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Audit Committee Agenda

Thursday, 18 November 2021 at 6.00 pm

Council Chamber, Muriel Matters House, Breeds Place, Hastings, TN34 3UY.
Please enter the building via the Tourist Information Centre entrance.

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AUDIT COMMITTEE

29 JULY 2021

Present: Councillors Rankin (Chair), Battley (Vice-Chair), Beaney and Sinden

116. APOLOGIES FOR ABSENCE

Apologies received for Councillor Chowney.

117. DECLARATIONS OF INTEREST

None received.

118. MINUTES OF THE LAST MEETING

RESOLVED – that the minutes of the meeting held on 2nd June 2021 be approved as a true record.

119. NOTIFICATION OF ANY ADDITIONAL URGENT ITEMS (IF ANY)

None.

120. GRANT THORNTON AUDIT COMPLETION REPORT

The Chief Finance Officer reported to the Audit Committee that the report from the external auditors on the final accounts 2019/20 is not ready. The external auditors are planning to have the report ready in the next few weeks.

The councillors discussed if another meeting of the Audit committee would be needed once the reports are completed. The Chief Finance Officer explained another meeting would not be needed if the chair was happy with the external auditor's report.

The Councillors discussed if the delay in the 2019/20 audit will influence the following year's reports being delayed from Grant Thornton. The Chief Finance Officer explained that all councils have had delays with their external audits, but the 2020/21 audit report though delayed from September should be available by the end of this year.

121. AUDIT COMMITTEE REPORT TO COUNCIL 2021

The Chief Auditor presented the report to the Audit Committee for it to be agreed.

Area's highlighted were that It is not possible to state a supported statement that all control systems are 'satisfactory'. However, based on the limited audit work carried out where controls were 'satisfactory' or better, the fact that 100% of staff were able to work from home in a secure way within less than a week of the first lock down being announced (apart from a handful whose home internet had problems) enquiries made with service managers, for example, that we are not facing any significant litigation and that controls against cyber-attacks are being continually improved, in his opinion, there was not any reason to believe that overall, controls might be unsatisfactory or worse. The Chief Auditor also informed the committee that a temp member of staff is being planned to be brought in to assist with the back log of audits.

The councillors discussed how many audits should be completed a year as in 2017-18 and 2018-9 seven and eight audits were completed. The Chief Auditor explained that there had been an agreement with the Audit Commission that 3 core audits are completed a year.

The councillors discussed was how major project risks are accounted for. The Chief Finance officer explained that if projects are looking like they will exceed their budget then there are the Constitution and Financial rules and the Financial Operating Procedure to follow.

The councillors asked about any areas that in the future maybe needing auditing. The Chief Auditor informed the committee that cyber attacks have affected other council's and is always being reviewed. The Chief Finance Officer informed the committee that treasury management and the Environmental Protection Act which may implement each household having 7 bins each.

RESOLVED (unanimously)
That the Audit Committee Report to Council 2020/21 is approved for presentation to Council

Reasons for recommendations
Regulation 6 of the Accounts and Audit Regulations (England) 2015 requires relevant bodies to conduct an annual review of the effectiveness of its system of internal audit and for a committee of the body to consider the findings

122. ANNUAL GOVERNANCE STATEMENT

The Chief Auditor reported to the Audit Committee the Annual Governance Statement provides an assurance on the adequacy of the Council's control and governance mechanisms and includes actions to improve the governance framework.

The Chief Auditor highlighted to the committee the areas on the report Decision-making and the effects of Covid19. Also highlighted was the Town Deal as this is likely to affect the deployment of council resources. The next area is 'Significant

Governance Issues' which reviews what was done on issues highlighted ion last years report and any new ones to have emerged.

The councillors discussed Climate change emergency and agreed it needs to be kept in the report this year and going forward.

The councillors highlighted the council being a conduit for government money paying housing benefit, covid grant money as well as the Town Deal. The Chief Finance officer explained with such large sums of money being dealt with lots of time is spent on treasury management and that's why it's a core audit.

RESOLVED (unanimously)
That the Audit Committee considers the draft statement for providing comments to the Leader and the Managing Director before they sign the Annual Governance Statement 2020/21.

