Sunderland City Council

**Item No. 3**

**At a meeting of the AUDIT AND GOVERNANCE COMMITTEE held in the CIVIC CENTRE on Friday 20 January 2012**

**Present:**

Mr G N Cook in the Chair

Councillor Forbes, Tate, T Wright and Mr Paterson.

**Declarations of Interest**

There were no declarations of interest.

**Apologies for Absence**

Apologies for absence were received from Councillors Rolph and Speding.

**Minutes**

34. RESOLVED that the minutes of the meeting of the Committee held on 25 November 2011 be confirmed and signed as a correct record.

Councillor Wright referred to the SWITCH project and queried whether Elected Members were receiving enough feedback and statistics. The Executive Director of Commercial and Corporate Services advised that figures were available and the Leader, Deputy Leader and Cabinet Secretary were regularly briefed. Further information could be made available to any Member on request.

**Presentation on Proposed Future Assurance Arrangements**

The Executive Director of Commercial and Corporate Services introduced the presentation and referred to the challenges to be faced by the Authority during the next financial year and the different landscape which would have to be negotiated in the future particularly in terms of the more diverse service delivery environment. The assurance arrangements which were in place would need to be efficient, flexible and fit for purpose. The changes which were being proposed would ensure arrangements were ready and prepared for the new landscape as it emerged.

The Head of Audit, Risk and Procurement delivered a presentation on the proposed future assurance arrangements within the Council.

The assurance arrangements should a) tell the Council if key safeguards are working, b) highlight problem/risk areas, and c) allow the authority to move ahead with changes with confidence, or slow down if required.

The changes to the Assurance arrangements were taking place within the context of significant external and internal changes and diversified (and increased) risk at times of reduced resource.

The Head of Audit, Risk and Procurement outlined the large number of areas, both internal and external which currently provided assurance to the Council and that the current arrangements were not all co-ordinated and not as efficient as they could be. The proposals for the future assurance arrangements were as follows: -

- Clear Corporate Lead
- Introduce an Integrated Assurance Framework
- Private sector partner and support
- Organisational Change – two new teams for Risk and Assurance and Internal Audit
- Review of other assurance activity

A diagram illustrating the Integrated Assurance Framework and an example of a Corporate Assurance map was presented to Members. The Committee were informed that the Corporate Assurance Map would be presented to the Executive Management Team and reported to the Audit and Governance Committee on a quarterly basis. The Head of Audit, Risk and Procurement highlighted that the map would ensure that there was no duplication of assurance and the work undertaken would still identify areas for improvement.

Councillor Wright asked where scrutiny would fit in with the assurance framework and the Head of Audit, Risk and Procurement advised that the role which the scrutiny committees play in scrutinising performance could be taken account of within the performance management element of the Corporate Assurance Map.

Councillor Tate highlighted that the Management Scrutiny Committee were engaged in a review of self regulation and it would be useful for the Committee to understand what was happening with regards to the Assurance Framework. He asked the Head of Audit, Risk and Procurement to consider this.

The Council would retain an Internal Audit function but it would be smaller and more focused and deal with planned audit work. The Risk and Assurance function would offer proactive support to managers and would still maintain risk registers and the Corporate Risk Profile.

The next steps in the process would be to: -

- Create Internal Audit and Risk and Assurance teams
- Develop/agree Corporate Assurance Map

- Develop Internal Audit Plan to support Map
- Develop Risk and Assurance Plan to support Map
- Appoint partner
- Review other internal assurance sources (2012/2013)

The new arrangements would involve significant changes for the Council, its staff and the Audit and Governance Committee.

With reference to the localism of business rates, Councillor Wright enquired if the collection process was to remain the same. The Head of Audit, Risk and Procurement advised that the Council currently collected business rates and paid these in to a central pool which was then redistributed to all local authorities. In the future, Sunderland would retain the business rates which it had collected, subject to some floors and ceilings. The Executive Director added that Sunderland was designated as a 'top-up' authority for business rates and it had not yet been clarified what this would mean in the new system. There were clearly inherent risks in both the starting point and the ongoing operation of the new system.

Councillor Wright also asked if the Audit and Governance Committee would have to consider whether the new Internal Audit section would be fit for purpose and if the Head of Audit, Risk and Procurement and Executive Director were satisfied with the new arrangements.

The Executive Director stated that he believed both the Internal Audit and Risk Management teams were very good and capable but it was clear that some different skills and approaches were needed moving forward given the likely picture over the medium term. If responsibility for delivery of services in some cases was to be handled elsewhere, the accountability would remain with the Council. He expressed confidence that the proposals would ensure that assurance arrangements in all circumstances were 'right by design'.

Councillor Forbes commented that the presentation was very clear and helpful, however she asked for further clarification about the position of Local Authority Companies within the Corporate Assurance Map. The Executive Director of Commercial and Consumer Services stated that these companies may be constituted differently depending on their purpose. If public funding was to be filtered through any vehicle then the authority would have certain rights and obligations and this would be assured through the Framework. The Council already had business relationships with a number of private providers and demanded a degree of assurance from them. In response to a query from Councillor Tate, it was confirmed that the protocol for working with outside organisations would still apply.

Mr Paterson sought further detail on the role of the partner in the new arrangements and the Executive Director advised that initially this would enable the Council to access expertise when establishing the Framework. This would also enable there to be leaner staffing internally and the partner would bring a different dynamic and level of flexibility. The costs incurred would be covered through savings and there would be a significant payback in value for money terms.

The Committee received the proposals very positively and having thanked the Head of Audit, Risk and Procurement for his comprehensive presentation, it was: -

35. RESOLVED that the proposals for future Assurance arrangements be noted.

**Internal Audit Plan – Consultation for 2012/2013**

The Head of Audit, Risk and Procurement submitted a report outlining the suggested priorities for the Internal Audit Plan for 2012/2013 and asking Members to consider and comment on the areas for inclusion within the plan.

The Audit and Counter Fraud Manager highlighted a number of key areas for the 2012/2013 Internal Audit Plan including: -

- Management of risks in developing new service delivery models
- Corporate Contract Management
- New Wear Crossing (SSTC)
- Changes in Welfare Benefits and Council Tax Benefits
- Adults safeguarding model
- ICT projects
- New Public Health responsibilities

Councillor Tate referred to the Public Health function and the future funding of this and the establishment of the Health and Wellbeing Board. The Executive Director stated that there would be funding associated with the new Public Health responsibilities but it was not clear at what level this would be. Some work was being undertaken by Risk Management on the Health and Wellbeing Board and this would become part of the internal audit framework moving forward.

The issue of Procurement was raised by Councillor Forbes and the Audit and Counter Fraud Manager stated that although the New Wear Crossing had been highlighted specifically as a key project, the procurement function was subject to a rolling programme of audit work.

The Chair indicated that he would like to see some information on the Localism Act and the impact of benefit changes on levels of child poverty within the city.

Having considered and commented on the proposed Internal Audit Plan 2012/2013, the Committee: -

36. RESOLVED that the report be noted.

(Signed) G N COOK
Chairman

Sunderland City Council

**Item No. 4**

**AUDIT AND GOVERNANCE COMMITTEE** **10 February 2012**

**INTERNAL AUDIT PROGRESS REPORT**

**Report of the Head of Audit, Risk and Procurement**

## 1. Purpose of Report

1.1 To consider the performance of Internal Audit up to 30th December 2011, areas of work undertaken, and the internal audit opinion regarding the adequacy of the overall system of internal control within the Authority.

## 2. Description of Decision

2.1 The Audit and Governance Committee is asked to consider the report.

## 3. Key Performance Indicators

3.1 Performance against the agreed KPIs to date is shown in Appendix 1.

3.2 All KPI's are on target with the following 2 exceptions:

- The percentage of medium risk recommendations implemented currently stands at 78% (excluding schools) against a target of 90%. A summary of the performance by Directorate for medium risk recommendations is shown in the table below. Members will be aware that action is being taken by Health, Housing and Adult Services to improve their implementation rate, although as explained in the November progress report this will take time to filter through to the overall rate.

| Directorate / Body | Implementation Rate - Nov | Implementation Rate - Dec |
|---|---|---|
| Children's Services (non schools) | 83% | 86% |
| City Services | 91% | 90% |
| Office of the Chief Executive | 83% | 82% |
| Commercial and Corporate Services | 94% | 94% |
| Health, Housing & Adult Services | 54% | 54% * |
| **Implementation Rate (exc. schools)** | **79%** | **78%** |
| Schools | 87% | 85% |

| Total Implementation Rate | 82% | 81% |
|---|---|---|

* no further follow up work has been undertaken since the last progress report

- Percentage of audits completed by the target date (from scoping meeting to issue of draft report). The actual performance is 72% against a target of 80%. This is mainly due to support work being required by managers across the Council due to the amount of change that is currently underway and the availability of clients. It is not of concern.

## 4. Summary of Internal Audit Work

4.1 The audit opinion for the audits carried out so far during the year is shown in Appendix 2 along with the current overall opinion based on the current and 2 previous years audit work. Of the 100 planned audits, 67 have been completed to date (5 of which relate to associated bodies). Two have been cancelled as they are no longer required, they are Stroke Care Grant and Information Governance at Beamish Museum. The following planned audits are currently ongoing:

- Payroll Processing and Accounts Payable (ongoing throughout the year)
- Council Tax – Recovery
- Responsive Local Services
- Information Technology Infrastructure Library

4.2 Since the last progress report 2 unplanned audits have been completed, as follows:

- Technoforge (property asset database)
- Future Jobs Fund – final audit certificate

4.3 Internal Audit carry out proactive advice and guidance work in many areas across the Council where procedures and arrangements are being developed or changed. This work is important in helping the Council build appropriate controls into new systems or procedures and helps to provide assurance that risks are being considered and managed, where appropriate. Guidance has been provided since the last progress report or continues to be provided in the following areas:

- A significant amount of time has been spent supporting the set up and implementation of a Local Authority Controlled Company, Care and Support Sunderland Limited. Support regarding the ongoing governance arrangements of the Company will continue as the arrangements develop.

- Internal Audit are advising the project board which is assessing options for the future delivery of care and support services to adults.

- Proposed changes to the way personal budgets are administered in relation to social care.

- The Council has purchased a replacement customer relationship management system for which support is being provided regarding its implementation.

- The Council is currently implementing a new Corporate Computing Model (CCM) involving the planning, design, and implementation of an end to end solution for server and end-user computing delivery. Internal Audit staff are working in conjunction with ICT, Risk Management and 3rd party partner organisation staff in supporting the implementation of this major project.

4.4 Specific work aimed at detecting fraud, misappropriation or errors which may have resulted in financial loss is currently ongoing in the following areas:

- From the National Fraud Initiative (NFI) 2010, work has been completed in relation to blue badge permits, residential care payments, pensions to deceased pensioners, payroll to UK visas, and insurance claims, which did not identify any issues of concern. In relation to Housing Benefit matches which were received in March 2011, from a total of 3,848 matches, 618 were recommended for further review, these are currently being reviewed with 7 fraud prosecutions resulting to date with an overpayment value of £33,506.74. Recovery of these monies is to be undertaken. Further matches are to be examined and additional prosecutions are anticipated.

- Review of creditor payment information has highlighted 8 duplicate payments to date with a value of £8,608.45. Recovery of these monies is underway. Three further matches are being investigated (£16,171.23).

- Overtime / honoraria payments to ensure they are legitimate, accurate and appropriately authorised.

- Processes to obtain low value goods / services to ensure compliance with established procedures.

4.5 During the summer a procurement exercise was carried out to appoint a specialist firm who will carry out an exercise to review the Council's creditor payments using advanced software technology to identify any further potential duplicate payments. The work will also help to establish the effectiveness of the NFI exercise. Work will be carried out on a commission only basis. A firm has been appointed and the work is due to start in February 2012.

**5. Conclusions**

5.1 This report provides information regarding progress against the planned audit work for the year and performance targets.

5.2 Results of the work undertaken so far during the year have not highlighted any issues which affect the opinion that overall throughout the Council there continues to be an adequate system of internal control.

## 6. Recommendations

6.1 Members are asked to consider the report.

## Appendix 1

| Internal Audit and Counter Fraud Unit - Overall Objectives, Key Performance Indicators (KPI's) and Targets for 2011/2012 | | | |
|---|---|---|---|
| **Efficiency and Effectiveness** | | | |
| **Objectives** | **KPI's** | **Targets** | **Actual Performance** |
| 1) To ensure the service provided is effective and efficient. | 1) Complete sufficient audit work to provide an opinion on the key risk areas identified for the Council | 1) All key risk areas covered over a 3 year period | 1) Achieved |
| | 2) Percentage of draft reports issued within 15 days of the end of fieldwork | 2) 90% | 2) On target - 90% to date |
| | 3) Percentage of audits completed by the target date (from scoping meeting to issue of draft report) | 3) 80% | 3) Behind target - 72% to date |
| | 4) Number of sanctions and prosecutions for housing benefit investigations | 4) 155 / annum | 4) Ahead of target – 148 to date |
| | 5) Value of overpayments identified during housing benefit investigations | 5) £600k / annum | 5) Ahead of target - £706,914 to date |

| Internal Audit and Counter Fraud Unit - Overall Objectives, Key Performance Indicators (KPI's) and Targets for 2011/2012 | | | |
|---|---|---|---|
| **Quality** | | | |
| **Objectives** | **KPI's** | **Targets** | **Actual Performance** |
| 1) To maintain an effective system of Quality Assurance | 1) Opinion of External Auditor | 1) Satisfactory opinion | 1) Achieved |
| 2) To ensure recommendations made by the service are agreed and implemented | 2) Percentage of agreed high, significant and medium risk internal audit recommendations which are implemented | 2) 100% for high and significant. 90% for medium risk | 2) On target – significant 100%<br>Behind target - Medium 78% (excluding schools) |
| **Client Satisfaction** | | | |
| **Objectives** | **KPI's** | **Targets** | **Actual Performance** |
| 1) To ensure that clients are satisfied with the service and consider it to be good quality | 1) Results of Post Audit Questionnaires | 1) Overall average score of better than 1.5 (where 1=Good and 4=Poor) | 1) On target - 1.1 to date |
| | 2) Results of other Questionnaires | 2) Results classed as 'Good' | 2) Non undertaken as yet |
| | 3) Number of Complaints / Compliments | 3) No target – actual numbers will be reported | 3) 20 compliments<br>2 complaints relating to benefit fraud investigations (one not upheld but improvements identified) |

**Appendix 2**

## Audit Coverage

| Key Risk Area | Planned Audits | Conclusion (audits undertaken 2011/12) | Overall Opinion |
|---|---|---|---|
| Corporate Governance | Annual Corporate Governance Review | Good | Good |
| Service / Business Planning | Responsive Local Services | | Satisfactory |
| | Facilities Management | | |
| | Reablement at Home - Adults | Satisfactory | |
| | Business Support | Satisfactory | |
| Partnerships | Non Planned | N/A | Satisfactory |
| Financial Management | Corporate Budget Setting and Management | | Good |
| | Adoption Allowances | Unsatisfactory | |
| | Social Care Resource Agency | | |
| | Personal Budgets - Adults | | |
| | Port Governance Arrangements | | |
| | Treasury Management | | |
| | 1 Leisure Centre | Good | |
| | Accounts Payable | | |
| | Accounts Receivable - Collection | Good | |
| | Periodic Income - Recovery and Enforcement | Good | |
| | Cash Receipting - Central System | Good | |
| | Council Tax - Setting | | |
| | Council Tax - Billing | | |
| | Council Tax - Valuation | | |
| | Council Tax - Recovery | | |
| | Business Rates – Recovery & Enforcement | Satisfactory | |
| | BACS Arrangements | Satisfactory | |
| | Charging for Services - HHA | Satisfactory | |
| | Stroke Care Grant | Cancelled | |
| | Future Jobs Fund Grant | Satisfactory | |
| | Deprived Areas Fund Grant | Satisfactory | |
| | Unplanned Audit – SIB and Community Chest Grants | Good | |
| | Unplanned Audit – SWITCH Modelling | Satisfactory | |
| | Unplanned Audit – Future Jobs Fund – final audit certificate | Satisfactory | |
| | Unplanned Audit – SWITCH Modelling | Satisfactory | |

| Key Risk Area | Planned Audits | Conclusion (audits undertaken 2011/12) | Overall Opinion |
|---|---|---|---|
| Risk Management | Port Governance Arrangements<br>1 Leisure Centre<br>Insurance Policies | <br>Good<br>Good | Good |
| Programme and Project Management | Project Management Information Governance (Project Server) | Good | Good |
| Local Taxation | Council Tax - Setting<br>Council Tax - Billing<br>Council Tax Valuation<br>Council Tax - Recovery<br>Business Rates - Recovery and Enforcement | <br><br><br><br>Satisfactory | Good |
| Procurement and Contract Management | Procurement of ICT Equipment<br>Purchasing Card Arrangements<br>Capital Procurement<br>Revenue Procurement | <br>Satisfactory<br>Good | Satisfactory |
| Human Resource Management | Corporate Training and Development Arrangements<br>Personnel Administration Arrangements<br>Management of Employees in SWITCH | Satisfactory<br><br>Unsatisfactory | Satisfactory |
| Asset Management | Asset Management (including Property Asset Database)<br>Asset Register/Capital Accounting<br>Unplanned Audit - Technoforge | <br>Good<br>Unsatisfactory | Satisfactory |
| ICT Strategy and Delivery | Implementation of the ICT Strategy<br>ICT Remote Access Threats<br>Information Technology Infrastructure Library | <br>Satisfactory | Satisfactory |
| Fraud and Corruption | Counter Fraud Testing (including in schools)<br>Access to IT systems - with movement of employees<br>Social Care Resource Agency<br>1 Leisure Centre<br>Asset Management - ICT Equipment<br>Unplanned Audit – SIB and Community Chest Grants | <br>Unsatisfactory<br><br>Good<br>Unsatisfactory<br>Good | Satisfactory |

| Key Risk Area | Planned Audits | Conclusion (audits undertaken 2011/12) | Overall Opinion |
|---|---|---|---|
| Information Governance | Corporate Information Governance (including procedures for remote working)<br>Email Security<br>Smarter Working - Employees Working Remotely within Children's Services<br>Document Management<br>Unplanned Audit – Corporate Data Protection Arrangements | Satisfactory<br><br>Good<br>Satisfactory<br><br>Satisfactory<br>Satisfactory (except re Subject Access Requests and Caldicott Guardian) | Satisfactory |
| Business Continuity and Emergency Planning | Major Incident Planning<br>Business Continuity Planning - Children's Services | Good<br>Satisfactory | Satisfactory |
| Performance Management | Responsive Local Services<br>Corporate Performance Management<br>Facilities Management<br>Port Governance Arrangements<br>Customer Services Network<br>Reablement at Home - Adults<br>Social Care Resource Agency<br>Follow up – Sunderland Compact | <br><br><br><br>Satisfactory<br>Satisfactory<br><br>Satisfactory | Satisfactory |
| Payroll | Payroll Processing and Payment | | Good |
| Housing Benefits | Housing Benefit Administration | Satisfactory | Satisfactory |
| Schools | 38 schools<br>31 schools audits completed – 28 good, 3 satisfactory | <br>Good | <br>Good |

Sunderland City Council

**Item No. 5**

**AUDIT AND GOVERNANCE COMMITTEE** **10 February 2012**

**TREASURY MANAGEMENT – THIRD QUARTERLY REVIEW 2011/2012**

**Report of the Executive Director of Commercial and Corporate Services**

## 1. Purpose of Report

1.1 To report on the Treasury Management, (TM) performance for the third quarter of 2011/2012.

## 2. Description of Decision

2.1 The Committee is requested to note the Treasury Management performance for Quarter 3 of 2011/2012;

2.2 To approve the amendments (detailed in bold print) to both the Lending List Criteria set out in Appendix B and the Lending List set out in Appendix C.

