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RUSHMOOR BOROUGH COUNCIL

LICENSING, AUDIT AND GENERAL PURPOSES COMMITTEE

at the Council Offices, Farnborough on
Monday, 28th January, 2019 at 7.00 pm

To:

Cllr J.E. Woolley (Chairman)
Cllr Jacqui Vosper (Vice-Chairman)

Cllr Sue Carter
Cllr M.S. Choudhary
Cllr A.K. Chowdhury
Cllr Liz Corps
Cllr A.H. Crawford
Cllr A.J. Halstead
Cllr B. Jones
Cllr Marina Munro
Cllr M.D. Smith

Enquiries regarding this agenda should be referred to the Committee Administrator, Kathy Flatt, Democratic and Customer Services, Tel. (01252 398829) or email kathy.flatt@rushmoor.gov.uk.

A G E N D A

1. **MINUTES –** (Pages 1 - 6)

   To confirm the Minutes of the Meeting held on 26th November, 2018 (copy attached).

2. **SELECTION OF THE MAYOR AND DEPUTY MAYOR 2019/20 –** (Pages 7 - 8)

   The Chief Executive to report on the outcome of the selection process for the Mayor-Elect and Deputy Mayor-Elect 2019/20. A copy of the criteria for the selection process is attached for information. The Committee will be asked to make a recommendation to the Council.

3. **INTERNAL AUDIT UPDATE –** (Pages 9 - 24)

   To consider the Audit Manager's Report No. AUD1901 (copy attached) which sets out an overview of the work completed in quarter 3 and sets out the expected deliverables for quarter 4.

4. **EXTERNAL AUDIT PLAN –** (Pages 25 - 62)

   To receive a report from Ernst & Young (copy attached) which sets out how the company will carry out its responsibilities as auditor for the audit of the 2018/19 financial year. Justine Thorpe (Manager – Government & Public Sector, Ernst & Young) will be in attendance at the meeting.

5. **CERTIFICATION OF CLAIMS AND RETURNS ANNUAL REPORT –** (Pages 63 - 70)

   To receive a report from Ernst & Young (copy attached) which summarises the results of the audit work on the Council's major grant claim under the Housing Benefits Subsidy Scheme for the financial year 2017/18.

6. **TREASURY MANAGEMENT AND INVESTMENT STRATEGY 2019/20 –** (Pages 71 - 106)

   To consider the Executive Head of Financial Services' Report No. FIN1905 (copy attached) which sets out the Treasury Management and Investment Strategy, Prudential Indicators for Capital Finance and the Minimum Revenue Provision Statement for 2019/20.

PUBLIC PARTICIPATION AT MEETINGS

Members of the public may ask to speak at the meeting on any of the items on the agenda by writing to the Committee Administrator at the Council Offices, Farnborough by 5.00 pm three working days prior to the meeting.

LICENSING, AUDIT AND GENERAL PURPOSES COMMITTEE

Meeting held on Monday, 26th November, 2018 at the Council Offices, Farnborough at 7.00 pm.

Voting Members

Cllr J.E. Woolley (Chairman)
Cllr Jacqui Vosper (Vice-Chairman)

Cllr Sue Carter
Cllr M.S. Choudhary
Cllr A.K. Chowdhury
Cllr A.H. Crawford
Cllr A.J. Halstead
Cllr B. Jones
Cllr Marina Munro
Cllr M.D. Smith

Apologies for absence were submitted on behalf of Cllr Liz Corps.

22. **MINUTES**

The minutes of the meeting held on 24th September, 2018 were approved and signed by the Chairman.

23. **TREASURY MANAGEMENT MID-YEAR REPORT**

The Committee considered the Executive Head of Finance's Report No. FIN1836, which set out the main activities of the Treasury Management Operations during the first half of 2018/19, provided an update on the current economic conditions affecting Treasury Management decisions and a forward look for the remainder of the financial year.

It was noted that the Council's full year 2018/19 budgeted investment income interest was estimated to be £835,000, compared to the original budget for the year of £846,000. Borrowing interest costs for the financial year were estimated to be £262,000 compared to a budget of £296,000 contained in the original budget for 2018/19.

The Committee was advised that the treasury team continued to concentrate on the security of deposits/investments while keeping a keen regard to the income returns available. Members were informed that the £5 million investment in Payden & Rygel's Sterling Reserve Fund had provided a 0.79% income performance. Due to the low level of income returned an alternative pooled fund option was being considered.

As a borrowing authority, any bonds that the Council redeemed would offset the need to borrow. However, interest income would then be lost which had a revenue implication. The Committee was advised that current short-term borrowing rates were around 1% and there was an option to reinvest a current active bond on redemption with a higher yielding pooled fund, producing a net benefit when taking into account borrowing rates. To enable a reinvestment of a Covered Bond in pooled funds the investment limit for pooled funds needed to be increased above the current £20 million limit by £5 million.

It was estimated that the Council's commitment towards capital expenditure in the current year would raise the level of external borrowing at the end of the year. Further capital expenditure in 2018/19 and future years would require further additional borrowing. Higher yielding pooled fund investments would be retained for as long as possible, as their redemption in the future to raise cash for capital purposes would cause significant revenue effects in relation to the loss of investment income.

It was confirmed that all treasury management activities undertaken during the first half of the financial year had fully complied with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy. The Council continued to seek to diversify its investments in order to maximise returns and to safeguard the Council's treasury management position.

During discussion, a question was raised regarding a previous request made for Arlingclose to attend a meeting of the Committee. It was agreed that this would be followed up. Members also raised questions regarding how long the Payden & Rygel's Sterling Reserve Fund had been underperforming and also on short-term investments and these were answered by the Executive Head of Finance. A question concerning the incremental impact of capital investment decisions would be given a written response by the Executive Head of Finance.

RESOLVED: That

(i) the Executive Head of Finance's Report No. FIN1836 be noted;

(ii) the low level of investment income returned from Payden & Rygel's Sterling Reserve pooled fund and the option to replace it with a higher yielding fund be noted; and

(iii) approval be given to an increase of £5 million in the Collective Investment Schemes (pooled funds) investment limit, as set in the Annual Treasury Management Strategy for 2018/19 and approved by the Council on 22nd February 2018.

24. INTERNAL AUDIT UPDATE

The Committee considered the Audit Manager's Report No. AUD1805 which gave an overview of the work completed by Internal Audit for Quarter 2, an update on progress made on expected deliverables for Quarters 3 and 4 and a schedule of work expected to be delivered in Quarter 4.

The Committee noted the status of audit findings following audit work carried out within Quarter 2 in respect of :

- Purchase Ledger
- GDPR
- Cyber Security

The status of the following audit findings would be reported to the Committee meeting in January 2019:

- IT access controls
- Weekly refuse and recycling contract
- Parking machine income follow-up
- Portable IT equipment follow-up
- Transparency code follow-up
- Depot

The Committee was also advised that work had been carried out in order to establish the current demands on the Corporate Investigations Officers, who now came under Internal Audit, so that a work programme could be established for the 2019/20 financial year and quarterly updates provided to the Committee on their work.

The Report also set out the work expected to be delivered in Quarters 3 and 4, on which an update would be provided at the next meeting in January, 2019.

During discussion, Members requested further information concerning the recommendations made regarding the purchase ledger audit.

RESOLVED: That

(i) the audit work carried out in Quarter 2 be noted;

(ii) the update to the expected deliverables for Quarter 3; and

(iii) the expected deliverables for Quarter 4 be endorsed.

25. **DATA PROTECTION BREACH POLICY**

The Committee considered the Audit Manager's Report No. AUD1807 which set out an updated Data Protection Breach Policy to meet the new General Data Protection Regulation (GDPR), including a form to record all data breaches. The updated policy would ensure that any data breaches, whether paper or electronic, were dealt with appropriately and the necessary action taken to mitigate the risk and, where necessary, inform individuals and regulatory bodies (eg the Information Commissioner's Office or National Cyber Security Centre).

The policy would be communicated to Members and Officers. A training session would be held at a middle-managers meeting to highlight the key issues and actions to be taken. This would then be cascaded down to all employees and Members.

The communication of the policy to new employees would be carried out during induction sessions.

During discussion, clarification was sought regarding registration with the Information Commissioner's Office.

RESOLVED: That approval be given to the Data Protection Breach Policy, as set out in the Audit Manager's Report No. AUD1807.

26. **AUDIT CHARTER**

The Committee considered the Audit Manager's Report No. AUD1806 which set out the purpose, authority and responsibility of Internal Audit within the Council.

It was noted that, as part of the Public Sector Internal Audit Standards, there was a requirement to have an Internal Audit Charter in place. As part of the Quality Assurance Improvement Plan, it was agreed that an Internal Audit Charter would be developed to ensure there was greater compliance towards the standards. The Charter would be updated annually and considered by the Committee, in line with the requirements of the Public Sector Internal Audit Standards.

RESOLVED: That the Audit Manager's Report No. AUD1806 be approved.

27. **URGENT ADDITIONAL ITEM - PROPOSED VARIATION TO THE STANDARD SEX SHOP LICENCE CONDITIONS**

The Chairman had agreed that this item could be included in the business of the meeting as a matter of urgency.

The Committee considered the Head of Operational Services' Report No. EHH1826 which outlined proposals to vary the standard conditions applied to sex shop licences. It was noted that the Council's standard conditions had previously been reviewed in 1999. Darker Enterprises Limited had recently submitted a request seeking permission to modernise its premises. Consideration of the request had prompted a review of the standard conditions, which required updating to take account of changes in the law and the experience of officers engaged in the regulation of the premises.

The Report set out the proposed standard conditions. It was noted that, following the removal of conditions that duplicated other regulatory requirements, the amended standard conditions consolidated the previous set of standard conditions and those of other authorities with licensed premises within the Hampshire & Isle of Wight Licensing Officers Group. It was further proposed that a six weeks period of public consultation would be undertaken in respect of the proposed changes. If no representations were made on the consultation, the revised conditions would take effect from 1st February 2019. Any substantive feedback would be referred back to the Committee for consideration.

RESOLVED: That

(i) approval be given to the proposed standard conditions for licensed sex shops for public consultation for a six weeks period; and

(ii) if no substantive representations be made during the consultation period, the revised conditions to take effect from 1st February, 2019.

28. **URGENT ADDITIONAL ITEM - APPOINTMENT OF EXECUTIVE HEAD OF FINANCE AND SECTION 151 OFFICER**

The Chairman had agreed that this item could be included in the business of the meeting as a matter of urgency.

The Committee was advised that, following interviews on ??? November, 2018 by a panel of Members, consisting of the Chairman, Cllrs P.F. Rust, D.M.T. Bell, D.E Clifford (Leader of the Council) and Barbara Hurst (Cabinet Member), the post of Executive Head of Finance and Section 151 Officer had been offered to, and verbally accepted by, Mr David Stanley.

RESOLVED: That

(i) approval be given to the appointment of David Stanley as the Executive Head of Finance and Section 151 Officer, subject to references and no Cabinet objection; and

(ii) the Chief Executive, in consultation with the Chairman, formally appoint the candidate, Mr David Stanley.

The meeting closed at 8.12 pm.

CLLR J.E. WOOLLEY (CHAIRMAN)

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CRITERIA FOR THE SELECTION OF THE MAYOR AND DEPUTY MAYOR

The Council has established criteria for selecting the Mayor and Deputy Mayor. The Licensing and General Purposes Committee keeps the criteria under regular review. The arrangements are as follows:

- The position of the Mayor and Deputy Mayor of the Borough will be taken in order of seniority from all the elected Members of the Council and will be calculated in accordance with the procedure adopted by the Council on 20th May 1976 as follows:

  "The order of seniority of Members of the Council shall be determined by the length of previous local government service with the Council, including past service with the former Aldershot Borough Council and Farnborough Urban District Council. In the case where two or more Members have the same length of service, then priority between such Members shall be determined by the number of votes received by each Member expressed as a percentage of the total number of ballot papers issued at the most recent election held in their respective Wards."

- The normal progression through the Mayoralty will be by the holding of the position of Deputy Mayor and then progressing to the position of Mayor the following year.

- Should an elected Member be in the position of not being able or wanting to accept the nomination when they reach their position within the seniority list, they will be considered in the following Municipal Year, depending on his or her wishes.

- The Offices of Mayor and Deputy Mayor must at all times be apolitical. The Offices should not be used for political advantage.

- Past Mayors will not be considered for the position of Mayor or Deputy Mayor until fifteen years after the completion of the end of their Mayoral Year; at that time their position on the seniority list will be calculated on the basis of total length of service less fifteen years.

- A Member will not normally be selected until that Member has served a full four year term.

- A Member will not normally be selected for Mayor or Deputy Mayor if they are seeking re-election at that year's Borough Council Elections.

- Where a Member who has not been mayor before has the same number of eligible years' service as a Member who has already been Mayor, the Member who has not been mayor shall be given priority in the selection Process.

- A Member should recognise the time required in carrying out the duties and responsibilities of the Mayor and be able to allocate that time during his or her year of office.

- Those considered for appointment:

    - must demonstrate a broad base of support amongst Councillors

    - should be able to demonstrate some experience of chairing meetings

- The Mayor-Elect and Deputy Mayor-Elect will be selected at the Licensing and General Purposes Committee on the basis of the selections being submitted to full Council in March.

LICENSING, AUDIT AND GENERAL PURPOSES COMMITTEE
28TH JANUARY 2019

AUDIT MANAGER
REPORT NO. AUD1901

INTERNAL AUDIT – AUDIT UPDATE

SUMMARY:
This report describes the work carried out by Internal Audit for quarter 3 and the proposed work to be delivered for quarter 4.

RECOMMENDATION:
Members are requested to:
i. Note the audit work carried out in quarter 3.
ii. Note the update to the expected deliverables for quarter 4.
iii. Endorse the expected deliverables for quarter 4

1 Introduction

1.1 This report is to provide Members with:

- An overview of the work completed by Internal Audit to date for quarter 3.
- An update of the progress made and any changes required for the expected deliverables for quarter 4, as approved by the Committee on the 26th November 2018.
- A schedule of work expected to be delivered in quarter 4.

2 Audit work – Q3 18/19

2.1 The following audit work has been carried out within quarter 3:

Work	Status
Audit findings – Appendix A of this report	
Depot (carried forward from 2017/18)	This audit was carried out by the contract auditors. It was carried forward from 17/18. A ***limited assurance*** opinion has been given to this area. Findings are detailed within Appendix A.
Transparency code follow up	A follow up was carried out on the recommendations made from the Transparency code audit carried out in 2017/18. The findings from the follow up has changed the assurance opinion within this area, from limited to ***reasonable assurance***. Findings are detailed within Appendix A.

