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The Chair and Members of Standards and Audit Committee

27 January 2016

Dear Councillor,

Please attend a meeting of the STANDARDS AND AUDIT COMMITTEE to be held on WEDNESDAY, 3 FEBRUARY 2016 at 2.00 pm in Committee Room 3, Town Hall, Rose Hill, Chesterfield, the agenda for which is set out below.

AGENDA

Part 1(Public Information)

1. Declarations of Members' and Officers' Interests relating to Items on the Agenda

2. Apologies for Absence

3. Minutes (Pages 3 - 4)

   Minutes of the Meeting of the Standards and Audit Committee held on 25 November, 2015.

4. External Audit Progress Report and Technical Update (Pages 5 - 24)

5. Summary of Internal Audit Reports Issued - January 2016 (Pages 25 - 28)

6. Risk Management Strategy and In-Year Review

   (Report to follow)

7. Treasury Management and Annual Investment Strategies (Pages 29 - 56)

Yours sincerely,

Local Government and Regulatory Law Manager and Monitoring Officer

# STANDARDS AND AUDIT COMMITTEE

## Wednesday, 25th November, 2015

Present:-

Councillor Rayner (Chair)

| Councillors | Sarvent<br>Derbyshire | Councillors | Caulfield |
|---|---|---|---|

*Matters dealt with under the Delegation Scheme

**22 DECLARATIONS OF MEMBERS' AND OFFICERS' INTERESTS RELATING TO ITEMS ON THE AGENDA**

No declarations of interest were received.

**23 APOLOGIES FOR ABSENCE**

An apology for absence was received from Councillor Tidd.

**24 MINUTES**

**RESOLVED –**

That the Minutes of the meetings of the Standards and Audit Committee held on 23 September and 25 September, 2015 be approved as a true record.

**25 SUMMARY OF INTERNAL AUDIT REPORTS ISSUED**

The Interim Head of the Internal Audit Consortium presented a report summarising the Internal Audit reports issued for the period 29 August, 2015 to 2 November, 2015 in respect of reports issued relating to the 2015/16 internal audit plan.

It was noted that of the eight reports issued five rated the reliability of internal controls as ‘good’ and three as ‘satisfactory’, that responses had been received to all reports and that all the recommendations had been accepted.

***RESOLVED –**

That the report be noted.

**26 UPDATE TO THE ANNUAL GOVERNANCE STATEMENT ACTION PLAN 2014/15**

The Interim Head of the Internal Audit Consortium presented a report on the progress in the implementation of the 2014/15 Annual Governance Statement Action Plan, which had been approved by the Standards and Audit Committee in June 2015.

The Corporate Management Team monitored the progress on the action plan and a summary of the progress as at the end of October 2015 was shown in Appendix 1 to the report. A further report would be submitted to the Committee in mid 2016.

*** RESOLVED –**

That the report be noted.

**27 NATIONAL FRAUD INITIATIVE**

The Interim Head of the Internal Audit Consortium presented a report summarising the results of the 2014/15 National Fraud Initiative for Chesterfield Borough Council.

No cases of fraud and only a small number of minimal errors were identified, resulting in a small financial saving.

*** RESOLVED –**

That the report be noted.

**28 INTRODUCTION OF EXTERNAL AUDITOR**

Mr Tony Crawley of KPMG, new external auditor for the Council, attended to introduce himself to the Committee and to outline some of the issues he anticipated arising for the Committee during the coming year.

# External audit progress report and technical update

## Chesterfield Borough Council

January 2016

Agenda Item 4

# External audit progress report and technical update – January 2016

**This report provides the Standards and 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 info


| PROGRESS REPORT | |
|---|---|
| External audit progress report | 3 |
| **KPMG RESOURCES** | |
| KPMG/Shelter report: Fix the housing shortage or see house prices quadruple in 20 years | 5 |
| KPMG publication titled: Value of Audit: Perspectives for Government | 6 |
| Audit Committee Institute: Local Government Seminar Series – Autumn 2015 | 7 |
| **TECHNICAL UPDATE** | |
| New local audit framework | 9 |
| Reporting developments – Infrastructure assets | 10 |
| Local Audit and Accountability Act 2014: Provisions affecting auditors' work from 1 April 2015 | 11 |
| Proposed changes to business rates and core grant | 15 |
| **APPENDIX** | |
| Appendix 1 – 2015/16 audit deliverables | 17 |




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# Progress report

# External audit progress report – January 2016

**This document provides the Standards and 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 deliverables is provided in Appendix 1 of this report.**

Page 8

| Area of responsibility | Commentary |
|---|---|
| **Financial statements** | We will discuss the outcome of the 2014/15 audit with finance staff during January 2016 and agree the timing and scope of the 2015/16 audit.<br><br>We are in the process of planning our 2015/16 audit, and we will be holding further discussions with the Chief Executive and the Head of Finance to identify the key issues and to obtain a general update on the Authority. |
| **Value for Money** | Guidance from the National Audit Office for the 2015/16 value for money work has recently been issued. Auditors are required to reach their statutory conclusion on arrangements to secure VFM based on the following overall evaluation criterion:<br>*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.*<br><br>There are three sub-criteria that are intended to guide auditors in reaching their overall judgements:<br>▪ informed decision making;<br>▪ sustainable resource deployment; and<br>▪ working with partners and other third parties.<br><br>We will discuss the new guidance with officers and update the Committee.<br><br>. |

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# KPMG resources

| Area | Comments |
|---|---|
| **KPMG/Shelter report: Fix the housing shortage or see house prices quadruple in 20 years** | Without a radical programme of house building, average house prices in England could double in just ten years to £446,000 at current prices, according to research. In twenty years they could quadruple, with the average house price estimated to rise to over £900,000 at current prices by 2034 if current trends continue.<br><br>The research from KPMG and Shelter also reveals that more than half of all 20-34 year olds could be living with their parents by 2040, as soaring housing costs caused by the shortage of affordable homes leave more and more people priced out of a home of their own.<br><br>The warning comes in a landmark report from KPMG and Shelter outlining how the 2015 government can turn the tide on the nation's housing shortage within a single parliament. With recent government figures showing that homeownership in England has been falling for over a decade, the consequences of our housing shortage are already being felt.<br><br>The report sets out a blueprint for the essential reforms that will increase the supply of affordable homes and stabilise England's rollercoaster housing market. It calls on politicians to commit to an integrated range of key measures, including:<br><br>■ giving planning authorities the power to create 'New Homes Zones' that would drive forward the development of new homes. Combined with infrastructure, this would be led by local authorities, the private sector and local communities, and self-financed by sharing in the rising value of the land;<br><br>■ unlocking stalled sites to speed up development and stop land being left dormant, by charging council tax on the homes that should have been built after a reasonable period for construction has passed;<br><br>■ introducing a new National Housing Investment Bank to provide low cost, long term loans for housing providers, as part of a programme of innovative ways to finance affordable house building;<br><br>■ helping small builders to get back into the house building market by using government guarantees to improve access to finance; and<br><br>■ fully integrating new homes with local infrastructure and putting housing at the very centre of City Deals, to make sure towns and cities have the power to build the homes their communities need.<br><br>To read the report, visit www.kpmg.com/UK/en/IssuesAndInsights/ArticlesPublications/Pages/building-the-homes-we-need–programme-2015.aspx |