## 3. Introduction

3.1 The report sets out the Treasury Management performance to date for the third quarter of the financial year 2011/2012, in accordance with the requirements of the Treasury Management Policy and Strategy agreed by Council.

## 4. Review of the Treasury Management Performance for 2011/2012 – Quarter 3

4.1 The performance of the Council's treasury management function continues to contribute financial savings to support future year's capital programmes and helps to support the Council's revenue budget by reducing borrowing costs by taking advantage of debt rescheduling opportunities as appropriate. At this stage, no debt rescheduling has been undertaken in 2011/2012 as rates have not been considered sufficiently favourable, but it should also be recognised that the Council's interest rate on borrowing is very low, currently averaging 3.42%, and as such the council continues to benefit from this low cost of borrowing and from the ongoing savings from past debt rescheduling exercises;

4.2 Treasury Management Prudential Indicators are regularly reviewed and the Council is within the limits set for all of its TM Prudential Indicators;

4.3 The investment policy is also regularly monitored and reviewed to ensure it has flexibility to take full advantage of any changes in market conditions to the benefit of the Council.

4.4 As at 31st December 2011, the funds managed by the Council's Treasury Management team has achieved a rate of return on its investments of 1.63% compared with the benchmark rate (i.e. the 7 day rate) of 0.50%. Performance is very positive and is significantly above the benchmark rate, whilst still adhering to the prudent policy agreed by the Council.

4.5 As a result the increased rate of return achieved on investments held by the Authority to date has generated additional interest above the budget target for 2011/12 of almost £1.1 million (up to the end of December 2011).

4.6 More detailed Treasury Management information is included in Appendix A for members' information.

**Background Papers**

Sector CityWatch (Monthly) and weekly credit rating list
Sector / Capital Economics / UBS Economic forecasts
Local Government Act 2003
Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes (2011 Edition)

**Appendix A**

**Detailed Treasury Management Performance Quarter 3 - 2011/2012**

## A1. Borrowing Strategy and Performance - 2011/2012

A1.1 The borrowing strategy for 2011/2012 was reported to Cabinet on 11th February 2011 and approved by full Council on 2nd March 2011.

The Borrowing Strategy was based upon interest rate forecasts from a wide cross section of City institutions. The view in February 2011, at the time the Treasury Management Policy and Strategy was drafted, was the Bank Base Rate was expected to increase over the next three financial years from its current level of 0.50% to 0.75% by December 2011, and to 3.25% by March 2014. It was anticipated that PWLB borrowing rates would steadily increase throughout 2011/2012 across all periods with the 5 years PWLB forecast to be around 3.5% by March 2012, and the 25 year and 50 year PWLB rates to be at the 5.3% mark.

Economists are now forecasting that the first increase in the bank base rate will be in September 2013. PWLB rates and bond yields remain extremely unpredictable and there are exceptional levels of volatility which are highly correlated to political developments in the Eurozone and the sovereign debt crisis within a number of Eurozone countries with the risk of further contagion.

Interest rate forecasts have altered as a result of two major events: -

1. The decision by the MPC to expand quantitative easing by a further £75bn. This tranche is due to be completed in February 2012. This decision had an immediate effect of depressing (lowering) gilt yields at the long end of the curve. It also clearly underlined how concerned the MPC is about the prospects for UK growth and that recession is now a much greater concern than inflation.

2. The marked deterioration of growth prospects in the major world economies especially as concerns have further increased over Greece and the potential fall out from their debt position exacerbating problems within other countries economies. This has led in turn to a further increase in safe haven flows into UK gilts which have depressed gilt yields and pushed PWLB rates to even lower levels.

These developments have left short term forecasts for PWLB rates greatly out of line with actual rates and have substantially pushed back expectations of the timing of the eventual start of increases in Bank Rate gilt yields and PWLB rates.

The following table overleaf shows the average borrowing rates for Q1, Q2 and Q3 in 2011/2012.

| 2011/2012 | Qtr 1 (Apr - June) % | Qtr 2 (July – Sept) % | Qtr 3 (Oct – Dec) % |
|---|---|---|---|
| 7 days notice | 0.40 | 0.38 | 0.37 |
| 1 year | 1.69 | 1.50 | 1.39 |
| 5 year | 3.29 | 2.59 | 2.25 |
| 10 year | 4.51 | 3.82 | 3.33 |
| 25 year | 5.22 | 4.84 | 4.22 |
| 50 year | 5.16 | 4.88 | 4.28 |

A1.2 The strategy for 2011/2012 was to adopt a pragmatic approach and to respond to any changing circumstances to seek to secure benefit for the Council. A benchmark financing rate of 5.50% for long-term borrowing was set for 2011/2012. Due to high levels of volatility in the financial markets, with borrowing rates still forecast to remain low over the short term, no new borrowing had been undertaken in the current financial year up to 31st December 2011.

A1.3 The Borrowing Strategy for 2011/2012 made provision for debt rescheduling but also stated that because of the proactive approach taken by the Council in recent years, and because of the very low underlying rate of the Council's long term debt it would be difficult to refinance long term loans at interest rates lower than those already in place.

At this stage, no debt rescheduling has been undertaken during 2011/2012 as rates have not been considered sufficiently favourable for rescheduling.

The strategy for the remainder of 2011/2012 is for the Treasury Management team to continue to monitor market conditions and secure early debt redemption if appropriate opportunities arise. Any rescheduling undertaken will be reported to Cabinet in line with the current Treasury Management reporting procedures.

The Council's treasury portfolio position at 31st December 2011 is set out below:

| | | Principal (£m) | Total (£m) | Average Rate (%) |
|---|---|---|---|---|
| **Borrowing** | | | | |
| Fixed Rate Funding | PWLB | 138.0 | | |
| | Market | 24.5 | | |
| | Other | 0.3 | 162.8 | 3.83 |
| Variable Rate Funding | PWLB | 0.0 | | |
| | Market | 15.0 | | |
| | Temporary/ Other | 30.0 | 45.0 | 1.98 |
| **Total Borrowing** | | | **207.8** | **3.42** |

## A2. Treasury Management Prudential Indicators – 2011/2012

A2.1 All external borrowing and investments undertaken in 2011/2012 have been subject to the monitoring requirements of the Prudential Code. Under the Code, Authorities must set borrowing limits (Authorised Borrowing Limit for External Debt and Operational Boundary for External Debt) and must report on the Council's performance for all of the other TM Prudential Indicators.

A2.2 The statutory limit under section 3(1) of the Local Government Act 2003 (which is also known as the Authorised Borrowing Limit for External Debt) was set by the Council for 2011/2012 as follows:

| | £m |
|---|---|
| Borrowing | 331.539 |
| Other Long Term Liabilities | 50.860 |
| **Total** | **382.399** |

The Operational Boundary for External Debt was set as shown below: -

| | £m |
|---|---|
| Borrowing | 261.603 |
| Other Long Term Liabilities | 50.860 |
| **Total** | **312.463** |

The maximum external debt in respect of borrowing in 2011/2012 (to 31st December 2011) was £208.943 million (which includes borrowing in respect of other organisations such as Tyne and Wear Fire and Rescue Authority but excludes other long term liabilities such as PFI and Finance leases which already include borrowing instruments) and is well within the borrowing limits set by both of these indicators.

A2.3 The table below shows that all other Treasury Management prudential indicators have been complied with.

| **Prudential Indicators** | **2011/2012 (to 31/12/2011) Limit £'000** | **Actual £'000** |
|---|---|---|
| P10 Upper limit for fixed interest rate exposure<br>Net principal re fixed rate borrowing / investments | 105,000 | 29,986 |
| P11 Upper limit for variable rate exposure<br>Net principal re variable rate borrowing / investments | 60,000 | 22,395 |
| P13 Upper limit for total principal sums invested for over 364 days | 100,000 | 0 |

A2.4 The Council is currently within the limits set for all of its TM Prudential Indicators.

## A3. Investment Strategy – 2011/2012

A3.1 The Investment Strategy for 2011/2012 was approved by Council on 2nd March 2011. The general policy objective for the Council is the prudent investment of its treasury balances. The Council's investment priorities in order of importance are:

(A) The **security** of capital;
(B) The **liquidity** of its investments and then
(C) The Council aims to achieve the **optimum yield** on its investments but this is commensurate with the proper levels of security and liquidity.

A3.2 As at 31st December 2011 the funds managed by the Council's in-house team amounted to £194.985 million and all investments complied with the Annual Investment Strategy. The table below shows the return received on these investments as compared with the Council's benchmark rate (i.e. the 7 day rate).

| | **2011/2012 Actual to 31/12/2011 %** | **2011/2012 Benchmark to 31/12/2011 %** |
|---|---|---|
| Return on investments (to 31st December 2011) | 1.63 | 0.50 |

A3.3 Investments placed in 2011/2012 have been made in accordance with the approved investment strategy and comply with the counterparty criteria used to identify organisations on the Approved Lending List in place.

A3.4 However the investment policy is regularly monitored and reviewed to ensure it has flexibility to take full advantage of any changes in market conditions to the benefit of the Council. There are no changes to report.

A3.5 Investment rates available in the market have continued at historically low levels.

A3.6 Due to the continuing high volatility within the financial markets, particularly in the euro zone, advice from our Treasury Management advisers (which we agree with) is to continue to restrict investments to all financial institutions for shorter term periods.

A3.7 Advice also continues that the above guidance is not applicable to institutions considered to be very low risk because the government holds shares in these organisations (i.e. Lloyds TSB and RBS) or in respect of Money Market Funds which are also AAA rated.

A3.8 The regular updating of the Council's authorised lending list is required to take into account financial institution mergers and changes in institutions' credit ratings. The Counterparty Criteria is shown in Appendix B and the Approved Lending List is shown in Appendix C have been updated with the proposed changes outlined above and summarised in 4.3 of the report.

**Appendix B**

**Counterparty Criteria**

The Council takes into account not only the individual institution's credit ratings issued by all three credit rating agencies (Fitch, Moody's and Standard & Poor's), but also all available market data and intelligence, the level of government support and advice from its Treasury Management advisors.

Set out below are the criteria to be used in determining the level of funds that can be invested with each institution. Where an institution is rated differently by the rating agencies, the lowest rating will determine the level of investment.

| **Fitch / S&P's Long Term Rating** | **Fitch Short Term Rating** | **S&P's Short Term Rating** | **Moody's Long Term Rating** | **Moody's Short Term Rating** | **Maximum Deposit £m** | **Maximum Duration** |
|---|---|---|---|---|---|---|
| AAA | F1+ | A1+ | Aaa | P-1 | 70 | 2 Years |
| AA+ | F1+ | A1+ | Aa1 | P-1 | 50 | 2 Years |
| AA | F1+ | A1+ | Aa2 | P-1 | 40 | 364 days |
| AA- | F1+ / F1 | A1+ / A-1 | Aa3 | P-1 | 20 | 364 days |
| A+ | F1 | A-1 | A1 | P-1 | 10 | 364 days |
| A | F1 / F2 | A-1 / A-2 | A2 | P-1 / P-2 | 10 | 364 days |
| A- | F1 / F2 | A-2 | A3 | P-1 / P-2 | 5 | 6 months |
| **Local Authorities** (limit for each local authority) | | | | | 30 | **2 Years** |
| **UK Government (including debt management office, gilts and treasury bills)** | | | | | **70** | **5 years** |
| **Money Market Funds**<br>Maximum amount to be invested in Money Market Funds is £50 million with a maximum of £30 million in any one fund. | | | | | 50 | **Liquid Deposits** |

Where the UK Government holds a shareholding in an institution the UK Government's credit rating of AAA will be applied to that institution to determine the amount the Council can place with that institution for a maximum period of **2 years**.

Where any banks / building societies are part of the UK Government's Credit Guarantee scheme (marked with * in the Approved Lending List), these counterparties will have an AA rating applied to them thus giving them a credit limit of £40 million for a maximum period of 364 days.

The Code of Practice for Treasury Management in the Public Services recommends that consideration should also be given to country, sector, and group limits in addition to the individual limits set out above, these new limits are as follows:

**Country Limit**
It is proposed that only countries with a minimum sovereign credit rating of AA+ by all three rating agencies will be considered for inclusion on the Approved Lending List.

It is also proposed to set a total limit of £40 million which can be invested in other countries provided they meet the above criteria. A separate limit of £300 million will be applied to the United Kingdom and is based on the fact that the government has done and is willing to take action to protect the UK banking system.

| **Country** | **Limit £m** |
|---|---|
| UK | 300 |
| Non UK | 40 |

**Sector Limit**
The Code recommends a limit be set for each sector in which the Council can place investments. These limits are set out below:

| **Sector** | **Limit £m** |
|---|---|
| Central Government | 300 |
| Local Government | 300 |
| UK Banks | 300 |
| UK Building Societies | 150 |
| **Money Market Funds** | **50** |
| Foreign Banks | 40 |

**Group Limit**
Where institutions are part of a group of companies e.g. Lloyds Banking Group, Santander and RBS, then total limit of investments that can be placed with that group of companies will be determined by the highest credit rating of a counterparty within that group, unless the government rating has been applied. This will apply provided that:

- the government's guarantee scheme is still in place;
- the UK continues to have a sovereign credit rating of AAA; and
- that market intelligence and professional advice is taken into account.

