homes. We support the Monitoring Officer in respect of Whistleblowing reports, most of which are received by Internal Audit. We advise on or carry out investigations in relation to suspected fraud and irregularities up to and including attendance in court as witness. We have continued to provide an e-learning tool on fraud awareness – which is available to departmental and school-based colleagues, and councillors, and have highlighted current fraud risks to colleagues through the council intranet. During this final quarter, we are coordinating and supporting investigation of returned data matches from National Fraud Initiative (NFI). We coordinated the provision of data for the NFI to use in this matching exercise during quarters 1 and 2.
- **Information and Technology:** We carry out a range of information and technology audits during the year which support management in understanding and addressing the related governance, risk and control issues. As part of audits completed earlier in the year, recommendations have been made to bring an annual IT Governance report to this committee. We are currently working on Change Control and finalising IT Asset Management. Following recruitment of a specialist we continue to develop our offer in this area.
- **Other / Consultancy:** No significant consultancy work has been carried out in this period

1.6 **Table 2** shows that actual days achieved are slightly less than expected at this point in the year. During the first two quarters we have been affected by restructure, which has taken up substantial amount of time. Some recruitment has taken place, effective from September, October and November which has allowed us to increase the productive days during the 3rd quarter. An additional vacancy has arisen during quarter 4 due to a colleague being recruited by another large authority. In mitigation of these vacancies, we have retained the services of an experienced contractor until March 2017 and we will investigate further recruitment and temporary measures during the quarter.

TABLE 2: ACTUAL v PLANNED AUDIT DAYS		
Total Planned Days	**Actual to date**	**Comments**
1990	1431	As predicted, additional resources has allowed us to increase productive days during quarter 3

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

TABLE 3: RECOMMENDATIONS ACCEPTED				
	To Date		**Period**	
	All	**High**	**All**	**High**
Total recommendations made	282	92	84	33
Rejected	6	0	2	0
Total recommendations accepted	276	92	82	33
% accepted	98%	100%	98%	100%

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 2015
- Internal Audit Plan 2016/17
- Public Sector Internal Audit Standards (2016 update)

Rosehill Special School

Executive Summary

Company : Rosehill School

Date of Review: 22 July 2016

Summary: Although certain procedures were found to meet the standards of good practice, our review identified a number of significant weaknesses in the school's financial management procedures where improvements need to be made. Due to these recommendations being classed as a high priority, it is important that it is implemented within the next three months.

Overall Opinion

Limited Assurance

Direction of Travel:

Previous Audit Report 25th July 2013 Significant Assurance

Scope and Approach: The scope of this review was limited to;

Leadership & Governance, People Management, Policy & Strategy, Processes, Purchasing, Invoice Processing, Banking Arrangements, School Fund, Income, Single Status, Website

High Priority Recommendations

R1 The Financial Administration and Control Policy should be presented to Governors annually to be reaffirmed and this should be recorded in the minutes of the Governors meeting.

R2 Outturn reports should be taken to Governor meetings each term.

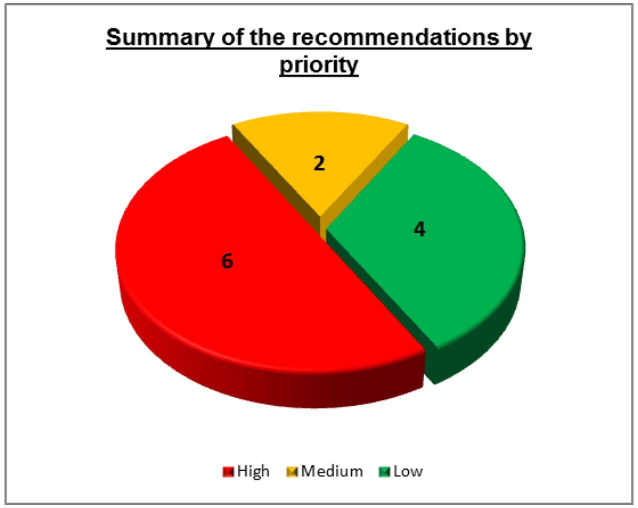
R3 Pecuniary interest forms should be completed annually for all Governors and staff with financial responsibilities including Support staff and the Site Manager.