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# KPMG resources



| Area | Comments |
|---|---|
| **KPMG publication titled: Value of Audit – Perspectives for Government** | **What does this report address?**<br>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.<br>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.<br>**What are the key issues?**<br>■ The lack of consistent accounting standards around the world and the impacts on the usefulness of government financial statements.<br>■ The importance of trust and independence of government across different markets.<br>■ How government audits can provide accountability thereby enhancing the government's controls and instigating decision-making.<br>■ The importance of technology integration and the issues that need to be addressed for successful implementation<br>■ The degree of reliance on government financial reports as a result of differing approaches to conducting government audits<br>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<br>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 |

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# KPMG resources

| Area | Comments |
|---|---|
| **Audit Committee Institute: Local Government Seminar Series – Autumn 2015** | Our Audit Committee Institute (‘ACI’) events have been designed to provide you with sessions that help you consider the challenges faced by Local Government bodies today, and to help you think about the questions you want to be asking in relation to the assurance you need.<br><br>Our bespoke seminars are tailored to your needs, offering you the opportunity to discuss and share best practice with your peers. They will encourage and spark debate and give you the opportunity to reflect on your role and how your organisation can meet the challenges ahead.<br><br>Our Autumn Local Government sessions in October 2015 were led by specialists from our dedicated Local Government practice and focused on hot topics such as Audit Procurement, Cyber Crime, Early Accounts Closure, Infrastructure Assets and Internal Audit thought Leadership.<br><br>Our next event is currently being arranged for early 2016. |



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# Technical update

| Area | Level of impact | Comments | KPMG perspective |
|---|---|---|---|
| **New local audit framework** | ● **Medium** | The Local Audit and Accountability Act 2014 included transitional arrangements covering the audit contracts originally let by the Audit Commission in 2012 and 2014. These contracts covered the audit of accounts up to 2016/17, and gave the Department for Communities and Local Government (DCLG) the power to extend these contracts to 2019/20.<br><br>DCLG have now announced that the audit contracts for large local government bodies (including district, unitary and county councils, police and fire bodies, transport bodies, combined authorities and national parks) will be extended to include the audit of the 2017/18 financial statements. From 2018/19, local government bodies will need to appoint their own auditors; it is not yet clear whether there will be a sector-led body that is able to undertake this role on behalf of bodies.<br><br>NHS and smaller local government bodies (town and parish councils, and internal drainage boards), will not have their contracts extended, and will have to appoint their own auditors for 2017/18, one year earlier than for larger local government bodies such as Chesterfield Borough Council. | ***Guidance has been prepared by CIPFA on the request of the NAO.*** |



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| Area | Level of impact | Comments | KPMG perspective |
| --- | --- | --- | --- |
| **Reporting developments – Infrastructure assets** | Medium | CIPFA/LASAAC, the group that produce the *Code of Practice for Local Authority Accounting*, have confirmed that transport infrastructure assets owned by local authorities will be required to be included in the accounts from 2016/17. This would require prior period adjustments for 2015/16, including the opening position at 1 April 2015.<br><br>The changes require local authorities to recognise the value of all transport infrastructure assets using the depreciated replacement cost method, i.e. the cost required to replace the asset with a new replacement depreciated over the life of the existing asset. Transport infrastructure assets include:<br>■ roads, bridges, roundabouts and traffic calming measures;<br>■ footways, footpaths and cycle tracks;<br>■ tunnels and underpasses; and<br>■ water supplies and drainage systems, as they support the assets identified above.<br><br>Even non-highway authorities will be affected to the extent that footways etc are material to their accounts. Railway assets are not currently included in the proposals, although it is possible that these may be included in subsequent periods.<br><br>CIPFA have issued a *Code of Practice on Transport Infrastructure Assets* which contains the requirements to be included in the Local Authority Code. This is available to purchase from the CIPFA website.<br><br>Local authorities should have developed a project plan to identify all of the relevant transport infrastructure they own and a timetable for valuing these. CIPFA expects authorities to have undertaken the 1 April 2015 valuations by 31 December 2015.<br><br>The Whole of Government Accounts submission includes unaudited data on transport infrastructure assets. 2013/14 data indicates assets of over £400 billion will be accounted for on local authority balance sheets. However, only 93% of authorities provided this information, and of these less than 70% used actual inventory data to complete the return. This indicates that the sector faces a significant challenge in accurately identifying the assets it owns and will have to account for. | ***The Committee may wish to enquire of officers whether a project plan has been developed to address the requirements and review progress against this on a regular basis.*** |



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| Area | Level of Impact | Comments | KPMG perspective |
|---|---|---|---|
| **Local Audit and Accountability Act 2014 – provisions affecting auditors' work from 1 April 2015** | Low | With effect from 1 April 2015, certain provisions of the *Local Audit and Accountability Act 2014* (LAAA 2014) came into force and are applicable to auditors' work for the year 2015/16. Whilst the *Audit Commission Act 1998* is transitionally saved for auditors engaged in planning work for 2015/16, or possibly considering public interest reports (PIRs) to be made during 2015/16, they need to be aware of the provisions of LAAA 2014 that are already in force.<br><br>Provisions affecting auditors' work with effect from 1 April 2015 are:<br><br>***1) New duty to publish PIRs on audited bodies' websites***<br><br>Under the new audit regime, there is an emphasis on the publication of relevant information on the relevant authority's website. The following provisions are relevant to auditors carrying out work on 2015/16 if they decide to issue a public interest report during the audit.<br><br>Under Schedule 7 LAAA 2014, the following matters must be published on the relevant authority's website (if it has one):<br><br>■ PIRs (relating to the relevant authority or a connected entity);<br>■ notice of a meeting to consider a PIR/written recommendation; and<br>■ notice summarising those decisions approved by the auditor as a result of consideration of the PIR/recommendation.<br><br>Where the relevant authority does not have a website, it is instead generally required to make the relevant publication "in such manner as it thinks is likely to bring the notice or report to the attention of persons who live in its area". This could be, for example, in a local newspaper (as was required in certain cases under the previous legislation). | ***The Committee need to be aware of the provisions that are in place from 1 April 2015*** |