Items for the March Committee	
IT access controls	Due to some long-term sickness with the contractors, this audit has been delayed. The findings of this audit will be communicated to the committee at the meeting in March 2019.
Weekly refuse and recycling contract	Due to some long-term sickness with the contractors, this audit has been delayed. An exit meeting has been carried out with the auditee. The findings of this audit will be communicated to the committee at the meeting in March 2019.
Portable IT Equipment follow up	A follow up is being carried out on the recommendations made from the portable IT equipment audit carried out in 2017/18. Due to other priority demands within IT Services the findings of this report has been delayed but will be communicated to the Committee at the March meeting.
Parking Machine Income follow up	A follow up on the recommendations made within the Parking Machine Income audit carried out in 2016/17 is being carried out. The findings of this follow up will be communicated to the Committee at the meeting in March 2019. This has been delayed due to a reduction in resources and other priorities within the Parking team. However, a meeting is booked for the end of January in order to finalise.
Benefits	This audit is being carried out by the contract auditors. Testing is currently underway and the findings will be communicated at the Committee meeting in March.
Recovery	This audit is being carried out by the contract auditors. Testing is currently underway and the findings will be communicated at the Committee meeting in March.
Sales Ledger	This audit is being carried out by the contract auditors. Testing is currently underway and the findings will be communicated at the Committee meeting in March.
Corporate Governance	Testing is currently underway and the findings will be communicated at the Committee meeting in March.
Awaiting information	
Contaminated water review	This review has been completed but the report has yet to be issued, as it will be done in conjunction with the Contaminated soil review.
Contaminated soil review	Currently waiting on information to be provided by the contractors.

2.2 *Other deliverables:*
Work has been continuing to establish the current demands on the Corporate Investigations Officers, who now come under Internal Audit, so that a work programme can be established for 2019/20 financial year and quarterly updates on their work reported to this Committee.

Work has also begun to develop the audit plan for 2019/20.

2.3 There has been a delay in some of the audits carried out by the contract auditors. This has been due to 2 officers being on long periods of sickness. I have had assurances from the senior auditor at Wokingham Borough Council that all the audits required to be completed by the end of March, as per the contract, will be.

3 Expected deliverables for Q4

3.1 The following changes will be made to quarter 4 work previously planned within the audit update provided to the Committee in November 2018.
The following audits/follow ups were to be carried out within quarter 3 but will be completed within quarter 4.

- Contract Management
- Corporate Governance
- Benefits
- Recovery
- Sales Ledger
- Purchase of property follow up
- Card payments follow up
- Contract letting & tendering follow up

3.2 The work expected to be delivered in quarter 4 is detailed within the table below. As with the previous quarter, these audits can be subject to change due to the changing needs of the organisation or resource availability. An update will be provided at the March meeting.

Service	Audit/ follow up/descriptor	Expected
Finance	Contract Management - *A review of how contracts are monitored within the Council to ensure they are delivering the outcomes we require.*	Q4
CLT	Corporate Governance - *Overview of corporate governance arrangements within the Council against CIPFA/SOLACE guidance.*	Q4
Finance	Benefits - *Key financial system review of the benefits system/process*	Q4

Finance	Recovery - *Key financial system review of the debt recovery system/process*	Q4
Finance	Sales Ledger - *Key financial system review of the sales ledger system/process*	Q4
Legal	Purchase of property follow up - *A follow up on the recommendations made within the audit carried out in 2017*	Q4
Finance	Card payments follow up - *A follow up on the recommendations made within the audit carried out in 2017*	Q4
Finance	Contract Letting & Tendering follow up - *A follow up on the recommendations made within the audit carried out in 2017*	Q4
IT	IT portable equipment follow up - *A follow up on the recommendations made within the audit carried out in 2017*	Q4
Planning	Planning Applications - *A review of adherence to statutory requirements and processes for planning applications*	Q4
Housing	Disabled Facilities Grant - *A review of processes for granting DFGs and process for the rotation of suppliers.*	Q4
Finance	Capital Programme Management - *A review of the arrangements in place to manage the capital programme and the projects included.*	Q4
CLT	Risk Management - *A review of the risk management process and system in place. This is an area that was highlighted within the Annual Governance Statement and by External Audit as having deficiencies.*	Q4

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HEAD OF SERVICE: David Stanley, Executive Head of Financial Services

References: *Internal Audit – Audit Plan* report, presented to the Committee on the 29th January 2018
https://democracy.rushmoor.gov.uk/ieListDocuments.aspx?CId=166&MId=459&Ver=4

Internal Audit – Audit update report, presented to the Committee on the 26th November 2018
https://democracy.rushmoor.gov.uk/ieListDocuments.aspx?CId=166&MId=555&Ver=4

Audit Title 1	**Depot**
Year of Audit	2018/19
Assurance given	**Limited** – *Minimal controls designed to achieve the system/function/process objectives, are in place. Significant improvements are required if key controls are to be established.*
Overview of area	This was a unique and large project for Rushmoor. There were certain construction related aspects that could have been better managed, e.g. design, and certain aspects that were foreseen, e.g. contamination, but not the extent. Some elements could not have been foreseen, e.g. existing cable alignment, but there are lessons that can be applied to and inform future projects of varying sizes. The selection of the Canna site was taken after consideration of a number of other options which were not deemed suitable for a variety of reasons. The basis of this selection and the risks could have been better presented to management and Members to help achieve transparency in these decisions. From the outset, once the decision to purchase the Canna site was made, the project was under time pressure to purchase the land, obtain permissions, manage existing tenants and build the depot ready for July 2017. This factor has influenced some decision making in regard to procurement where Exemptions were applied and value for money for the Council was not always fully tested. The expectation of costs was set in October 2015 when Canna site purchase costs were known (£1.3m) and the development costs (£1.5m) were based on figures from a desktop exercise by the then waste contractor, Veolia, and officer assessment of other elements. The total value of £3.05m was reported to senior management and Cabinet and the capital budget approved was based on this. This capital budget set the expectation, which in hindsight was unrealistic, and the project has suffered from this perception. The actual construction was much more complex than the basis of the third party 'desktop exercise'. The full skill set/experience required in the Project Team was not utilised from the beginning and as such, there were certain elements that could have been foreseen, e.g. construction design. Despite the difficulties with this project and the additional costs, it is recognised that the availability of a bespoke depot for waste contractors to utilise, assisted in attracting more companies in the re-letting of the waste contract in 2017, and savings with the new provider, Serco, of c.£700k per annum were realised over the initial 10 year contract. There are, of course, operational costs to off-set, against this saving, in RBC running their own depot.

<table>
<tr><td></td><td colspan="3">Post-Audit Note:
As part of the recent corporate restructure, Property and Legal have been split to avert future conflicts with Exemptions. Additionally, a new Executive Head of Regeneration & Property and a Corporate Property Manager have been appointed to ensure that there are increased resources into those areas. The new Head reports directly to the Chief Executive to emphasise the importance and the level of risk of these areas.
A Gateway process has been introduced for all capital projects together with detailed business cases and formal reporting. These are supported by the newly formed Capital and Property Strategy Group and the Regeneration Steering Group.

The Executive team have taken on board the recommendations made within the audit report and have acted promptly to ensure that the recommendations have all been implemented, apart from further training which has been scheduled for April 2019. This is to ensure that the necessary controls are in place for any future projects of this calibre.</td></tr>
<tr><th>Priority</th><th>Key findings</th><th>Management response and agreed action</th><th>Action by who and when</th></tr>
<tr><td>Medium</td><td>Corporate Project Management
There is an absence of a corporate framework for all stages in managing major projects including:
• feasibility / due diligence;
• risk assessment;
• scope;
• skills assessment:
• defining roles;
• reporting, etc.

Risk: Senior management and Members did not have clear guidance as to the requirements in setting up and managing this major project. Project Managers have to reinvent / create a framework and governance controls for each new project.</td><td>A Gateway process has been introduced for all capital projects, which will provide the basis for a corporate framework of approval and management going forward.
The Executive Leadership Team will act as Project Board for the Gateway process.</td><td>Executive Leadership Team as Project Board

In place</td></tr>
</table>

High	**Project Initiation / Pre-Contract** There was an absence of key documents and actions, which would be expected for the commencement of any major project. These included: • Project Initiation Document – The foundation for any project and setting out the why, what, when and how, sensitivity analysis, etc. • Detailed business case • Risk Assessment • Skills assessment • Organisation and governance • Defining roles and responsibilities • Reporting needs **Risk:** *The Project Team were managing the project and making decisions without a full framework in place.*	Business cases are now developed for all significant projects and scoping is carried out before a project commences. This, coupled with the process rethink detailed above, provides the necessary assurance and governance going forward.	Executive Leadership Team as Project Board In place
High	**Site Selection** The basis of the sites chosen for purchase and seeking approval were presented in narrative form and it was difficult to compare directly with the other possible site options. There was no assessment of all sites against a standard RBC required criteria, e.g. a matrix. **Risk:** *It was not possible for management and Members to directly compare the pros and cons of all of the sites considered, to ensure that the best overall site was being purchased.*	Future capital projects will include a full options appraisals including an assessment of all sites.	Executive Head of Regeneration and Property In place

Medium	**Initial Project Team** The original project team did not incorporate all the key representatives which would have added specialist construction/building experience. In addition, the Corporate Project Officer was not allocated until after site selection. **Risk:** *Certain skills and experience were not utilised from the initiation of the project and the council incurred additional time delays and costs.*	Accepted that the involvement of key staff at an earlier stage would have improved the pace of delivery. Future projects will involve all key staff from the outset.	Corporate Leadership Team In place
Medium	**Risk Assessment** A Project Risk Analysis / Register was set up by the Corporate Projects Officer (CPO) to assist managing the project but this was only after the site purchase and the CPOs appointment to the project. **Risk:** *Risks to the project were not identified at the earliest possible opportunity.*	Again, lessons have been learned – see above.	Executive Leadership Team as Project Board In place
Medium	**Capital Budget setting** The development element of the original capital budget was based on an estimated and inaccurate basis, which was not like-for like to the actual development needed and did not provide scenarios / options for potential risks. **Risk:** *Senior management and Members had unrealistic expectation on the cost of the project.*	In addition to the responses already given, the expertise to the council has been improved with the appointment of a new Executive Head of Regeneration and Property, Corporate Property Manager and Executive Head of Finance to help enable this to be dealt with.	Executive Leadership Team as Project Board In place

Medium	**Main Contract - Award Criteria** The appointment of the original main contractor, Kier, was weighted towards quality aspects of their submission whereas the replacement, Neilcott, was weighted on costs, with no formal record of the quality aspects. **Risk:** *The 'Award Criteria' on a 60:40 cost v quality split in the Contract Standing Orders, to ensure the "most economically advantageous" offer, was inconsistently applied.*	Both the MCS and Neilcott tenders, for the replacement contract, included a programme, method statements and health and safety information which were required to judge the quality of their submission, and in future this will be properly recorded.	Executive Head of Finance In place
High	**Variable Quote Values** a) The appointment of the demolition contractor (ARD) was based on a significantly lower quote to the other 14 contractors. b) The appointment of the Quantity Surveyors (MTPC) was based on variable prices from 3 companies, which were not compared on a like-for-like basis. **Risk:** *a) Although appearing value for money, the notable variance in the accepted quote for the Demolition contractor may have avoided subsequent issues, delays and costs.* *b) It is not possible to assess whether MTPC were the best value option for RBC.*	a) The Council sought reassurance but accepts that this could have been more robustly challenged. b) Only MTPC provided a quotation that appeared to match the project requirements and had quantified the extent of their professional services, which would serve as a basis for payment of services rendered. Again, it is accepted that this could have been more robustly challenged and a comparison undertaken.	Executive Head of Finance In place

High	**Use of Exemptions** a) Although unusual, the former Solicitor to the Council was the only officer able to approve Exemptions (to the Contract Standing Orders) and was also the overall managing officer for the project. Two Exemptions were applied to this project with one not being signed off and formally approved. b) The Exemption basis of 'quality' for the replacement build-only contract does not appear to have been formally considered. **Risk:** *There was a conflict of interest in the use of Exemptions and no alternative set out in the Contract Standing Orders. The basis of the Exemption was not fully applied.*	The Chief Executive recognised this issue previously and has subsequently removed the conflict with the separation of Legal and Property in the corporate restructure. The overall approach would now ensure that any Exemptions are dealt with properly.	Corporate Manager - Legal In place
High	**Build-only Contractor** a) The choice of contractors for the build-only contract tender invite was selected by 2 officers without the involvement of the Procurement team. Those selected were not on the RBC contracts lists. One of those selected was by the officer who also approved the Exemption from Standing Orders. b) Although tendered on build-only, the contract was eventually let as Design & Build but the other tenderer was not given the opportunity to price for the design element. **Risk:** *The specialist knowledge of the procurement team was not utilised, as required by Contract standing Orders, and there is a risk of conflict of interest. Also, RBC may not have received the best value for money.*	a) The procurement officer will be involved in future and the conflict of interest has been dealt with. b) Whilst time was important, the Neilcott tender with design costs was less than the build-only cost of MCS. As such, an assumption was made and they were not invited to offer a design and build cost. Full tender processes will be adhered to in future.	Executive Head of Regeneration and Property In place

Medium	**Contracts Register** None of the four major contracts raised during the Depot project were recorded on the Contracts Register. **Risk:** *The council procedures and records required under the Transparency Code are not being complied with.*	This will be corrected in future.	Executive Head of Finance In place
Medium	**Contracts: 'Lessons Learned'** As part of the assessment by Legal as to whether there was a claim against AR Demolition, the Legal team included a 'Lesson Learned' element which included contracting/documentation weaknesses. These have not been shared outside of the small project team. **Risk:** *Past weaknesses in contracting arrangements have not been informed to officers that need to be made aware, e.g. procurement team, other project managers.*	The lessons will be shared across the Corporate Leadership Team and further training will be provided for our managers on the contracting arrangements.	Corporate Manager - Legal April 2019
Medium	**Procurement documentation** Suppliers of services linked to the Depot project were engaged and paid without order or contract documentation being located. **Risk:** *Standard RBC procurement procedures have not been applied.*	This will be corrected. An order for MTPC was provided post-audit.	Executive Head of Finance In place
Medium	**Roles and Responsibilities** The roles and responsibilities of the project team were not formally set out. **Risk:** *Project team members were not fully certain of their role and expectations of them.*	See arrangements laid out above relating to gateway processes.	Corporate Leadership Team In place

Medium	**Agency staff** The BSM/PM was an agency staff working part-time and was a key member of the team in overseeing the contractor contracts, reviewing on-site progress, attending site meetings and assessing the monthly valuations for payment. **Risk:** *The BSM/PM could have left at short notice and there was the potential for delays in decisions/work due to the part-time nature of the employment. The PM also selected the successful build-only contract, Neilcott, when the in-house procurement team should have been more actively involved in the selection.*	This was recognised as a weakness by the Executive Leadership Team with the Executive Director taking responsibility for the project. Enhanced reporting on the progress of the project was also introduced by the Chief Executive at this time. The corporate restructure mentioned has also increased the resilience of the team.	Executive Head of Regeneration and Property In place
Medium	**Project Team meetings** a) There was no representative from Finance at project meetings until towards the latter stages when pressures on the budget were realised. b) The risk register updates were not always formally shared / presented to all of the project team. **Risk:** *All aspects of project management should be represented at project meetings throughout to identify risks.*	Representation from Finance is now considered at the outset of projects.	Executive Leadership Team as Project Board In place

Medium	**Senior Management / Member Reporting** For this unique project, there was no formal reporting to CLT or the Executive on progress, budget, risks, etc until initiated by the new Chief Executive. **Risk:** *No extra reporting considerations were given for this exceptional project and key stakeholders for the organisation were not formally kept up-to-date.*	Mechanisms for the formal reporting of projects have now been introduced, most notably through the Regeneration Steering Group, the regeneration and property projects and through the Corporate Leadership Team.	Executive Leadership Team as Project Board In place
High	**Neilcott Variations** There are a significant value of variations claimed by Neilcott (over £1m) and although audit testing verified a sample as satisfactory, all variations should be independently reviewed and signed off before the final account is settled with Neilcott. **Risk:** *The significant variable element of Neilcott's account may be paid without independent verification. These payments are being managed by the officer (BSM/PM) who recommended them for selection.*	All variations were discussed and agreed with the Project team before being authorised as a contract instruction, which was copied to the project team. Final payments and variations will be agreed by the Executive Head only.	Executive Head of Regeneration and Property In place

Priority key for way forwards	
High priority	A fundamental weakness in the system/area that puts the Authority at risk. To be addressed as a matter of urgency.
Medium priority	A moderate weakness within the system/area that leaves the system/area open to risk.
Low priority	A minor weakness in the system/area or a desirable improvement to the system/area.