Current group limits are set out in Appendix C

## Approved Lending List Appendix C

| | Fitch | | | | Moody's | | | Standard & Poor's | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | L Term | S Term | Individual | Support | L Term | S Term | Fin Strength Rating | L Term | S Term | Limit £m | Max Deposit Period |
| **UK** | AAA | F1+ | | | Aaa | | | AAA | | 300 | 2 years |
| **Lloyds Banking Group** (see Note 1) | | | | | | | | | | Group Limit 70 | |
| Lloyds Banking Group plc | **A** | **F1** | **bbb** | 1 | **A2** | - | - | **A-** | **A-2** | 70 | **2 years** |
| Lloyds TSB Bank Plc | **A** | **F1** | **bbb** | 1 | **A1** | P-1 | C- | **A** | A-1 | 70 | **2 years** |
| Bank of Scotland Plc | **A** | **F1** | **-** | 1 | **A1** | P-1 | D+ | **A** | A-1 | 70 | **2 years** |
| **Royal Bank of Scotland Group** (See Note 1) | | | | | | | | | | Group Limit 70 | |
| Royal Bank of Scotland Group plc | **A** | **F1** | **bbb** | 1 | **A1** | **P-2** | **-** | **A-** | **A-2** | 70 | **2 years** |
| The Royal Bank of Scotland Plc | **A** | **F1** | **bbb** | 1 | **A3** | P-1 | C- | **A** | A-1 | 70 | **2 years** |
| National Westminster Bank Plc | **A** | **F1** | **-** | 1 | **A2** | P-1 | C- | **A** | A-1 | 70 | **2 years** |
| Ulster Bank Ltd | **A-** | **F1** | **ccc** | 1 | **Baa1** | **P-2** | D- | **BBB+** | **A-2** | 70 | **2 years** |
| **Santander Group *** | | | | | | | | | | Group Limit 40 | |
| Santander UK plc | **A+** | **F1** | **a+** | **1** | **A1** | P-1 | C- | **AA-** | A-1+ | 40 | 364 days |
| Cater Allen | **-** | **-** | - | **-** | - | **-** | - | **-** | - | 40 | 364 days |
| | | | | | | | | | | | |
| Barclays Bank plc * | **A** | **F1** | **a** | 1 | Aa3 | P-1 | C | **A+** | **A-1** | 40 | 364 days |
| HSBC Bank plc * | AA | F1+ | **aa-** | 1 | Aa2 | P-1 | C+ | **AA** | A-1+ | 40 | 364 days |

**Appendix C (continued)**

| | Fitch | | | | Moody's | | | Standard & Poor's | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | L Term | S Term | Individual | Support | L Term | S Term | Fin Strength | L Term | S Term | Limit £m | Max Deposit Period |
| Nationwide BS * | **A+** | **F1** | **a+** | 1 | **A2** | P-1 | C | A+ | A-1 | 40 | 364 days |
| Standard Chartered Bank * | AA- | F1+ | **aa-** | 1 | **A1** | P-1 | B- | **AA-** | **A-1+** | 40 | 364 days |
| Clydesdale Bank / Yorkshire Bank ** | **A+** | **F1** | **bbb** | 1 | **A2** | P-1 | C- | **BBB** | **A-2** | **0** | 364 days |
| Co-Operative Bank Plc | A- | F2 | **a-** | 3 | **A3** | **P-2** | **C-** | - | - | 5 | 6 months |
| Northern Rock *** | BBB+ | F2 | **bbb+** | 2 | - | - | - | **BBB+** | A-2 | 0 | |
| **Top Building Societies (by asset value)** | | | | | | | | | | | |
| Nationwide BS (see above) | | | | | | | | | | | |
| Yorkshire BS *** | **BBB+** | F2 | **bbb+** | 5 | **Baa2** | P-2 | C- | A- | A-2 | 0 | |
| Coventry BS | **A** | F1 | **a** | 5 | A3 | P-2 | C | - | - | 5 | 6 months |
| Skipton BS *** | **BBB** | **F3** | **bbb** | 5 | **Ba1** | **NP** | D+ | - | - | 0 | |
| Leeds BS | **A-** | **F2** | **a-** | 5 | **A3** | **P-2** | **C** | - | - | **5** | **6 months** |
| West Bromwich BS *** | **B+** | **B** | **b+** | 5 | **B2** | **NP** | E+ | - | - | 0 | |
| Principality BS *** | BBB+ | F2 | **bbb+** | 5 | **Ba1** | **NP** | D+ | - | - | 0 | |
| Newcastle BS *** | **BB+** | **B** | **bb+** | 5 | **-** | **-** | **-** | - | - | 0 | |
| Nottingham BS | - | - | - | - | **Baa2** | P-2 | C- | - | - | **0** | |
| **Foreign Banks have a combined total limit of £40m** | | | | | | | | | | | |
| **Australia** | **AAA** | - | - | - | Aaa | - | - | AAA | | 40 | 364 Days |
| National Australia Bank | AA | F1+ | **aa** | 1 | **Aa2** | P-1 | **B-** | **AA-** | A-1+ | 40 | 364 Days |
| Australia and New Zealand Banking Group Ltd | AA- | F1+ | **aa-** | 1 | **Aa2** | P-1 | **B-** | **AA-** | A-1+ | 20 | 364 Days |
| Commonwealth Bank of Australia | AA | F1+ | **aa** | 1 | **Aa2** | P-1 | **B-** | **AA-** | A-1+ | 40 | 364 Days |
| Westpac Banking Corporation | AA | F1+ | **aa** | 1 | **Aa2** | P-1 | **B-** | **AA-** | A-1+ | 40 | 364 Days |

| Appendix C (continued) | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | **Fitch** | | | | **Moody's** | | | **Standard & Poor's** | | | |
| | L Term | S Term | Individual | Support | L Term | S Term | Fin Strength | L Term | S Term | Limit £m | Max Deposit Period |
| **Canada** | AAA | | | | Aaa | | | AAA | | 40 | 364 Days |
| Bank of Nova Scotia | AA- | F1+ | **aa-** | 1 | Aa1 | P-1 | B | AA- | A-1+ | 20 | 364 Days |
| Royal Bank of Canada | AA | F1+ | **aa** | 1 | Aa1 | P-1 | **B** | AA- | A-1+ | 20 | 364 Days |
| Toronto Dominion Bank | AA- | F1+ | **aa-** | 1 | Aaa | P-1 | B+ | AA- | A-1+ | 20 | 364 Days |
| **Money Market Funds** | | | | | | | | | | 50 | **Liquid Deposits** |
| Prime Rate Stirling Liquidity | AAA MMF | | | | | | | AAAm | | 30 | **Liquid Deposits** |
| Insight Liquidity Fund | | | | | AAA MR1 | | | AAAm | | 30 | **Liquid Deposits** |
| Ignis Sterling Liquidity | AAA MMF | | | | | | | AAAm | | 30 | **Liquid Deposits** |

## Notes

Note 1 **Nationalised / Part Nationalised**
The counterparties in this section will have the UK Government's AAA rating applied to them thus giving them a credit limit of £70 million for a maximum period of **2 years**

* Banks / Building Societies which are part of the UK Government's Credit Guarantee scheme
The counterparties in this section will have a AA rating applied to them thus giving them a credit limit of £40 million for a maximum period of 364 days

** The Clydesdale Bank (under the UK section) is owned by National Australia Bank

*** These will be revisited and used only if they meet the minimum criteria (ratings of A- and above)

Any bank which is incorporated in the United Kingdom and controlled by the FSA is classed as a UK bank for the purposes of the Approved Lending List

Sunderland City Council

**Item No. 6**

**AUDIT AND GOVERNANCE COMMITTEE** **10 February 2012**

**TREASURY MANAGEMENT POLICY AND STRATEGY 2012/2013, INCLUDING PRUDENTIAL 'TREASURY MANAGEMENT' INDICATORS FOR 2012/2013 TO 2014/2015**

**Report of the Executive Director of Commercial and Corporate Services**

## 1. Purpose of the Report

1.1 To inform the Audit and Governance Committee on the Treasury Management Policy and Strategy (including both borrowing and investment strategies) proposed for 2012/2013 and to note the Prudential 'Treasury Management' Indicators for 2012/2013 to 2014/2015 and to provide comments to Cabinet and Council on the proposed policy and indicators where appropriate.

## 2. Description of Decision

2.1 Committee is requested to:

- Provide any appropriate comments to Cabinet / Council on the proposed:
  - Annual Treasury Management Policy and Strategy (including specifically the Annual Borrowing and Investment Strategies);
  - Prudential 'Treasury Management' Indicators.

## 3. Treasury Management

3.1 Treasury management is defined as "the management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

### 3.2 Statutory requirements

The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Management Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable, these are set out in Appendix 1.

The Act also requires the Council to adopt a Treasury Management Policy Statement (detailed in Appendix 2) and to set out its Treasury

Management Strategy comprising the Council's strategy for borrowing and the Council's policies for managing its investments and giving priority to the security and liquidity of those investments (Appendix 3).

The Department of Communities and Local Government issued revised investment guidance which came into effect from 1 April 2010 and the Charted Institute of Public Finance and Accountancy (CIPFA) has updated its Treasury Management in the Public Services Code of Practice in November 2011. Revisions made in the Code of Practice were largely regulatory updates to reflect developments resulting from the Localism Act 2011 and in particular changes to the way that local authority housing finance will operate. The Council has adopted the CIPFA Code of Practice and there are no major changes required to Treasury Management practices and arrangements that the Council already has in place. This is due in the main to the fact the Council undertook a Large Scale Voluntary Transfer in March 2001 and consequently has no housing stock.

3.3 **CIPFA requirements**

The CIPFA Code of Practice on Treasury Management was adopted by this Council on 3rd March 2010.

The primary requirements of the Code are as follows:

1. The Council will create and maintain, as the cornerstones for effective treasury management:
   - a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities;
   - suitable treasury management practices (TMP's), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

   The content of the policy statement is detailed in Appendix 2 and the TMP's follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of the Council. Such amendments which are minor in nature do not result in the Council deviating from the Code's key principles.

2. The Council will receive reports on treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMP's.

3. The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet, and for the execution and administration of treasury management decisions to the Executive Director of Commercial and Corporate Services, who acts in accordance with the organisation's Policy Statement, TMPs and CIPFA's Standard of Professional Practice on Treasury Management.

4. The Council has previously nominated the Audit and Governance Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

**Treasury Management Strategy for 2012/2013**

3.4 The Treasury Management Strategy comprises a Borrowing and an Investment Strategy. These set out the Council's policies for managing its borrowing and investments and for giving priority to the security and liquidity of investments.

3.5 There are no major changes being proposed to the overall Treasury Management Strategy in 2012/2013 which maintains the careful and prudent approach adopted by the Council in previous years. Particular areas that inform the strategy include the extent of potential borrowing included in the Council's capital programme, the availability of borrowing, and the current and forecast world and UK economic position, in particular forecasts relating to interest rates and security of investments.

3.6 The proposed Treasury Management Strategy Statement for 2012/2013 is set out in Appendix 3 and is based upon the views of the Executive Director of Commercial and Corporate Services, supplemented with market data, market information and leading market forecasts provided by the Council's treasury adviser, Sector Treasury Services.

3.7 The strategy is subject to regular review to ensure compliance to the agreed treasury management strategy and that the strategy adapts to changing financial markets as appropriate. It is pleasing to note that the Council's current average rate of borrowing at 3.42% is low in comparison with other local authorities whilst the current rate earned on investments at 1.63% is higher than the benchmark rate. In addition debt rescheduling undertaken by the Council has achieved significant savings in interest charges and discounts and these interest savings have been secured for many years to come. Market conditions are also under constant review so that the Council can take a view on the optimum time to carry out further borrowing or debt rescheduling. This is reflected in the recent acquisition of a 50 year PWLB loan for £10m at a rate of 3.99%, where rates have been monitored daily and the council has taken advantage of a dip in the rates to access a loan that represents excellent value over the longer term.

## 4. Suggested Reason for Decision

4.1 To comply with statutory requirements.

## 5. Alternative Options

5.1 No alternatives are submitted for Cabinet consideration

**Appendix 1**

**Prudential 'Treasury Management' Indicators 2012/2013 to 2014/2015**

The indicators below relate to Treasury Management (all indicators relating to capital financing have been removed for clarity and can be found in the Capital Programme 2012/2013 and Treasury Management Policy and Strategy 2012/2013, including Prudential Indicators for 2012/2013 to 2014/2015 report to be received by Cabinet – 15th February 2012).

P5 In respect of its external debt, it is recommended that the Council approves the following authorised limits for its total external debt, gross of investments for the next three financial years, and agrees the continuation of the previously agreed limit for the current year since no change to this is necessary. These limits separately identify borrowing from other long-term liabilities such as PFI schemes and finance leases. The Council is asked to approve these limits and to delegate authority to the Executive Director of Commercial and Corporate Services, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities, in accordance with option appraisal and best value for the authority. Any such changes made will be reported to Cabinet and the Council at the next meetings following the change.

| | **Authorised Limit for External Debt** | | | |
|---|---|---|---|---|
| | **2011/2012 £000** | **2012/2013 £000** | **2013/2014 £000** | **2014/2015 £000** |
| Borrowing | 331,539 | 342,199 | 352,103 | 363,945 |
| Other long term liabilities | 50,860 | 34,928 | 33,394 | 32,830 |
| **Total** | **382,399** | **377,127** | **385,497** | **396,775** |

The Executive Director of Commercial and Corporate Services reports that these authorised limits are consistent with the Authority's current commitments, existing plans and the proposals for capital expenditure and financing, and with its approved treasury management policy statement and practices. The Executive Director of Commercial and Corporate Services also confirms that they are based on the estimate of most likely, prudent, but not worst case scenario, with, in addition, sufficient headroom over and above this to allow for operational management, for example unusual cash movements. Risk analysis and risk management strategies have been taken into account, as have plans for capital expenditure, estimates of the Capital Financing Requirement and estimates of cash flow requirements for all purposes. It should be noted that the Council undertakes investment and borrowing on behalf of external bodies such as Tyne and Wear Fire and Rescue Authority. Treasury Management undertaken on behalf of other authorities is included in Sunderland's borrowing limits, however it is excluded when considering financing costs and when calculating net borrowing for the Council. A specific element of risk has also been taken into account for these bodies.

In taking its decisions on the Revenue Budget and Capital Programme for 2012/2013, the Council is asked to note that the authorised limit determined for 2012/2013 of £377.127 million, (see P5 above), will be the statutory limit determined under section 3(1) of the Local Government Act 2003.

P6 The Council is also asked to approve the following operational boundary for external debt for the same time period and agrees the continuation of the previously agreed limit for the current year since no change to this is necessary. The proposed operational boundary for external debt is based on the same estimates as the authorised limit, but reflects directly the estimate of the most likely, prudent but not worst case scenario level, without the additional headroom included within the authorised limit to allow for example for unusual cash movements, and equates to the maximum of external debt projected by this estimate. The operational boundary represents a key management tool for in year monitoring. Within the operational boundary, figures for borrowing and other long-term liabilities are separately identified. The Council is also asked to delegate authority to the Executive Director of Commercial and Corporate Services, within the total operational boundary for any individual year, to effect movement between the separately agreed figures for borrowing and other long term liabilities, similar to the authorised limit set out above.

The operational boundary limit for 2012/13 will be £339.011 million and will be closely monitored and a report will be made to Cabinet and Council if it is exceeded at any point. It is not anticipated that there will be any issues in terms of remaining within the operational limit for 2012/13.

| | **Operational Boundary for External Debt** | | | |
|---|---|---|---|---|
| | **2011/12** | **2012/13** | **2013/14** | **2014/15** |
| | **£000** | **£000** | **£000** | **£000** |
| Borrowing | 261,603 | 300,011 | 299,487 | 297,891 |
| Other long term liabilities | 50,860 | 39,000 | 37,000 | 36,000 |
| **Total** | **312,463** | **339,011** | **336,487** | **333,891** |

P7 The Council's actual external debt at 31st March 2011 was £244.373 million and was made up of actual borrowing of £208.941 million and actual other long term liabilities of £35.432 million.

The Council includes an element for long-term liabilities relating to PFI schemes and finance leases in its calculation of the operational and authorised boundaries to allow further flexibility over future financing. It should be noted that actual external debt is not directly comparable to the authorised limit and operational boundary, since the actual external debt reflects the position at any one point in time and allowance needs to be made for cash flow variations.

P9 The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The revised Code was adopted on 3rd March 2010 by full council.

The objective of the Prudential Code is to provide a clear framework for local authority capital finance that will ensure for individual local authorities that:

(a) capital expenditure plans are affordable;

(b) all external borrowing and other long term liabilities are within prudent and sustainable levels;

(c) treasury management decisions are taken in accordance with professional good practice;

and that in taking decisions in relation to (a) to (c) above the local authority is

(d) accountable, by providing a clear and transparent framework.

Further, the framework established by the Code should be consistent with and support:

(e) local strategic planning;

(f) local asset management planning;

(g) proper option appraisal.

In exceptional circumstances the objective of the Code is to provide a framework that will demonstrate that there is a danger of not ensuring the above, so that the Authority can take timely remedial action.

CIPFA Treasury Management in the Public Services Code of Practice - Indicators 2012/2013 to 2014/2015 are as follows:

P10 It is recommended that the Council sets an upper limit on its fixed interest rate exposures of £130 million in 2012/2013, £190 million in 2013/2014 and £200 million in 2014/2015.

P11 It is further recommended that the Council sets an upper limit on its variable interest rate exposures of £60 million in 2012/2013, £50 million in 2013/2014 and £60 million in 2014/2015.

P12 It is recommended that the Council sets upper and lower limits for the maturity structure of its borrowings as follows:

Amount of projected borrowing that is fixed rate maturing in each period expressed as a percentage of total projected borrowing that is fixed rate at the start of the period:

| | Upper limit | Lower limit |
|---|---|---|
| Under 12 months | 50% | 0% |
| 12 months and within 24 months | 60% | 0% |
| 24 months and within 5 years | 80% | 0% |
| 5 years and within 10 years | 100% | 0% |
| 10 years and within 20 years | 100% | 0% |
| 20 years and within 30 years | 100% | 0% |
| 30 years and within 40 years | 100% | 0% |
| 40 years and within 50 years | 100% | 0% |
| over 50 years | 100% | 0% |

P13 A maximum maturity limit of £75 million is set for each financial year (2012/2013, 2013/2014 and 2014/2015) for long term investments, (those over 364 days), made by the authority. This gives additional flexibility to the Council in undertaking its Treasury Management function. Should the Council appoint any external fund managers during the year, these limits will be apportioned accordingly. The type of investments to be allowed are detailed in the Annual Investment Strategy (Appendix 3).

At present the Council has £0.817 million of long-term investments. This is £0.797 million for the value of share capital held in NIAL Holdings PLC. This equates to a 9.41% share in Newcastle International Airport. The Council also holds £0.020 million in government securities, other shares and unit trusts.