Reasons for recommendations
To comply with our statutory duty to produce an annual statement on the Council's governance arrangements.

(The Chair declared the meeting closed at. 7.13 pm)

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Report To:	**Audit Committee**
Date of Meeting:	**18 November 2021**
Report Title:	**Grant Thornton Audit Completion Report - Audit for the year ended 31 March 2020**
Report By:	**Peter Grace, Assistant Director Financial Services & Revenues (Chief Finance Officer)**
Key Decision:	**No**

Purpose of Report

To consider the matters raised by the Council's external auditors (Grant Thornton) in respect of their Governance Report . This includes the audit opinion of the Council's 2019/20 accounts, and their value for money assessment of the Council.

Recommendation

1. **That the report and action plan be accepted.**

Reasons for Recommendations

Compliance with statutory requirements and good practice. The Council is accountable for the use of public money and continuously seeks to improve Value for Money. The Council's external auditors are required to submit a report to the Council's Audit Committee on any matters that are identified during their audit.

Introduction

1. The report summarises the principal matters arising from the audit carried out by Grant Thornton along with other areas that they are required to give an opinion on. Auditing standards require the external auditors to report to those charged with governance, certain matters before giving an opinion on the accounts.

2. A Senior Grant Thornton representative is expected to attend the Committee and present the report.

3. The Audit Findings Report is attached at Appendix 1.

Timetable of Next Steps

4. Please include a list of key actions and the scheduled dates for these:

Action	Key milestone	Due date (provisional)	Responsible
Accepted actions per the Audit Findings report	-	Per the Audit Findings report	Chief Accountant

Wards Affected

None.

Policy Implications

Reading Ease Score: Flesch-Kincaid grade 11.1

Have you used relevant project tools?: N/A

Please identify if this report contains any implications for the following:

Equalities and Community Cohesiveness	No
Crime and Fear of Crime (Section 17)	No
Risk Management	Yes
Environmental Issues & Climate Change	No
Economic/Financial Implications	Yes
Human Rights Act	No
Organisational Consequences	No
Local People’s Views	No
Anti-Poverty	No
Legal	No

Additional Information

Appendix A – Grant Thornton Audit Findings Report - Audit for the year ended 31 March 2020

Officer to Contact

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The Audit Findings for Hastings Borough Council

Year ended 31 March 2020

November 2021

Contents

Your key Grant Thornton team members are:

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Headlines

This table summarises the key findings and other matters arising from the statutory audit of Hastings Borough Council ('the Council') and the preparation of the group and Council's financial statements for the year ended 31 March 2020 for those charged with governance.

Progress update

The outbreak of the Covid-19 coronavirus pandemic has had a significant impact on the normal operations of the group and Council.

Although the income and expenditure impacts in 2019/20 were not significant and are likely to be felt in 2020/21, the pandemic has presented the Council with significant front-line challenges such as administration of grants to businesses, starting to provide additional support to customers unable to pay council tax or business rates and additional monitoring and resetting of the 2020/21 budget and the Medium Term Financial Strategy to factor in the high level of uncertainty around the impact of Covid-19.

The pandemic has also impacted the Finance Team who like many other employees have had to adapt to working from home at short notice.

Authorities are still required to prepare financial statements in accordance with the relevant accounting standards and the CIPFA Code of Practice, albeit to an extended deadline for the preparation of the financial statements up to 31 August 2020 and the date for audited financials statements to 30 November 2020.

We updated our audit risk assessment to consider the impact of the pandemic on our audit and issued an audit plan addendum in January 2021 to the Audit Committee. In that addendum we reported an additional financial statement risk in respect of Covid-19 and highlighted the impact on our VfM approach. Further detail is set out on page 7.