R4 The school should look towards resolving the concerns and ensure an agreed 3 year Financial Plan and Deficit Recovery Plan is submitted to the LA.

R10 The electronic signing in system should be updated to include all staff and their contracted working hours. A formal monitoring procedure should be implemented that allows the school to ensure staff are working to their contracted hours.

R11 Lease agreements should not be entered into by the school.

A summary of the recommendation priority is shown below:



Commercial Waste Follow-up

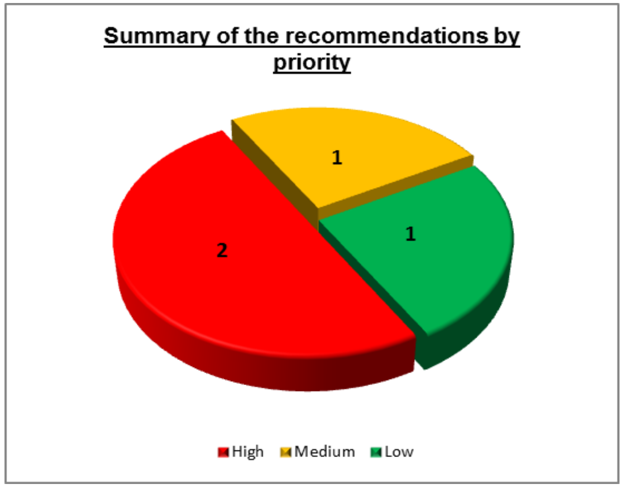
Executive Summary

Organisation: Nottingham City Council Directorate: Commercial & Operations	Overall Opinion: Significant Assurance	Direction of Travel:
Previous reviews: Commercial Waste 2010/11 Issued August 2012	<u>Scope and Approach:</u> The scope was limited to a review of outstanding recommendations from the 2010/11 report	

High Priority Recommendations:

R1 2010/11 An attempt should be made to establish a level of stock control over the skips in accordance with Financial Regulations.

R6 2010/2011 An attempt should be made to establish a level of stock control over the bins in accordance with Financial Regulations.



Repairs and Maintenance 2016/17

Executive Summary

Organisation: Nottingham City Council

Directorate: Neighbourhood Services

Previous review: November 2013

Overall Opinion:

Significant Assurance

Direction of Travel:

The previous review gave limited assurance but there have been significant improvements resulting in significant assurance.

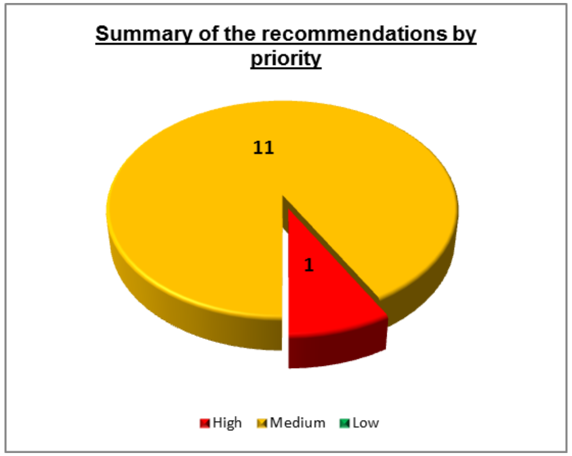
Scope and Approach: The scope of this audit covered the following :-

- Testing and inspection regimes
- Reactive works
- Minor works
- Payment of suppliers
- Condition surveys

High Priority Recommendations

There is 1 high priority recommendation.

5b Those suppliers failing to achieve the required response and completion times should be contacted and the necessary action taken.



IT Security 2015/16

Executive Summary

Organisation: Nottingham City Council

Directorate: Resilience
Previous reviews: IT Access Controls 2014-15

Overall Opinion:

Limited Assurance

Direction of Travel:

This review has identified a slight reduction in the level of controls from previously reported.

<u>Scope and Approach:</u> The scope of this review will look at:

- Review IT security processes and changes since the last review
- Review IT awareness training provided to colleagues
- Management of employees joining/re-joining the Council, including those employed on a temporary contracts
- Management of employees leaving the Council, including those employed on temporary contracts
- The process of reporting IT Security incidents and actions taken by senior management in response to the issues raised.