Audit Title 3	**Transparency code - follow up**		
Year of Audit	2018/19		
Assurance given at time of the audit	***Limited*** – *Minimal controls designed to achieve the system/function/process objectives, are in place. Significant improvements are required if key controls are to be established.*		
Assurance given at time of the follow up	***Reasonable*** – *Basic controls designed to achieve the system/function/process objectives, are in place. Improvements are required if key controls are to be established.*		
Overview of area	The Local Government Transparency Code (the Code) was introduced in May 2014 by the Department for Communities and Local Government. The Code specifies certain data, which is required to be published at varying intervals. An audit was carried out in 2017/18 in which 4 recommendations, 1 medium and 3 low priority, were agreed by the Corporate Leadership Team.		
Priority	**Way forward agreed**	**Follow up findings**	**Recommendation status**
Low	CLT agreed that Internal Audit would be the corporate key contact/ co-ordinator for ensuring publication deadlines and requirements for compliance are met.	Internal Audit is the corporate key contact for the transparency code. Details of requirements were emailed to Heads of Service.	Implemented
Low	An email will be sent from the corporate key contact to all Heads of Service detailing what is required to be carried out. Heads of service will respond to the email with details of who will be the key responsible person within their service for specific areas.	An email was sent out to all Heads of Service, which was responded to detailing who will be the key responsible person within their service. This information was updated onto the spreadsheet held by the corporate key contact.	Implemented

Medium	CLT agreed that relevant services would review the requirements of the code to ensure that their service provides the relevant information required following the email from the corporate key contact.	The required information has not been published for all the requirements of the code for the following: • Organisational Chart • Senior Salaries • Parking spaces • Procurement data • Waste contract The following information is correct but is not up to date: • Procurement card transactions • Local Authority Land • Parking account • Fraud An email has been sent to the key responsible persons' to ensure that the data is up to date and all the relevant information is included. The areas of non-compliance will be reviewed in a month's time to ensure they have been updated. Any which remain non-compliant will be reported to CLT for further action.	Not implemented
Low	The review identified that it is not always easy or clear where to find the relevant published data on the website and more user-friendly guidance would assist, particularly for FOI requests. The web team will look into making it easier for the public to identify the published	A clear page showing transparency information is not available on the Council's website. Majority of the data is held on the data.gov.uk site. However, the link to this data is held on a page on our website titled 'Our	Not implemented

	data on the Council's website.	spending over £250' which is not clear that this is where all of our transparency data can be located. Furthermore, data relating to community grants is held on the community, youth and sports grants webpage and data relating to contracts is held on the contracts webpage on Rushmoor's website. Therefore, all data relating to the transparency code is not held in one central or clear location on the Council's website.	

Rushmoor Borough Council

Audit planning report

Year ended 31 March 2019

28 January 2019

AGENDA ITEM No. 4

Building a better working world

Private and Confidential

28 January 2019

Licensing, Audit and General Purposes Committee,
Rushmoor Borough Council,
Council Offices,
Farnborough Rd,
Farnborough,
Hampshire.
GU14 7JU.

Dear Committee Members

We are pleased to attach our Audit Plan which sets out how we intend to carry out our responsibilities as auditor. Its purpose is to provide the Committee with a basis to review our proposed audit approach and scope for the 2017/18 audit in accordance with the requirements of the Local Audit and Accountability Act 2014, the National Audit Office's 2015 Code of Audit Practice, the Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA) Ltd, auditing standards and other professional requirements. It is also to ensure that our audit is aligned with the Committee's service expectations.

This plan summarises our initial assessment of the key risks driving the development of an effective audit for the Council, and outlines our planned audit strategy in response to those risks.

This report is intended solely for the information and use of the Committee and management, and is not intended to be and should not be used by anyone other than these specified parties.

We welcome the opportunity to discuss this report with you on 28 January 2019 as well as to understand whether there are other matters which you consider may influence our audit.

Yours faithfully

Andrew Brittain

Associate Partner

For and on behalf of Ernst & Young LLP

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In April 2015 Public Sector Audit Appointments Ltd (PSAA) issued "Statement of responsibilities of auditors and audited bodies". It is available from the via the PSAA website (www.PSAA.co.uk).
The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.
The "Terms of Appointment (updated February 2017)" issued by the PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and in legislation, and covers matters of practice and procedure which are of a recurring nature.
This report is made solely to the Licensing, Audit and General Purposes Committee and management of Rushmoor Borough Council in accordance with the statement of responsibilities. Our work has been undertaken so that we might state to the Licensing, Audit and General Purposes Committee, and management of Rushmoor Borough Council those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the Licensing, Audit and General Purposes Committee and management of Rushmoor Borough **Council** for this report or for the opinions we have formed. It should not be provided to any third-party without our prior written consent.

01 Overview of our 2018/19 audit strategy

Overview of our 2018/19 audit strategy

The following 'dashboard' summarises the significant accounting and auditing matters outlined in this report. It seeks to provide the Licensing, Audit and General Purposes Committee with an overview of our initial risk identification for the upcoming audit and any changes in risks identified in the current year.

Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from PY	Details
Misstatements due to fraud or error	Fraud risk	No change in risk or focus	As identified in ISA 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that would otherwise appear to be operating effectively. In addition to our overall response, we consider where these risks may manifest themselves and identify separate fraud risks as necessary below.
Misstatements due to fraud or error – capitalisation of revenue spend	Fraud risk	No change in risk or focus	In considering how the risk of management override may present itself, we conclude that this is primarily through management taking action to override controls and manipulate in year financial transactions that impact the medium to longer term projected financial position. A key way of improving the revenue position is through the inappropriate capitalisation of revenue expenditure. The Council has a significant fixed asset base and a material capital programme and therefore has the potential to materially impact the revenue position through inappropriate capitalisation.
Valuation of Land and Buildings	Significant risk	No change in risk or focus	The fair values of Property, Plant and Equipment (PPE) and Investment Properties (IP) represent significant balances in the Council's accounts and are both subject to valuation changes and impairment reviews. Valuation of land and property assets is a significant accounting estimate that, in the context of an uncertain economic environment, has a material impact on the financial statements.

Overview of our 2018/19 audit strategy (continued)

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The following ‘dashboard’ summarises the significant accounting and auditing matters outlined in this report. It seeks to provide the Licensing, Audit and General Purposes Committee with an overview of our initial risk identification for the upcoming audit and any changes in risks identified in the current year.

Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from PY	Details
Pension Net Liability	Inherent risk	No change in risk or focus	The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by Hampshire County Council. The Council’s pension fund liability is a material estimated balance and the Code requires that this is disclosed on the Council’s balance sheet. Accounting for this scheme involves significant estimation and judgement, in the context of an uncertain economic environment.
New Accounting Standards	Inherent risk	New risk identified this year.	IFRS 9 (Financial Instruments) and IFRS 15 (Revenue from contracts) apply from 1 April 2018. We will assess the impact of these new standards to determine whether they have been appropriately implemented by the Council.

Overview of our 2018/19 audit strategy (continued)

Audit scope

This Audit Plan covers the work that we plan to perform to provide you with:

- Our audit opinion on whether the financial statements of Rushmoor Borough Council give a true and fair view of the financial position as at 31 March 2019 and of the income and expenditure for the year then ended; and
- Our conclusion on the Council's arrangements to secure economy, efficiency and effectiveness.

We will also review and report to the National Audit Office (NAO), to the extent and in the form required by them, on the Council's Whole of Government Accounts return.

Our audit will also include the mandatory procedures that we are required to perform in accordance with applicable laws and auditing standards.

When planning the audit we take into account several key inputs:

- Strategic, operational and financial risks relevant to the financial statements;
- Developments in financial reporting and auditing standards;
- The quality of systems and processes;
- Changes in the business and regulatory environment; and,
- Management's views on all of the above.

This means that our audit is focused on the areas that matter and our feedback is more likely to be relevant to the Council.

Materiality

Planning materiality
£1.321m

Materiality has been set at £1.321m, which represents 2% of the prior year's gross expenditure on provision of services.

Performance materiality
£0.990m

Performance materiality has been set at £0.990m, which represents 75% of materiality.

Audit differences
£0.066m

We will report all uncorrected misstatements relating to the primary statements greater than £0.066m. Other misstatements identified will be communicated to the extent that they merit the attention of the Licensing, Audit and General Purposes Committee.

02 Audit risks

Our response to significant risks

We have set out the significant risks (including fraud risks denoted by*) identified for the current year audit along with the rationale and expected audit approach. The risk identified below may change to reflect any significant findings or subsequent issues we identify during the audit.

Misstatements due to fraud or error *

What is the risk?

The financial statements as a whole are not free of material misstatements whether caused by fraud or error.

As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.

What will we do?

We will undertake our standard procedures to address fraud risk, which include:

- Identifying fraud risks during the planning stages.
- Inquiring of management about risks of fraud and the controls put in place to address those risks.
- Understanding the oversight given by those charged with governance of management's processes over fraud.
- Considering the effectiveness of management's controls designed to address the risk of fraud.
- Determining an appropriate strategy to address those identified risks of fraud.

Performing mandatory procedures regardless of specifically identified fraud risks, including:

- Testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements
- Assessing accounting estimates for evidence of management bias, and
- Evaluating the business rationale for significant unusual transactions.

In addition to our overall response, we consider where these risk may manifest themselves and identify separate fraud risks as necessary below.

Our response to significant risks (continued)

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We have set out the significant risks (including fraud risk denoted by*) identified for the current year audit along with the rationale and expected audit approach. The risk identified below may change to reflect any significant findings or subsequent issues we identify during the audit.

Incorrect capitalisation of revenue expenditure*

What is the risk?

Under ISA240 there is also a presumed risk that revenue may be misstated due to improper recognition of revenue. In the public sector, this requirement is modified by Practice Note 10, issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.

Linking to our risk of misstatements due to fraud and error above, we have considered the capitalisation of revenue expenditure on property, plant and equipment as a specific area of risk given the extent of the Council's capital programme which is some £46.2m for 2018/19, including expenditure in relation to the purchase of investment properties.

What will we do?

As capital expenditure is material to the financial statements, we will undertake additional procedures to address the specific risk we have identified, which will include:

- Sample testing additions to property, plant and equipment at a lower testing threshold, to ensure that they have been correctly classified as capital and included at the correct value in order to identify any revenue items that have been inappropriately capitalised.

Our response to significant risks (continued)

We have set out the significant risks (including fraud risks) identified for the current year audit along with the rationale and expected audit approach. The risk identified below may change to reflect any significant findings or subsequent issues we identify during the audit.

Valuation of Land and Buildings

Financial statement impact

We have assessed that the risk of valuation of land and buildings is most likely to affect the PPE and Investment Property accounts. Misstatements that occur could impact both on the Balance Sheet and Income Statement.

What is the risk?

The fair value of Property, Plant and Equipment (PPE) and Investment Properties (IP) represents significant balances in the Council's accounts and is subject to valuation changes and impairment reviews.

Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.

The council commissions property valuation specialists to determine asset valuations and small changes in assumptions when valuing these assets can have a material impact on the financial statements and therefore the balances are susceptible to misstatement

What will we do?

In terms of the overall response, we will:

- evaluate the selection and application of accounting policies established to determine whether the accounting policies are being applied in an inappropriate manner;
- adjust the nature, timing and extent of our audit procedures by, for example, increasing our sample sizes

We will take a substantive approach to respond to the specific risk, undertaking the following procedures related to the valuation of property, including investment properties.

- Consider the work performed by the Council's valuers (Wilks, Head & Eve), including the adequacy of the scope of the work performed, their professional capabilities and the results of their work.
- Sample test key asset information used by the valuers in performing their valuation (e.g. building areas to support valuations based on price per square metre).
- Consider the annual cycle of valuations to ensure that assets have been valued within a five-year rolling programme as required by the Code for PPE, and annually for Investment Properties. We also consider if there are any specific changes to assets communicated to the valuer.
- Review assets not subject to valuation in 2018/19 to confirm that the remaining asset base is not materially misstated.
- Consider changes to useful economic lives as a result of the most recent valuation.
- Test accounting entries have been correctly processed in the financial statements.
- We will consider engaging EY valuation specialists to assist the audit team.

Other areas of audit focus

We have identified other areas of the audit, that have not been classified as significant risks, but are still important when considering the risks of material misstatement to the financial statements and disclosures and therefore may be key audit matters we will include in our audit report.

What is the risk/area of focus?	What will we do?
<u>IFRS 9 Financial instruments – inherent risk</u> This new accounting standard is applicable for local authority accounts from the 2018/19 financial year and will change: ▸ How financial assets are classified and measured; ▸ How the impairment of financial assets are calculated; and ▸ The disclosure requirements for financial instruments. There are transitional arrangements within the standard; and the 2018/19 CIPFA Code of Practice on Local Authority Accounting provides guidance on the application of IFRS 9. Central government has indicated following consultation that statutory overrides for certain classes of financial assets will be put in place, however until these are confirmed there remains some uncertainty on the full accounting treatment. The Council is yet to undertake and document its assessment of the impact of IFRS9.	We will: ▸ assess the authority's implementation arrangements that should include an impact assessment paper setting out the application of the new standard, transitional adjustments and planned accounting for 2018/19; ▸ consider the classification and valuation of financial instrument assets; ▸ review the implementation of the new expected credit loss model impairment calculations for assets; and ▸ check additional disclosure requirements for compliance with the CIPFA Code.
<u>IFRS 15 Revenue from contracts with customers – inherent risk</u> This new accounting standard is applicable for local authority accounts from the 2018/19 financial year. The key requirements of the standard cover the identification of performance obligations under customer contracts and the linking of income to the meeting of those performance obligations. The 2018/19 CIPFA Code of practice on local authority accounting provides guidance on the application of IFRS 15 and includes a useful flow diagram and commentary on the main sources of LG revenue and how they should be recognised. The impact on local authority accounting is likely to be limited as large revenue streams like council tax, non domestic rates and government grants will be outside the scope of IFRS 15. However where that standard is relevant, the recognition of revenue may change and new disclosure requirements introduced. The Council is yet to undertake and document its assessment of the impact of IFRS15.	We will: ▸ Assess the authority's implementation arrangements that should include an impact assessment paper setting out the application of the new standard, transitional adjustments and planned accounting for 2018/19. ▸ Consider application to the authority's revenue streams, and where the standard is relevant test to ensure revenue is recognised when (or as) it satisfies a performance obligation; and ▸ Check additional disclosure requirements.