Restrictions for non-essential travel and home working during the pandemic have meant both Authority and audit teams have had to perform the audit entirely remotely. This has required the audit team to use regular video calls to ensure that both teams kept in close contact as we would when carrying out fieldwork on site. The audit team have also had to consider alternative approaches to obtaining audit evidence to corroborate transactions, estimates and judgements in the financial statements. Remote working also requires our teams to carry out additional tests to corroborate the completeness and accuracy of information produced by the Council which we would otherwise have performed in person on site (for example viewing a report being run from Council systems by the officer). In common with all audit firms we have found that this way of working has proved more challenging and time consuming than carrying out an audit under normal circumstances on site and largely face to face.

The audit has also taken much longer to complete than would be expected for various reasons:

- The planned date to start the audit in July 2020 was moved back as accounts and working papers were not available until late September. This required us carry out the work alongside other audits and led to the handover of significant and complex pieces of work between members of the audit team;
- This impacted on the time taken to complete audit work and the completeness/quality of that work produced, meaning that some areas had to be tracked over again to re-work/raise further more detailed queries in order to complete the work.
- There were several versions of the accounts produced where management have amended the figures in the accounts for further information and/or corrections to previous journals entered into the accounts. These changes were not always supported by a clear audit trail. Combining this with the audit being handed over to GT team members who had not previously worked on the audit has proved challenging.
- Some of our 2018/19 observations about the clarity of balance sheet reconciliations and working papers underlying the accounts still remain an issue which we would recommend improvements in to assist an efficient audit process going forwards.

Headlines (continued)

Progress update (continued)	See above.	We are now reaching the end of our Senior Manager and Engagement Lead review of the file which has brought up some additional queries which we are working through with your finance team. The work we are completing at this stage is: - Final Senior Manager/Engagement Lead sign off on clearance of review notes; - Clearing Senior Manager/Engagement Lead review notes on the significant risk areas for Land and Buildings valuation and Net Pension Liability valuation; - Clearing Senior Manager/Engagement Lead review notes as final reviews are completed; - Final castings and checks on a final amended set of statements, agreeing the tie through from version 1 to the current version 4 of the accounts provided - as mentioned above tracking through these additional journals has meant significant updates to lead schedules on file and further checks of the subsequent versions of the statements; - Checking all agreed amendments made correctly to the statements; - Re-checking that financial figures in the Narrative Statement agree to the amended financial statements and all figures are internally consistent; - receipt of management representation letter Our findings are summarised on pages 7-16. We have identified audit adjustments to the financial statements that have resulted in adjustment to the Council's Comprehensive Income and Expenditure Statement. Audit adjustments are detailed in Appendix B. Our follow up of recommendations from the prior year's audit and current year recommendations are detailed in Appendix A. We will be proposing an audit fee variance and this will be discussed with your Chief Finance Officer at the end of the audit. Any fee variance is subject to Public Sector Audit Appointments (PSAA) consideration and approval.
Value for Money arrangements	Under the National Audit Office (NAO) Code of Audit Practice ('the Code'), we are required to report if, in our opinion, the Council has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources ('the value for money (VFM) conclusion').	We have completed our risk based review of the Council's value for money arrangements. We have concluded that Hastings Borough Council has proper arrangements to secure economy, efficiency and effectiveness in its use of resources. We updated our VfM risk assessment to document our understanding of your arrangements to ensure critical business continuity in the current environment. We did not identify any new VfM risks in relation to Covid-19. We therefore anticipate issuing an unqualified value for money conclusion, as detailed in Appendix D. Our findings are summarised on pages 19 to 23.
Statutory duties	The Local Audit and Accountability Act 2014 ('the Act') also requires us to: • report to you if we have applied any of the additional powers and duties ascribed to us under the Act; and • To certify the closure of the audit.	We have not exercised any of our additional statutory powers or duties. We have completed the majority of work under the Code and expect to be able to certify the completion of the audit when we give our audit opinion.

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Audit approach

Overview of the scope of our audit

This Audit Findings Report presents the observations arising from the audit that are significant to the responsibility of those charged with governance to oversee the financial reporting process, as required by International Standard on Auditing (UK) 260 and the Code of Audit Practice ('the Code'). Its contents have been discussed with management.

As auditor we are responsible for performing the audit, in accordance with International Standards on Auditing (UK) and the Code, which is directed towards forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities for the preparation of the financial statements.