High Priority Recommendations

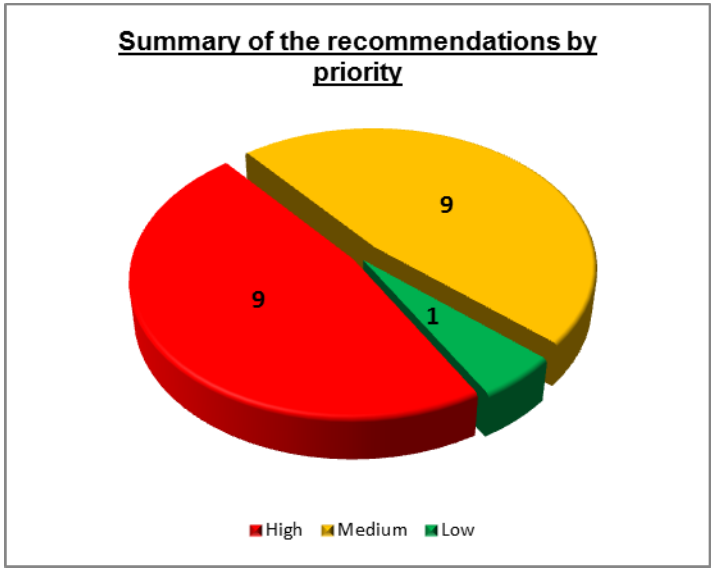
R1 The Information Security Policy should be reviewed and submitted to the Audit Committee as part of the City Council's Governance and Risk Management arrangements

R2 All users should be set up following the appropriate process in order that there is full management trail of who is allowed and authorised to access the network.

R3 All colleagues, including contractors, temporary staff and casuals, should undergo the Information Security and Data Protection training in line with the requirements of the Financial Regulations.

In addition, Corporate Directors should establish monitoring and reporting arrangements to ensure that the training is successfully completed.

R4 All colleagues should be required to undergo the Information Security Awareness Training and Data Protection Training prior to having formal access to the IT network.



In addition, Managers should be informed where either colleagues fail to complete the course or fail to achieve a pass in order that they may be offered additional support and training to ensure that appropriate standards may be achieved and maintained.

R7 The password domain setting should be reset to 6 failed access attempts

R8 Users should be forced to set more complex passwords, preferably by means of a software solution and be aligned to the recommendations made by the Penetration testers suggestions.

R9 We would suggest that the period between forced password resets should be reviewed to take account of the risks to the network.

R10 All PCs and mobile working devices should have a default time out period set in order to protect sensitive data and access to the City Councils Network and this should be stated in the Information Security Policy and password standards.

R17 Admin Accounts should be deleted within 30 days of the user leaving or moving from the post in order there is less opportunity for systems or data to be compromised.

Health and Safety 2016
Executive Summary

Organisation: Nottingham City Council

Directorate: Legal & Democratic

Previous review: None

Overall Opinion:

Limited Assurance

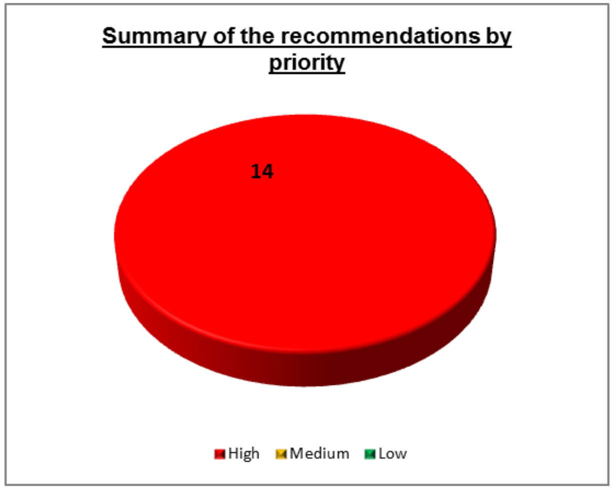
Direction of Travel:

This area of Health & Safety has not been subject to any prior review by Internal Audit

<u>Scope and Approach:</u> This review considered the following aspects of the service:

- Recording of accidents/violent incidents
- Risk assessments
- Training and awareness of staff
- CSAT audits
- HSE involvement
- Reporting arrangements

High Priority Recommendations



01. All accidents and violent incidents should be investigated fully and promptly with all associated paperwork uploaded to the Incident Reporting Database.