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| Area | Level of Impact | Comments | KPMG perspective |
|---|---|---|---|
| **Local Audit and Accountability Act 2014 – provisions affecting auditors' work from 1 April 2015 (continued)** | Low | ***2) Prohibition on disclosure***<br>The prohibition against disclosure that was previously to be found in section 49 of the *Audit Commission Act 1998* has been repealed and replaced by provisions in Schedule 11 of LAAA 2014. This change has not been transitionally introduced and auditors and local authority bodies need to be aware that this applies to all audits, irrespective of the year. Thus, any reference to the prohibition against disclosure needs to be to Schedule 11 and not section 49. There are no material differences between the two sets of provisions.<br>***3) Connected entities***<br>LAAA 2014 introduces a new concept into the audit regime, "connected entities". Connected entities are bodies that are separate to the relevant authority, but are associated with the authority in such a manner that requires the authority to record financial information relating to the entity in its accounts.<br>The full definition of "connect entities" is set out in paragraph 8 of Schedule 4 LAAA 2014.<br>For the purposes of this Act, an entity ("E") is connected with a relevant authority at any time if E is an entity other than the relevant authority and the relevant authority considers that, in accordance with proper practices in force at that time:<br>▪ the financial transactions, reserves, assets and liabilities of E are to be consolidated into the relevant authority's statement of accounts for the financial year in which that time falls;<br>▪ the relevant authority's share of the financial transactions, reserves, assets and liabilities of E is to be consolidated into the relevant authority's statement of accounts for that financial year; or<br>▪ the relevant authority's share of the net assets or net liabilities of E, and of the profit or loss of E, are to be brought into the relevant authority's statement of accounts for that financial year. | ***The Committee need to be aware of the provisions that are in place from 1 April 2015*** |



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| Area | Level of Impact | Comments | KPMG perspective |
|---|---|---|---|
| **Local Audit and Accountability Act 2014 – provisions affecting auditors' work from 1 April 2015 (continued)**<br><br>Page 18 | Low | ***3) Connected entities (continued)***<br><br>Authorities have a number of duties in relation to their connected entities under LAAA 2014 beyond those which are expanded on below:<br><br>■ Auditors have a right to access documents (at all reasonable times) relating to connected entities, as well as those relating to the "parent" relevant authority. The auditor can inspect, copy or take away documents. The auditor can also require people who are in possession or are accountable for the document (or have been in the past) to provide the auditor with any information or explanation that may be needed, and can require a meeting with such persons. Where a document is stored electronically, the auditor can require assistance from the relevant person at the connected entity or relevant authority in accessing the document. The connected entity must provide the auditor with such facilities and information as are reasonably required to carry out the audit functions.<br><br>■ The right to information and explanation, or to require a meeting, extends in relation to connected entities to:<br><br>– any persons elected or appointed to an entity;<br>– any employee of the entity; and<br>– an auditor of the accounts of the entity.<br><br>Many of the provisions on PIRs and written recommendations in Schedule 7 apply to connected entities. Accordingly, auditors must consider whether a PIR should be made on any matter coming to their attention during the audit and relating to the authority and/or a connected entity. Similarly, an auditor may make a written recommendation to a relevant authority relating to a connected entity. | ***The Committee need to be aware of the provisions that are in place from 1 April 2015*** |

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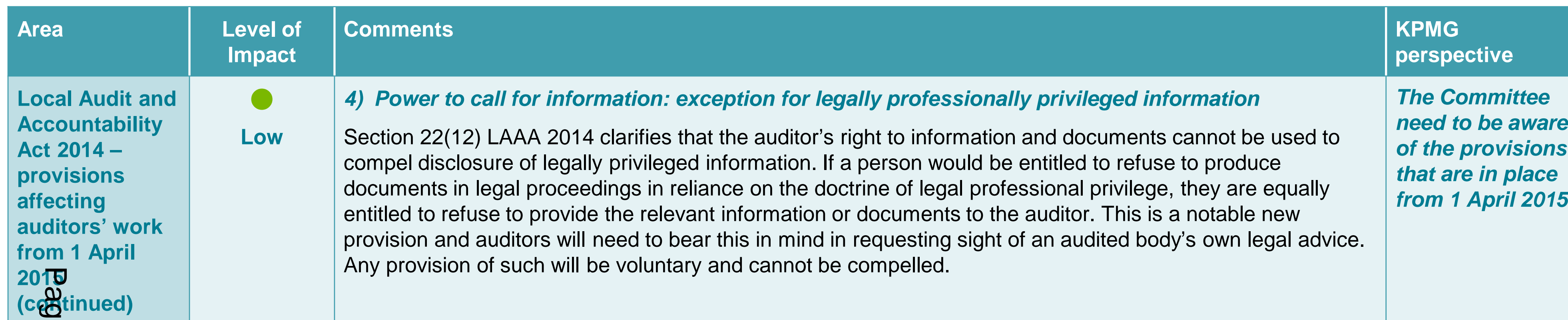

| Area | Level of Impact | Comments | KPMG perspective |
|---|---|---|---|
| **Local Audit and Accountability Act 2014 – provisions affecting auditors' work from 1 April 2015 (continued)** | Low | ***4) Power to call for information: exception for legally professionally privileged information***<br><br>Section 22(12) LAAA 2014 clarifies that the auditor's right to information and documents cannot be used to compel disclosure of legally privileged information. If a person would be entitled to refuse to produce documents in legal proceedings in reliance on the doctrine of legal professional privilege, they are equally entitled to refuse to provide the relevant information or documents to the auditor. This is a notable new provision and auditors will need to bear this in mind in requesting sight of an audited body's own legal advice. Any provision of such will be voluntary and cannot be compelled. | ***The Committee need to be aware of the provisions that are in place from 1 April 2015*** |



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# Technical update

| Area | Level of Impact | Comments |
|---|---|---|
| **Proposed changes to business rates and core grant** | **For Information** | The Chancellor of the Exchequer has proposed some radical reforms of local government finance. The proposals are that by the end of the decade, councils will retain all locally raised business rates but will cease to receive core grant from Whitehall.<br>The Chancellor set out the landmark changes in a speech to the Conservative party conference in Manchester, saying it was time to face up to the fact that “the way this country is run is broken”.<br>Under the proposals, authorities will be able to keep all the business rates that they collect from local businesses, meaning that power over £26 billion of revenue from business rates will be devolved, he said<br>The uniform national business rate will be abolished, although only to allow all authorities the power to cut rates. Cities that choose to move to systems of combined authorities with directly elected city wide mayors will be able to increase rates for specific major infrastructure projects, up to a cap, likely to be set at 2p on the rate.<br>The system of tariffs and top-ups designed to support areas with lower levels of business activity will be maintained in its present state. |



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# Appendix

# Appendix 1 – 2015/16 Audit deliverables

| Deliverable | Purpose | Timing | Status |
|---|---|---|---|
| **Planning** | | | |
| Fee letter | Communicate indicative fee for the audit year | April 2015 | Complete |
| External audit plan | Outline our audit strategy and planned approach<br>Identify areas of audit focus and planned procedures | March 2016 | TBC |
| **Substantive procedures** | | | |
| Report to those charged with governance (ISA+260 report) | Details the resolution of key audit issues.<br>Communication of adjusted and unadjusted audit differences.<br>Performance improvement recommendations identified during our audit.<br>Commentary on the Authority's VFM arrangements. | September 2016 | TBC |
| **Completion** | | | |
| Auditor's report | Providing an opinion on your accounts (including the Annual Governance Statement).<br>Concluding on the arrangements in place for securing economy, efficiency and effectiveness in your use of resources (the VFM conclusion). | September 2016 | TBC |
| WGA | Concluding on the Whole of Government Accounts consolidation pack in accordance with guidance issued by the National Audit Office. | September 2016 | TBC |
| Annual audit letter | Summarise the outcomes and the key issues arising from our audit work for the year. | October 2016 | 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. | February 2016 | In progress |