Other areas of audit focus

We have identified other areas of the audit, that have not been classified as significant risks, but are still important when considering the risks of material misstatement to the financial statements and disclosures and therefore may be key audit matters we will include in our audit report.

What is the risk/area of focus?	What will we do?
<u>Pension Asset Valuation – inherent risk</u> The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by the Council. The Council's pension fund liability is a material estimated balance and the Code requires that this asset be disclosed on the Council's balance sheet. The information disclosed is based on the IAS 19 report issued to the Council by the actuary Aon Hewitt. Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.	We will: ▸ Undertake IAS19 protocol procedures assisted by the pension fund audit team to obtain assurances over the information supplied to the actuary in relation to Rushmoor Borough Council; ▸ Assess the work of the Pension Fund actuary (Aon Hewitt) including the assumptions they have used. We do this by relying on the work of PWC, the Consulting Actuaries commissioned by the National Audit Office for all Local Government sector auditors, and considering any relevant reviews by the EY actuarial team; and ▸ Review and test the accounting entries and disclosures made within the Council's financial statements in relation to IAS19.

03 Value for Money Risks

Value for Money

Background

We are required to consider whether the Council has 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. This is known as our value for money conclusion.

For 2018/19, this is based on the overall evaluation 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"

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

- Take informed decisions;
- Deploy resources in a sustainable manner; and
- Work with partners and other third parties.

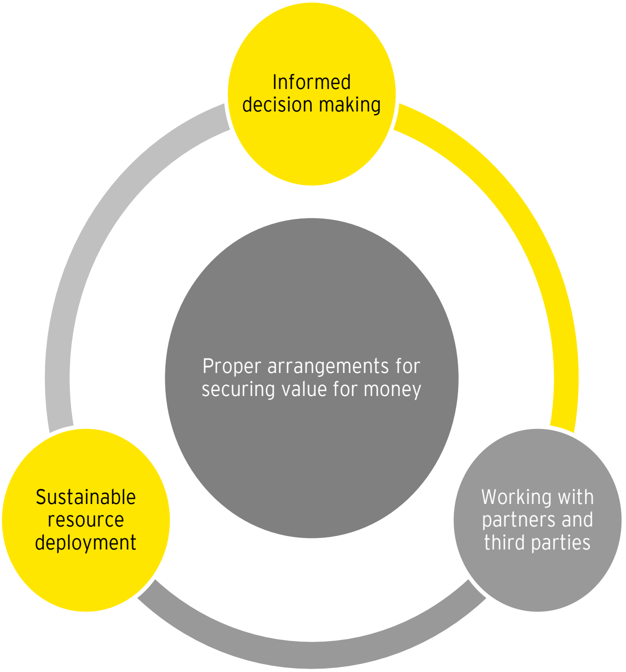
In considering your proper arrangements, we will draw on the requirements of the CIPFA/SOLACE framework for local government to ensure that our assessment is made against a framework that you are already required to have, and to report on through documents such as your annual governance statement.

We are only required to determine whether there are any risks that we consider significant, which the Code of Audit Practice defines as:

"A matter is 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"

Our risk assessment supports the planning of sufficient work to enable us to deliver a safe conclusion on arrangements to secure value for money and enables us to determine the nature and extent of further work that may be required. If we do not identify any significant risks there is no requirement to carry out further work. Our risk assessment has therefore considered both the potential financial impact of any issues we have identified, and also the likelihood that the issue will be of interest to local taxpayers, the Government and other stakeholders. This has resulted in the following two significant VFM risks which we view as relevant to our value for money conclusion:

- Delivery of a sustainable medium term financial plan
- Commercialisation and the purchase of investment properties.



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Value for Money Risks

What is the significant value for money risk?	What arrangements does the risk affect?	What will we do?
Delivery of a robust Medium Term Financial Plan (MTFP)		
In the Council's Medium Term Financial Plan (MTFP), reported to Cabinet in February 2018, the Council was able to set a balanced budget for 2018/19, as it planned to withdraw £41k from reserves. However, from 2019/20 onwards the funding gaps are predicted to increase significantly year on year, with a cumulative shortfall in 2021/22 of £3.842 million. The Council's reserves are currently in excess of this, but some of these are earmarked to invest in future projects. The Council's planned MTFP is reliant on the delivery of the Council's "Rushmoor 2020" strategy to cover significant "savings proposals" each year, as shown below.	Deploy resources in a sustainable manner	We will: • assess the key assumptions made within the annual budget and MTFP • review the progress made in identifying savings for 2019/20 and beyond; • assess the effectiveness of project management and clarity of reporting to members in overseeing the Rushmoor 2020 transformational projects and income generation opportunities; • review the Council's business planning process for both generating savings and also undertaking commercial and regeneration projects.

Revenue forecasts 18/19 to 21/22	2018/19 (£000)	2019/20 (£000)	2020/21 (£000)	2021/22 (£000)
Net budget	11,957	13,616	14,667	16,384
Total funding	-11,275	-10,886	-11,585	-12,542
Funding gap	682	2,730	3,082	3,842
Savings	-641	-2,559	-3,055	-3,090
Funding gap	41	171	27	752
Cumulative funding gap	41	212	239	992

However, these "savings proposals" of £3.055 million in 2020/21 for example are not true savings. They are mix of income from commercial investments (some £1.8 million), net savings from transformation projects (£900k), increase in fees & charges (£129k), efficiencies (£65k) and other income (£161k). The figures vary year on year but the greatest percentage "savings" are to be achieved through the income generation projects. Given the fact that the Council's capital programme, in terms of investment and regeneration, has slipped in 2018/19 then the impact on the delivery of the "savings proposals" and therefore a robust MTFP needs to be more closely monitored as these initiatives are higher risk and less outside of the Council's control.

Value for Money Risks

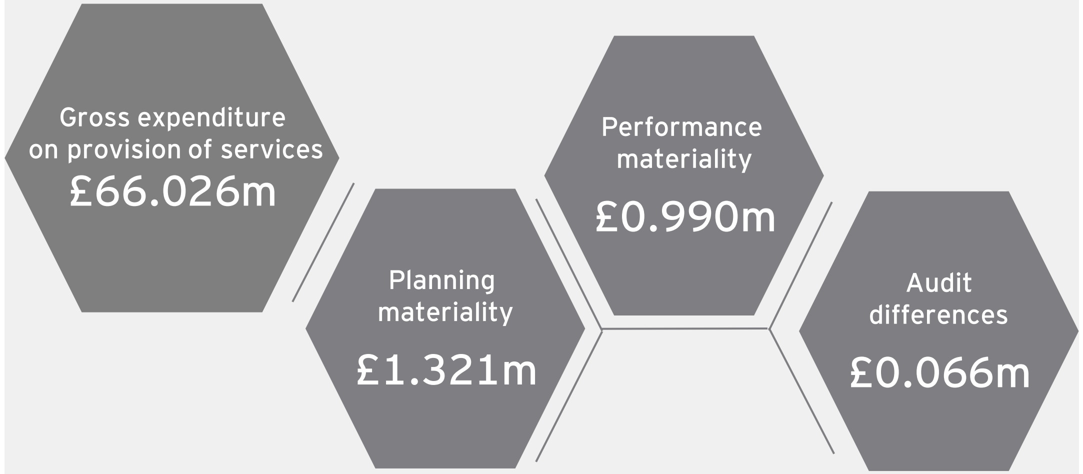
What is the significant value for money risk?	What arrangements does the risk affect?	What will we do?
Commercialisation and the purchase of investment properties		
The Council continues to develop significant commercial and investment opportunities to impact on annual income targets so that it can improve its financial sustainability. Full Council has granted approval to borrow up money and the Council will invest some £31.7 million in investment properties and some £7.2 million in regeneration properties in 2018/19. The Prudential Code, issued by CIPFA has always contained a statement that local authorities should not borrow more than, or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. Paragraph 46 of the Statutory Guidance on Local Government Investments states that 'Authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed'. However, para 47 of the Statutory Guidance also states that where a local authority has chosen to disregard the Prudential Code and the Guidance, additional explanations and disclosures will be required, including risk management. The Guidance also requires investments to have regard to Security, Liquidity and Yield in that order.	Deploy resources in a sustainable manner Informed decision making	We will review: • The underlying rationale for the Council's proposed investments and clarity on how this sits with the Council's strategy and objectives; • Legal powers and other advice obtained e.g. tax, investment decisions; • Compliance with sections 46 and 47 of Statutory Guidance on Local Authority Investments and the Prudential Code; • The Council's MRP policy; • Clarity of governance arrangements for the Council's decision making with regard to their investment property purchases; • Recognition and reporting of risks in the corporate/strategic risk register We will also consider the extent to which the Council has demonstrated the key Prudential Code considerations: • Existence of capital expenditure plans and a clear strategy that has regard to have regard to; service objectives, stewardship of assets, value for money, prudence and sustainability, affordability and practicality • Demonstrating value for money in borrowing decisions • Security of borrowed funds • Extent of borrowing for investments and borrowing overall • The nature of the investment • Risks involved, including falling capital values, borrowing costs, illiquidity of assets.

04 Audit materiality

Materiality

Materiality

For planning purposes, materiality for 2018/19 has been set at £1.321m. This represents 2% of the Council's prior year gross expenditure on provision of services. It will be reassessed throughout the audit process. We have provided supplemental information about audit materiality in Appendix D.



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We request that the Licensing, Audit and General Purposes Committee confirm its understanding of, and agreement to, these materiality and reporting levels.

Key definitions

Planning materiality – the amount over which we anticipate misstatements would influence the economic decisions of a user of the financial statements.

Performance materiality – the amount we use to determine the extent of our audit procedures. We have set performance materiality at £0.990m which represents 75% of planning materiality. The rationale for using 75% is that we anticipate finding few or no errors during the audit. This expectation arises from our experience of the Council in the previous year.

Audit difference threshold – we propose that misstatements identified below this threshold are clearly trivial. We will report to you all uncorrected misstatements over this amount relating to the comprehensive income and expenditure statement, balance sheet and collection fund that have an effect on income or that relate to other comprehensive income.

Other uncorrected misstatements, such as reclassifications and misstatements in the cash flow statement and movement in reserves statement or disclosures, and corrected misstatements will be communicated to the extent that they merit the attention of the Licensing, Audit and General Purposes Committee, or are important from a qualitative perspective.

Specific materiality – We have set a materiality of £1,000 for remuneration disclosures , related party transactions, members' allowances and exit packages. This is because these areas are perceived to be more sensitive to users of the financial statements.

05 Scope of our audit

Our Audit Process and Strategy

Objective and Scope of our Audit scoping

Under the Code of Audit Practice our principal objectives are to review and report on the Council's financial statements and arrangements for securing economy, efficiency and effectiveness in its use of resources to the extent required by the relevant legislation and the requirements of the Code.

We issue an audit report that covers:

1. **Financial statement audit**

Our objective is to form an opinion on the financial statements under International Standards on Auditing (UK and Ireland).

We also perform other procedures as required by auditing, ethical and independence standards, the Code and other regulations. We outline below the procedures we will undertake during the course of our audit.

Procedures required by standards

- Addressing the risk of fraud and error;
- Significant disclosures included in the financial statements;
- Council-wide controls;
- Reading other information contained in the financial statements and reporting whether it is inconsistent with our understanding and the financial statements; and
- Auditor independence.

Procedures required by the Code

- Reviewing, and reporting on as appropriate, other information published with the financial statements, including the Annual Governance; and
- Reviewing and reporting on the Whole of Government Accounts return, in line with the instructions issued by the NAO

2. **Arrangements for securing economy, efficiency and effectiveness (value for money)**

We are required to consider whether the Council has 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources.

Our Audit Process and Strategy (continued)

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Audit Process Overview

Our audit involves:

- Identifying and understanding the key processes and internal controls; and
- Substantive tests of detail of transactions and amounts.

For 2018/19 we plan to follow a substantive approach to the audit, as we have concluded this is the most efficient way to obtain the level of audit assurance required to conclude that the financial statements are not materially misstated.

Analytics:

We will use our computer-based analytics tools to enable us to capture whole populations of your financial data, in particular journal entries. These tools;

- Help identify specific exceptions and anomalies which can then be subject to more traditional substantive audit tests; and
- Give greater likelihood of identifying errors than random sampling techniques.

We will report the findings from our process and analytics work, including any significant weaknesses or inefficiencies identified and recommendations for improvement, to management and the Licensing, Audit and General Purposes Committee.

Internal audit:

We will review the internal audit plan and the results of their work. We will reflect the findings from these reports, together with reports from any other work completed in the year where they raise issues that could have an impact on the financial statements.

06 Audit team

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Audit team

Audit team structure:

Andrew Brittain
Associate Partner

Justine Thorpe
Manager

Taher Merimi
Lead Senior

Audit seniors and associates

Pensions Specialist

EY Actuaries

Property Specialist

EY Valuations

Use of specialists

When auditing key judgements, we are often required to rely on the input and advice provided by specialists who have qualifications and expertise not possessed by the core audit team. The areas where either EY or third party specialists provide input for the current year audit are:

Area	Specialists
Valuation of Land and Buildings	Wilkes, Head and Eve – RICS Registered Valuers EY Property specialists
Pensions disclosure	EY Actuaries PWC Actuary commissioned by NAO Aon Hewitt- Actuary

In accordance with Auditing Standards, we will evaluate each specialist's professional competence and objectivity, considering their qualifications, experience and available resources, together with the independence of the individuals performing the work.

We also consider the work performed by the specialist in light of our knowledge of the Council's business and processes and our assessment of audit risk in the particular area. For example, we would typically perform the following procedures:

- Analyse source data and make inquiries as to the procedures used by the specialist to establish whether the source data is relevant and reliable;
- Assess the reasonableness of the assumptions and methods used;
- Consider the appropriateness of the timing of when the specialist carried out the work; and
- Assess whether the substance of the specialist's findings are properly reflected in the financial statements.

07 Audit timeline

Audit timeline

Timetable of communication and deliverables

Timeline

Below is a timetable showing the key stages of the audit and the deliverables we have agreed to provide to you through the audit cycle in 2017/18.

From time to time matters may arise that require immediate communication with the Licensing, Audit and General Purposes Committee and we will discuss them with the Committee Chairman as appropriate. We will also provide updates on corporate governance and regulatory matters as necessary.

Audit phase	Timetable	Licensing, Audit and General Purposes Committee meeting	Deliverables
Planning: Risk assessment and setting of scopes. Walkthrough of key systems and processes	**December 2018**	January 2019	Audit Planning Report
Interim audit testing	**January to March 2019**	March 2019	Interim audit progress report
Year end audit Audit Completion procedures	**May to June 2019**	July 2019	Audit Results Report Audit opinions and completion certificates
Conclusion of reporting	**August 2019**	September 2019	Annual Audit Letter

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08 Independence

Introduction

The FRC Ethical Standard and ISA (UK) 260 "Communication of audit matters with those charged with governance", requires us to communicate with you promptly on all significant facts and matters that bear upon our integrity, objectivity and independence. The Ethical Standard, as revised in June 2016, requires that we communicate formally both at the planning stage and at the conclusion of the audit, as well as during the course of the audit if appropriate. The aim of these communications is to ensure full and fair disclosure by us to those charged with your governance on matters in which you have an interest.