**Appendix 2**

## Treasury Management Policy Statement

In line with CIPFA recommendations, on the 3rd March 2010 the Council adopted the following Treasury Management Policy Statement, which defines the policies and objectives of its treasury management activities:

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

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

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

The Council has an agreed Borrowing and Investment Strategy, the high level policies of which are set out as follows:

The basis of the agreed Borrowing Strategy is to:

- continuously monitor prevailing interest rates and forecasts;
- secure long-term funds to meet the Council's future borrowing requirement when market conditions are favourable;
- use a benchmark financing rate of 4.50% for long term borrowing (i.e. all borrowing for a period of one year or more);.
- take advantage of debt rescheduling opportunities, as appropriate.

The general policy objective for the Council in considering potential investments is the prudent investment of its treasury balances.

- the Council's investment priorities in order of importance are:
  1) The security of capital
  2) The liquidity of its investments and then
  3) The Council aims to achieve the optimum yield on its investments but this is commensurate with the proper levels of security and liquidity
- the Council has a detailed Lending List and criteria that must be observed when placing funds – these are determined using expert TM advice, view of money market conditions and using detailed rating agency information as well as using our own market intelligence.

- Limits are also placed on the amounts that can be invested with individual and grouped financial institutions based on the Lending List and agreed detailed criteria.

The Council also re-affirms its commitment to the Treasury Management Policy and Strategy Statement each year.

**Appendix 3**

## Treasury Management Strategy Statement for 2012/2013

## 1. Introduction

1.1 The Local Government Act 2003 and subsequent guidance requires the Council to set out its Treasury Management Strategy for Borrowing and to prepare an Annual Investment Strategy. This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The suggested strategy for 2012/2013 is set out below and is based upon the Executive Director of Commercial and Corporate Services views on interest rates, supplemented with leading market forecasts and other financial data available and advice provided by the Council's treasury adviser, Sector Treasury Services.

1.2 The treasury management strategy covers:

**A. Borrowing Policy and Strategy**

- treasury limits for 2012/2013 to 2014/2015
- the past and current treasury management position
- the borrowing requirement 2012/2013
- prudential and treasury management Indicators for 2012/13 to 2014/15
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling

**B. Annual Investment Policy and Strategy**

- Investment policy and objectives
- the investment strategy
- investment types
- investments defined as capital expenditure
- investment limits
- provision for credit related losses
- creditworthiness policy
- monitoring of credit ratings
- past performance and current position
- outlook and proposed investment strategy
- external fund managers
- policy on use of external service providers

## 2. Borrowing Policy and Strategy

### 2.1 Treasury Limits for 2012/13 to 2014/15

It is a statutory duty under Section 3 of the Local Government Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". In England and

Wales the Authorised Limit represents the legislative limit specified in the Act.

The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council rent levels is 'acceptable'.

Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is set, on a rolling basis, for the forthcoming financial year and two successive financial years and details can be found in Appendix 1 (P5) of this report. The Council is asked to approve these limits and to delegate authority to the Executive Director of Commercial and Corporate Services, within the total limit for any individual year, to action movement between the separately agreed limits for borrowing and other long term liabilities where this would be appropriate. Any such changes made will be reported to Cabinet and the Council at their next meetings following the change.

Also, the Council is asked to approve the Operational Boundary Limits which are included in the Prudential Indicators in Appendix 1 (P6). This operational boundary represents a key management tool for in year monitoring. Within the operational boundary, figures for borrowing and other long-term liabilities are separately identified and the Council is also asked to delegate authority to the Executive Director of Commercial and Corporate Services, within the total operational boundary for any individual year, to action movement between the separately agreed figures for borrowing and other long-term liabilities, in a similar fashion to the authorised limit.

### 2.2 The Past and Current Treasury Management Position

#### 2.2.1 Interest Rates 2011/2012

*PWLB Interest rates gradually fell during the first half of 2011/2012 and were at their lowest level in early October 2011. Rates have increased slightly since but have generally remained fairly static with only small variations.*

The interest rates offered by the PWLB to local authorities with a Housing Revenue Account, will be temporarily reduced in March 2012. The reduced rate will only apply to borrowing to allow local authorities to leave the existing subsidy system for council housing finance to allow them to be 'self financing'. As the Council does not have any housing stock it is unaffected by the changes in PWLB interest rates.

| Loan Type | 31st March 2011 % | 31st December 2011 % | Difference % |
|---|---|---|---|
| 7 Day Notice | 0.40 | 0.30 | 0.10 |
| 1 Month | 0.50 | 0.63 | 0.15 |
| PWLB – 1 Year | 1.89 | 1.19 | 0.70 |
| 5 Years | 3.61 | 1.97 | 1.64 |
| 10 Years | 4.75 | 3.03 | 1.72 |
| 25 Years | 5.35 | 3.99 | 1.36 |
| 50 Years | 5.29 | 4.05 | 1.24 |

The Bank of England Base Rate has remained at 0.50% since 5th March 2009 with little sign that it will be raised in the short term.

2.2.2 **Long Term Borrowing 2011/2012**

The Treasury Management Policy and Strategy Statement for 2011/2012 included a benchmark rate of 5.5% for all long-term borrowing on the basis that interest rates would increase.

The Council's strategy for 2011/2012 is to adopt a pragmatic approach and to respond to any changing circumstances to seek to secure benefit for the Council.

So far in 2011/2012 the Council has taken out one new loan, detailed in the table below. No debt rescheduling has been undertaken as rates have not been considered sufficiently favourable. The new borrowing, at a historic low rate of interest for 50 year loans since the Coalition Government increased rates in October 2010, will support borrowing requirements within the Council's capital programme. The loan, at 3.99%, was 1.51% below the 5.50% target set for long term borrowing and represents a lower cost of borrowing to the council going forward. Any loan of this duration especially below the 4% level is regarded as an opportune time to acquire longer term debt as levels historically are rarely seen below this rate.

| Date | Lender | Amount £m | Period (Years) | Rate % | Benchmark Rate % | Margin % |
|---|---|---|---|---|---|---|
| 20/01/2012 | PWLB | 10.0 | 50 | 3.99 | 5.50 | (1. 51) |
| **Total** | | **10.0** | | | | |

The Council also has nine market Lender's Option / Borrower's Option (LOBO) loans totalling £39.5 million. The lender has the option to alter the rate on these loans at set intervals and the Council can either accept the new rate or repay the loan without penalty. The following table shows the LOBO's that were subject to a potential rollover this financial year but have not been replaced as the option was not exercised.

| Roll Over Dates | Lender | Amount £m | Rate % | Roll Over Periods |
|---|---|---|---|---|
| 21/04/2011 and 21/10/2011 | Barclays | 5.0 | 4.50 | Every 6 months |
| 10/12/2011 | Barclays | 9.5 | 4.37 | every 3 years |
| 27/01/2012 | Dexia | 5.0 | 4.32 | every 3 years |
| **Total** | | **19.5** | | |

2.2.3 **Current Portfolio Position**

The Council's treasury portfolio position at 31st December 2011 comprised:

| | | Principal (£m) | Total (£m) | Average Rate (%) |
|---|---|---|---|---|
| **Borrowing** | | | | |
| Fixed Rate Funding | PWLB | 138.0 | | |
| | Market (LOBO's) | 24.5 | | |
| | Other | 0.3 | 162.8 | 3.83 |
| Variable Rate Funding | PWLB | 0.0 | | |
| | Market (LOBO's) | 15.0 | | |
| | Temporary/ Other | 30.0 | 45.0 | 1.98 |
| **Total Borrowing** | | | **207.8** | **3.42** |
| **Total Investments** | In House | | **195.0** | **1.63** |
| **Net Position** | | | **(12.8)** | |

The Council currently has a difference between gross debt and net debt of £12.777 million, however this position is expected to change over the next few years as the Council has to manage its finances with significantly less government grant in both capital and revenue funding. This could impact in the form of increased borrowing and reductions to reserves, with the result that the net borrowing position of the Council will increase.

There are a number of risks and benefits associated with having both a large amount of debt whilst at the same time having a considerable amount of investments.

Benefits of having a high level of investments are;

- liquidity risk – having a large amount of investments means that the Council is at less of a risk should money markets become restricted or borrowing less generally available, this mitigates against liquidity risk;
- interest is received on investments which helps the Council to address its Strategic Priorities;

- the Council has greater freedom in the timing of its borrowing as it can afford to wait until the timing is right rather than be subject to the need to borrow at a time when interest rates are not advantageous.

Risks associated with holding a high level of investments are;

- the Counterparty risk – institutions cannot repay the Council investment placed with them;
- interest rate risk – the rate of interest earned on the investments will be less than that paid on debt, thus causing a loss to the Council.

The Council has mitigated these risks by having a risk averse Treasury Management Investment Strategy and by detailed monitoring of counterparties through its borrowing and investment strategies and treasury management working practices and procedures.

2.3 **Borrowing Requirement 2012/2013**

The Council's borrowing requirement is as follows**:**

| | | **2012/13 £m** | **2013/14 £m** | **2014/15 £m** |
|---|---|---|---|---|
| **1.** | Capital Borrowing (potential) | 49.8 | 53.1 | 15.3 |
| **2.** | Replacement borrowing (PWLB) | 5.0 | 5.0 | 10.0 |
| **3.** | Replacement borrowing (Market) | 0.0 | 0.0 | 0.0 |
| **4.** | Market LOBO replacement (potential) | 20.0 | 10.0 | 19.5 |
| **TOTAL – KNOWN (2+3)** | | **5.0** | **5.0** | **10.0** |
| **TOTAL – POTENTIAL (1+4)** | | **69.8** | **63.1** | **25.3** |

2.4 **Prudential and Treasury Management Indicators for 2012/2013 – 2014/2015**

Prudential and Treasury Indicators (as set out in Appendix 1) are a requirement of the CIPFA Prudential Code and are relevant for the purposes of setting an integrated treasury management strategy and to ensure that treasury management decisions are taken in accordance with good professional practice.

The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The original 2001 Code was adopted on 20th November 2002 and the revised 2009 Code was adopted by the full Council on 3rd March 2010. The Code has been revised in November 2011 and the Council re-affirms its full adherence to the code annually (as set out in Appendix 2).

2.5 **Prospects for Interest Rates**

The Council's treasury advisors are Sector Treasury Services and part of their service is to assist the Council to formulate a view on interest rates. A number of current City forecasts for short term (Bank Rate) and longer fixed interest rates are set out in Appendix 4. The following gives the Sector Treasury Services Bank Rate forecast for the next 4 financial year ends (March).

- 2011/2012 0.50%
- 2012/2013 0.50%
- 2013/2014 1.25%
- 2014/2015 2.50%

There are downside risks to these forecasts (i.e. start of increases in Bank Rate is delayed even further) if economic growth remains weaker for longer than expected. However, should the pace of growth pick up more sharply than expected there could be upside risk, particularly if Bank of England inflation forecasts for two years ahead exceed the Bank of England's 2% target rate. A detailed view of the current economic background is contained within Appendix 5 to this report.

2.6 **Borrowing Strategy**

2.6.1 **Borrowing rates**

The Sector forecast in respect of interest rates for loans charged by the PWLB is as follows: -

| **Annual Average %** | **Bank Rate** | **PWLB Borrowing Rates** | | |
|---|---|---|---|---|
| | | **5 year** | **25 year** | **50 year** |
| March 2012 | 0.50 | 2.30 | 4.20 | 4.30 |
| June 2012 | 0.50 | 2.30 | 4.20 | 4.30 |
| Sept 2012 | 0.50 | 2.30 | 4.30 | 4.40 |
| Dec2012 | 0.50 | 2.40 | 4.30 | 4.40 |
| March 2013 | 0.50 | 2.50 | 4.40 | 4.50 |
| June 2013 | 0.50 | 2.60 | 4.50 | 4.60 |
| Sept 2013 | 0.75 | 2.70 | 4.60 | 4.70 |
| Dec 2013 | 1.00 | 2.80 | 4.70 | 4.80 |
| March 2014 | 1.25 | 2.90 | 4.80 | 4.90 |
| June 2014 | 1.50 | 3.10 | 4.90 | 5.00 |

A more detailed forecast from Sector is included in Appendix 4.

The main sensitivities of the forecast are likely to be;

- if it was felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate borrowing will be undertaken whilst interest rates are still relatively cheap.

- if it was felt that there was a significant risk of a sharp fall in long and short term rates, e.g. due to a marked increase of risks around a relapse into recession or, a risk of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

The Council officers, in conjunction with the Council's treasury advisers, will monitor both the prevailing interest rates and the market forecasts. With long-term interest rate forecasts set to remain around their current levels the Executive Director of Commercial and Corporate Services, taking into account the advice of the Council's treasury adviser considers a benchmark financing rate of 4.50% for any further long-term borrowing for 2012/2013 to be appropriate.

Consideration will be given to various options, including utilising some investment balances to fund the borrowing requirement in 2012/2013. The need to adapt to changing circumstances and revisions to profiling of capital expenditure is required, and flexibility needs to be retained to adapt to any changes that may occur.

The Executive Director of Commercial and Corporate Services, taking advice from the Council's treasury advisers will continue to monitor rates closely, and whilst implementing the borrowing strategy, will adopt a pragmatic approach in identifying the low points in the interest rate cycle at which to borrow.

## 2.7 Policy on borrowing in advance of need

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

Risks associated with any borrowing in advance of activity will be subject to prior appraisal and borrowing undertaken will be reported to Cabinet as part of agreed treasury management reporting arrangements.

## 2.8 Debt Rescheduling

The reasons for any rescheduling of debt will include:

- the generation of cash savings at minimum risk;
- in order to help fulfil the Treasury Management Strategy;
- in order to enhance the balance of the long-term portfolio (by amending the maturity profile and / or the balance of volatility).

In previous years, debt rescheduling has achieved significant savings in interest charges and discounts and these interest savings have been secured for many years to come. For example, since November 2008 the Council has rescheduled debt worth £59.5 million with an ongoing reduction in interest costs of just under £1.0 million per annum. The introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and premature repayment of debt, which has now been compounded since 20 October 2010 by a considerable further widening of the difference between new borrowing and repayment rates, has meant that PWLB debt restructuring is much less attractive than it was before both of these measures were introduced.

Consideration will also be given to other options where interest savings may be achievable by using LOBO (Lenders Option Borrowers Option) loans, and / or other market loans, in rescheduling exercises rather than solely using PWLB borrowing as the source of replacement financing but this would only be the case where this would represent best value to the Council.

The latest interest rate projections for 2012/2013 show short term borrowing rates will be considerably cheaper than longer term rates and as such there may be potential for some opportunities to generate savings by switching from long term debt to short-term debt. However, these savings will need to be considered in the light of the size of premiums incurred, their short term nature, and the likely cost of refinancing those short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio.

The Council is keeping a watching brief on market conditions in order to secure further debt rescheduling when, and if, appropriate opportunities arise. The timing of all borrowing and investment decisions inevitably includes an element of risk, as those decisions are based upon expectations of future interest rates. The policy to date has been very firmly one of risk spread and this prudent policy will be continued.

Any rescheduling undertaken will be reported to Cabinet, as part of agreed treasury management reporting arrangements.

## 3. Annual Investment Policy and Strategy

### 3.1 Investment Policy and Objectives

When considering its investment policy and objectives, the Council has taken regard to the Department of Communities and Local Government's (CLG) Guidance on Local Government Investments ("the Guidance") and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code").

The Council's investment objectives are: -

(a) the security of capital, and
(b) the liquidity of its investments.

The Council also aims to achieve the optimum return on its investments but commensurate with proper levels of security and liquidity. The risk appetite of the Council is regarded as low in order to give priority to security of its investments.

The borrowing of monies purely to invest or on-lend and make a return is unlawful and the Council will not engage in such activity.

3.2 **Investment Strategy**

This Strategy sets out:

- the procedures for determining the use of each class of investment (advantages and associated risk), particularly if the investment falls under the category of “non-specified investments”;
- the maximum periods for which funds may be prudently committed in each class of investment;
- the amount or percentage limit to be invested in each class of investment;
- whether the investment instrument is to be used by the Council’s in-house officers and/or by the Council’s appointed external fund managers, (if used); and, if non-specified investments are to be used in-house, whether prior professional advice is to be sought from the Council’s treasury advisers;
- the minimum amount to be held in short-term investments (i.e. an investment which the Council may require to be repaid or redeemed within 12 months of making the investment).

3.3 **Investment Types**

The Council is allowed to invest in two types of investment, namely Specified Investments and Non-specified Investments.

Specified Investments are those investments that are for a period of less than one year, are not classed as capital expenditure, and are placed with high credit rated counterparties.

Non-specified Investments are any investments which are not classified as specified investments. As the Council only uses high credit rated counterparties this means in effect that any investments placed with those counterparties for a period of one year or more will be classed as Non-specified Investments. Any investment by the Council in a type of investment classed as capital expenditure (see 3.4 overleaf) will be subject to a full appraisal and reported to Cabinet for approval.

The type of investments to be used by the in-house team will be limited to term deposits, interest bearing accounts, Money Market Funds, treasury bills and gilt edged securities and will follow the criteria as set out in Appendix 6.

3.4 **Investments Defined as Capital Expenditure**

The acquisition of share capital or loan capital in any body corporate is defined as capital expenditure under Section 16(2) of the Local Government Act 2003. Such investments have to be funded out of capital or revenue resources and are classified as ‘non-specified investments’.