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# FOR PUBLICATION

## SUMMARY OF INTERNAL AUDIT REPORTS ISSUED

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| | |
|---|---|
| MEETING: | **STANDARDS AND AUDIT COMMITTEE** |
| DATE: | **3RD FEBRUARY 2016** |
| REPORT BY: | **INTERNAL AUDIT CONSORTIUM MANAGER** |
| WARD: | **ALL** |
| COMMUNITY ASSEMBLIES: | **ALL** |
| KEY DECISION REFERENCE (IF APPLICABLE): | |

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FOR PUBLICATION

BACKGROUND PAPERS FOR PUBLIC REPORTS:

TITLE: LOCATION:

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## 1.0 PURPOSE OF REPORT

1.1 To present for members' information a summary of Internal Audit Reports issued during the period 3rd November 2015 – 8th January 2016 in respect of reports issued relating to the 2015/16 internal audit plan.

## 2.0 RECOMENDATION

2.1 That the report be noted.

## 3.0 BACKGROUND

3.1 The Public Sector Internal Audit Standards require that the Internal Audit Consortium Manager reports periodically to the Standards and Audit Committee in respect of performance against the audit plan. Significant risk and control issues should also be reported.

3.2 In preparing this report, no standard corporate issues (e.g. risk management, equalities) were considered relevant.

## 4.0 SUMMARY OF REPORTS ISSUED

4.1 Attached, as Appendix 1, is a summary of reports issued covering the period 3rd November 2015 to 8th January 2016, for audits included in the 2015/16 internal audit plan.

4.2 The Appendix also shows for each report a summary of the scope and objectives of the audit, the overall conclusion of the audit and the number of recommendations made / agreed where a full response has been received.

4.3 The conclusion column of Appendix 1 gives an overall assessment of the reliability of the internal controls examined in accordance with the following classifications:

| Control Level | Definition |
|---|---|
| Good | A few minor recommendations (if any). |
| Satisfactory | Minimal risk; a few areas identified where changes would be beneficial. |
| Marginal | A number of areas have been identified for improvement. |
| Unsatisfactory | Unacceptable risks identified, changes should be made. |
| Unsound | Major risks identified; fundamental improvements are required. |

4.4 In respect of the audits being reported, it is confirmed that there were no issues arising relating to fraud that need to be brought to the Committees attention.

## 5.0 **RECOMMENDATION**

5.1 That the report be noted.

## 6.0 **REASON FOR RECOMMENDATION**

6.1 To inform Members of the internal audit reports issued.

JENNY WILLIAMS
INTERNAL AUDIT CONSORTIUM MANAGER

Further information on this report can be obtained from Jenny Williams (Extension 5468)

# Chesterfield Borough Council – Internal Audit Consortium

## Report to Standards and Audit Committee

### Summary of Internal Audit Reports Issued 2015/16– Period 3rd November 2015 – 8th January 2016

| Report Ref No. | Report Title | Scope & Objectives | Overall Opinion | Date | | | Number of Recommendations | |
|---|---|---|---|---|---|---|---|---|
| | | | | Report Issued | Response Due | Response Received | Made | Accepted |
| 19 | Accounts Payable | To ensure that invoices are paid accurately and promptly | Satisfactory | 25/11/2015 | 9/12/2015 | Extension Granted Note 2 | 3 | |
| 20 | IT Security | To review IT Security | Satisfactory | 2/12/2015 | 23/12/2015 | 16/12/2015 | 4 | 4 |
| 21 | Venues | To ensure that fees are charged correctly and that all income is banked in full | Satisfactory | 7/12/2015 | 31/12/2015 | 18/12/2015 | 5 | 5 |
| 22 | Payroll | To review Payroll processes and procedures | Satisfactory | 4/01/2016 | 25/01/2016 | Note 1 | 2 | |

Note 1 Response not due at time of writing report
Note 2 Extension granted due to staff shortages/holidays

**FOR PUBLICATION**

# TREASURY MANAGEMENT AND ANNUAL INVESTMENT STRATEGIES (J000)

| | | |
|---|---|---|
| MEETING: | (1) | COUNCIL |
| | (2) | DEPUTY LEADER |
| | (3) | STANDARDS AND AUDIT COMMITTEE |
| DATE: | (1) | 25 FEBRUARY 2016 |
| | (2) | 5 FEBRUARY 2016 |
| | (3) | 3 FEBRUARY 2016 |
| REPORT BY: | CHIEF FINANCE OFFICER | |
| WARD: | ALL | |
| COMMUNITY ASSEMBLY | ALL | |
| KEY DECISION NO: | 603 | |

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FOR PUBLICATION

BACKGROUND PAPERS
Local Government act 2003, CIPFA Prudential Code & Guidance and Sector's Economic Forecasts.

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## 1. PURPOSE OF REPORT

1.1 To approve the Treasury Management Strategy Statement and the Annual Investment Strategy Statement for 2016/17.

## 2. RECOMMENDATIONS

2.1 That the Council affirms its adoption of CIPFA's Code of Practice on Treasury Management.

2.2 That the Treasury Management Strategy Statement and Annual Investment Strategy, including the Prudential Code Indicators, the Minimum Revenue Provision Policy, and the extended list of permitted investments be approved.

## 3. BACKGROUND

3.1 The key aims of the CIPFA 'Code of Practice for Treasury Management in the Public Services' (the Code) are:

a) Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities;
b) Their policies and practices should make clear that the effective management and control of risk are prime objectives of their treasury management activities;
c) They should acknowledge that the pursuit of best value in treasury management, and the use of suitable performance measures, are valid and important tools to employ.

3.2 The Council first adopted the Code at its meeting on the 22nd October 2003. The Council is required to approve the Treasury Management and Investment Strategies and reaffirm its adoption of the Code before the start of each financial year.

3.3 CIPFA amended the Code in 2011 to take account of developments in the financial market place and the introduction of the Localism Act.

## 4. TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY

4.1 The Strategy Statement is shown in Annexe 1. The key Sections are explained below.

4.2 **Treasury Limits and Prudential Indicators** - sets the limits and indicators for the forthcoming financial year and two successive financial years, including:

4.2.1 Affordability Ratios:

- Ratio of financing costs to net revenue stream (para 2.6 of Annexe 1) shows the trend in the cost of capital based on the programme against the net revenue stream (i.e. council tax for the General Fund and rent income for the Housing Revenue Account). The General Fund ratio increases in 2016/17 which reflects the prudential borrowing required to finance the rebuild of Queens Park Sports Centre but this reduces in 2017/18 as capital receipts are set aside to repay that debt. The HRA ratio is fairly static due to both reducing financing costs and a reducing revenue stream as a result of the 1% per annum rent reduction requirement.