Required communications	
Planning stage	**Final stage**
▸ Any principal threats to objectivity and independence identified by Ernst & Young (EY) including consideration of all relationships between you, your affiliates and directors and us; ▸ Any safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality review; ▸ The overall assessment of threats and safeguards; ▸ Information about the general policies and process within EY to maintain objectivity and independence.	▸ In order for you to assess the integrity, objectivity and independence of the firm and Andrew Brittain, Associate Partner, we are required to provide a written disclosure of relationships (including the provision of non-audit services) that may bear on our integrity, objectivity and independence. This is required to consider relationships with the Council, its directors and senior management, its affiliates, and its connected parties and any threats to integrity or objectivity, including those that could compromise independence. We are also required to disclose any safeguards that we have, and why they address such threats, together with any other information necessary to enable our objectivity and independence to be assessed; ▸ Details of non-audit services provided and the fees charged for them; ▸ Written confirmation that all covered persons are independent; ▸ Details of any inconsistencies between FRC Ethical Standard and your policy for the supply of non-audit services by EY and any apparent breach of that policy; ▸ Details of any contingent fee arrangements for non-audit services provided by us or our network firms; and ▸ An opportunity to discuss auditor independence issues.

During the audit we are also required to communicate with you whenever we make any significant judgements about threats to objectivity and independence, and the appropriateness of safeguards, e.g. when accepting an engagement to provide non-audit services.

We also provide information on any contingent fee arrangements, the amounts of any future contracted services, and details of any written proposal to provide non-audit services that has been submitted.

We ensure that the total amount of fees that EY and our network firms have charged for the provision of services during the reporting period are disclosed.

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Relationships, services and related threats and safeguards

We highlight the following significant facts and matters that may be reasonably considered to bear upon our objectivity and independence, including any principal threats. We have adopted the safeguards noted below to mitigate these threats along with the reasons why they are considered to be effective. However we will only perform non – audit services if the service has been pre-approved in accordance with your policy.

Overall Assessment

Overall, we consider that the safeguards that have been adopted appropriately mitigate the principal threats identified. We therefore confirm that EY is independent and the objectivity and independence of Andrew Brittain, your audit engagement partner, and the audit engagement team have not been compromised.

Self interest threats

A self-interest threat arises when EY has financial or other interests in the Council. Examples include where we receive significant fees for non-audit services; where we need to recover long outstanding fees; or where we enter into a business relationship with you. At the time of writing, there are no long outstanding fees.

We believe that it is appropriate for us to undertake permissible non-audit services and we will comply with the policies that you have approved.

None of the services are prohibited under the FRC's ES or the National Audit Office's Auditor Guidance Note 01 and the services have been approved in accordance with your policy on pre-approval. The ratio of non-audit fees to audits fees is not permitted to exceed 70%.

At the time of writing, no non-audit services have been undertaken. No additional safeguards are required.

A self-interest threat may also arise if members of our audit engagement team have objectives or are rewarded in relation to sales of non-audit services to you. We confirm that no member of our audit engagement team, including those from other service lines, has objectives or is rewarded in relation to sales to you, in compliance with Ethical Standard part 4.

There are no other self-interest threats at the date of this report.

Self review threats

Self-review threats arise when the results of a non-audit service performed by EY or others within the EY network are reflected in the amounts included or disclosed in the financial statements.

There are no self-review threats at the date of this report.

Management threats

Partners and employees of EY are prohibited from taking decisions on behalf of management of the Council. Management threats may also arise during the provision of a non-audit service where management is required to make judgements or decision based on that work.

There are no management threats at the date of this report.

Other threats

Other threats, such as advocacy, familiarity or intimidation, may arise.

There are no other threats at the date of this report.

Other communications

EY Transparency Report 2018
Ernst & Young (EY) has policies and procedures that instil professional values as part of firm culture and ensure that the highest standards of objectivity, independence and integrity are maintained. Details of the key policies and processes in place within EY for maintaining objectivity and independence can be found in our annual Transparency Report which the firm is required to publish by law. The most recent version of this Report is for the year ended 1 July 2018 and can be found here: https://www.ey.com/uk/en/about-us/ey-uk-transparency-report-2018

09 Appendices

Fees

The duty to prescribe fees is a statutory function delegated to Public Sector Audit Appointments Ltd (PSAA) by the Secretary of State for Communities and Local Government.

PSAA has published a scale fee for all relevant bodies. This is defined as the fee required by auditors to meet statutory responsibilities under the Local Audit and Accountability Act 2014 in accordance with the NAO Code.

	Planned fee 2018/19	Final fee 2017/18	Planned fee 2017/18
	£	£	£
Total Fee – Code work	38,375 (1)	49,838	49,838
Additional fee for VFM work	(2)	1,873	0
Other non-audit services not covered above (Housing Benefits)	N/A	7,511	7,511
Total fees	**38,375**	**59,222**	**58,490**

All fees exclude VAT

Note:

(1) Our 2018/19 Code work includes additional planned procedures highlighted in section two of this report to address the new accounting requirements of IFRS 9 Financial Instruments and IFRS 15 Revenue from contracts with customers for the 2018/19 accounts. As at the date of our planning report the Council is yet to evidence their assessment of the impact of these standards, and so we cannot currently quantify the expected scale fee variation for these additional procedures. We will agree this with management, depending on the identified impact of the new standards.

(2) As noted above the Council's significant financial pressures and resulting commercial activity present additional value for money risks and therefore we may need to undertake additional VfM procedures that are incremental to those assumed in the PSAA's scale fee. The scale fee is based on historic levels of activity and risks. We will work with management to minimise the fee impact, but an increased fee is likely due to the extent of the value for money risks.

The audit fee covers:

- Audit of the financial statements
- Value for money conclusion
- Whole of Government Accounts.

For Rushmoor Borough Council our indicative fee is set at the scale fee level. This indicative fee is based on certain assumptions, including:

- The overall level of risk for the audit of the financial statements is not significantly different from the previous year;
- Officers meet the agreed timetable of deliverables;
- Our accounts opinion and value for money conclusion is unqualified;
- Appropriate quality documentation is provided by the Council;
- There is an effective control environment;
- Prompt responses are provided to our draft reports.

If any of the above assumptions prove to be unfounded, we will seek a variation to the agreed fee. This will be discussed with the Council in advance.

Fees for the auditor's consideration of correspondence from the public and formal objections will be charged in addition to the scale fee.

Appendix B

Required communications with the Licensing, Audit and General Purposes Committee

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We have detailed the communications that we must provide to the Licensing, Audit and General Purposes Committee.

		Our Reporting to you
Required communications	**What is reported?**	**When and where**
Terms of engagement	Confirmation by the Licensing, Audit and General Purposes Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Our responsibilities	Reminder of our responsibilities as set out in the engagement letter	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Planning and audit approach	Communication of the planned scope and timing of the audit, any limitations and the significant risks identified. When communicating key audit matters this includes the most significant risks of material misstatement (whether or not due to fraud) including those that have the greatest effect on the overall audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team	Audit planning report
Significant findings from the audit	▸ Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures ▸ Significant difficulties, if any, encountered during the audit ▸ Significant matters, if any, arising from the audit that were discussed with management ▸ Written representations that we are seeking ▸ Expected modifications to the audit report ▸ Other matters if any, significant to the oversight of the financial reporting process	Audit results report

Appendix B

Required communications with the Licensing, Audit and General Purposes Committee (continued)

		Our Reporting to you
Required communications	**What is reported?**	**When and where**
Going concern	Events or conditions identified that may cast significant doubt on the Council's ability to continue as a going concern, including: ▸ Whether the events or conditions constitute a material uncertainty ▸ Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements ▸ The adequacy of related disclosures in the financial statements	Audit results report
Misstatements	▸ Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation ▸ The effect of uncorrected misstatements related to prior periods ▸ A request that any uncorrected misstatement be corrected ▸ Corrected misstatements that are significant ▸ Material misstatements corrected by management	Audit results report
Fraud	▸ Ask the Licensing, Audit and General Purposes Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the Council ▸ Any fraud that we have identified or information we have obtained that indicates that a fraud may exist ▸ A discussion of any other matters related to fraud	Audit results report
Related parties	▸ Significant matters arising during the audit in connection with the Council's related parties including, when applicable: ▸ Non-disclosure by management ▸ Inappropriate authorisation and approval of transactions ▸ Disagreement over disclosures ▸ Non-compliance with laws and regulations	Audit results report

Appendix B

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Required communications with the Licensing, Audit and General Purposes Committee (continued)

Our Reporting to you

Required communications	What is reported?	When and where
Independence	Communication of all significant facts and matters that bear on the objectivity and independence of EY and all audit team members Communicating key elements of the audit engagement partner's consideration of independence and objectivity such as: ▸ Any principal threats ▸ Safeguards adopted and their effectiveness ▸ An overall assessment of threats and safeguards ▸ Information about the general policies and process within the firm to maintain objectivity and independence	Audit Planning Report and Audit Results Report
External confirmations	▸ Management's refusal for us to request confirmations ▸ Inability to obtain relevant and reliable audit evidence from other procedures	Audit results report
Consideration of laws and regulations	▸ Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off ▸ Enquiry of the Licensing, Audit and General Purposes Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Licensing, Audit and General Purposes Committee may be aware of	Audit results report
Internal controls	▸ Significant deficiencies in internal controls identified during the audit	Audit results report
Representations	Written representations we request from management and/or those charged with governance	Audit results report
Material inconsistencies and misstatements	Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	Audit results report
Auditors report	▸ Key audit matters included in our auditor's report ▸ Any circumstances identified that affect the form and content of our auditor's report	Audit results report
Fee Reporting	▸ Breakdown of fee information when the audit plan is agreed ▸ Breakdown of fee information at the completion of the audit ▸ Any non-audit work	Audit planning report and Audit results report

Appendix C

Additional audit information

Other required procedures during the course of the audit

As well as the key areas of audit focus outlined in section 2, we must perform other procedures as required by auditing, ethical and independence standards and other regulations. We outline these below.

Our responsibilities as required by auditing standards

- Identifying and assessing the risks of material misstatement of the financial statements (either from fraud or error), design and perform audit procedures considering those risks, and obtain enough appropriate audit evidence to provide a basis for our opinion.
- Obtaining an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Council's internal control.
- Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Concluding on the appropriateness of management's use of the going concern basis of accounting.
- Evaluating the overall presentation, structure and content of the financial statements (including the disclosures), and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtaining enough appropriate audit evidence on the financial information of the services provided by the Council to express an opinion on the financial statements. Reading other information contained in the financial statements, whether the Licensing, Audit and General Purposes Committee reporting appropriately addresses matters communicated by us and reporting whether it is materially inconsistent with our understanding and the financial statements; and
- Maintaining auditor independence.

Purpose and evaluation of materiality

For the purposes of determining whether the accounts are free from material error, we define materiality as the magnitude of an omission or misstatement that, individually or in the aggregate, in light of the surrounding circumstances, could reasonably be expected to influence the economic decisions of the users of the financial statements. Our evaluation of it requires professional judgement and necessarily takes into account qualitative as well as quantitative considerations implicit in the definition. We would be happy to discuss with you your expectations regarding our detection of misstatements in the financial statements.

Materiality determines the level of work performed on individual account balances and financial statement disclosures.

The amount we consider material at the end of the audit may differ from our initial determination. At this stage, however, we cannot anticipate all the circumstances that may influence our judgement about materiality. At the end of the audit we will form our final opinion by considering all matters that could be significant to users of the accounts, including the total effect of the audit misstatements we identify, and our evaluation of materiality at that date.

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Certification of housing benefit claim report 2017-18

Rushmoor Borough Council

28 January 2019

Ernst & Young LLP

Building a better working world

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RG1 1YE,
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Licensing, Audit and General Purposes Committee
Rushmoor Borough Council
Council Offices
Farnborough Road
Farnborough
GU14 7JU

28 January 2019
Ref: 19RBC/HB1

Direct line: 07976 515115
Email: ABrittain@uk.ey.com

Dear Members

Certification of Housing Benefit claim report 2017-18

We are pleased to report on our housing benefit certification work for the Council's 2017-18 housing benefit claim.

Section 1 of this report outlines the results of our 2017-18 certification work and highlights the significant issues. We checked and certified the housing benefits subsidy claim with a total value of £35,785,954. We issued a letter to the DWP with observations in, ahead of the deadline. It was not necessary to amend the claim.

We welcome the opportunity to discuss the contents of this report with you at the Licensing, Audit and General Purposes Committee on 28 January 2019. We would like to thank the Council's officers for their help. The certification process requires considerable input from them to be carried out efficiently and we are most grateful for their assistance.

Yours faithfully

Andrew Brittain
Associate Partner
Ernst & Young LLP
Enc

Contents

1. Housing benefits subsidy claim

Scope of work	Results
Value of claim presented for certification	£35,785,954
Amended/Not amended	Not amended
Qualification letter	Letter issued to the DWP with observations only
Fee – 2017-18 Fee – 2016-17	£8,652 £7,511

Local Government administers the Government's housing benefits scheme for tenants and can claim subsidies from the Department for Work and Pensions (DWP) towards the cost of benefits paid.

The certification guidance requires auditors to complete more extensive '40+' or extended testing if initial testing identifies errors in the calculation of benefit or compilation of the claim. 40+ testing may also be carried out as a result of errors that have been identified in the audit of previous year's claims.

For the 2017/18, HB audit, we carried out extended testing on two errors identified within Rent Allowances (Cell 94). On receipt of our letter, the DWP may decide whether to ask the Council to carry our further work to quantify the error or to claw back the benefit subsidy paid.

These are the main items we reported:

Cell 94 Rent Allowances – Total expenditure (Benefit Granted)

- Cell total: £35,785,954
- Cell population: 7,372
- Headline Cell: £35,785,954

Testing of the initial sample of 20 claims identified:

- one error where earnings had been incorrectly calculated; and
- one error where the incorrect attendance allowance had been used where the 17/18 uprating was not correctly applied. However, as attendance allowance is disregarded in full, this error had no impact on the subsidy.

In view of this, an additional random sample of 40 cases was selected from both the sub-populations of rent and earnings cases in 2017/18. Testing of the additional sample identified one error where the benefit was underpaid and another error which had no impact on the benefit. As there was no overstatement of the claim, the identified errors were not extrapolated. We reported these observations to the DWP in a letter and stated that there was no impact on the claim.

2. 2017-18 certification fees

The PSAA determine a scale fee each year for the audit of claims and returns. For 2017-18, these scale fees were published by the Public Sector Audit Appointments Ltd (PSAA's) in March 2017 and are now available on the PSAA's website (www.psaa.co.uk).

Claim or return	2017-18	2017-18	2016-17
	Actual fee £	Indicative fee £	Actual fee £
Housing benefits subsidy claim	8,652	8,652	7,511

No changes to the 2017-18 fees are proposed.

3. Looking forward

2018/19

From 2018-19, the Council is responsible for appointing their own reporting accountant to undertake the certification of the housing benefit subsidy claim in accordance with the Housing Benefit Assurance Process (HBAP) requirements that are being established by the DWP. DWP's HBAP guidance has now been published.