A loan or grant by this Council to another body for capital expenditure by that body is also deemed by regulation to be capital expenditure by the Council. It is therefore important for the Council to clearly identify if the loan has been made for policy reasons or if it is an investment for treasury management purposes. Only the latter will be governed by the framework set by the Council for ‘specified’ and ‘non-specified’ investments.

The Council will not use (or allow any external fund managers it may appoint to use) any investment which will be deemed as capital expenditure.

3.5 **Investment Limits**

One of the recommendations of the Code is that local authorities should set limits for the amounts of investments that can be placed with institutions by country, sector and group. These limits are applied in the Council's Counterparty criteria set out in Appendix 6.

The minimum amount of overall investments that the Council will hold in short-term investments (less than one year) is £50 million. As the Council has decided to restrict most of its investments to term deposits, it will maintain liquidity by having a minimum of 30% of these short-term investments maturing within 6 months.

A maximum limit of £75 million is to be set for in-house non-specified investments over 364 days up to a maximum period of 2 years. This amount has been calculated by reference to the Council’s cash flows, including the potential use of earmarked reserves. The Executive Director of Commercial and Corporate Services will monitor long-term investment rates and identify any investment opportunities if market conditions change.

3.6 **Provisions for Credit Related Losses**

If any of the Council’s investments appear at risk of loss due to default, (i.e. a credit-related loss, and not one resulting from a fall in price due to movements in interest rates), then the Council will make revenue provision of an appropriate amount in accordance with proper accounting practice or any prevailing government regulations, if applicable. This position has not occurred and the Council mitigates this risk with its prudent investment policy.

3.7 **Creditworthiness policy**

The creditworthiness policy adopted by this Council takes into account not only the credit ratings issued by all three credit rating agencies (Fitch, Moody's and Standard & Poor's), but also, available market data and intelligence such as Credit Default Swap levels and share prices, the level of government support to financial institutions and advice from its Treasury Management advisors.

Set out in Appendix 6 is the detailed criteria that will be used, subject to approval, in determining the level of investments that can be invested with each counterparty or institution. Where a counterparty is rated differently by any of the 3 rating agencies, the lowest rating will be used to determine the level of investment.

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3.8 **Monitoring of Credit Ratings**

- All credit ratings are monitored on a daily basis. The Council has access to all three credit ratings agencies and is alerted to changes through its use of the Sector Treasury Services credit worthiness service.

- If a counterparty's rating is downgraded with the result that it no longer meets the Council's minimum criteria, the Council will cease to place funds with that counterparty. The Council will also immediately inform its external fund manager(s), if used, to cease placing funds with that counterparty.

- If a counterparty's rating is downgraded with the result that, their rating is still sufficient for the counterparty to remain on the Approved Lending List, then the counterparty's authorised investment limit will be reviewed accordingly. A downgraded credit rating may result in the lowering of the counterparty's investment limit and vice versa. The Council will also immediately inform its external fund manager(s), if used, of any such change(s).

Should fund managers be employed by the Council, the Council will establish with its fund manager(s) their credit criteria and the frequency of their monitoring of credit ratings so as to be satisfied as to their adherence to the Council's policy.

The ratings agencies have reaffirmed the UK's AAA sovereign rating. They have, though, warned that this could be reviewed if Government policy were to change, or was seen to be failing to achieve its desired outcome. Should the UK Government AAA sovereign rating be withdrawn the Council's Investment Strategy and Lending List criteria will be reviewed and any changes necessary will be reported to Cabinet.

3.9 **Past Performance and Current Position**

During 2011/2012 the Council did not employ any external fund managers, all funds being managed by the in-house team. The performance of the fund by the in-house team is shown overleaf and compares this with the relevant benchmarks and performance from the previous year:

| | **2010/11 Return %** | **2010/11 Benchmark %** | **2011/12 Return % Year to date** | **2011/12 Benchmark % Year to date** |
|---|---|---|---|---|
| Council | 1.50 | 0.36 | 1.63 | 0.37 |

During 2012/2013 the Council will continue to review the optimum arrangements for the investment of its funds whilst fully observing the investment strategy in place. The Council uses the 7 day London Interbank Bid (LIBID) rate as a benchmark for its investments

3.10 **Outlook and Proposed Investment Strategy**

Based on its cash flow forecasts, the Council anticipates its fund balances in 2012/2013 are likely to range between £120 million and £270 million. This represents a cautious approach and provides for funding being received in excess of the level budgeted for, and also for unexpected and unplanned levels of capital under spending in the year or re-profiling of spend into future years. In 2012/2013, with short-term interest rates forecast to be materially below long-term rates, it is possible that some investment balances may be used to fund some long-term borrowing or used for debt rescheduling. Such funding is wholly dependent upon market conditions and will be assessed and reported to Cabinet if and when the appropriate conditions arise.

The Council is not committed to any investments, which are due to commence in 2012/2013, (i.e. it has not agreed any forward deals).

Activities likely to have a significant effect on investment balances are:

- Capital expenditure during the financial year, (dependent upon timing), will affect cash flow and short term investment balances;
- Any re-profiling of capital expenditure from, and to, other financial years will also affect cash flow, (no re-profiling has been taken into account in current estimates);
- Any unexpected capital receipts or income;
- Timing of new long-term borrowing to fund capital expenditure;
- Possible funding of long-term borrowing from investment balances (dependent upon appropriate market conditions).

The Executive Director of Commercial and Corporate Services, in conjunction with the Council's treasury adviser Sector Treasury Services, and taking into account the minimum amount to be maintained in short-term investments, will continue to monitor investment rates closely and to identify any appropriate investment opportunities that may arise.

It is proposed that delegated authority continues for the Executive Director of Commercial and Corporate Services, in consultation with the Cabinet Portfolio holder for Resources, to vary the Lending List Criteria and Lending List itself should circumstances dictate, on the basis that changes be reported to Cabinet retrospectively, in accordance with normal treasury management reporting procedures.

3.11 **External fund managers**

At present the Council does not employ any external fund managers.

Should the Council appoint any external fund managers in the future, they will have to agree to strict investment limits and investment criteria. These external fund managers will work to the following parameters:

- The institutions on the Approved Lending list of the external manager must correspond to those agreed with Sunderland City Council (i.e. only institutions on Sunderland City Council's Approved Lending List to be included as shown in Appendix 7);
- they will be allowed to invest in term deposits, Certificates of Deposit (CD's) and government gilt securities;
- An investment limit of £3 million per institution (per manager);
- A maximum limit of 50% fund exposure to government gilts;
- A maximum proportion of the fund invested in instruments carrying rates of interest for periods longer than 364 days shall not exceed 50%. It is proposed to only recommend the use of fixed term deposits up to a maximum of 2 years.

3.12 **Policy on the use of external service providers**

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

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

4. **Scheme of delegation**

4.1 The Treasury Management Strategy Statement has been prepared in accordance with the revised Code. Accordingly, the Council's Treasury Management Strategy (TMS) is approved annually by the full Council and receives, as a minimum, a mid-year TMS report and an annual Treasury Management outturn report for the previous year by no later than the 30th September of the following year. In addition quarterly reports are made to Cabinet and the Audit and Governance Committee and monitoring reports are reviewed by members in both executive and scrutiny functions respectively. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

The Council adopted the following reporting arrangements in accordance with the requirements of the Code:

| **Area of Responsibility** | **Council/ Committee/ Officer** | **Frequency** |
|---|---|---|
| Treasury Management Policy Statement (revised) | Full Council | Reaffirmed annually and updated as appropriate |
| Treasury Management Strategy / Annual Investment Strategy | Full Council | Annually before the start of the year |
| Treasury Management Strategy / Annual Investment Strategy – mid year report | Full Council | Mid year |
| Treasury Management Strategy / Annual Investment Strategy –updates or revisions at other times | Full Council | As appropriate |
| Annual Treasury Management Outturn Report | Full Council | Annually by 30/9 after the end of the financial year |
| Treasury Management Monitoring Reports | Executive Director of Commercial and Corporate Services | Monthly |
| Treasury Management Practices | Executive Director of Commercial and Corporate Services | Annually |
| Scrutiny of Treasury Management Strategy | Cabinet / Audit and Governance Committee | Annually before Full Council |
| Scrutiny of Treasury Management Performance | Cabinet / Audit and Governance Committee | Quarterly |

## 5. The Treasury Management Role of the Section 151 Officer

5.1 The Executive Director of Commercial and Corporate Services is the Council's Section 151 Officer and has specific delegated responsibility in the Council's Constitution to manage the borrowing, financing, and investment requirements of the Council in accordance with the Treasury Management Policy agreed by the Council. This includes;

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports

- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit
- recommending the appointment of external service providers.

**Appendix 4**

## Interest Rate Forecasts

The data set out below shows a variety of forecasts published by Sector Treasury Services, Capital Economics (an independent forecasting consultancy) and UBS (which represents summarised figures drawn from the population of all major City banks and academic institutions).

The forecast within this strategy statement has been drawn from these diverse sources and officers' own views.

## 1. Individual Forecasts

**Appendix 4**

| Sector's Interest Rate View | Now | Dec-11 | Mar-12 | Jun-12 | Sep-12 | Dec-12 | Mar-13 | Jun-13 | Sep-13 | Dec-13 | Mar-14 | Jun-14 | Sep-14 | Dec-14 | Mar-15 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Sector's Bank Rate View | **0.50%** | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.75% | 1.00% | 1.25% | 1.50% | 2.00% | 2.25% | 2.50% |
| 3 Month LIBID | **0.87%** | 0.70% | 0.70% | 0.70% | 0.70% | 0.70% | 0.75% | 0.80% | 0.90% | 1.20% | 1.40% | 1.60% | 2.10% | 2.40% | 2.60% |
| 6 Month LIBID | **1.16%** | 1.00% | 1.00% | 1.00% | 1.00% | 1.00% | 1.10% | 1.20% | 1.40% | 1.60% | 1.80% | 2.00% | 2.50% | 2.70% | 2.90% |
| 12 Month LIBID | **1.65%** | 1.50% | 1.50% | 1.50% | 1.50% | 1.60% | 1.70% | 1.80% | 1.90% | 2.20% | 2.40% | 2.60% | 3.10% | 3.20% | 3.30% |
| 5yr PWLB Rate | **2.25%** | 2.30% | 2.30% | 2.30% | 2.30% | 2.40% | 2.50% | 2.60% | 2.70% | 2.80% | 2.90% | 3.10% | 3.30% | 3.50% | 3.70% |
| 10yr PWLB Rate | **3.33%** | 3.30% | 3.30% | 3.30% | 3.40% | 3.40% | 3.50% | 3.60% | 3.70% | 3.80% | 4.00% | 4.20% | 4.40% | 4.60% | 4.80% |
| 25yr PWLB Rate | **4.24%** | 4.20% | 4.20% | 4.20% | 4.30% | 4.30% | 4.40% | 4.50% | 4.60% | 4.70% | 4.80% | 4.90% | 5.00% | 5.10% | 5.20% |
| 50yr PWLB Rate | **4.26%** | 4.30% | 4.30% | 4.30% | 4.40% | 4.40% | 4.50% | 4.60% | 4.70% | 4.80% | 4.90% | 5.00% | 5.10% | 5.20% | 5.30% |
| **Bank Rate** | | | | | | | | | | | | | | | |
| Sector's View | **0.50%** | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.75% | 1.00% | 1.25% | 1.50% | 2.00% | 2.25% | 2.50% |
| UBS | **0.50%** | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | - | - | - | - | - | - | - | - | - |
| Capital Economics | **0.50%** | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | 0.50% | - | - | - | - | - |
| **5yr PWLB Rate** | | | | | | | | | | | | | | | |
| Sector's View | **2.25%** | 2.30% | 2.30% | 2.30% | 2.30% | 2.40% | 2.50% | 2.60% | 2.70% | 2.80% | 2.90% | 3.10% | 3.30% | 3.50% | 3.70% |
| UBS | **2.25%** | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Capital Economics | **2.25%** | 2.00% | 2.00% | 2.00% | 2.00% | 2.00% | 2.00% | 2.00% | 2.00% | 2.00% | - | - | - | - | - |
| **10yr PWLB Rate** | | | | | | | | | | | | | | | |
| Sector's View | **3.33%** | 3.30% | 3.30% | 3.30% | 3.40% | 3.40% | 3.50% | 3.60% | 3.70% | 3.80% | 4.00% | 4.20% | 4.40% | 4.60% | 4.80% |
| UBS | **3.33%** | 3.45% | 3.45% | 3.50% | 3.60% | 3.65% | - | - | - | - | - | - | - | - | - |
| Capital Economics | **3.33%** | 3.00% | 3.00% | 3.00% | 3.00% | 3.00% | 3.00% | 3.00% | 3.00% | 3.00% | - | - | - | - | - |
| **25yr PWLB Rate** | | | | | | | | | | | | | | | |
| Sector's View | **4.24%** | 4.20% | 4.20% | 4.20% | 4.30% | 4.30% | 4.40% | 4.50% | 4.60% | 4.70% | 4.80% | 4.90% | 5.00% | 5.10% | 5.20% |
| UBS | **4.24%** | 4.80% | 4.90% | 4.90% | 4.90% | 4.90% | - | - | - | - | - | - | - | - | - |
| Capital Economics | **4.24%** | 4.30% | 4.30% | 4.30% | 4.30% | 4.30% | 4.30% | 4.30% | 4.30% | 4.30% | - | - | - | - | - |
| **50yr PWLB Rate** | | | | | | | | | | | | | | | |
| Sector's View | **4.26%** | 4.30% | 4.30% | 4.30% | 4.40% | 4.40% | 4.50% | 4.60% | 4.70% | 4.80% | 4.90% | 5.00% | 5.10% | 5.20% | 5.30% |
| UBS | **4.26%** | 4.80% | 4.95% | 4.95% | 5.00% | 5.00% | - | - | - | - | - | - | - | - | - |
| Capital Economics | **4.26%** | 4.40% | 4.40% | 4.40% | 4.40% | 4.40% | 4.40% | 4.40% | 4.40% | 4.40% | - | - | - | - | - |

## 2. Survey of Economic Forecasts **Appendix 4**

**HM Treasury January 2012**

The current Q4 2011 and 2012 forecasts are based on the December 2011 report. Forecasts for 2011 – 2015 are based on 32 forecasts in the last quarterly forecast – in November 2011.

| BANK RATE FORECASTS | | quarter ended | | annual average Bank Rate | | |
|---|---|---|---|---|---|---|
| | actual | Q4 2012 | | ave. 2013 | ave. 2014 | ave. 2015 |
| Median | 0.50% | 0.60% | | 1.20% | 2.10% | 3.10% |
| Highest | 0.90% | 1.80% | | 3.10% | 4.10% | 4.50% |
| Lowest | 0.50% | 0.10% | | 0.50% | 0.90% | 1.40% |

**Appendix 5**

## Economic Background

### 1.1 Global economy

The outlook for the global economy remains uncertain with the UK economy struggling to generate sustained recovery that offers grounds for optimistim for the outlook for 2012 and into 2013. Consumer and business confidence levels are still low with little to boost sentiment, as such it is not easy to see potential for a significant increase in the economic growth rate in the short term.

At the centre of much of the uncertainty is the ongoing Eurozone sovereign debt crisis which has intensified, rather than dissipated throughout 2011. The main problem has been Greece, where, even with an Eurozone / IMF / ECB bailout package and the imposition of austerity measures aimed at deficit reduction, the lack of progress and the ongoing deficiency in addressing the underlying lack of competitiveness of the Greek economy, has seen an escalation of their problems. These look certain to result in a default of some kind but it currently remains unresolved. Many commentators view is that Greece will have to exit the Eurozone in 2012.

There is also growing concern about the situation in Italy and the risk that contagion has not been contained. Italy is the third biggest debtor country in the world but its prospects are limited given the poor rate of economic growth over the last decade and likely difficulties in implementing the required level of fundamental reforms in the economy. There is a rising level of electoral opposition in Germany to bailing out other countries which could hinder any potential rescue package.

### 1.2 UK economy

The Government's austerity measures, aimed at getting the public sector deficit into order over the next four years, have yet to fully impact on the economy. However, coming at a time when economic growth has been weak there are concerns at the risk of a technical recession (two quarters of negative growth) in 2012. It looks likely that the private sector will not make up for the negative impact of these austerity measures given the lack of an export led recovery due to the downturn in our major trading partner – the EU. The housing market, a gauge of consumer confidence, remains weak and the outlook is for house prices to be little changed for a prolonged period.

**Economic Growth.** GDP growth has remained low since the election of 2010 and economic forcecasts for 2012 and beyond have been revised lower on a near quarterly basis. With concerns of a potential return to recession, the Bank of England embarked on a second round of Quantitive Easing to stimulate economic activity. It appears likely that there will be another expansion of quantitative easing in early, 2012 in order to stimulate economic growth.

**Unemployment.** With the impact of the Government's austerity strategy impacting the trend for 2011 of steadily increasing unemployment, there are limited prospects for any improvement in 2012 given the prospects for weak growth.

**Inflation and Bank Rate.** For the last two years, the MPC's contention has been that high inflation was the outcome of temporary external factors and other one offs (e.g. changes in VAT); that view remains in place with CPI inflation starting quarter 1 of 2012 at 4.8%, having peaked at 5.2% in September 2011. They remain of the view that the rate will fall back to, or below, the 2% target level within the next two years.