02. Directors should be informed of all incidents that have not been investigated and properly dealt with after a set amount of time.

03. Managers should be reminded of their responsibility to ensure that they undertake the appropriate health and safety training.

04. If the limitation of Oracle reporting continues, the CSA Team should undertake a manual sweep of managerial grades on a periodic basis and confirm completion of the necessary modules and refresher courses.

05. Managers should be reminded of their responsibility to ensure that their staff have all received the appropriate health and safety training.

06. The CSA Team should consider carrying out more comprehensive audits.

07. The CSA Team should also consider the adoption of a risk based approach in how audit locations are chosen with more time allocated to the highest risk areas.

08. The CSAT should make Corporate Directors/Directors aware of any concerns that are highlighted during an audit.

09. An annual report should be prepared on the current status of health and safety across the Council, by the CSA Team. The report could include areas such as :- number of HSE notices and fines in a year, number of non-investigated accidents and violent incidents in the year by department, numbers of Managers trained and not trained, CSA Team audit points outstanding after X months by department, cost of health and safety related insurance claims.

10. The Domestic Waste Manager should ensure that all new starters are adequately trained with comprehensive training records maintained.

11. The Domestic Waste Manager should ensure that all staff sign for their personal protective equipment and that complete records of issue are maintained.

12. The Head of Parks & Open Spaces should ensure that the risk assessments are brought up to the required standard.

13. The Head of Parks & Open Spaces should ensure that all new starters are adequately trained with comprehensive training records maintained.

14. The Head of Parks & Open Spaces should ensure that exposure time on vibrating equipment should be monitored in accordance with a recommendation from Earlsmere who carry out the departmental HAV and WBV training.

APPENDIX 2

Final Audit Reports issued 1st October to 31st December 2016

Department	Division	Activity	Level of assurance	No of Recommendations accepted		
				High	Medium	Low
Children and Adults	Education	Heathfield Primary & Nursery School	Significant Assurance	0	5	2
		Rosehill Special School	Limited Assurance	6	2	4
	Education Total			6	7	6
Children and Adults Total				**6**	**7**	**6**
Commercial and Operations	Neighbourhood Services	Commercial Waste Follow Up 2015-16	Significant Assurance	2	1	1
	Neighbourhood Services Total			2	1	1
Commercial and Operations Total				**2**	**1**	**1**
Development & Growth	Economic Development	Nottingham Jobs Fund	Significant Assurance	0	5	0
	Economic Development Total			0	5	0
	Strategic Asset & Property Management	Repairs and Maintenance 2016/17	Significant Assurance	1	11	0
	Strategic Asset & Property Management Total			1	11	0
Development & Growth Total				**1**	**16**	**0**
Strategy and Resources	Information Technology	IT Security 2015/16	Limited Assurance	10	6	1
	Information Technology Total			10	6	1
	Legal & Democratic Services	Councillors Allowances	High Assurance	0	0	0
	Legal & Democratic Services	Health & Safety 2016	Limited Assurance	14	0	0
	Legal & Democratic Services Total			14	0	0
	Organisational Transformation	Recruitment 2017	Significant Assurance	0	3	0
	Organisational Transformation Total			0	3	0
	Strategic Finance	NCC - AP Duplicate Payments Testing	Limited Assurance	0	5	0
		Capital Fees	Short Report	0	1	2
	Strategic Finance Total			0	6	2
Strategy and Resources Total				**24**	**15**	**3**
			Grand Total	**33**	**39**	**10**

APPENDIX 3

SUMMARY OF POSITION AGAINST UPDATED INTERNAL AUDIT PLAN 2016/17

Audit Title	Planned Days	Actual Days
Strategic Risk Register	30	0
Resources	124	58
Chief Executive/Transformation	70	62
Children & Families	140	89
Commercial & Operations	70	28
Development	108	58
Corporate Audits	346	217
Fraud / Counter Fraud	500	386
Corporate Fraud Strategy	48	8
Companies / Other Bodies	354	326
Consultancy, Advice and Support	120	92
Developments / Other Work	80	107
Total Days	**1990**	**1431**

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