- Estimates of the incremental impact of capital decisions on the Council Tax and housing rents are shown in para's 2.7 and 2.8 of Annexe 1. These costs have been incorporated into the revenue budget forecasts.

4.2.2 Borrowing Limits (Annexe 1, para. 3.2):

- Operational Boundary - £139m in 2016/17, this is an estimate of the probable external borrowing during the year, it is not a limit and actual borrowing can vary for short periods during the year.

- Authorised Limit - £150m in 2016/17, represents the limit beyond which borrowing is not permitted. It includes estimates for long and short-term borrowing. The limit must be set and can be revised by the Council.

4.2.3 Other Prudential Indicators:

- Capital expenditure - the planned capital expenditure over the medium term.
- Net Borrowing - estimates of the net of borrowing and investments.
- Capital Financing Requirement - enables the net borrowing position to be compared to the capital financing requirement.
- Fixed and variable rate exposures, maturity structures and long term investments.

4.3 **Borrowing Strategy** (para. 3.4 of Annexe 1) - the current borrowing strategy is to bring the long term debt into line with the capital borrowing limit as determined by the Capital Financing Requirement. The Public Works Loans Board continues to be the main source of long-term financing.

4.4 **Debt Repayment and Minimum Revenue Provision Policy (Annexe 1, para. 2.3)**

The Minimum Revenue Provision (MRP) Policy which determines the rate at which debt will be repaid is:

a) General Fund - unchanged from last year with new borrowing usually repaid on an 'asset life' basis; and

b) Housing Revenue Account - based on 1.5% of the Capital Financing Requirement. This policy will be reviewed in future years in line with the 30 year Business Plan.

**Debt Re-scheduling** (Annexe 1, para. 3.6) – PWLB rescheduling rates has continued to limit the opportunities. The Chief Finance Officer will continue to monitor rescheduling opportunities and report any actions taken to the next available Cabinet meeting.

4.5 **Annual Investment Strategy** (Section 4 of Annexe 1) - defines what categories of investments are to be used and the restrictions placed on their use. The primary objective is to protect capital and the maximisation of returns is secondary. The credit ratings of the approved counterparties for investments are regularly reviewed.

Appendix 5.1 of Annexe 1 provides details of permitted investments which have been extended to cover a wider range of investment instruments including up to £5m in Property Funds.

## 5. RECOMMENDATIONS

5.1 That the Council affirms its adoption of CIPFA's Code of Practice on Treasury Management.

5.2 That the Treasury Management Strategy Statement and Annual Investment Strategy, including the Prudential Code Indicators, the Minimum Revenue Provision Policy, and the extended list of permitted investments be approved.

## 6 REASON FOR RECOMMENDATIONS

6.1 To comply with regulations and recognised best practice.

**B DAWSON**
**CHIEF FINANCE OFFICER**

Further information on this matter can be obtained from
Barry Dawson, Chief Finance Officer (Tel: 345451).

# Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

2016/17

# 1 INTRODUCTION

## 1.1 Background

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

CIPFA defines treasury management as:

> *"The management of the local authority'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."*

## 1.2 Reporting requirements

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

**Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

**A mid year treasury management report** – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.

**An annual treasury report** – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

**Scrutiny**
The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Standards & Audit Committee.

### 1.3 Treasury Management Strategy for 2016/17

The strategy for 2016/17 covers two main areas:

**Capital issues**

- the capital plans and the prudential indicators;
- the minimum revenue provision (MRP) policy.

**Treasury management issues**

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, CLG MRP Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance.

### 1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsibe for scrutiny. Training will be arranged as required. The training needs of treasury management officers are periodically reviewed.

### 1.5 Treasury management consultants

The Council uses Capita Asset Services, Treasury solutions as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

# 2 THE CAPITAL PRUDENTIAL INDICATORS 2016/17 – 2018/19

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

### 2.1 Capital expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts:

| Capital expenditure £000 | 2014/15 Actual | 2015/16 Estimate | 2016/17 Estimate | 2017/18 Estimate | 2018/19 Estimate |
|---|---|---|---|---|---|
| **General Fund** | 8,002 | 8,869 | 2,224 | 1,211 | 1,095 |
| **HRA** | 15,423 | 22,000 | 17,000 | 17,000 | 17,000 |
| **Total** | 23,425 | 30,869 | 19,224 | 18,211 | 18,095 |

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

| Capital expenditure £000 | 2014/15 Actual | 2015/16 Estimate | 2016/17 Estimate | 2017/18 Estimate | 2018/19 Estimate |
|---|---|---|---|---|---|
| **Financed by:** | | | | | |
| Capital receipts | 2,549 | 2,973 | 2,429 | 1,720 | 1,575 |
| Capital grants | 8,675 | 5,668 | 960 | 660 | 660 |
| Revenue | 7,788 | 20,729 | 15,835 | 15,831 | 15,860 |
| **Net financing need for the year** | **4,413** | **1,499** | **-** | **-** | **-** |

### 2.2 The Council's borrowing need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has no such schemes within the CFR.

The Council is asked to approve the CFR projections below. These projections exclude the loan from Sheffield City Region LEP for the £2.4m Waterside project.

| £000 | 2014/15 Actual | 2015/16 Estimate | 2016/17 Estimate | 2017/18 Estimate | 2018/19 Estimate |
|---|---|---|---|---|---|
| **Capital Financing Requirement** | | | | | |
| CFR – General Fund | 13,627 | 14,796 | 13,170 | 6,801 | 6,527 |
| CFR – HRA | 138,482 | 136,405 | 134,359 | 132,431 | 130,358 |
| **Total CFR** | 152,109 | 151,201 | 147,529 | 139,144 | 136,885 |
| **Movement in CFR** | 909 | (9,108) | (3,672) | (8,385) | (2,259) |

| **Movement in CFR represented by** | | | | | |
|---|---|---|---|---|---|
| Net financing need for the year (above) | 4,413 | 1,499 | - | - | - |
| Less MRP/VRP and other financing movements | (3,504) | (2,407) | (3,672) | (8,385) | (2,259) |
| **Movement in CFR** | 909 | (9,108) | (3,672) | (8,385) | (2,259) |

### 2.3 Minimum revenue provision (MRP) policy statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

CLG regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year.

For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

- **Based on CFR** – MRP will be based on the CFR (option 2);

This option provides for an approximate 4% reduction in the borrowing need (CFR) each year.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be:

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (option 3);

These options provide for a reduction in the borrowing need over approximately the asset's life.

However, the annuity method will be used where it is anticipated that the benefits of the scheme will increase over time i.e the debt repayments are lower in the early years and increase over time. The typical useful lives for various categories of assets are shown in the table below, but will be assessed when each project is approved:

| | Asset Life (years) |
|---|---|
| Land | 50 |
| Buildings | 50 |
| Infrastructure | 40 |
| Plant & Equipment | Up to 20 |
| Vehicles | 5 to 7 |

Prudential borrowing will continue to be used for invest-to-save type schemes, even where assets lives might be quite short, provided the anticipated efficiency savings are sufficient to cover the MRP charges i.e.the investment is self financing.