**AAA rating.** The ratings agencies have, in contrast to reductions in a number of other European countries, reaffirmed the UK's AAA sovereign rating and have expressed satisfaction with Government policy for deficit reduction. They have, though, warned that this could be reviewed if the policy were to change, or was seen to be failing to achieve its desired outcome. This credit position has ensured that the UK government is able to fund itself at historically low levels and, with the safe haven status from Eurozone debt also drawing in external investment, the pressure on rates has been downward, and looks set to remain so for some time

## 1.3 Economic Forecast

Economic forecasting remains troublesome with so many extermal influences weighing on the UK. There does, however, appear to be consensus among analysts that the economy remains weak and whilst there is still a broad range of views as to potential performance, they have all been downgraded throughout 2011. Key areas of uncertainty include:

- a worsening of the Eurozone debt crisis and heightened risk of the breakdown of the bloc or even of the currency itself;
- the wider impact of the Eurozone crisis on financial markets and the banking sector;
- the impact of the Government's austerity plan on confidence and growth and the need to rebalance the economy from services to exporting manufactured goods;
- the under-performance of the UK economy which could undermine the Government's policies that have been based upon levels of growth that inceasingly seem likely to be undershot;
- a continuation of high levels of inflation;
- the economic performance of the UK's trading partners, in particular the EU and US, with some analysts suggesting that recession could return to both;
- stimulus packages failing to stimulate growth;
- elections due in the US, Germany and France in 2012 or 2013;
- potential for protectionism i.e. an escalation of the currency war / trade dispute between the US and China.

The overall balance of risks remains weighted to the downside. Lack of economic growth, both domestically and overseas, will impact on confidence putting upward pressure on unemployment. It will also further knock levels of demand which will bring the threat of recession back into focus.

Many forecasters believe that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries.

Given the weak outlook for economic growth the prospects for any interest rate changes before mid-2013 is very limited. There is potential for the start of Bank Rate increases to be even further delayed if growth disappoints.

**Appendix 6**

## Lending List Criteria

### Counterparty Criteria

The Council takes into account not only the individual institution's credit ratings issued by all three credit rating agencies (Fitch, Moody's and Standard & Poor's), but also all available market data and intelligence, the level of government support and advice from its Treasury Management advisors.

Set out below are the criteria to be used in determining the level of funds that can be invested with each institution. Where an institution is rated differently by the rating agencies, the lowest rating will determine the level of investment.

| Fitch / S&P's Long Term Rating | Fitch Short Term Rating | S&P's Short Term Rating | Moody's Long Term Rating | Moody's Short Term Rating | Maximum Deposit £m | Maximum Duration |
|---|---|---|---|---|---|---|
| AAA | F1+ | A1+ | Aaa | P-1 | 70 | 2 Years |
| AA+ | F1+ | A1+ | Aa1 | P-1 | 50 | 2 Years |
| AA | F1+ | A1+ | Aa2 | P-1 | 40 | 364 days |
| AA- | F1+ / F1 | A1+ / A-1 | Aa3 | P-1 | 20 | 364 days |
| A+ | F1 | A-1 | A1 | P-1 | 10 | 364 days |
| A | F1 / F2 | A-1 / A-2 | A2 | P-1 / P-2 | 10 | 364 days |
| A- | F1 / F2 | A-2 | A3 | P-1 / P-2 | 5 | 6 months |
| **Local Authorities** (limit for each local authority) | | | | | 30 | 2 years |
| **UK Government** (including debt management office, gilts and treasury bills) | | | | | 70 | 5 years |
| **Money Market Funds** Maximum amount to be invested in Money Market Funds is £50 million with a maximum of £30 million in any one fund. | | | | | 50 | Liquid Deposits |

Where the UK Government holds a shareholding in an institution the UK Government's credit rating of AAA will be applied to that institution to determine the amount the Council can place with that institution for a maximum period of 2 years.

Where any banks / building societies are part of the UK Government's Credit Guarantee scheme (marked with * in the Approved Lending List), these counterparties will have an AA rating applied to them thus giving them a credit limit of £40 million for a maximum period of 364 days

The Code of Practice for Treasury Management in the Public Services recommends that consideration should also be given to country, sector, and group limits in addition to the individual limits set out above, these new limits are as follows:

**Country Limit**
It is proposed that only countries with a minimum sovereign credit rating of AA+ by all three rating agencies will be considered for inclusion on the Approved Lending List.

It is also proposed to set a total limit of £40 million which can be invested in other countries provided they meet the above criteria. A separate limit of £300 million will be applied to the United Kingdom and is based on the fact that the government has done and is willing to take action to protect the UK banking system.

| Country | Limit £m |
|---|---|
| UK | 300 |
| Non UK | 40 |

**Sector Limit**
The Code recommends a limit be set for each sector in which the Council can place investments. These limits are set out below:

| Sector | Limit £m |
|---|---|
| Central Government | 300 |
| Local Government | 300 |
| UK Banks | 300 |
| UK Building Societies | 150 |
| Money Market Funds | 50 |
| Foreign Banks | 40 |

**Group Limit**
Where institutions are part of a group of companies e.g. Lloyds Banking Group, Santander and RBS, then total limit of investments that can be placed with that group of companies will be determined by the highest credit rating of a counterparty within that group, unless the government rating has been applied. This will apply provided that:

- the government's guarantee scheme is still in place;
- the UK continues to have a sovereign credit rating of AAA; and
- that market intelligence and professional advice is taken into account.

Proposed group limits are set out in Appendix 7

**Appendix 7**

## Approved Lending List

| | Fitch | | | | Moody's | | | Standard & Poor's | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | L Term | S Term | Individual | Support | L Term | S Term | Fin Strength | L Term | S Term | Limit £m | Max Deposit Period |
| **UK** | AAA | F1+ | | | Aaa | | | AAA | | 300 | 2 years |
| **Lloyds Banking Group** (see Note 1) | | | | | | | | | | **Group Limit 70** | |
| Lloyds Banking Group plc | A | F1 | bbb | 1 | A2 | - | - | A- | A-2 | 70 | 2 years |
| Lloyds TSB Bank Plc | A | F1 | bbb | 1 | A1 | P-1 | C- | A | A-1 | 70 | 2 years |
| Bank of Scotland Plc | A | F1 | - | 1 | A1 | P-1 | D+ | A | A-1 | 70 | 2 years |
| **Royal Bank of Scotland Group** (See Note 1) | | | | | | | | | | **Group Limit 70** | |
| Royal Bank of Scotland Group plc | A | F1 | bbb | 1 | A1 | P-2 | - | A- | A-2 | 70 | 2 years |
| The Royal Bank of Scotland Plc | A | F1 | bbb | 1 | A3 | P-1 | C- | A | A-1 | 70 | 2 years |
| National Westminster Bank Plc | A | F1 | - | 1 | A2 | P-1 | C- | A | A-1 | 70 | 2 years |
| Ulster Bank Ltd | A- | F1 | ccc | 1 | Baa1 | P-2 | D- | BBB+ | A-2 | 70 | 2 years |
| **Santander Group *** | | | | | | | | | | **Group Limit 40** | |
| Santander UK plc | A+ | F1 | a+ | 1 | A1 | P-1 | C- | AA- | A-1+ | 40 | 364 days |
| Cater Allen | A+ | F1 | a+ | 1 | A1 | P-1 | C- | AA- | A-1+ | 40 | 364 days |
| | | | | | | | | | | | |
| Barclays Bank plc * | A | F1 | a | 1 | Aa3 | P-1 | C | A+ | A-1 | 40 | 364 days |
| HSBC Bank plc * | AA | F1+ | aa- | 1 | Aa2 | P-1 | C+ | AA | A-1+ | 40 | 364 days |

**Appendix 7 (continued)**

| | Fitch | | | Moody's | | | | Standard & Poor's | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | L Term | S Term | Individual | Support | L Term | S Term | Fin Strength | L Term | S Term | Limit £m | Max Deposit Period |
| Nationwide BS * | A+ | F1 | a+ | 1 | A2 | P-1 | C | A+ | A-1 | 40 | 364 days |
| Standard Chartered Bank * | AA- | F1+ | aa- | 1 | A1 | P-1 | B- | AA- | A-1+ | 40 | 364 days |
| Clydesdale Bank / Yorkshire Bank **/*** | A+ | F1 | bbb | 1 | A2 | P-1 | C- | BBB | A-2 | 10 | |
| Co-Operative Bank Plc | A- | F2 | a- | 3 | A3 | P-2 | C- | - | - | 5 | 6 months |
| Northern Rock *** | BBB+ | F2 | bbb+ | 2 | - | - | - | BBB+ | A-2 | 0 | |
| **Top Building Societies (by asset value)** | | | | | | | | | | | |
| Nationwide BS (see above) | | | | | | | | | | | |
| Yorkshire BS *** | BBB+ | F2 | bbb+ | 5 | Baa2 | P-2 | C- | A- | A-2 | 0 | |
| Coventry BS | A | F1 | a | 5 | A3 | P-2 | C | - | - | 5 | 6 Months |
| Skipton BS *** | BBB | F3 | bbb | 5 | Ba1 | NP | D+ | - | - | 0 | |
| Leeds BS | A- | F2 | a- | 5 | A3 | P-2 | C | - | - | 5 | 6 Months |
| West Bromwich BS *** | B+ | B | b+ | 5 | B2 | NP | E+ | - | - | 0 | |
| Principality BS *** | BBB+ | F2 | bbb+ | 5 | Ba1 | NP | D+ | - | - | 0 | |
| Newcastle BS *** | BB+ | B | bb+ | 5 | - | - | - | - | - | 0 | |
| Nottingham BS *** | - | - | - | - | Baa2 | P-2 | C- | - | - | 0 | |
| **Foreign Banks have a combined total limit of £40m** | | | | | | | | | | | |
| **Australia** | AAA | - | - | - | Aaa | - | - | AAA | | 40 | 364 Days |
| National Australia Bank | AA | F1+ | aa | 1 | Aa2 | P-1 | B- | AA- | A-1+ | 40 | 364 Days |
| Australia and New Zealand Banking Group Ltd | AA- | F1+ | aa- | 1 | Aa2 | P-1 | B- | AA- | A-1+ | 20 | 364 Days |
| Commonwealth Bank of Australia | AA | F1+ | aa | 1 | Aa2 | P-1 | B- | AA- | A-1+ | 40 | 364 Days |
| Westpac Banking Corporation | AA | F1+ | aa | 1 | Aa2 | P-1 | B- | AA- | A-1+ | 40 | 364 Days |

| Appendix 7 (continued) | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Fitch | | | | Moody's | | | Standard & Poor's | | | |
| | L Term | S Term | Individual | Support | L Term | S Term | Fin Strength | L Term | S Term | Limit £m | Max Deposit Period |
| **Canada** | AAA | | | | Aaa | | | AAA | | 40 | 364 Days |
| Bank of Nova Scotia | AA- | F1+ | aa- | 1 | Aa1 | P-1 | B | AA- | A-1+ | 20 | 364 Days |
| Royal Bank of Canada | AA | F1+ | aa | 1 | Aa1 | P-1 | B | AA- | A-1+ | 20 | 364 Days |
| Toronto Dominion Bank | AA- | F1+ | aa- | 1 | Aaa | P-1 | B+ | AA- | A-1+ | 20 | 364 Days |
| Money Market Funds | | | | | | | | | | 50 | 2 Years |
| Prime Rate Stirling Liquidity | AAA MMF | | | | | | | AAAm | | 30 | 2 Years |
| Insight Liquidity Fund | | | | | AAA MR1 | | | AAAm | | 30 | 2 Years |
| Ignis Sterling Liquidity | AAA MMF | | | | | | | AAAm | | 30 | 2 Years |

**Notes**

Note 1 **Nationalised / Part Nationalised**

The counterparties in this section will have the UK Government's AAA rating applied to them thus giving them a credit limit of £70 million

* Banks / Building Societies which are part of the UK Government's Credit Guarantee scheme
The counterparties in this section will have an AA rating applied to them thus giving them a credit limit of £40 million

** The Clydesdale Bank (under the UK section) is owned by National Australia Bank

*** These will be revisited and used only if they meet the minimum criteria (ratings of A- and above)

Any bank which is incorporated in the United Kingdom and controlled by the FSA is classed as a UK bank for the purposes of the Approved Lending List.

Sunderland City Council

**Item No. 7**

**AUDIT AND GOVERNANCE COMMITTEE** **10 FEBRUARY 2012**

**AUDIT COMMISSION – ANNUAL GRANTS REPORT 2010/11**

**Report of Executive Director of Commercial and Corporate Services**

## 1.0 Purpose of the report

1.1 This report details the Audit Commission's (AC) work that they have carried out for all grant claims and returns made by the council for the financial year 2010/2011, which according to Government regulations required an external audit opinion and/or audit certificate.

## 2.0 Summary of the Report

2.1 The attached document (Appendix 1) advises members of the main coverage and findings of the audit work carried out on all grant claims and returns subject to external audit.

2.2 The report is very positive in that the council suffered no loss of grant in 2010/2011 for the total amount of almost £261 million of grant claims / returns covered by this report.

2.3 Amendments to grant claims

The amendments identified in the report (Appendix 1 – Pages 5 to 7) were due in the main to external factors, these are summarised below for information:

- Single Programme £4.099m – this was mainly as a result of the grant funding stream ending on 31st March 2011 and the fact One North East had extended their timetable to allow additional expenditure of £4.134m to be claimed after the deadline date. A minor grant amount identified as not being defrayed in the year of £0.034m has also since been accepted and honoured (paid) by One North East.
- New Deal for Communities £0.774m – this was as a result of the council's effective verification process that identified that some external organisations had not complied with the grant funding criteria and amendments to their grant entitlement was therefore necessary. This is because the council is the accountable body and must ensure all funding allocated to external bodies is used in accordance with the grant conditions. No grant was lost as other eligible costs / schemes used this funding.
- NNDR £1.698m – error on return which because of the way the grant form is completed, had no impact on the level of grant received. The section involved has acknowledged this issue.
- Teachers Pension Return £0.015m – no grant lost but noted that in future all schools that become academies are to be excluded from the return.

It should be noted that none of above amendments resulted in the council losing any grant claimed and that where appropriate responsible officers have been notified of errors to avoid such occurrences in the future.

2.4 The auditor tests all grant claim details and the level of testing is sometimes determined by the grant awarding body. In the case for the Housing and Council Tax Benefit grant the DWP agreed that all claims nationally should follow a standard audit process that does not rely on the Council's control environment. It is pleasing to report that the Housing and Council Tax Benefit and Sure Start and Early Years grant claims with a total value of £156.778m had no amendments.

2.5 The cost of the work in 2010/11 was £40,460 compared to £39,571 for the previous year however the cost was £3,500 below that anticipated (Page 9).

2.6 An officer from the Audit Commission will be in attendance to outline the content of the Report and to answer member questions.

**3.0 Description of Decision**

3.1 The Committee is recommended to note the contents of this report

**Background Papers**

Audit Commission: Certification of Claims and Returns – Annual Report 2010/2011

# Certification of claims and returns - annual report

**Sunderland City Council**

**Audit 2010/11**

# Contents

# Introduction

**Local authorities claim large sums of public money in grants and subsidies from central government and other grant-paying bodies and are required to complete returns providing financial information to government departments. My certification work provides assurance to grant-paying bodies that claims for grants and subsidies are made properly or that information in financial returns is reliable. This report summarises the outcomes of my certification work on your 2010/11 claims and returns.**

Under section 28 of the Audit Commission Act 1998, the Audit Commission may, at the request of authorities, make arrangements for certifying claims and returns because scheme terms and conditions include a certification requirement. Where such arrangements are made, certification instructions issued by the Audit Commission to its auditors set out the work auditors must do before they give their certificate. The work required varies according to the value of the claim or return and the requirements of the government department or grant-paying body, but in broad terms:

- for claims and returns below £125,000 the Commission does not make certification arrangements and I was not required to undertake work;
- for claims and returns between £125,000 and £500,000, I undertook limited tests to agree form entries to underlying records, but did not undertake any testing of eligibility of expenditure; and
- for claims and returns over £500,000 I planned and performed my work in accordance with the certification instruction to assess the control environment for the preparation of the claim or return to decide whether or not to place reliance on it. Depending on the outcome of that assessment, I undertook testing as appropriate to agree form entries to underlying records and test the eligibility of expenditure or data.

Claims and returns may be amended where I agree with your officers that this is necessary. Amendments are not always the result of errors by officers. This year, for example, the most significant amendment was due to single programme being extended so that expenditure in 2011/12 could be claimed (leading to a net increase in grant of £4.1m). My certificate may also refer to a qualification letter where there is disagreement or uncertainty, or you have not complied with scheme terms and conditions.  This year there was one qualification letter, although the issues raised were not significant.

# Summary of my 2010/11 certification work

## The Authority provided excellent working papers, although some claim amendments were necessary.

Grant claims and returns continue to be supported by excellent working papers. Of the £261m of grant claims subject to audit, there was no loss of grant due to errors by officers. Our work gave rise to amendments to five of the eight claims and returns for the year ended 31 March 2011 that the Authority was required to submit for certification. The most significant change to a claim was Single Programme where amendments to the claim included £4,134,300 of expenditure on projects completed after the draft claim deadline. Inclusion of these projects was allowed because of the demise of the grant paying body (One North East).

We also issued one qualification letter for the New Deal for Communities grant.