The Council has not appointed EY as its reporting accountant from 2018-19 and therefore 2017-18 was our last year as the Council's reporting accountant for housing benefit.

EY | Assurance | Tax | Transactions | Advisory

Ernst & Young LLP

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LICENCING, AUDIT & GENERAL PURPOSES
28 JANUARY 2019

EXECUTIVE HEAD OF FINANCE
REPORT NO. FIN1905

ANNUAL TREASURY MANAGEMENT STRATEGY AND INVESTMENT STRATEGY 2019/20

SUMMARY AND RECOMMENDATIONS:

SUMMARY:

The Council is required to approve a Treasury Management Strategy and Investment Strategy for 2019/20 before 1 April 2019.

CIPFA has conducted reviews of the "Prudential Code" and the "Treasury Management Code of Practice" in 2017, and the Ministry of Housing, Communities and Local Government (MHCLG) also issued revised guidance on Local Government Investment. The attached Treasury Management Strategy Statement (TMSS) for 2019/20 (Appendix A) and Investment Strategy (Appendix B) is prepared in accordance with the new guidance.

RECOMMENDATION:

Members are requested to recommend to Cabinet:

(i) Approval of the Treasury Management Strategy, Annual Borrowing Strategy attached at Appendix A, and
(ii) Approve Annual Investment Strategy attached at Appendix B; and
(iii) Approval of the Minimum Revenue Provision (MRP) Statement set out in Appendix C.

1. INTRODUCTION

1.1 This report sets out the proposed Treasury Management Strategy and Investment Strategy for the year 2019/20, including the borrowing and investment strategies and treasury management indicators for capital finance for 2019/20 and the Minimum Revenue Provision Statement.

1.2 The Council has adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Council to approve a treasury management strategy and Investment Strategy before the start of each financial year.

1.3 The CIPFA “Prudential Code” 2017 edition, “Treasury Management Code of Practice” 2017 edition and MHCLG revised guidance February 2018 focus on “non- treasury” investments. With particular attention on the purchase of investment property and other commercial activities that aim to generate income; but may require external borrowing (or the use of existing cash balances) to raise the cash to finance such activities.

1.4 Investment now includes all financial assets of the Council and those non-financial assets held primarily or partially to generate profit, including investment property and loans to subsidiaries and third parties. A new separate investment strategy (Appendix B) must be approved before April 2019.

2. PURPOSE

2.1 The purpose of the treasury management operation is to ensure that cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in counterparties or instruments commensurate with the Council’s low risk approach, pursuing optimum performance while ensuring that security of the investment is considered ahead of investment return. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure.

2.2 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 the Council can meet its capital spending obligations. The management of longer-term cash may involve the arrangement of long and/or short term loans (external borrowing) or may use longer term cash flow surpluses in lieu of external borrowing (internal borrowing).

2.3 Accordingly, the Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as: *“The management of the Council’s borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks”.*

2.4 The purpose of investment management operations is to ensure that all investment decisions that are made primarily to generate a profit have a suitable level of security and liquidity. Ensuring risks and rewards are monitored regularly.

2.5 The second main function of investment management is to generate potential returns and monitor performance of returns on a regular basis.

2.6 The purpose of the Indicators is to set a framework for affordable, prudent and sustainable capital investment.

2.7 The appendices (A to C) set out the Treasury Management Strategy, Investment Strategy and Minimal Revenue Provision Statement for 2019/20 to 2022/23 and fulfil key legislative requirements as follows:

Appendix A

- The **Treasury Management Strategy** which sets out how the Council's treasury service will support capital decisions taken during the period, the day to day treasury management and the limitations on activity through treasury prudential indicators, in accordance with CIPFA's Code of Practice on Treasury Management and Prudential Code;
- The **Annual Borrowing Strategy** which sets out the Council's objectives for borrowing together with the approved sources of long and short-term borrowing and;
- **Annual Investment Strategy** which sets out the Council's criteria for choosing investment counterparties and limiting exposure to the risk of loss, in accordance with CIPFA's Code of Practice on Treasury Management.

Appendix B

- The new **Non-Treasury Investment Strategy** sets out the Councils makes investment decisions taken during the period and monitors performance and security, in accordance with MHCLG Investment Guidance.

Appendix C

- The Council's **Minimum Revenue Provision (MRP) Statement,** which sets out how the Council will pay for capital assets through revenue each year, as required by the Local Government Act 2003 (Regulations 27 and 28 in the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003). At the time, the 2017/18 MRP statement was issued Government guidance was expected to set the maximum useful economic life of 50 years for freehold land and 40 years for other assets. Government guidance actually set the maximum useful economic life of 50 years for freehold land and 40 years for other assets The Council's Minimum Revenue Provision (MRP) Statement is therefore suitably updated in line with the issued guidance and will be prospectively applied from 18/19 onward.

2.8 These policies and parameters provide an approved framework within which officers undertake the day-to-day capital, treasury and non- treasury investment activities.

3. SCOPE

3.1 This report covers the Council's treasury management and investment activities as set out in paragraphs 2.1 to 2.5 above. The funds invested consist of short-term cash available due to timing of income and expenditure, prudential borrowing and the Council's capital receipts.

3.2 Arlingclose advice continues to indicate that the Council should diversify investment risk (spreading smaller amounts over an increasing number of counterparties) wherever possible. The Council is now progressively incurring further borrowing, and Arlingclose have advised that in the circumstances of some current investments reaching their maturity date(s) the Council should replace with long-term pooled funds. This strategy allows for the maintained level of principle sums to be invested during a period when borrowing is increasing.

3.3 The Council incurred prudential code borrowing in 2017/18 in the sum of £5.89m in relation to its capital expenditure. Further borrowing to support the financing of its approved capital programme in the year 2018/19 will also be required. It therefore commences the year 2019/20 in a position where its investment holdings continue to remain significant (although, less than in previous financial years) but it also carries some accumulating debt. There will be an inevitable requirement to incur some further borrowing to service capital expenditure in future years.

3.4 Careful observation of the "gross debt v capital financing requirement" indicator will need to be undertaken progressively throughout the financial year.

3.5 Where a material change to the attached strategies during the year a revised strategy will be presented to full council before the change is implemented.

BACKGROUND DOCUMENTS:

1. Treasury Management in the Public Services (CIPFA) 2017 Edition
2. The Prudential Code for Capital Finance (CIPFA) 2017 Edition
3. SI 2003/3146 - Local Authorities (Capital Finance and Accounting) (England) Regulations 2003
4. SI 2004/3055 - Local Authorities (Capital Finance and Accounting) (Amendment)
5. Capital Finance: Guidance on local government investment (third edition) (Issued under section 15 (1)(a) of eth Local Government Act 2003)

CONTACT DETAIL:

Report Author – **Alan Gregory** / alan.gregory@rushmoor.gov.uk / 01252 398441

Head of Service – **David Stanley** / david.stanley@rushmoor.gov.uk / 01252 398440

APPENDIX A

TREASURY MANAGEMENT STRATEGY 2019/20

1. INTRODUCTION

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

1.2 Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code. The Licensing, Audit and General Purposes Committee is the nominated Committee responsible for the effective scrutiny of the Treasury Management Strategy and policies.

1.3 Investments held for service purposes or for commercial profit are considered in a separate report, the Investment Strategy at Appendix B.

1.4 This strategy covers:

- External context
- Current borrowing and investment portfolio position
- Annual Borrowing Strategy
- Annual Investment Strategy
- Performance Indicators

2. EXTERNAL CONTEXT (commentary provided by Arlingclose)

2.1 **Economic background:** The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Council's treasury management strategy for 2019/20.

2.2 UK Consumer Price Inflation (CPI) for October was up 2.4% year/year, slightly below the consensus forecast and broadly in line with the Bank of England's November Inflation Report. The most recent labour market data for October 2018 showed the unemployment rate edged up slightly to 4.1% while the employment rate of 75.7% was the joint highest on record. The 3-month average annual growth rate for pay excluding bonuses was 3.3% as wages continue to rise steadily and provide some pull on general inflation. Adjusted for inflation, real wages grew by 1.0%, a level still likely to have little effect on consumer spending.

2.3 The rise in quarterly GDP growth to 0.6% in Q3 from 0.4% in the previous quarter was due to weather-related factors boosting overall household consumption and construction activity over the summer following the weather-related weakness in Q1. At 1.5%, annual GDP growth continues to remain below trend. Looking ahead, the BoE, in its November Inflation Report, expects GDP growth to average around 1.75% over the forecast horizon, providing the UK's exit from the EU is relatively smooth.

2.4 Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy have been made since. However, the Bank expects that should the economy continue to evolve in line with its November forecast, further increases in Bank Rate will be required to return inflation to the 2% target. The Monetary Policy Committee continues to reiterate that any further increases will be at a gradual pace and limited in extent.

2.5 While US growth has slowed over 2018, the economy continues to perform robustly. The US Federal Reserve continued its tightening bias throughout 2018, pushing rates to the current 2%-2.25% in September. Markets continue to expect one more rate rise in December, but expectations are fading that the further hikes previously expected in 2019 will materialise as concerns over trade wars drag on economic activity.

2.6 **Credit outlook**: The big four UK banking groups have now divided their retail and investment banking divisions into separate legal entities under ringfencing legislation. Bank of Scotland, Barclays Bank UK, HSBC UK Bank, Lloyds Bank, National Westminster Bank, Royal Bank of Scotland and Ulster Bank are the ringfenced banks that now only conduct lower risk retail banking activities. Barclays Bank, HSBC Bank, Lloyds Bank Corporate Markets and NatWest Markets are the investment banks. Credit rating agencies have adjusted the ratings of some of these banks with the ringfenced banks generally being better rated than their non-ringfenced counterparts.

2.7 The Bank of England released its latest report on bank stress testing, illustrating that all entities included in the analysis were deemed to have passed the test once the levels of capital and potential mitigating actions presumed to be taken by management were factored in. The BoE did not require any bank to raise additional capital.

2.8 European banks are considering their approach to Brexit, with some looking to create new UK subsidiaries to ensure they can continue trading here. The credit strength of these new banks remains unknown, although the chance of parental support is assumed to be very high if ever needed. The uncertainty caused by protracted negotiations between the UK and EU is weighing on the creditworthiness of both UK and European banks with substantial operations in both jurisdictions.

2.9 **Interest rate forecast**: Following the increase in Bank Rate to 0.75% in August 2018, the Council's treasury management adviser Arlingclose is forecasting two more 0.25% hikes during 2019 to take official UK interest rates to 1.25%. The Bank of England's MPC has maintained expectations for slow and steady rate rises over the forecast horizon. The MPC continues to have a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. Arlingclose believes that MPC members consider both that ultra-low interest rates result in other economic problems, and that higher Bank Rate will be a more effective policy weapon should downside Brexit risks crystallise when rate cuts will be required.

2.10 The UK economic environment remains relatively soft, despite seemingly strong labour market data. Arlingclose's view is that the economy still faces a challenging outlook as it exits the European Union and Eurozone growth softens. While assumptions are that a Brexit deal is struck and some agreement reached on transition and future trading arrangements before the UK leaves the EU, the possibility of a "no deal" Brexit still hangs over economic activity *(at the time of writing this commentary in mid-December).* As such, the risks to the interest rate forecast are considered firmly to the downside.

2.11 Gilt yields and hence long-term borrowing rates have remained at low levels but some upward movement from current levels is expected based on Arlingclose's interest rate projections, due to the strength of the US economy and the ECB's forward guidance on higher rates. 10-year and 20-year gilt yields are forecast to remain around 1.7% and 2.2% respectively over the interest rate forecast horizon, however volatility arising from both economic and political events are likely to continue to offer borrowing opportunities.

2.12 A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix 1.

2.13 For the purpose of setting the budget, it has been assumed that investments will be made at an average rate of 3.86%, and that new short-term loans will be borrowed at an average rate of 1.25%.

3 LOCAL CONTEXT

3.1 On 31st December 2018, the Council held £26.6m of borrowing, long-term liabilities of £3.2 and £28.5m of investments. This is set out in further detail below in table 3. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance sheet (Capital Expenditure and Capital Financing summary and forecast)

	31.3.2018 actual	31.3.2019 forecast	31.3.2020 budget	31.3.2021 budget	31.3.2022 budget
Debt (incl. leases)	15.6	60.7	121.6	142.5	168.2
Capital Financing Requirement	99.9	111.6	172.5	176.6	176.8
Difference	84.3	50.9	50.9	34.1	8.5
Investments	27.3	25.6	25.6	25.6	25.6

3.2 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.

3.3 The Council has an increasing CFR due to the capital programme, stable level of investments and will therefore be required to borrow up to £128.5 m over the forecast period.

3.4 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 2019/20.

3.5 **Liability benchmark:** To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as table 1 above, but that cash and investment balances are kept to a minimum level of £4m at each year-end to maintain sufficient liquidity but minimise credit risk.

Table 2: Liability benchmark

	31.3.2018 actual	31.3.2019 forecast	31.3.2020 budget	31.3.2021 budget	31.3.2022 budget
Outstanding borrowing	15.6	60.7	121.6	142.5	168.2
Investment min	4.0	4.0	4.0	4.0	4.0
Liability benchmark	-7.7	39.1	100.0	120.9	146.6

5. CURRENT BORROWING & INVESTMENT PORTFOLIO POSITION

5.1 The Guidance on Local Government Investments in England gives priority to security and liquidity, and the Council's aim has been to achieve a yield commensurate with these principles. The Council continues to follow Arlingclose advice in the knowledge that whilst long-term interest rate forecasts remain low it should generate enhanced returns with counterparties other than banks and to invest across a diverse investment portfolio.

5.2 During 2018/19 the Council has generated returns from existing long-term pooled fund investments together with diversification within the Council's investment portfolio. The Council held the following investments at 31st December 2018:

- £19.6m in pooled funds (providing a balance across a range of 5 different types of fund).
- Various temporary investments of minor amounts held in Money Market funds all for durations of 6 months or less

5.3 Local Authorities have adopted the new IFRS 9 accounting standard for the financial instruments including investments, borrowing, receivables and payables in 2018/19. A statutory override has been applied to the fair value movement on pooled investment fund. Any fair value movement can be reversed out from the General Fund to an unusable reserve called the Pooled Fund Adjustment Account. It is forecast that all Treasury Management investments will be held within pooled funds including Money Market Funds.

Table 3: – Existing Investment & Debt Portfolio Position

	Actual Portfolio at 31st Dec 18 £m	Average Rate %	
Total External Borrowing			
Borrowing from the M3 LEP	2.1	0	
Borrowing from other Local Authorities	24.5	0.86	***
Other external Borrowing	0		
Total Gross External Debt	26.6		
Other long-term liabilities:			
Finance Leases	3.2		
Total other long-term liabilities	3.2		
Investments:			
Managed in-house:			
Money Market Funds	8.9	0.47	**
Managed externally:			
Pooled Funds:			
Schroder Income Maximiser Fund	5	7.43	*
CCLA LAMIT Property Fund	3.6	4.83	**
M&G Investments Strategic Corporate Bond Fund	4	3.6	**
UBS Multi Asset Fund	5	3.86	**
Threadneedle Investments	2	3.15	**
Total Investments	28.5	3.89	
Net debt	1.3		

*Estimated return based on 12 month average between July 17 to June 18

**Based on 12 month average April 2018 to December 2018

***Based on average of borrowing holding at December 2018

Table 1 Illustrates the Council's investment and debt portfolio position as at 31st December 2018.