Audit approach

Our audit approach was based on a thorough understanding of the group's business and is risk based, and in particular included:

- An evaluation of the group's internal controls environment, including its IT systems and controls;
- Substantive testing on significant transactions and material account balances, including the procedures outlined in this report in relation to the key audit risks; and
- An evaluation of the component of the group based on a measure of materiality considering each as a percentage of the group's gross revenue expenditure to assess the significance of the component and to determine the planned audit response. From this evaluation we determined that we would carry out specific audit procedures on property, plant and equipment balances, along with substantive testing on other material balances and analytical review on remaining income/expenditure/assets and liabilities.

We have not had to alter our audit approach, as communicated to you in our Audit Plan and subsequent Addendum.

Conclusion

We have substantially completed our audit of your financial statements and subject to our completion of the audit work on page 4, we anticipate issuing an unqualified audit opinion, as detailed in Appendix D.

Our approach to materiality

The concept of materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to the monetary misstatements but also to disclosure requirements and adherence to acceptable accounting practice and applicable law.

Materiality levels remain the same as reported in our audit plan.

	Group Amount (£)	Council Amount (£)	Qualitative factors considered
Materiality for the financial statements	1,450,000	1,447,000	We have determined financial statement materiality based on a proportion of the gross expenditure of the Council for the financial year.
Performance materiality	1,013,000	1,010,000	The maximum amount of misstatement the audit team could accept in an individual account or group of related accounts. This is less than materiality due to "aggregation risk".
Trivial matters	72,500	72,200	We are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance
Materiality for cash and cash equivalents	500,000	500,000	Our assessment of what users would consider to be material with respect to these disclosure areas.
Remuneration disclosures	20,000	20,000	Our assessment of what users would consider to be material with respect to cash

Significant audit risks

Risks identified in our Audit Plan	Auditor commentary
Covid– 19 Risk description unchanged from that reported in our audit plan addendum.	We have: • worked with management to understand the implications the response to the Covid-19 pandemic had on the organisation's ability to prepare the financial statements and update financial forecasts and assessed the implications for our materiality calculations. No changes were made to materiality levels previously reported. The completed draft financial statements were provided in early September 2020; • liaised with other audit suppliers, regulators and government departments to co-ordinate practical cross-sector responses to issues as and when they arose. Examples include the material uncertainty disclosed by the Council's property valuation expert; • evaluated the adequacy of the disclosures in the financial statements that arose in light of the Covid-19 pandemic; • evaluated whether sufficient audit evidence could be obtained through remote technology; • evaluated whether sufficient audit evidence could be obtained to corroborate significant management estimates such as assets and the pension fund liability valuations; • evaluated management's assumptions that underpin the revised financial forecasts and the impact on management's going concern assessment; • discussed with management the implications for our audit report where we have been unable to obtain sufficient audit evidence. As a result of the Covid-19 pandemic, the property market remains very uncertain. Consequently, material uncertainties have been declared by the professional valuer relating to land and buildings, and also by an investment manager for pooled property investments held by the pension fund administrator and underlying the net pension liability. We have discussed this with management to agree disclosure of these uncertainties in Note 5 Assumptions Made About The Future And Other Sources Major Sources of Estimation Uncertainty. Where such disclosures are included within financial statements auditors consider the need to include an 'emphasis of matter' paragraph within their audit report. An emphasis of matter is not a qualification or modification of the auditor's report, but is used to draw the reader's attention to a matter that has been appropriately presented or disclosed in the financial statements and which, in the auditor's judgement, is of such importance that it is fundamental to the users' understanding of the financial statements. We have concluded that our audit opinion on the Council's 2019/20 financial statements should include an Emphasis of Matter drawing attention to the material valuation uncertainties disclosed Subject to completion of the work on page 4, our work against this risk has not raised further issues.