Table 1: **Summary of 2010/11 certification work**

| Number of claims and returns certified | |
|---|---|
| Total value of claims and returns certified | 8 |
| Number of claims and returns amended due to errors | 5 |
| Number of claims and returns where I issued a qualification letter because there was disagreement or uncertainty over the content of the claim or return or scheme terms and conditions had not been complied with | 1 |
| Total cost of certification work | £40,460 |

# Results of 2010/11 certification work

## This section summarises the results of my 2010/11 certification work and highlights the significant issues arising from that work.

Grant claims and returns continue to be supported by excellent working papers. The Council's grants coordinator monitors the submission of grant claims and provides a quality review to ensure that suitable working papers are presented to us. Officers are experienced in claim preparation and have a good knowledge of grant schemes. Our good working relationships with officers have helped us meet certification deadlines.

Table 2: **Claims and returns above £500,000**

| Claim or return | Value of claim or return presented for certification (£'000) | Was reliance placed on the control environment? | Value of any amendments made | Was a qualification letter issued? |
|---|---|---|---|---|
| Housing and Council Tax Benefit Scheme | 142,136 | Our approach to this claim does not allow reliance. | None | No |
| National Non-Domestic Rates Return | 73,079 | No | £1,697,716. No financial impact - see below. | No |
| Teachers' Pensions Return | 17,972 | No | £14,526. No financial impact - see below | No |
| Sure Start, Early Years and | 14,642 | No | £1 rounding error | No |

| Claim or return | Value of claim or return presented for certification (£'000) | Was reliance placed on the control environment? | Value of any amendments made | Was a qualification letter issued? |
|---|---|---|---|---|
| Childcare Grant and Aiming High for Disabled Children Grant | | | | |
| Disabled Facilities | 1,029 | No | None | No |
| New Deal for Communities | 3,725 | No | £774,104. No impact on grant funding - see below | Yes - see below |
| Single Programme | 8,224 | No | £4,099,591 net additional grant claimed due to extended timeframe for claim – see below | No |

## National Non-Domestic Rates Return

Our work highlighted two errors that required amendments to the return:

- there was a calculation error of £1,605,298 on Small Business Rate Relief; and
- a notional figure was included in the calculation of void and deleted properties. There was a difference of £92,418.

However, because of the way the claim is prepared, there was no change to the net position on the return.

## Teachers' pension return

The return wrongly included £14,526 that related to March salaries for two schools that had become academies. This amount was to be included in the academy's return. This is not a grant claim and no funding was lost as a result of the amendment.

## New Deal for Communities (NDC)

We issued a qualification letter for the NDC claim that included:

- a number of payments amounting to £55,391 had been included in claims by an external grant claimant. These payments covered a range of services, including VAT advice, conversion to charitable status and property management contracts. The grant applicant was not able to demonstrate that the procurement of these services was in accordance with NDC procurement guidance;
- our 2008/09 qualification letter highlighted payments by an external grant claimant to a supplier where the need for tendering was not identified. The supplier selected was one that had been shown to offer the best value for money on a previous similar contract. Payments continued to be made to this supplier in 2010/11 to the value of £27,162; and
- one of the externally–led projects included in the NDC claim made small charges for activities but did not record the income received. While the amount involved could not be quantified, verification work concluded that ultimately the income was used for the benefit of the project.

Because of the Council's verification work, match funding figures were increased by £774,104 to reflect officers' findings. However, this did not impact on NDC grant receivable.

## Single Programme

Because of the demise of the grant paying body (One North East), claims for completed projects need to be submitted promptly. Another £4,134,300 was included in the final claim because of two projects being completed after the deadline for presenting the draft claim.

£34,709 known future costs were removed from the claim as these had not been defrayed before the submission deadline for the final claim. This amount however has since been accepted by One North East and subsequently no grant loss has occurred.

Table 3: **Claims between £125,000 and £500,000**

| Claim or return | Value of claim or return presented for certification (£'000) | Value of any amendments made | Qualification letter |
|---|---|---|---|
| Flood and coastal erosion management | 149 | None | No |

# Summary of certification fees

**This section summarises the fees arising from my 2010/11 certification work and highlights the reasons for any significant changes in the level of fees from 2009/10.**

Table 4: **Summary of certification fees**

| Claim or return | 2010/11 fee | 2009/10 fee | Reasons for changes in fee greater than +/- 10 per cent |
|---|---|---|---|
| Housing and council tax benefit scheme | £20,733 | £17,944 | Additional sample testing undertaken to explore an error identified in extended payments. |
| National non-domestic rates return | £4,425 | £3,868 | Additional work on resolving errors. |
| Teachers' pensions return | £2,430 | £2,890 | Smaller sample sizes used due to low risk assessment. |
| Sure start, early years and childcare grant and aiming high for disabled children grant | £2,813 | £3,145 | Smaller sample sizes used due to low risk assessment. |
| Disabled facilities | £2,345 | £631 | Reliance placed on control environment in previous two years. Our approach is that full testing is carried out every three years. |
| Flood and coastal erosion management | £988 | N/A | N/A |

| Claim or return | 2010/11 fee | 2009/10 fee | Reasons for changes in fee greater than +/- 10 per cent |
|---|---|---|---|
| New deal for communities | £3,958 | £6,163 | Scheme winding down and fewer projects. |
| Single programme | £2,768 | £4,930 | Smaller sample sizes used due to low risk assessment. |
| **Total Fee** | **£40,460** | **£39,571** | |
| Estimated Fee in the Audit Fee Letter | £43,960 | £40,250 | |
| **Saving against Estimated Fee** | **£3,500** | **£679** | |

The Statement of responsibilities of grant-paying bodies, authorities, the Audit Commission and appointed auditors in relation to claims and returns issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body.

www.audit-commission.gov.uk

**February 2012**

Sunderland City Council

**Item No. 8**

**AUDIT AND GOVERNANCE COMMITTEE** **10 FEBRUARY 2012**

**AUDIT COMMISSION AUDIT PLAN 2011/12 – JANUARY 2012**

**Report of Executive Director of Commercial and Corporate Services**

## 1.0 Purpose of the report

1.1 This report details the Audit Commission's (AC) Audit Plan which notifies the Council of the work that the AC is proposing to undertake in respect of the audit of the financial statements and the value for money conclusion for 2011/2012.

## 2.0 Audit Plan 2011/2012

2.1 The attached document advises on the nature of this work together with the scale of fee for the 2011/2012 audit and the assumptions that inform this charge to the Council.

2.2 It is welcomed that the Audit Commission has reviewed the fees it is intending to charge the Council for its audit services, to recognise the cuts in government grant funding to local government. This has meant that the fees stated on page 14 of the document as £299,270 (excluding grant work charges) which show a further reduction of £33,252 in the scale fees charged as compared to the 2010/2011 £332,522 total. This represents a 10% reduction in scale fees for 2011/12 and is welcomed by the Council. Grant work charges are also reducing as the number of grants subject to audit reduces.

2.3 The Audit Plan also identifies the specific areas for the planned audit work based upon a risk assessment process. These areas of work are set out in the attached document on Pages 5 and 6 of the document and have been discussed with officers.

2.4 An officer, Gavin Barker, of the Audit Commission, will be in attendance at the Audit and Governance Committee meeting in order to outline the content of the Plan and to answer any questions that may arise.

## 3.0 Description of Decision

3.1 The Committee is recommended to:

- Note the contents of this report
- Note the reduced audit fees for the work to be undertaken in 2011/2012, based on the Audit Commission's risk-based approach to audit planning.

**Background Papers**

Audit Commission:  Audit Opinion Plan 2011/2012

# Audit plan

**Sunderland City Council**

**Audit 2011/12**

# Contents

# Introduction

**This plan sets out the work for the 2011/12 audit. The plan is based on the Audit Commission's risk-based approach to audit planning.**

## Responsibilities

The Audit Commission's Statement of Responsibilities of Auditors and of Audited Bodies sets out the respective responsibilities of the auditor and the audited body. The Audit Commission has issued a copy of the Statement to you.

The Statement summarises where the different responsibilities of auditors and of the audited body begin and end and I undertake my audit work to meet these responsibilities.

I comply with the statutory requirements governing my audit work, in particular:

- the Audit Commission Act 1998; and
- the Code of Audit Practice for local government bodies.

My audit does not relieve management or the Audit and Governance Committee, as those charged with governance, of their responsibilities.

# Accounting statements and Whole of Government Accounts

**I will carry out the audit of the accounting statements in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board (APB). I am required to issue an audit report giving my opinion on whether the accounts give a true and fair view.**

## Materiality

I will apply the concept of materiality in planning and performing my audit, in evaluating the effect of any identified misstatements, and in forming my opinion.

## Identifying audit risks

I need to understand the Council to identify any risk of material misstatement (whether due to fraud or error) in the accounting statements. I do this by:

- identifying the business risks facing the Council, including assessing your own risk management arrangements;
- considering the financial performance of the Council;
- assessing internal control, including reviewing the control environment, the IT control environment and internal audit; and
- assessing the risk of material misstatement arising from the activities and controls within the Council's information systems.

## Identification of significant risks

I have considered the additional risks that are relevant to the audit of the accounting statements and have set these out in table 1.

Table 1: **Significant risks**

| Risk | Audit response |
| --- | --- |
| **Potential liabilities in respect of equal pay**<br>The Council currently discloses a significant contingent liability in relation to equal pay. Disclosures in the 2011/12 financial statements will depend on the outcome of legal cases. | I will monitor developments in relation to equal pay on an ongoing basis, and discuss with officers the most appropriate disclosures in the financial statements, consistent with accounting standards. |
| **Valuation of Newcastle International Airport**<br>The valuation of the airport is important in the context of the impact of the recession on air travel, and the future refinancing of the airport's debts that needs to be arranged in the near future. It is important to reflect an appropriate valuation in the 2011/12 accounts. | I will discuss with officers the most appropriate valuation method. I will also highlight the importance of consistency among the shareholders of the airport. |
| **Correct accounting treatment of Care and Support Sunderland**<br>The Council has established a new company following the collapse of Choices Care Ltd. It is important that the Council accounts for the company properly, including group accounts considerations. | I will discuss with officers the most appropriate accounting treatment for Care and Support Sunderland. |
| **New requirement to account for heritage assets**<br>The 2011/12 CIPFA Code adopts the requirements of FRS 30 Heritage Assets. A heritage asset is a tangible asset with historical, artistic, scientific, technological, geophysical or environmental qualities that is held and maintained principally for its contribution to knowledge and culture. It is important that this new requirements are met. | I will evaluate the management controls you have in place to recognise and value heritage assets. I will also undertake testing to check that the Council has accounted for heritage assets in accordance with FRS 30 and the Code. |

## Testing strategy

My audit involves:

- review and where appropriate re-performance of work of your internal auditors;
- testing of the operation of controls;
- reliance on the work of other auditors;
- reliance on the work of experts; and
- substantive tests of detail of transactions and amounts.

I have sought to:

- wherever possible, maximise reliance, subject to review and re-performance, on the work of your internal auditors; and
- maximise the work that can be undertaken before you prepare your accounting statements.

The nature and timing of my proposed work is as follows.

Table 2: **Proposed work**

| | Review of internal audit | Controls testing | Reliance on the work of other auditors | Reliance on work of experts | Substantive testing |
|---|---|---|---|---|---|
| **Interim visit**<br>Dec 2011 to June 2012 | Consideration of scope for reliance on Internal Audit work, particularly in respect of cash receipting and Technology Forge system | Main accounting system<br>Cash receipting<br>(all financial systems are subject to documentation review and walk through testing) | | | Bank reconciliation work.<br>Loans and investments external verification.<br>Journals testing.<br>Other substantive testing of key areas including capital accounting. |

| | Review of internal audit | Controls testing | Reliance on the work of other auditors | Reliance on work of experts | Substantive testing |
|---|---|---|---|---|---|
| **Final visit** June to Sept 2012 | | | Pensions assets and liabilities; auditor to Tyne and Wear Pension Fund. | Pensions liabilities and assets – the pension fund actuary Aon Hewitt and our own consulting actuary.<br>Valuation of property, plant and equipment – your internal valuer.<br>Fair value disclosures – the information provided by Sector. | All material accounts balances and amounts.<br>Year-end feeder system reconciliations. |

I have agreed with officers a protocol setting out our joint working arrangements and a schedule of working papers required to support the entries in the accounting statements.

## Whole of Government Accounts

Alongside my work on the accounting statements, I will also review and report to the National Audit Office on your Whole of Government Accounts return. The extent of my review and the nature of my report are specified by the National Audit Office.

# Value for money

## I am required to reach a conclusion on the Council’s arrangements to secure economy, efficiency and effectiveness.

My conclusion on the Council’s arrangements is based on two criteria, specified by the Commission. These relate to the Council’s arrangements for:

- securing financial resilience – focusing on whether the Council is managing its financial risks to secure a stable financial position for the foreseeable future; and
- challenging how the Council secures economy, efficiency and effectiveness – focusing on whether the Council is prioritising its resources within tighter budgets and improving productivity and efficiency.

## Identification of significant risks

I have considered the risks that are relevant to my value for money conclusion. I have identified the following significant risks that I will address through my work.

Table 3: **Significant risks**

| Risk | Audit response | Separate audit output? |
| --- | --- | --- |
| ■ Delivery of the improvements through the Sunderland Way of Working and Corporate Transformation Programmes.<br>■ Close monitoring of the budget position to ensure the delivery of actual savings and efficiencies, given the tight financial settlement, particularly the SWITCH process.<br>■ Maintenance of good governance during a period of major change – evidence of the maintenance and/or improvement of service delivery, despite the difficult financial position.<br>■ Review of any further measures to make savings required in future years.<br>■ The exploration of alternative models for service delivery. | Discussions are now undertaken on an ongoing basis with officers to continually update and refresh our views in relation to value for money.<br>Future work will focus on updating our understanding on an ongoing basis until the point at which the VFM conclusion is issued, and will largely comprise:<br>■ outcomes from our review of agendas and minutes; and<br>■ outcomes from our programme of established liaison meetings with officers.<br>Our view continues to be that Sunderland City Council has sound arrangements to address financial resilience and arrangements to secure economy, efficiency and effectiveness. Our audit work will challenge whether this continues to be the case.<br>We will follow up areas where we have previously identified improvement opportunities:<br>■ asset management; and<br>■ natural resources. | Our reporting will be through the Annual Governance Report and Annual Audit Letter. |

# Key milestones and deadlines

The Council is required to prepare the accounting statements by 30 June 2012. I aim to complete my work and issue my opinion and value for money conclusion by 30 September 2012.

Table 4: **Proposed timetable and planned outputs**

| Activity | Date | Output |
|---|---|---|
| Opinion: controls and early substantive testing | December 2011 to June 2012 | Interim Opinion Report |
| Opinion: receipt of accounts and supporting working papers | June and July 2012 | Annual Governance Report |
| Opinion: substantive testing | June to September 2012 | Annual Governance Report |
| Value for money work | December 2011 to September 2012 | Annual Governance Report |
| Present Annual Governance Report at the Audit Committee | 28 September 2012 | Annual Governance Report |
| Issue opinion and value for money conclusion | By 30 September 2012 | Auditor's report |
| Summarise overall messages from the audit | October 2012 | Annual Audit Letter |

# The audit team

The key members of the audit team for the 2011/12 audit are as follows.

Table 5: **Audit team**

| Name | Contact details | Responsibilities |
| --- | --- | --- |
| Steve Nicklin<br>District Auditor | s-nicklin@audit-commission.gov.uk<br>0844 798 1621 | Responsible for the overall delivery of the audit including the quality of outputs, signing the opinion and conclusion, and liaison with the Chief Executive. |
| Gavin Barker<br>Senior Audit Manager | g-barker@audit-commission.gov.uk<br>0191 561 1917<br>0844 798 1654 | Gavin manages and coordinates the different elements of the audit work. Key point of contact for the Executive Director of Commercial and Corporate Services. |
| Ian Rutter<br>Team Leader | ian-rutter@audit-commission.gov.uk<br>0191 561 1919<br>0844 798 1643 | Ian has experience of auditing the financial statements of large local authorities. He will lead the on-site team in delivering the audit. |

# Independence and quality

## Independence

I comply with the ethical standards issued by the APB and with the Commission's additional requirements for independence and objectivity as summarised in appendix 1.

I am not aware of any relationships that may affect the independence and objectivity of the Audit Commission, the audit team or me, that I am required by auditing and ethical standards to report to you.

However, you may wish to note that a member of my staff is married to a member of the Council's staff and that arrangements are in place to ensure that independence is maintained.

## Quality of service

I aim to provide you with a fully satisfactory audit service. If, however, you are unable to deal with any difficulty through me and my team please contact Chris Westwood, Director – Standards & Technical, Audit Practice, Audit Commission, 1st Floor, Millbank Tower, Millbank, London SW1P 4HQ (c-westwood@audit-commission.gov.uk) who will look into any complaint promptly and to do what he can to resolve the position.

If you are still not satisfied you may of course take up the matter with the Audit Commission's Complaints Investigation Officer (The Audit Commission, Westward House, Lime Kiln Close, Stoke Gifford, Bristol BS34 8SR).

# Fees

## The fee for the audit is £299,270 as set out in my letter of 6 April 2011.

### The audit fee

The Audit Commission has set a scale audit fee of £299,270 which represents a 10 per cent reduction on the audit fee for 2010/11.

The scale fee covers:

- my audit of your accounting statements and reporting on the Whole of Government Accounts return; and
- my work on reviewing your arrangements for securing economy, efficiency and effectiveness in your use of resources.