6. ANNUAL BORROWING STRATEGY 2018/19

6.1 The Council currently holds £26.6 million of loans, an increase of £13.5 million on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Council expects to borrow up to £60.7m in 2019/20.

6.2 The Council has made use of funds from the Enterprise M3 (LEP) by borrowing £3m in an earlier year to progress the Aldershot regeneration schemes. External contributions will be received over a seven-year period to fully finance this amount. At the commencement of 2019/20, £2.1m of this borrowed amount remains outstanding.

6.3 Capital expenditure in the previous financial year (2018/19) is programmed to be substantial, including a significant amount for investment property acquisitions in Ash Road, Eelmoor Road and invincible Road, property purchases in Union Street Aldershot. Capital expenditure in relation to the Farnborough International Loan will be concluded within 2019/20. Prudential code borrowing will therefore be required in order to achieve overall financing. The Council will incur some further borrowing during 2019/20 in order assist in the financing of its capital programme.

6.4 **Objectives**: The Council's chief objective when borrowing money will be 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.

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

6.6 By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) 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. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2019/20 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

6.7 Alternatively, the Council may arrange forward starting loans during 2019/20, 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.

6.8 In addition, the Council may borrow further short-term loans to cover unplanned cash flow shortages.

6.9 **Sources of borrowing**: The approved sources of long-term and short-term borrowing are detailed within Treasury Management Practices (TMP) 4 (Approved Instruments, Methods and Techniques), and are summarised below:

- Public Works Loan Board (PWLB) and any successor body
- Money market loans (long term & temporary)
- Any bank or building society authorised to operate in the UK
- UK Local Authorities
- UK public and private sector pension funds (except the Local Government Pension Scheme administered by Hampshire County Council)
- Capital market bond investors
- UK Municipal Bond Agency plc and other special purpose companies created to enable local authority bond issues.
- Lottery monies

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

- Leasing
- Hire purchase
- Private Finance Initiative
- Sale and leaseback

6.11 The Council has previously raised the majority of its borrowing from Local Authorities, but it continues to investigate other sources of finance, that may be available at more favourable rates.

6.12 **Municipal Bonds 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 to full Council.

6.13 **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 interest rate exposure limits in the treasury management indicators below.

7. ANNUAL INVESTMENT STRATEGY 2019/20

7.1 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. As at 31 December, the Council's investment balance stood at £28.5m, and similar levels are expected to be maintained in the forthcoming year.

7.2 **Objectives**: Both the CIPFA Code and the MHCLG 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 of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

7.3 **Negative interest rates:** If the UK enters into a recession in 2019/20, 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.

7.4 **Strategy**: The Council continues to maintain a diverse range of secure and/or higher yielding asset classes during 2019/20. All of the Council's surplus cash remains invested in short-term unsecured bank deposits, and money market funds.

7.4 **Business models:** Under the new IFRS 9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

7.5 **Approved counterparties:** The Council may invest its surplus funds with any of the counterparty types in table 4 below, subject to the cash limits (per counterparty) and the time limits shown. The schedule of approved counterparties is underpinned by a detailed list of named counterparties. This list is maintained within Financial Services for treasury management operational purposes.

Table 4: Approved Investment Counterparties

Counterparty		Cash limit per counterparty	Investment Limit (per type of counterparty)	Time limit †
Banks Unsecured whose lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's is:	AAA	£2m	£20m in total	5 Years*
	AA+	£2m		5 Years*
	AA	£2m		4 years*
	AA-	£2m		3 years*
	A+	£2m		2 years
	A	£2m		13 months
	A-	£2m		6 months
	BBB+	£1m		100 days
Banks Secured whose lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's is:	AAA	£4m	Unlimited	20 years
	AA+	£4m		10 years
	AA	£4m		5 years
	AA-	£4m		4 years
	A+	£4m		3 years
	A	£4m		2 years
	A-	£4m		13 months
	BBB+	£2m		6 months
	BBB or BBB-	£2m		100 days
Government whose lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's is:	AAA	£4m	Unlimited	50 Years
	AA+	£4m		25 Years
	AA	£4m		15 Years
	AA-	£4m		10 Years
	A+	£2m		5 Years
	A	£2m		5 Years
	A-	£2m		5 Years
	BBB+	£1m		2 Years
	None	£4m		25 Years
Corporates whose lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's is:	AAA	£2m	£6m in total	20 Years
	AA+	£2m		10 Years
	AA	£2m		10 Years
	AA-	£2m		10 Years
	A+	£2m		5 Years
	A	£2m		2 Years
	A-	£1m		13 months
	BBB+	£1m		6 months
	none	£0.5m		5 Years

Counterparty		Cash limit per counterparty	Investment Limit (per type of counterparty)	Time limit †
Registered Providers whose lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's is:	AAA	£4m	£10m in total	20 Years
	AA+	£4m		10 Years
	AA	£4m		10 Years
	AA-	£4m		10 Years
	A+	£4m		5 Years
	A	£4m		5 Years
	A-	£4m		5 Years
	BBB+	£4m		5 Years
	None	£4m		5 Years
The Council's current account bank if it fails to meet the above criteria		£2m	£2m	next day
UK Building Societies without credit rating		£1m	£4m	1 Year
Money market funds		£5m	£20m in total	n/a
Collective Investment Schemes (pooled funds)		£5m per fund	£25m in total	These funds do not have a defined maturity date

† *no longer than 2 years in fixed-term deposits and other illiquid instruments*

7.6 Investments may be made with banks or any public or private sector organisations that meet the above credit rating criteria. The Council may also invest with organisations and pooled funds without credit ratings, following an external credit assessment and advice from the Council's treasury management adviser.

7.7 **Credit rating:** Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. 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.

7.8 **Investment limits**: The Council's revenue reserves available to cover investment losses are forecast to be £2 million on 31st March 2019. In order that no more than 20% 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 £4 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. Detail of investment limits are given in table 4 above.

7.9 Further information as to why certain counterparties have been included in Table 4 is set out below:

- **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 generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

- **Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made as part of a diversified pool in order to spread the risk widely.

  Investments in unrated small businesses may provide considerably higher rates of return. They will however only be made following a favourable external credit assessment and on the specific advice of the Council's treasury management adviser.

- **Registered Providers:** Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing and registered social landlords, formerly known as Housing

Associations. These bodies are tightly regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain a high likelihood of receiving government support if needed.

- **Money Market Funds**: These funds are pooled investment vehicles consisting of money market deposits and similar instruments. They have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager. We will continue to use funds that offer same-day liquidity as an alternative to instant access bank accounts, while funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

- **Other Pooled Funds**: Shares or units in diversified investment vehicles consisting of the any of the above investment types, plus 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.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

7.10 **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 with that entity
- 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.

7.11 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.

7.12 **Liquidity management**: The Council reviewed cash flow on a daily basis to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments.

7.13 **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, reports in the quality financial press and analysis and advice from the Council's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

7.14 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not reflected in general credit-ratings. In these circumstances, where the Council feels the whole market has been affected, it 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. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

8. TREASURY MANAGEMENT INDICATORS

8.1 The Treasury Management Code requires that local authorities set a number of indicators for treasury management performance, which have been set as below. A voluntary measure for credit risk as set out in paragraph 8.2

8.2 **Credit Risk (Credit Score Analysis)**:
The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating / credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

The advice from Arlingclose is to aim for an average A-, or higher, average credit rating, with an average score of 7 or lower. The scores are weighted according to the size of our deposits (value-weighted average) and the maturity of the deposits (time-weighted average).

Credit Risk Indicator	Target
Portfolio average credit rating	A-
Portfolio average credit score	7.0

8.3 **Liquidity:** The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount it can borrow each quarter without giving prior notice.

Liquidity risk indicator	**Target**
Total sum borrowed in past 3 months without prior notice	£2m

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

Interest rate risk indicator	**Limit**
Upper limit on one-year revenue impact of a 1% rise in interest rates	£500,000
Upper limit on one-year revenue impact of a 1% fall in interest rates	£500,000

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

8.5 **Maturity Structure of Borrowing**: This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Maturity Structure	Upper	Lower
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

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

8.6 **Principal Sums Invested for Periods Longer than a year**: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Principle Sums Invested	2019/20	2020/21	2021/22
Limit on principal invested beyond year end at any one time	£40m	£40m	£40m

9. OTHER ITEMS

9.1 The CIPFA Code requires the Council to include the following in its treasury management strategy.

9.2 **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, and to reduce costs or increase income at the expense of greater risk. 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. Embedded derivatives, including those present in pooled funds, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

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

9.3 **Markets in Financial Instruments Directive**: The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but with the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Executive Head of Finance believes this to be the most appropriate status.

9.4 **Investment Training**: The needs of the Council's treasury management staff for training in investment management are assessed on a continuous basis, discussed as part of the staff appraisal process and reviewed as the responsibilities of individual members of staff change.

Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA.

9.5 **Investment Advisers:** The Council jointly tendered the treasury management service together with three other District Councils located within the Hampshire area, and appointed Arlingclose Limited for a further 3 year contract in April 2016. This contract enables the Council to receive specific advice on investment, debt and capital finance issues. The quality of this service will be reviewed on an ongoing basis as part of the process of monitoring the Council's investment portfolio.

9.6 **Financial Implications -** Investments**:** The budget for investment income in 2019/20 is £1.36 million (gross of borrowing interest), based on an average investment portfolio of £28.5 million at interest rates ranging from 0.47% liquid MMF and other short-term investments to 7.43% on the highest yielding long-term pooled property investment fund. Performance of investments against budget will be reviewed on an ongoing basis and as part of our quarterly budget monitoring process.

9.7 **Financial Implications -** Borrowing**:** The budget for interest costs in relation to borrowing in 2019/20 is £1.0m (not including IFRIC 4 lease accounting interest). It is determined using estimated short-term interest rates. The Council's actual borrowing at the end of 2019/20 is estimated to be in the region of £121.6m

9.8 **Other Options Considered:** The CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Executive Head of Finance continues to believe that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term

		interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Appendix A – Arlingclose Economic & Interest Rate Forecast December 2018

Underlying assumptions:

- Our central interest rate forecasts are predicated on there being a transitionary period following the UK's official exit from the EU.
- The MPC has a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. We believe that MPC members consider that: 1) tight labour markets will prompt inflationary pressure in the future, 2) ultra-low interest rates result in other economic problems, and 3) higher Bank Rate will be a more effective policy weapon if downside risks to growth crystallise.
- Both our projected outlook and the increase in the magnitude of political and economic risks facing the UK economy means we maintain the significant downside risks to our forecasts, despite the potential for slightly stronger growth next year as business investment rebounds should the EU Withdrawal Agreement be approved. The potential for severe economic outcomes has increased following the poor reception of the Withdrawal Agreement by MPs. We expect the Bank of England to hold at or reduce interest rates from current levels if Brexit risks materialise.
- The UK economic environment is relatively soft, despite seemingly strong labour market data. GDP growth recovered somewhat in the middle quarters of 2018, but more recent data suggests the economy slowed markedly in Q4. Our view is that the UK economy still faces a challenging outlook as the country exits the European Union and Eurozone economic growth softens.
- Cost pressures are easing but inflation is forecast to remain above the Bank's 2% target through most of the forecast period. Lower oil prices have reduced inflationary pressure, but the tight labour market and decline in the value of sterling means inflation may remain above target for longer than expected.
- Global economic growth is slowing. Despite slower growth, the European Central Bank is conditioning markets for the end of QE, the timing of the first rate hike (2019) and their path thereafter. More recent US data has placed pressure on the Federal Reserve to reduce the pace of monetary tightening – previous hikes and heightened expectations will, however, slow economic growth.
- Central bank actions and geopolitical risks have and will continue to produce significant volatility in financial markets, including bond markets.

Forecast:

- The MPC has maintained expectations of a slow rise in interest rates over the forecast horizon, but recent events around Brexit have dampened interest rate expectations. Our central case is for Bank Rate to rise twice in 2019, after the UK exits the EU. The risks are weighted to the downside.

- Gilt yields have remained at low levels. We expect some upward movement from current levels based on our central case that the UK will enter a transitionary period following its EU exit in March 2019. However, our projected weak economic outlook and volatility arising from both economic and political events will continue to offer borrowing opportunities.

	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.17**
Arlingclose Central Case	**0.75**	**0.75**	**1.00**	**1.00**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.13**
Downside risk	0.00	-0.50	-0.75	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	**-0.85**
3-mth money market rate														
Upside risk	0.10	0.10	0.10	0.10	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	**0.17**
Arlingclose Central Case	**0.90**	**0.95**	**1.10**	**1.30**	**1.40**	**1.40**	**1.40**	**1.35**	**1.35**	**1.35**	**1.35**	**1.35**	**1.35**	**1.27**
Downside risk	-0.20	-0.45	-0.60	-0.80	-0.90	-0.90	-0.90	-0.85	-0.85	-0.85	-0.85	-0.85	-0.85	**-0.76**
1-yr money market rate														
Upside risk	0.20	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	**0.33**
Arlingclose Central Case	**1.15**	**1.25**	**1.35**	**1.50**	**1.70**	**1.60**	**1.50**	**1.40**	**1.35**	**1.35**	**1.35**	**1.35**	**1.35**	**1.40**
Downside risk	-0.35	-0.50	-0.60	-0.80	-0.90	-0.90	-0.90	-0.85	-0.85	-0.85	-0.85	-0.85	-0.85	**-0.77**
5-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.37**
Arlingclose Central Case	**1.15**	**1.25**	**1.35**	**1.50**	**1.50**	**1.40**	**1.35**	**1.35**	**1.30**	**1.30**	**1.30**	**1.30**	**1.30**	**1.33**
Downside risk	-0.50	-0.60	-0.65	-0.80	-0.80	-0.70	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	**-0.66**
10-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.37**
Arlingclose Central Case	**1.50**	**1.65**	**1.70**	**1.80**	**1.80**	**1.75**	**1.75**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**
Downside risk	-0.55	-0.70	-0.70	-0.80	-0.80	-0.75	-0.75	-0.70	-0.70	-0.70	-0.70	-0.70	-0.70	**-0.71**
20-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.37**
Arlingclose Central Case	**2.00**	**2.10**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.18**
Downside risk	-0.60	-0.70	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.73**
50-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.37**
Arlingclose Central Case	**1.90**	**1.95**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**1.99**
Downside risk	-0.60	-0.70	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.73**

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%

PWLB Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

APPENDIX B

INVESTEMENT STRATEGY

1. INTRODUCTION

1.1 The Council invests its money for three broad purposes:

- because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as **treasury management investments**),
- to support local public services by lending to or buying shares in other organisations (**service investments**), and
- to earn investment income (known as **commercial investments** where this is the main purpose).

1.2 This investment strategy is a new report for 2019/20, meeting the requirements of statutory guidance issued by the government in January 2018, and focuses on the second and third of these categories.