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Significant audit risks

Risks identified in our Audit Plan	Auditor commentary
Improper revenue recognition Under ISA (UK) 240 there is a rebuttable presumed risk that revenue may be misstated due to the improper recognition of revenue. In our audit plan we reported that we had rebutted this presumed risk for revenue streams that are derived from Council Tax, Business Rates and Grants on the basis that they are income streams primarily derived from grants or formula based income from central government and tax payers and that opportunities to manipulate the recognition of these income streams is very limited. We erroneously stated in the plan that we had not rebutted the risk for fees, charges and other service income. We had in fact determined from our experience as your auditor from 2018/19, and through our documentation and walkthrough of your business processes around revenue recognition that the risk of fraud arising from revenue recognition could be rebutted, because: - there is little incentive to manipulate revenue recognition; - opportunities to manipulate revenue recognition are very limited; - the culture and ethical frameworks of local authorities, including Hastings Borough Council, mean that all forms of fraud are seen as unacceptable.	We did not change our planned approach, and therefore there is nothing further to report with respect to revenue recognition.
Management override of controls Risk description unchanged from that reported in our audit plan.	We have: • evaluated the design effectiveness of management controls over journals; • analysed the journals listing and determined the criteria for selecting high risk unusual journals; • tested unusual journals recorded during the year and as part of accounts production for appropriateness and corroboration; • gained an understanding of the accounting estimates and critical judgements made by management and considered their reasonableness with regard to corroborative evidence; • evaluated the rationale for any changes in accounting policies, estimates or significant unusual transactions. Our audit work has not identified any issues in respect of management override of controls.

Significant audit risks

Risks identified in our Audit Plan	Auditor commentary
Valuation of land and buildings Risk description unchanged from that reported in our audit plan.	We have: • evaluated management's processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work; • evaluated the competence, capabilities and objectivity of the valuation expert; • written to the valuer to confirm the basis on which the valuation was carried out to ensure that the requirements of the Code are met and discuss this basis where there are any departures from the Code; • challenged the information and assumptions used by the valuer to assess completeness and consistency with our understanding; • assessed how management have challenged the valuations produced internally, by professional valuers and by independent property managing consultants to assure themselves that these represent the materially correct current value; • tested revaluations made during the year to see if they had been input correctly into the Authority's asset register; and • evaluated the assumptions made by management for any assets not revalued during the year and how management has satisfied themselves that these are not materially different to current value. On all material areas of land and buildings which were revalued during the year we have reviewed and challenged the valuations method, and key assumptions and inputs into the valuation estimate. We have shown our detailed analysis and review of the estimation process in the key judgement and estimates section. See comments about the estimation uncertainty around valuation of land and buildings on page 7 above. Our audit work so far has not identified any issues in respect of valuation of land and buildings. However we are still completing senior management review of this area of the audit. Subject to satisfactory resolution of matters identified on page 4, our audit work has not so far identified any issues in respect of valuation of land and buildings.

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Significant audit risks

Risks identified in our Audit Plan	Auditor commentary
Valuation of pension fund net liability Risk description unchanged from that reported in our audit plan.	We have: • updated our understanding of the processes and controls put in place by management to ensure that the Authority's pension fund net liability is not materially misstated and evaluated the design of the associated controls; • evaluated the instructions issued by management to their management expert (an actuary) for this estimate and the scope of the actuary's work; • assessed the competence, capabilities and objectivity of the actuary who carried out the Authority's pension fund valuation; • assessed the accuracy and completeness of the information provided by the Authority to the actuary to estimate the liability; • tested the consistency of the pension fund asset and liability and disclosures in the notes to the core financial statements with the actuarial report from the actuary; and • undertaken procedures to confirm the reasonableness of the actuarial assumptions made by using an auditor's expert. • obtained assurance from the auditor of the East Sussex Pension Fund (ESPF) on the validity and accuracy of the membership, contributions and benefits data provided by ESPF to the actuary, and used by the actuary to calculate the Council's net pension liability. We have provided information about our detailed review of the estimation process in the key judgement and estimates section. We report our commentary on sources of estimation uncertainty stemming from the Covid-19 pandemic impacts and their disclosure in the accounts at page 7, the Covid-19 audit risk. In 2018 the Court of Appeal ruled there was age discrimination in the judges and firefighters pension schemes where there was transitional protections given to scheme members – this also impacted Local Government Pension Schemes. Following the McCloud judgment the cases were referred back to Employment Tribunals for remedy. The tribunal issued an interim declaration providing that claimants who were active members on 31 March 2012 are entitled to be treated as having met the conditions for full transitional protection. In July 2020, the government released a consultation on applying the remedy, and this is the next phase of the Government's response to address this discrimination. From an accounting perspective, we concluded that the consultation is an event after the reporting period which provides an indication of possible remedy. However, as there remain a number of uncertainties before this is implemented, we do not regard publication of the consultation to be an adjusting event. It may be some time before the outcome of the consultation is known, and an adjusting event crystallises, but management should continue to keep the development of the pension schemes under review. The accounts presented to members, correctly, do not reflect the impact of the government's remedy consultation. Note that in the accounts presented for audit there was a discrepancy in the value of the net pension liability which was shown on the balance sheet as a £77m liability which did not agree to the actuarial estimate of the liability. The Finance Team subsequently picked up the discrepancy and have adjusted the accounts so that they agree to the actuarial report. As this was a management adjustment to the accounts during the audit, we have not reported this as an audit adjustment. We are still completing senior management review of the audit work in assessing the reasonableness of the estimated pension fund net liability. Subject to satisfactory resolution of matters identified on page 4, our audit work has not so far identified any issues in respect of valuation of the net liability.