The scale fee reflects:

- the Audit Commission's decision not to increase fees in line with inflation;
- a reduction resulting from the new approach to local VFM audit work; and
- a reduction following the one-off work associated with the first-time adoption of International Financing Reporting Standards (IFRS).

Variations from the scale fee only occur where my assessments of audit risk and complexity are significantly different from those reflected in the 2010/11 fee. I have not identified significant differences and have therefore set the fee equal to the scale fee.

### Assumptions

In setting the fee, I have made the assumptions set out in appendix 2. Where these assumptions are not met, I may be required to undertake more work and therefore increase the audit fee. Where this is the case, I will discuss this first with the Executive Director of Commercial and Corporate Services and I will issue a supplement to the plan to record any revisions to the risk and the impact on the fee.

## Specific actions you could take to reduce your audit fee

The Audit Commission requires me to inform you of specific actions you could take to reduce your audit fee. The only action I have identified that you could take to reduce your fees is to further improve final accounts working papers.

## Total fees payable

In addition to the fee for the audit, the Audit Commission will charges fees for:

- certification of claims and returns; and
- the agreed provision of non-audit services under the Audit Commission's advice and assistance powers.

Based on current plans the fees payable are as follows.

Table 6: **Fees**

| | 2011/12 proposed | 2010/11 planned | Variance | |
|---|---|---|---|---|
| Audit | 299,270 | 332,522 | -33,252 | -10.0% |
| Certification of claims and returns | 38,070 | 43,960 | -5,890 | -13.4% |
| Non-audit work | 0 | 0 | 0 | |
| **Total** | **337,340** | **376,482** | **-39,142** | **-10.4%** |

# Appendix 1 – Independence and objectivity

Auditors appointed by the Audit Commission must comply with the Commission's Code of Audit Practice and Standing Guidance for Auditors. When auditing the accounting statements, auditors must also comply with professional standards issued by the Auditing Practices Board (APB). These impose stringent rules to ensure the independence and objectivity of auditors. The Audit Practice puts in place robust arrangements to ensure compliance with these requirements, overseen by the Audit Practice's Director – Standards and Technical, who serves as the Audit Practice's Ethics Partner.

Table 7: **Independence and objectivity**

| Area | Requirement | How we comply |
|---|---|---|
| Business, employment and personal relationships | Appointed auditors and their staff should avoid any official, professional or personal relationships which may, or could reasonably be perceived to, cause them inappropriately or unjustifiably to limit the scope, extent or rigour of their work or impair the objectivity of their judgement.<br>The appointed auditor and senior members of the audit team must not take part in political activity for a political party, or special interest group, whose activities relate directly to the functions of local government or NHS bodies in general, or to a particular local government or NHS body. | All audit staff are required to declare all potential threats to independence. Details of declarations are made available to appointed auditors. Where appropriate, staff are excluded from engagements or safeguards put in place to reduce the threat to independence to an acceptably low level. |

| Area | Requirement | How we comply |
| --- | --- | --- |
| Long association with audit clients | The appointed auditor responsible for the audit should, in all but the most exceptional circumstances, be changed at least once every seven years, with additional consideration of threats to independence after five years. | The Audit Practice maintains and monitors a central database of assignment of auditors and senior audit staff to ensure this requirement is met. |
| Gifts and hospitality | The appointed auditor and members of the audit team must abide by the Commission's policy on gifts, hospitality and entertainment. | All audit staff are required to declare any gifts or hospitality irrespective of whether or not they are accepted. Gifts and Hospitality may only be accepted with line manager approval. |
| Non-audit work | Appointed auditors should not perform additional work for an audited body (that is work above the minimum required to meet their statutory responsibilities) if it would compromise their independence or might result in a reasonable perception that their independence could be compromised.<br>Auditors should not accept engagements that involve commenting on the performance of other auditors appointed by the Commission on Commission work without first consulting the Commission.<br>Work over a specified value must only be undertaken with the prior approval of the Audit Commission's Director of Audit Policy and Regulation. | All proposed additional work is subject to review and approval by the appointed auditor and the Director – Standards and Technical, to ensure that independence is not compromised. |

*Code of Audit Practice, Audit Commission Standing Guidance and APB Ethical Standards*

# Appendix 2 – Basis for fee

In setting the fee, I have assumed the following.

- The risk in relation to the audit of the accounting statements is not significantly different to that identified for 2010/11.
- The risk in relation to my value for money responsibilities is not significantly different to that identified for 2010/11.
- Internal Audit meets professional standards.
- The Authority provides:
  - good quality working papers and records to support the accounting statements and the text of the other information to be published with the statements;
  - other information requested within agreed timescales; and
  - prompt responses to draft reports.
- There are no questions asked or objections made by local government electors.

Where these assumptions are not met, I will have to undertake more work which is likely to result in an increased audit fee.

# Appendix 3 – Glossary

**Accounting statements**

The annual statement of accounts that the Council is required to prepare, which report the financial performance and financial position of the Council in accordance with the Accounts and Audit (England) Regulations 2011 and the Code of Practice on Local Authority Accounting in the United Kingdom.

**Annual Audit Letter**

Report issued by the auditor to the Council after the completion of the audit that summarises the audit work carried out in the period and significant issues arising from auditors' work.

**Annual Governance Report**

The auditor's report on matters arising from the audit of the accounting statements presented to those charged with governance before the auditor issues their opinion and conclusion.

**Annual Governance Statement**

The annual report on the Council's systems of internal control that supports the achievement of the Council's policies aims and objectives.

**Audit of the accounts**

The audit of the accounts of an audited body comprises all work carried out by an auditor under the Code to meet their statutory responsibilities under the Audit Commission Act 1998.

**Audited body**

A body to which the Audit Commission is responsible for appointing the external auditor.

**Auditing Practices Board (APB)**

The body responsible in the UK for issuing auditing standards, ethical standards and associated guidance to auditors. Its objectives are to establish high standards of auditing that meet the developing needs of users of financial information and to ensure public confidence in the auditing process.

**Auditing standards**

Pronouncements of the APB that contain basic principles and essential procedures with which auditors must comply, except where otherwise stated in the auditing standard concerned.

**Auditor(s)**

Auditors appointed by the Audit Commission.

**Code (the)**

The Code of Audit Practice for local government bodies issued by the Audit Commission and approved by Parliament.

**Commission (the)**

The Audit Commission for Local Authorities and the National Health Service in England.

**Ethical Standards**

Pronouncements of the APB that contain basic principles relating to independence, integrity and objectivity that apply to the conduct of audits and with which auditors must comply, except where otherwise stated in the standard concerned.

**Group accounts**

Consolidated accounting statements of a Council and its subsidiaries, associates and jointly controlled entities.

**Internal control**

The whole system of controls, financial and otherwise, that the Council establishes to provide reasonable assurance of effective and efficient operations, internal financial control and compliance with laws and regulations.

### Materiality

The APB defines this concept as 'an expression of the relative significance or importance of a particular matter in the context of the accounting statements as a whole. A matter is material if its omission would reasonably influence the decisions of an addressee of the auditor's report; likewise a misstatement is material if it would have a similar influence. Materiality may also be considered in the context of any individual primary statement within the accounting statements or of individual items included in them. Materiality is not capable of general mathematical definition, as it has both qualitative and quantitative aspects'.

The term 'materiality' applies only to the accounting statements. Auditors appointed by the Commission have responsibilities and duties under statute, as well as their responsibility to give an opinion on the accounting statements, which do not necessarily affect their opinion on the accounting statements.

### Significance

The concept of 'significance' applies to these wider responsibilities and auditors adopt a level of significance that may differ from the materiality level applied to their audit of the accounting statements. Significance has both qualitative and quantitative aspects.

### Those charged with governance

Those entrusted with the supervision, control and direction of the Council. This term includes the members of the Council and its Audit Committee.

### Whole of Government Accounts

A project leading to a set of consolidated accounts for the entire UK public sector on commercial accounting principles. The Council must submit a consolidation pack to the department for Communities and Local Government which is based on, but separate from, its accounting statements.

If you require a copy of this document in an alternative format or in a language other than English, please call:
**0844 798 7070**


Design and production by the Audit Commission Publishing Team.


The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to non-executive directors, members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any director/member or officer in their individual capacity; or
- any third party.

audit commission

www.audit-commission.gov.uk

**January 2012**

Sunderland City Council

**Item No. 9**

**AUDIT AND GOVERNANCE COMMITTEE 10 February 2012**

# LOCAL PUBLIC AUDIT – THE GOVERNMENT'S RESPONSE TO THE CONSULTATION

**Report of the Executive Director of Commercial and Corporate Services**

## 1. Purpose of Report

1.1 To provide a summary of the Government's response to the recent consultation regarding their proposals for the future arrangements for local public audit. The report also includes a brief Council commentary on the proposals in bold italics.

## 2. Background

2.1 Following the announcement of its decision to abolish the Audit Commission in August 2010, the Government consulted on its proposals for a new local public audit framework from 31 March to 30 June 2011.

2.2 The design principles of the new framework for local public audit are that it should be local and transparent, achieve a reduction in the overall cost of audit, and uphold high standards of auditing, ensuring that there is effective and transparent regulation of public audit, and conformity to the principles of public audit. Key elements are set out in the following sections.

## 3. Regulation

3.1 The National Audit Office is best placed to produce the Code of Practice and supporting guidance for audit of local public bodies, subject to Parliamentary approval. The National Audit Office will be required to consult key partners in developing the Code.

3.2 The Financial Reporting Council will be the overall regulator, mirroring its role under the Companies Act 2006. The Financial Reporting Council will be responsible for recognition and supervision of Recognised Supervisory Bodies (professional accountancy bodies responsible for supervising the work of auditors, and setting criteria which their members must fulfil before they can be registered auditors) and for Recognised Qualifying Bodies (professional accountancy bodies responsible for awarding audit qualifications).

***The proposals are appropriate.***

## 4. Auditor Registration

4.1 Mirroring the Companies Act 2006, Recognised Supervisory Bodies will:

- have the roles of registration, monitoring and discipline for local public audit,
- put in place rules and practices covering eligibility of firms to undertake local public audit; and
- keep a register of firms eligible to undertake local public audit.

***The proposals are appropriate.***

## 5. Monitoring and Enforcement

5.1 As under the Companies Act 2006, Recognised Supervisory Bodies will monitor the quality of audits undertaken by their member firms, and investigate complaints, disciplinary cases and issues identified during the monitoring of firms on the register of local public auditors.

5.2 The Accountancy and Actuarial Disciplinary Board (part of the Financial Reporting council) investigates significant public interest disciplinary cases and can impose sanctions on those auditors found guilty of misconduct in both the companies and public sectors. This arrangement is to continue.

5.3 There will be additional oversight and monitoring of the audits of significant local public bodies (referred to as "Bodies of Significant Public Interest") - the Financial Reporting Council will monitor the quality of the audits of these bodies, mirroring the arrangements for Public Interest Entities under the Companies Act

***The proposals are appropriate.***

## 6. Commissioning Local Public Audit Services

6.1 <u>Auditor Appointment</u>

- Local public bodies will have a duty to appoint an auditor from the register of local public auditors, on the advice of an Independent Auditor Appointment Panel. The Independent Audit Appointment Panel will have an independent chair and a majority of independent members. Where the body already has an independent audit committee, this could be used to meet this requirement.

  ***The proposal seems reasonable. Given that Sunderland's Audit and Governance Committee does not have a majority of independent members this would either need to change or a separate Appointment Panel used.***

- Local public bodies will be able to share appointment panels (and therefore independent members) to ease admin burdens and reduce costs.

***The potential advantages and disadvantages of a single authority or collaborative approach will require consideration.***

- Local public bodies will be required to publish details of the auditor appointment on their website within 28 days of making the appointment, together with the Independent Audit Appointment Panel's advice and, if they did not follow that advice, a statement explaining why.

***The proposal is reasonable.***

6.2 Role of Independent Auditor Appointment Panels

- Government intends to prescribe specific functions to the Independent Audit Appointment Panel limited to the external audit, including advising on auditor appointment, independence, removal and resignation, and in relation to public interest reports.

- The arrangements will allow local public bodies to share Independent Audit Appointment Panels, and to expand on the remit of their Panel if they wish, choosing a model which best suits their circumstances.

***The proposals are reasonable.***

6.3 Failure to Appoint an Auditor

Local public bodies will be required to appoint an auditor by 31 December in the year preceding the financial year to be audited, and notify the Secretary of State if they have not done so. The Secretary of State will be able to direct the local public body to appoint an auditor or make the auditor appointment directly. In addition to meeting the cost of the appointment the local public body could be subject to a sanction for failing to make the appointment.

***The proposal is reasonable.***

6.4 Rotation of Audit Firms and Audit Staff

- Local public bodies will be required to run a procurement competition for its audit services at least every five years.

  ***The proposal is appropriate given the need to continue to secure vfm.***

- Auditors will have to comply with the standards and rules set by the regulator. Applying the current standards means the audit engagement partner will be able to undertake audit for a local public body for an initial five years and be reappointed for a further two years. The audit manager will be able to be appointed for a maximum of ten years. After these periods, these key audit staff will not be able to work with the local public body for a further five years.

  ***The proposal is reasonable.***

6.5 Resignation or Removal of an Auditor

There will be rigorous, transparent processes for auditor resignation or removal, designed to protect auditor independence, quality of audit, and accountability to the electorate. These broadly mirror those in the Companies Act, but are adapted to reflect the principles of public audit.

***The proposal is reasonable.***

6.6 Scope of Local Public Audit and Auditors' Work

- The scope of local public audit will remain broadly similar. As now, auditors of local public bodies will be required to satisfy themselves that the accounts have been prepared in accordance with the necessary directions, proper practices have been observed in the compilation of the accounts, and the body has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

- The detail of how auditors should fulfil these requirements will, as now, be set out in a code of audit practice. The value for money component should be more risk based and proportionate based on evidence provided by the local body.

- The duty for auditors of local public bodies to undertake Public Interest Reporting will be retained, as will their ability to charge audited bodies for reasonable work.

- Auditors will be permitted to provide non-audit services to the audited body, subject to adhering to the Auditing Practices Board's ethical standards and the Independent Auditor Appointment Panel's approval.

- The local public auditor and the Independent Auditor Appointment Panel will be defined as designated persons under the Public Interest Disclosure Act [relates to whistleblowing], to enable individuals to make disclosures under the Act.

- The new framework will retain the rights of local electors to make formal objections to the accounts, but give auditors greater discretion regarding whether to pursue an objection.

***The proposals are appropriate***

6.7 Non Audit Functions of Audit Commission

- Following the Audit Commission's closure, Government considers that for new grants, the grant paying bodies should agree certification arrangements with grant recipients and auditors.

  ***The approach is reasonable, and Government Departments should seek to rely upon certification from the LA's Director of Finance or Head of Internal Audit.***

- Government proposes to continue the National Fraud Initiative, and is discussing with partners and the local public sector about how best to achieve this.

  ***This initiative should be continued as it provides a valuable service in relation to the detection of fraud.***

- The Government considers that there is scope for rationalisation in the number of these value for money studies compared to the number previously undertaken and would like to see a coherent and complementary programme of offerings across all providers.

  ***The proposal is appropriate***

## 7. Implementation and Next Steps

7.1 In progressing the proposals the Government intends to:

- hold further discussions with local authorities, other local public bodies and the audit sector to flesh out the underlying detail of the framework, and how it might be implemented;

  An event with the ANEC Leaders was held on 27$^{th}$ January 2012 to seek their views. The Executive Director of Commercial and Corporate Services attended this event and will update Members at the Committee meeting.

- publish a draft Bill for pre-legislative scrutiny in Spring 2012, which allows for examination and amendments to be made before formal introduction to Parliament.

7.2 The Audit Commission is currently in the process of outsourcing all the audit work of its in-house practice The outsource contracts will start from 2012-13 and are expected to run for three or five years giving local councils the time to plan for appointing own auditors. Once the audits have been outsourced the Commission will be radically reduced in size to become a residuary body responsible for overseeing the contracts and making any necessary changes to the individual audit appointments during the life of the contracts.

**8. Audit Commission's View of the Government's Response**

8.1 The Audit Commission states that it has had a constructive dialogue with DCLG in developing the proposals and a lot of progress has been made, but there is still further work to do in a number of areas:

- It is still unclear how the proposed statutory Independent Audit Appointment Panels (IAAP), which may be shared with a number of other local public bodies, will operate. How they will relate to existing governance structures of individual bodies also remains to be worked out. It is considered they are not yet an adequate substitute for proper independent appointment of auditors.

- There is a potential 'accountability gap' in the proposals. A mechanism needs to be developed to ensure Departmental Accounting Officers continue to receive the assurance they have from the Commission's regime, that the billions of pounds of public money given to local public bodies have been safeguarded, accounted for properly and spent for the purposes intended.

- The proposed regulatory framework provides for three separate agencies - the National Audit Office (NAO), the Financial Reporting Council (FRC) and Recognised Supervisory Bodies - to discharge the Commission's current regulatory functions in relation to local public audits. It is not clear that this would be more effective, or cheaper, than a single, integrated regulatory body.

**9. Recommendations**

9.1 Members are asked to note the report.

**Background Papers**
Consultation on Local Public Audit – Audit and Governance Committee 30th June 2011
Government response to the future of local audit consultation (DCLG) – January 2012