2. SERVICE IMPROVEMNTS: LOANS

2.1 **Contribution:** The Council lends money to its subsidiaries, local businesses, and its employees to support local public services and stimulate local economic growth. The Council is a funding partner of Farnborough International Limited. The loans have enables to development of the Farnborough International exhibition and conference centre. Expanding the exhibition and conferencing capabilities in Farnborough brings increased economic capacity to the Borough and is a reinvestment in local business.

2.2 **Security:** The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the Council, upper limits on the outstanding loans to each category of borrower have been set as follows:

Table 1: Loans for service purposes in £ millions

Category of borrower	31.3.2018 actual			18/19	2019/20
	Balance owing	Loss allowance	Net figure in accounts	Forecast	Approved Limit
Local businesses	4.5	0	4.5	5.6	6.7
Employees	0.1	0	0.1	0.1	0.1
TOTAL	**4.6**	**0**	**4.6**	**5.7**	**6.8**

2.3 Accounting standards require the Council to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Council's statement of accounts from 2018/19 onwards will be shown net of this loss allowance. However, the Council makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

2.4 Risk assessment: The Council assesses the risk of loss before entering into and whilst holding service loans by assessing the counterparty's resilience, the service users' needs that the loan is designed to help meet and how these will evolve over time. During the life of the loan, any change in original assumptions will be monitored. The Council will use external advisors if felt appropriate by the Executive Head of Finance. All loans will be subject to contract agreed by the Corporate Manager – Legal Services. All loans must be approved by full Council and will be monitored by the Executive Head of Finance.

3. SERVICE INVESTMENTS: SHARES

3.1 **Contribution:** The Council invests in the shares of its subsidiary and holds a financial share in a development partnership to support local public services and stimulate local economic growth.

3.2 The creation of a Wholly Owned Company (WOC) subsidiary will assist to develop new homes to meet the Council's regeneration priorities and desire to improve the availability of quality housing within the Borough. It will enable the Council to hold existing properties, acquire and develop rented homes, responding to housing needs in the Borough and providing social and economic benefits. It is anticipated that approximately 52 houses and apartments will be constructed on up to 14 sites initially. Other foreseeable potential sites for development may be pursued once the WOC is operating. The WOC could create a number of jobs and training opportunities during the construction and operational phase, stimulating economic growth and regeneration. The income and capital growth generated can be reinvested in delivering Council services.

3.3 The purpose of Rushmoor Development Partnership (RDP) is to develop the Civic Quarter, Union St Farnborough, Union St Aldershot and Parson's Barracks Aldershot. All developments will include retail and housing items. Elements of the developments may also include relocation of some RBC operational services. In particular, it directly contributes to the delivery of the following Place Making strategic objective which underpins the Vision: "Great Places to Live – to make Aldershot and Farnborough town centres great places to live with a wide variety of quality new homes attractive to a diverse range of people"

3.4 **Security:** One of the risks of investing in shares is that they fall in value meaning that the initial outlay may not be recovered. In order to limit this risk, upper limits on the sum invested in each category of shares have been set as follows:

Table 2: Shares held for service purposes in £ millions

Category of company	**18/19**	**2019/20**
	Forecast	**Approved Limit**
Subsidiaries and Partnerships	0	10
TOTAL	**0**	**10**

3.5 **Risk assessment:** The Council assesses the risk of loss before entering into and whilst holding shares in line with paragraph 41 of *Capital Finance: Guidance on local government investment (third edition)* *[41]*

3.6 The Council has excellent knowledge of the market planned for WOC developments, as each of the initial 14 sites that may be developed by the WOC are currently in the ownership of the Council. Given that the WOC aim is to provide private sector rental units the Council (as 100% shareholder of the WOC) on sites of limited space and accessibility then the nature and level of competition is considered to be low or none. There is every expectation that the market demand for PRS will continue to grow within the local economy, particularly as the possibility of home ownership for a significant element of the local population becomes less achievable as time progresses. The Council considers that exit from the WOC (& market) is viable (if required) as the WOC investment is locked into quality housing stock, which has the potential for sale disposal as soon as it is developed.

3.7 The Council has good knowledge of the RDP intended developments. RDP is effectively a closed market and it will provide development in accordance with agreement between the Council and the developer. Competition has effectively been evaluated at the time of the creation of RDP. The Council considers that RDP (an LLP) is the most appropriate mechanism to achieve the developments required. Hence, the barriers to entry have been lifted (by creation of RDP) and barriers to exit are eliminated because RDP has a specific set of defined initiatives.

3.8 The Council has used three external advisors regarding the potential for creation and development of the WOC and development of the RDP. These three advisors are Freeths (legal and financial advice), Regenco (housing & economic advice) & Arlingclose (treasury management and financial advice).

3.9 The Council observes strict procedure regarding its procurement of external advisors. They are appointed utilising specific competitive tendering procedure processes, relevant to the category of advice and guidance that is sought. Maintenance of the quality of advice is reviewed within the relatively frequent tender engagement process.

3.10 The market for the WOC and RDP is localised to the Borough of Rushmoor only in the first instance, but noting that it possible that the WOC may look for development potential outside of the local economy at some time in the future. The local market cannot be compared to any global information issued by credit agencies. Hence, no element of the risk assessment utilises credit ratings.

3.11 In the circumstances of the WOC and RDP, no credit ratings have been used.

3.12 The relatively stable asset stability of the WOC assists to significantly lower financial risk. A detailed financial model has been developed by Council staff to enable it to provide monthly budget/target achievement information. This model can be used to identify development risk, which (if it occurred) is limited mainly to asset creation achieved within the WOC budget plan. There is a perception that risk is greater during site development(s) as work in progress has lesser value when compared to a finished product article. The WOC development team will monitor developments to ensure minimisation of risk.

3.13 The RDP Investment team will monitor developments to ensure minimisation of risk. None of the site developments would proceed if there were considerations that no financial return would be achieved. The developer would not participate in any venture that did not deliver financial return. Both partners are insistent on the creation of specific and clearly defined development plans for all sites. Data and advice from the developer is paramount to assess and monitor risk for each development.

3.14 **Liquidity:** The creation of the WOC will commit funds initially a period of 26 years. There is potential to extend the commitment to 40 years. RDP funds will be committed for an estimated period of 10 years

3.15 **Non-specified Investments:** Shares are the only investment type that the Council has identified that meets the definition of a non-specified investment in the government guidance. The limits above on share investments are therefore also the Council's upper limits on non-specified investments. The Council has not adopted any procedures for determining further categories of non-specified investment since none are likely to meet the definition.

4. COMERCIAL INVESTMENTS: PROPERTY

4.1 **Contribution:** The Council invests in local and regional commercial and residential property with the intention of making a profit that will be spent on local public services.

Table 3: Property held for investment purposes in £ millions

Property by type	31.3.2018 actual			31.3.2019 expected		
	Pre-18/19 Investment Property portfolio	Gains or (losses)	Value in accounts	Purchase cost during 18/19	Gains or (losses)	Value in accounts
Historic Investment Portfolio	44.3	1.8	46.1	0	0	46.1
Industrial units				6.7	0	6.7
Retail				11.7	0	11.7
Offices				12.8	0	12.8
TOTAL	**44.3**	**1.8**	**46.1**	**31.2**	**0**	**77.31861**

4.2 **Security:** In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.

4.3 *Where value in accounts is at or above purchase cost:* A fair value assessment of the Council's investment property portfolio has been made within the past twelve months, and the underlying assets provide security for capital investment.

4.4 Should the 2018/19 year end accounts preparation and audit process value these properties below their purchase cost, then an updated investment strategy will be presented to full council detailing the impact of the loss on the security of investments and any revenue consequences arising therefrom.

4.5 *Where value in accounts is below purchase cost:* The fair value of the Council's investment property portfolio is no longer sufficient to provide security against loss, and the Council is therefore taking mitigating actions to protect the capital invested. These actions include:

- Review of the portfolio during 2019/20 by external agency
- An assessment from the Executive Head of Regeneration and Property that the best course of action is to hold the assets as values will increase over the long term. Giving consideration to the soundness of the assets with strong covenants/dependable income streams.

4.6 **Risk assessment:** The Council assesses the risk of loss before entering into and whilst holding property investments by:

- Assessment of the relevant market sector(s) including the level of

competition, barriers to entry/exit, future market prospects
- Assessment of exposure to particular market segments to ensure adequate diversification
- Use of external advisors if considered appropriate by the Executive Head of Finance
- Full and comprehensive report on all new investments to Cabinet
- Continual monitoring of risk across the whole portfolio and specific assets

4.7 **Liquidity:** Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice, and can take a considerable period to sell in certain market conditions. To ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed, the Council. It is clearly difficult to sell property/convert into liquid asset at short notice and will be subject to market conditions in terms of timescales involved. However, to ensure that invested sums could be accessed when they are needed the portfolio will be regularly reviewed and prioritised to ensure that commercial property could be sold as a going concern within a period of six months.

5. LOAN COMMITMENTS AND FINANCIAL GUARANTEES

5.1 Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the Council and are included here for completeness.

5.2 The Council has contractually committed to make up to £1.1m of loans to local businesses should it request it during 2019/20.

6. PROPORTIONALITY

6.1 The Council plans to become dependent on profit generating investment activity to achieve a balanced revenue budget. Table 4 below shows the extent to which the expenditure planned to meet the service delivery objectives and/or place making role of the Council is dependent on achieving the expected net profit from investments over the lifecycle of the Medium Term Financial Plan. Should it fail to achieve the expected net profit, the Council has earmerked reserves available to cover any immediate shortfall in income. The Executive Head of Regeneration and Property would review the cause of any shortfall and identify any actions needed to ensure the income shortfall is mitigated or remidied.

Table 4: Proportionality of Investments

	2017/18 Actual	2018/19 Forecast	2019/20 Budget
Gross service expenditure	65.5	63.9	57.9
Investment income	4.7	4.0	8.4
Proportion	7.2%	6.2%	14.5%

7. BORROWING IN ADVANCE OF NEED

7.1 Government guidance is that local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. The Council may, in supporting the delivery of the Council's Capital Programme, borrow in advance of need where it is expected to demonstrate the best longer-term value for money position. 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 (ie: the cost of holding does not outweigh the benefits of early borrowing) and that the Council can ensure the security of such funds. the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and potential interest rate changes. These risks will be managed as part of the Council's overall management of its treasury risks and will be reported through the standard reporting method.

8. CAPACITY, SKILLS AND CULTURE

8.1 **Elected members and statutory officers:** The Council recognises that those elected Members and statutory officers involved in the investments decision making process must have appropriate capacity, skills and information to enable them to:

- take informed decisions as to whether to enter into a specific investment;
- to assess individual assessments in the context of the strategic objectives and risk profile of the Council; and
- to enable them to understand how new decisions have changed the overall risk exposure of the Council.

The Council will ensure that the relevant officers and the Members of Cabinet have appropriate skills, providing training and advisor support where there is a skills gap

8.2 **Commercial deals:** The Council will ensure that the Cabinet and officers negotiating commercial deals are aware of the core principles of the prudential framework and of the regulatory regime within which local authorities operate.

8.3 **Corporate governance:** Any investment decisions will be scrutinised by Executive Leadership Team and Cabinet before final approval. The Overview and Scrutiny committee review all decisions made by the Cabinet. Although after the event, the Committee can make any recommendations to the Council if it sees fit.

9. INVESTMENT INDICATORS

9.1 The Council has set the following quantitative indicators to allow elected members and the public to assess the Council's total risk exposure as a result of its investment decisions.

9.2 **Total risk exposure:** The first indicator shows the Council's total exposure to potential investment losses. This includes amounts the Council is contractually committed to lend but have yet to be drawn down and guarantees the Council has issued over third party loans.

Table 5: Total investment exposure in £millions

Total investment exposure	**31.03.2018 Actual**	**31.03.2019 Forecast**	**31.03.2020 Forecast**
Treasury management investments	27.3	25.6	25.6
Service investments: Loans	4.5	5.6	6.7
Service investments: Shares	0	0	10
Commercial investments: Property	46.1	77.3	119.1
TOTAL INVESTMENTS	77.9	108.5	161.4
Commitments to lend	1.1	1.1	0
TOTAL EXPOSURE	79	109.6	161.4

9.3 **How investments are funded:** Government guidance is that these indicators should include how investments are funded. Since the Council does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. However, the following investments could be described as being funded by borrowing. The remainder of the Council's investments are funded by usable reserves and income received in advance of expenditure.

Table 6: Investments funded by borrowing in £millions

Investments funded by borrowing	31.03.2018 Actual	31.03.2019 Forecast	31.03.2020 Forecast
Treasury management investments	0	0	0
Service investments: Loans	0	1.1	2.2
Service investments: Shares	0	0	2
Commercial investments: Property	0	31.23261	73.02521
TOTAL FUNDED BY BORROWING	0	32.33261	77.22521

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

Table 7: Investment rate of return (net of all costs)

Investments net rate of return	2017/18 Actual	2018/19 Forecast	2019/20 Forecast
Treasury management investments	2.5%	3.0%	4.2%
Service investments: Loans	4.1%	4.0%	4.1%
Service investments: Shares	0%	0%	1%
Commercial investments: Property	8.4%	5.4%	7.6%
ALL INVESTMENTS	6.2%	4.6%	6.3%

9.5 The Council has considered the following additional indicators prudent to report given the investment activities

Table 8: Other investment indicators

Indicator	2017/18 Actual	2018/19 Forecast	2019/20 Forecast
Debt to net service expenditure ratio	1.1	4.1	8.2
Commercial income to net service expenditure ratio	0.28	0.22	0.5

APPENDIX C

MINIMUM REVENUE PROVISION STATEMENT

1.1 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.

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

1.3 The broad aim of the MHCLG 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.

1.4 The MHCLG 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. This statement only incorporates options recommended in the Guidance.

1.5 For any unsupported capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant assets, starting in the year after the asset becomes operational. MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure for all other assets or on capital expenditure not related to fixed assets but which has been capitalised by regulation or direction (revenue expenditure financed by capital under statute), will be charged over 50 years. MRP will be applied in the year following expenditure was incurred.

1.6 For assets acquired by finance lease or 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.

1.7 Where loans are made to other bodies and designated as capital expenditure, no MRP will be charged. However, the capital receipts generated by the repayments on those loans will be set aside to repay debt instead.

1.8 It should be noted that the Council continues to make use of two revolving infrastructure funds from the Local Enterprise Partnership (LEP). The related capital expenditure does not however give rise to MRP, as a contract of structured external repayments will eliminate the need to incur MRP.

1.9 At the commencement of 2018/19 the Council had, a Capital Financing Requirement (CFR) of £15.6million in relation to a specific elements of capital expenditure incurred in the previous financial year (2017/18). The Council has incurred further amounts of capital expenditure in 2018/19 and will need to engage in an element of Prudential Code borrowing in that financial year to achieve total financing of its capital programme. It is inevitable therefore that the borrowing that is required in 2018/19 will require MRP to be charged to the Council's General Fund Revenue Account in 2019/20 and future years.

1.10 The implementation of International Financial Reporting Standards (IFRS) has meant that the accounting treatment for assets used within major contracts may result in embedded finance leases appearing on the Balance Sheet, leading to a requirement for MRP. This is purely an accounting requirement and does not give rise to any requirement to borrow to fund these assets.