Other audit issues

Risks identified in our Audit Plan	Auditor commentary
IFRS 16 implementation has been delayed by one year Although the implementation of IFRS 16 has been delayed to 1 April 2021, audited bodies still need to include disclosure in their 2019/2020 statements to comply with the requirement of IAS 8 para 31. As a minimum, we would expect audited bodies to disclose the title of the standard, the date of initial application and the nature of the changes in accounting policy for leases.	In our review of the Council's accounting policies we identified that the disclosure in relation to IFRS 16 was not included in the draft accounts – we have raised this with management as an update to the disclosures and this is included in Appendix B.

Significant findings – other issues

This section provides commentary on new issues and risks which were identified during the course of the audit that were not previously communicated in the Audit Plan and a summary of any significant control deficiencies identified during the year.

Issue	Commentary	Auditor view
Loan to subsidiary Hastings Housing Company Ltd The loan made to the subsidiary has grown significantly from £1.3m at 31 March 2019 to £5.8m at 31 March 2020. Any loan made presents some recovery risk to the Council. In the case of the subsidiary the assets on the company balance sheet are properties purchased since the company was formed.	We have carried out targeted procedures on the investment property assets which are held on the balance sheet of Hastings Housing Company and which are consolidated into the group accounts. We have assessed the valuation of the properties by carrying out a market comparative analysis against similar properties in the area. We were satisfied that the stated values of the investment properties in the company balance sheet are materially correct, and that these balance sheet assets sufficiently underpin the recoverability of the loans.	We are satisfied that there is no evidence to suggest that the loan repayable from the subsidiary to the Council is unrecoverable, and therefore no evidence of a missing provision in the single entity accounts.

Significant findings – key estimates and judgements

Accounting area	Summary of management's policy	Auditor commentary	Assessment
Provisions for receivables - £1.477m	The Council makes allowance for the non-recoverability of receivables relating to housing benefit overpayments, council tax, non domestic rates and trade receivables. These allowances are management estimates based on historic experience, judgement and experience across the sector.		
	Housing benefit overpayments: a provision of 50% based on a recoverability analysis.	We reviewed the reasonableness of the recoverability analysis and we were satisfied that a provision of 50% was reasonable.	
	Trade receivables general bad debt provision: the Council has provided for specific debt known to be unrecoverable, and 50% provision for balances older than 90 days. This excludes all other local authorities and public bodies. There is then a 10% provision against all other balance less than 90 days but greater than 10 days, again excluding other local authorities and public bodies.	We reviewed the ageing of debt and the variance in trade receivables year on year to conclude on the reasonableness of this provision. The exclusion from the provision of all other local authorities and public bodies is considered reasonable as from prior experience these bodies are often slow to pay each other but the debt is recoverable over time. Note that working papers for the provision did not clearly set out commentary on the basis of the estimate and judgements made as we would expect. We have added a recommendation to the action plan in the Action Plan related to this.	