The Council has the discretion to determine the debt repayment policy for the HRA. The Policy from April 2013 is to set aside a provision for debt repayment based on 1.5% of the Capital Financing Requirement. This policy will be reviewed in later years as the Business Plan develops.

### 2.4 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

| Year End Resources £000 | 2014/15 Actual | 2015/16 Estimate | 2016/17 Estimate | 2017/18 Estimate | 2018/19 Estimate |
|---|---|---|---|---|---|
| Fund balances / reserves | 28,355 | 23,409 | 13,458 | 5,691 | 5,558 |
| Capital receipts | 700 | - | - | 1,013 | 9,581 |
| Provisions | 1,960 | 1,901 | 1,821 | 1,766 | 1,711 |
| Other | 3,587 | 1,100 | 1,050 | 1,000 | 950 |
| **Total core funds** | **34,602** | **26,410** | **16,329** | **9,470** | **17,800** |

### 2.5 Affordability prudential indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators.

### 2.6 Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

| % | 2014/15 Actual | 2015/16 Estimate | 2016/17 Estimate | 2017/18 Estimate | 2018/19 Estimate |
|---|---|---|---|---|---|
| General Fund | 4.51 | 4.69 | 5.40 | 3.52 | -0.86 |
| HRA | 19.36 | 18.36 | 18.83 | 18.49 | 18.31 |

The estimates of financing costs include current commitments and the proposals in this budget report.

### 2.7 Incremental impact of capital investment decisions on council tax

This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

**Incremental impact of capital investment decisions on the band D council tax**

| £ | 2015/16 Estimate | 2016/17 Estimate | 2017/18 Estimate | 2018/19 Estimate |
|---|---|---|---|---|
| **Council tax - band D** | | 0.30 | 0.62 | 1.23 |

## 2.8 Estimates of the incremental impact of capital investment decisions on housing rent levels

Similar to the council tax calculation, this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in the budget report compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

**Incremental impact of capital investment decisions on housing rent levels**

| £ | 2015/16 Estimate | 2016/17 Estimate | 2017/18 Estimate | 2018/19 Estimate |
|---|---|---|---|---|
| **Weekly housing rent levels** | 0.04 | 0.18 | 0.40 | 0.61 |

This indicator shows the revenue impact on any newly proposed changes, although any discrete impact will be constrained by rent controls.

# 3 BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

### 3.1 Current portfolio position

The Council's treasury portfolio position at 31 March 2015, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

| £000 | 2014/15 Actual | 2015/16 Estimate | 2016/17 Estimate | 2017/18 Estimate | 2018/19 Estimate |
|---|---|---|---|---|---|
| **External Debt** | | | | | |
| Debt at 1 April | 145,016 | 140,095 | 139,317 | 133,245 | 131,303 |
| Expected change in Debt | (4,921) | (778) | (6,072) | (1,942) | (1,967) |
| Other long-term liabilities (OLTL) | - | - | - | - | - |
| Expected change in OLTL | - | - | - | - | - |
| **Actual gross debt at 31 March** | 140,095 | 139,317 | 133,245 | 131,303 | 129,336 |
| **The Capital Financing Requirement** | 152,109 | 151,201 | 147,529 | 139,144 | 136,855 |
| **Under / (over) borrowing** | 12,014 | 11,884 | 14,284 | 7,841 | 7,519 |

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2016/17 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Chief Finance Officer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

### 3.2 Treasury Indicators: limits to borrowing activity

**The operational boundary.** This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

| Operational boundary £000 | 2015/16 Estimate | 2016/17 Estimate | 2017/18 Estimate | 2018/19 Estimate |
|---|---|---|---|---|
| | 140,050 | 139,320 | 133,250 | 131,300 |

**The authorised limit for external debt.** A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.
2. The Council is asked to approve the following authorised limit:

| Authorised limit £000 | 2015/16 Estimate | 2016/17 Estimate | 2017/18 Estimate | 2018/19 Estimate |
|---|---|---|---|---|
| | 151,000 | 150,000 | 143,000 | 141,000 |

Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is currently:

| HRA Debt Limit £000 | 2015/16 Estimate | 2016/17 Estimate | 2017/18 Estimate | 2018/19 Estimate |
|---|---|---|---|---|
| HRA debt cap | 155,612 | 155,612 | 155,612 | 155,612 |
| HRA CFR | 136,405 | 134,359 | 132,343 | 130,358 |
| HRA headroom | 19,207 | 21,253 | 23,269 | 25,254 |

### 3.3 Prospects for interest rates

The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives our central view.

| | Mar-16 | Jun-16 | Sep-16 | Dec-16 | Mar-17 | Jun-17 | Sep-17 | Dec-17 | Mar-18 | Jun-18 | Sep-18 | Dec-18 | Mar-19 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Bank rate | 0.50% | 0.50% | 0.50% | 0.75% | 0.75% | 1.00% | 1.00% | 1.25% | 1.25% | 1.50% | 1.50% | 1.75% | 1.75% |
| 5yr PWLB rate | 2.00% | 2.10% | 2.20% | 2.30% | 2.40% | 2.50% | 2.60% | 2.70% | 2.80% | 2.90% | 3.00% | 3.10% | 3.20% |
| 10yr PWLB rate | 2.60% | 2.70% | 2.80% | 2.90% | 3.00% | 3.10% | 3.20% | 3.30% | 3.40% | 3.50% | 3.60% | 3.60% | 3.70% |
| 25yr PWLB rate | 3.40% | 3.40% | 3.50% | 3.60% | 3.70% | 3.70% | 3.80% | 3.90% | 4.00% | 4.00% | 4.10% | 4.10% | 4.10% |
| 50yr PWLB rate | 3.20% | 3.20% | 3.30% | 3.40% | 3.50% | 3.60% | 3.70% | 3.80% | 3.90% | 3.90% | 4.00% | 4.00% | 4.00% |

**UK.** UK GDP growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and although the 2015 growth rate is likely to be a leading rate in the G7 again, it looks likely to disappoint previous forecasts and come in at about 2%. Quarter 1 of 2015 was weak at +0.4% (+2.9% y/y) though there was a slight increase

in quarter 2 to +0.5% (+2.3% y/y) before weakening again to +0.4% (2.1% y/y) in quarter 3. The November Bank of England Inflation Report included a forecast for growth to remain around 2.5 – 2.7% over the next three years, driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that CPI inflation has fallen to, or near to, zero since February 2015. Investment expenditure is also expected to support growth. However, since the August Inflation report was issued, most worldwide economic statistics have been weak and financial markets have been particularly volatile. The November Inflation Report flagged up particular concerns for the potential impact of these factors on the UK.

The Inflation Report was also notably subdued in respect of the forecasts for inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. The increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon was the biggest since February 2013. However, the first round of falls in oil, gas and food prices over late 2014 and also in the first half 2015, will fall out of the 12 month calculation of CPI during late 2015 / early 2016 but a second, more recent round of falls in fuel and commodity prices will delay a significant tick up in inflation from around zero: this is now expected to get back to around 1% by the end of 2016 and not get to near 2% until the second half of 2017, though the forecasts in the Report itself were for an even slower rate of increase. However, more falls in the price of oil and imports from emerging countries in early 2016 will further delay the pick up in inflation. There is therefore considerable uncertainty around how quickly pay and CPI inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing Bank Rate.

The weakening of UK GDP growth during 2015 and the deterioration of prospects in the international scene, especially for emerging market countries, have consequently led to forecasts for when the first increase in Bank Rate would occur being pushed back to quarter 4 of 2016. There is downside risk to this forecast i.e. it could be pushed further back.

**USA.** The American economy made a strong comeback after a weak first quarter's growth at +0.6% (annualised), to grow by no less than 3.9% in quarter 2 of 2015, but then pulled back to 2.0% in quarter 3. The run of strong monthly increases in nonfarm payrolls figures for growth in employment in 2015 prepared the way for the Fed. to embark on its long awaited first increase in rates of 0.25% at its December meeting. However, the accompanying message with this first increase was that further increases will be at a much slower rate, and to a much lower ultimate ceiling, than in previous business cycles, mirroring comments by our own MPC.

**EZ.** In the Eurozone, the ECB fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it was intended to run initially to September 2016. At the ECB's December meeting, this programme was extended to March 2017 but was not increased in terms of the amount of monthly purchases. The ECB also cut its deposit facility rate by 10bps from -0.2% to -0.3%. This programme of monetary easing has had a limited positive effect in helping a recovery in consumer and business confidence and a start to some improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.3% y/y) but has then eased back to +0.4% (+1.6% y/y) in quarter 2 and to +0.3% (+1.6%) in quarter 3. Financial markets were disappointed by the ECB's lack of more decisive action in December and it is likely that it will need to boost its QE programme if it is to succeed in

significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

Greece. During July, Greece finally capitulated to EU demands to implement a major programme of austerity and is now cooperating fully with EU demands. An €86bn third bailout package has since been agreed though it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the resistance of the Syriza Government, elected in January, to EU demands. The surprise general election in September gave the Syriza government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so Greek exit from the euro may only have been delayed by this latest bailout.

Portugal and Spain. The general elections in September and December respectively have opened up new areas of political risk where the previous right wing reform-focused pro-austerity mainstream political parties have lost their majority of seats. An anti-austerity coalition has won a majority of seats in Portugal while the general election in Spain produced a complex result where no combination of two main parties is able to form a coalition with a majority of seats. It is currently unresolved as to what administrations will result from both these situations. This has created nervousness in bond and equity markets for these countries which has the potential to spill over and impact on the whole Eurozone project.

- Investment returns are likely to remain relatively low during 2016/17 and beyond;
- Borrowing interest rates have been highly volatile during 2015 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. Gilt yields have continued to remain at historically phenominally low levels during 2015. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt;
- There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

### 3.4 Borrowing strategy

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

Against this background and the risks within the economic forecast, caution will be adopted with the 2016/17 treasury operations. The Chief Finance Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

Any decisions will be reported to the appropriate decision making body at the next available opportunity.

The Council's overall core borrowing strategy is as follows:-

- To reduce the revenue costs of debt
- To manage the Council's debt maturity profile, leaving no one future year with a high level of repayments that might cause problems in re-borrowing
- To secure funding at the cheapest cost commensurate with future risk
- To reschedule debt in order to take advantage of potential savings as interest rates change. Any reschedule exercise will be considered in terms of the premiums and discounts on the General Fund and HRA.
- To manage the day to day cash flow of the Authority in order to, where possible, negate the need for short term borrowing.

The Chief Finance Officer will take the most appropriate form of borrowing depending on prevailing interest rates at the time. It is likely that short term fixed rates may provide lower cost opportunities in the short/medium term.

The option of postponing borrowing and running down investment balances will also be considered. This would reduce counterparty risk and offset the expected fall in investment returns.

Abnormally low interest rates are expected to continue during 2016. This provides a continuation of the current window of opportunity for local authorities to fundamentally review their strategy of undertaking new external borrowing.

Over the next three years, investment rates are expected to be below long term borrowing rates and so value for money considerations would indicate that value could best be obtained by avoiding new external borrowing and by using internal cash balances to finance new capital expenditure or to replace maturing external debt ( referred to as internal borrowing). This would maximise short term savings.

However, short term savings by avoiding new long term external borrowing in 2016/17 will also be weighed against the potential for incurring additional long term extra costs by delaying unavoidable new external borrowing until later years when PWLB long term rates are forecast to be significantly higher.

**Treasury management limits on activity**

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

The Council is asked to approve the following treasury indicators and limits:

| £m | 2016/17 | 2017/18 | 2018/19 |
|---|---|---|---|
| **Interest rate exposures** | | | |
| | **Upper** | **Upper** | **Upper** |
| **Limits on fixed interest rates based on net debt** | 50 – 100% | 50 – 100% | 50 – 100% |
| **Limits on variable interest rates based on net debt** | 0 – 50% | 0 – 50% | 0 – 50% |
| **Maturity structure of fixed interest rate borrowing 2016/17** | | | |
| | | **Lower** | **Upper** |
| Under 12 months | | 0% | 15% |
| 12 months to 2 years | | 0% | 15% |
| 2 years to 5 years | | 0% | 45% |
| 5 years to 10 years | | 5% | 75% |
| 10 years and above | | 25% | 95% |

### 3.5 Policy on borrowing in advance of need

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

### 3.6 Debt rescheduling

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported to the Cabinet, at the earliest meeting following its action.

# 4 ANNUAL INVESTMENT STRATEGY

**Introduction: changes to credit rating methodology**

The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support. Commencing in 2015, in response to the evolving regulatory regime, all three agencies have begun removing these "uplifts" with the timing of the process determined by regulatory progress at the national level. The process has been part of a wider reassessment of methodologies by each of the rating agencies. In addition to the removal of implied support, new methodologies are now taking into account additional factors, such as regulatory capital levels. In some cases, these factors have "netted" each other off, to leave underlying ratings either unchanged or little changed. A consequence of these new methodologies is that they have also lowered the importance of the (Fitch) Support and Viability ratings and have seen the (Moody's) Financial Strength rating withdrawn by the agency.

In keeping with the agencies' new methodologies, the rating element of our own credit assessment process now focuses solely on the Short and Long Term ratings of an institution. While this is the same process that has always been used for Standard & Poor's, this has been a change in the use of Fitch and Moody's ratings. It is important to stress that the other key elements to our process, namely the assessment of Rating Watch and Outlook information as well as the Credit Default Swap (CDS) overlay have not been changed.

The evolving regulatory environment, in tandem with the rating agencies' new methodologies also means that sovereign ratings are now of lesser importance in the assessment process. Where through the crisis, clients typically assigned the highest sovereign rating to their criteria, the new regulatory environment is attempting to break the link between sovereign support and domestic financial institutions. While this authority understands the changes that have taken place, it will continue to specify a minimum sovereign rating of AA-. This is in relation to the fact that the underlying domestic and where appropriate, international, economic and wider political and social background will still have an influence on the ratings of a financial institution.

It is important to stress that these rating agency changes do not reflect any changes in the underlying status or credit quality of the institution. They are merely reflective of a reassessment of rating agency methodologies in light of enacted and future expected changes to the regulatory environment in which financial institutions operate. While some banks have received lower credit ratings as a result of these changes, this does not mean that they are suddenly less credit worthy than they were formerly. Rather, in the majority of cases, this mainly reflects the fact that implied sovereign government support has effectively been withdrawn from banks. They are now expected to have sufficiently strong balance sheets to be able to withstand foreseeable adverse financial circumstances without government support. In fact, in many cases, the balance sheets of banks are now much more robust than they were before the 2008 financial crisis when they had higher ratings than now. However, this is not universally applicable, leaving some entities with modestly lower ratings than they had through much of the "support" phase of the financial crisis.

### 4.1 Investment policy

The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then return.

In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

Investment instruments identified for use in the financial year are listed in appendix 5.1 under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices – schedules.

### 4.2 Creditworthiness policy

This Council applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

- Yellow 5 years
- Dark pink 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.25
- Light pink 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.5
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)

- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

| Y | Pi1 | Pi2 | P | B | O | R | G | N/C |
|---|---|---|---|---|---|---|---|---|
| 1 | 1.25 | 1.5 | 2 | 3 | 4 | 5 | 6 | 7 |
| Up to 5yrs | Up to 5yrs | Up to 5yrs | Up to 2yrs | Up to 1yr | Up to 1yr | Up to 6mths | Up to 100days | No Colour |

The Capita Asset Services' creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Capita Asset Services' creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Capita Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on any external support for banks to help support its decision making process.

### 4.3 Country limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch. The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 5.2. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

### 4.4 Investment strategy

**In-house funds.** Investments will be made with reference to the core balance and cash flow requirements and the outlook for interest rates.

**Investment returns expectations.** Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 4 of 2016. Bank Rate forecasts for financial year ends (March) are:

- 2016/17 0.75%

- 2017/18 1.25%
- 2018/19 1.75%

The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year are as follows:

2016/17 0.60%
2017/18 1.25%
2018/19 1.75%
2019/20 2.25%
2020/21 2.50%
2021/22 2.75%
2022/23 2.75%
2023/24 3.00%
Later years 3.00%

The Council will avoid locking into longer term deals while investment rates are down at historically low levels unless attractive rates are available with counterparties of particularly high credit worthiness which make longer term deals worthwhile and within the risk parameters set by this council.

**Investment treasury indicator and limit** - total principal funds invested for greater than 364 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

The Council is asked to approve the treasury indicator and limit: -

| **Maximum principal sums invested > 364 days** | | | |
|---|---|---|---|
| | **2016/17** | **2017/18** | **2018/19** |
| Principal sums invested > 364 days | 25% | 25% | 25% |

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to 3 months) in order to benefit from the compounding of interest.

## 4.5 End of year investment report

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

# 5 APPENDICES

1. Credit and counterparty risk management
2. Approved countries for investments
3. Treasury management scheme of delegation
4. The treasury management role of the section 151 officer

## 5.1 APPENDIX: Credit and Counterparty Risk Management

**SPECIFIED INVESTMENTS:** All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' quality criteria where applicable.

**NON-SPECIFIED INVESTMENTS**: These are any investments which do not meet the specified investment criteria. A maximum of 33% will be held in aggregate in non-specified investment

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

Specified Investments

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

| | **Minimum credit criteria / colour band** | **Max. maturity period** |
|---|---|---|
| DMADF – UK Government | N/A | 12 months |
| UK Government gilts | UK sovereign rating | 12 months |
| UK Government Treasury bills | UK sovereign rating | 12 months |
| Bonds issued by multilateral development banks | AAA | 12 months |
| Money market funds | AA- | Liquid |
| Enhanced money market funds with a credit score of 1.25 | AA- | Liquid |
| Enhanced money market funds with a credit score of 1.5 | AA- | Liquid |
| Local authorities | N/A | 12 months |
| Term deposits with banks and building societies | Blue<br>Orange<br>Red<br>Green<br>No Colour | 12 months<br>12 months<br>6 months<br>3 months<br>Not for use |

| | | |
|---|---|---|
| CDs or corporate bonds with banks and building societies | Blue<br>Orange<br>Red<br>Green<br>No Colour | 12 months<br>12 months<br>6 months<br>3 months<br>Not for use |
| Gilt funds | UK sovereign rating | |

| **Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)** | |
|---|---|
| 1. Government Liquidity Funds | AA- |
| 2. Money Market Funds | AA- |
| 3. Enhanced Money Market Funds with a credit score of 1.25 | AA- |
| 4. Enhanced Money Market Funds with a credit score of 1.5 | AA- |
| 5. Bond Funds | AA- |
| 6. Gilt Funds | AA- |

## Counterparty & Group Limits

Investments with each individual counterparty should not exceed £5m. The sum of investments with individual counterparties who belong to the same banking group, shall not exceed £7.5m. The investment limit for Enhanced Money Market Funds is £15m per fund.

**Accounting treatment of investments.** The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

**NON-SPECIFIED INVESTMENTS**: A maximum of 33% will be held in aggregate in non-specified investment.

| | **Minimum Credit Criteria** | **Max %/£m of total investments** | **Max. maturity period** |
|---|---|---|---|
| | | 33% in total | |
| Term deposits – local authorities | -- | | 3 years |
| Term deposits – banks and building societies | Purple | | 3 years |
| Certificates of deposit issued by banks and building societies | Purple | | 1 year |
| Local Authority Mortgage Scheme* | Short-term F1, Long-term A- | £1m | 7 years |
| UK Government Gilts | UK sovereign rating | | 5 years |
| Bonds issued by multilateral development banks | AAA | | 3 years |
| Sovereign bond issues (other than the UK govt) | AAA | | 3 years |
| Corporate bonds | Short-term F1, Long-term A-, | | 3 years |
| **Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)** | | | |
| 1. Bond funds | | | |
| 2. Gilt funds | | | |
| 3. Property funds** | | £5m | |

*The Council established a **Local Authority Mortgage Scheme** during 2013/14 which is delivered through the Lloyds Banking Group with an initial deposit of £1m for up to 7 years.

**The use of these instruments can be deemed capital expenditure, and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any fund it may consider using. Appropriate due diligence will also be undertaken before investment of this type is undertaken.

## 5.2 APPENDIX: Approved countries for investments

Based on lowest available rating

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Finland
- U.K.
- U.S.A.

AA

- Abu Dhabi (UAE)
- France
- Qatar

AA-

- Belgium

## 5.3 APPENDIX: Treasury management scheme of delegation

### (i) Full Council

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

### (ii) Cabinet

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

### (iii) Standards & Audit Committee

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

## 5.4 APPENDIX: The treasury management role of the section 151 officer

### The S151 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.