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Assessment

- We disagree with the estimation process or judgements that underpin the estimate and consider the estimate to be potentially materially misstated
- We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider optimistic
- We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider cautious
- We consider management's process is appropriate and key assumptions are neither optimistic or cautious

Significant findings – key estimates and judgements

Accounting area	Summary of management's policy	Auditor commentary	Assessment
Provisions for NNDR appeals - £1.771m	The Council are responsible for repaying a proportion of successful rateable value appeals. The provision includes an amount for appeals lodged to date but yet to be determined by the Valuation Office Agency (VOA) plus an amount for appeals expected but not yet lodged with VOA which has been estimated. The estimate is calculated using information on outstanding appeals at 31 March 2020 and success rates for settled appeals provided by the Valuation Office Agency. The latest information from the Valuation Office Agency has been used to estimate the provision required at 31 March 2020 for appeals against the 2010 list that remain outstanding at the balance sheet date. The appeals process changed with effect from April 2017 following the introduction of 'Check, Challenge, Appeal'. This introduces two initial stages prior to the appeal stage. The overall provision is estimated calculated on the basis of experience in regards to the 2010 List, and by applying a single estimated success rate to the 2017 List which is based on a look across other authorities at what is considered to be reasonable/comparative, and also by carrying out a sense check against actual reductions applied for difference appeals grounds.	We have reviewed the basis of this provision and considered this to be reasonable based on the assumptions underlying the provision and previous success rates. The information used to calculate the estimate is the most recently available information from the Valuation Office Agency, which we consider to be the most reliable available source for this information. We consider the calculation method for the estimate, based on average historic success rates to be reasonable. Note that working papers for the provision did not clearly set out commentary on the basis of the estimate and judgements made as we would expect. We have added a recommendation to the action plan in the Action Plan related to this.	
The Foreshore Charitable Trust	Although the Council is the sole trustee of the charitable trust, it is not consolidated into the group accounts. This is because a management critical judgement is that the scheme is so constituted as to prevent the Council from obtaining any benefit from the Trust's activities.	We have discussed this critical judgement with management, and obtained a more detailed commentary on the constitution of the charitable fund. We have reviewed the constitution of the charitable fund to confirm the basis of management's critical judgement and the way Council Committees have been structured so that the Council does not control the charitable Trust. We were satisfied that this critical judgement was reasonable.	

Assessment

- We disagree with the estimation process or judgements that underpin the estimate and consider the estimate to be potentially materially misstated
- We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider optimistic
- We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider cautious
- We consider management's process is appropriate and key assumptions are neither optimistic or cautious

Significant findings – key estimates and judgements

Accounting area	Summary of management's policy	Auditor commentary	Assessment
Land and Buildings – Other - £113.254m **Surplus Assets – £8.179m** **Investment Properties - £1.166m single entity accounts, £6.636m group accounts**	**Land and Buildings** Other land and buildings comprises £15.356m of specialised assets such as, leisure Centres and Public Conveniences which are required to be valued at depreciated replacement cost (DRC) at year end, reflecting the cost of a modern equivalent asset necessary to deliver the same service provision. The remainder of other land and buildings (£97.898m) are not specialised in nature and are required to be valued at existing use in value (EUV) at year end. The Council has engaged Wilks Head & Eve LLP to complete the valuation of properties as at 31/3/2020 on a five yearly cyclical basis. 57% of total assets were revalued during 2019/20. In line with RICS guidance, the Council's valuer disclosed a material uncertainty in the valuation of the Council's land and buildings at 31 March 2020 as a result of Covid-19. The Council had not disclosed this in the accounts. We discussed this with management, and it was agreed that information regarding the material uncertainty would be included in disclosures in Note 5 to the financial statements. The valuation of properties valued by the valuer has resulted in a net increase in valuation. Management have assessed their assets for any impairments; no material impairments were noted. **Surplus Assets** Estimated by the professional valuer at fair value based on notional "alternative use" based on potential development on a land basis. **Investment Properties** Estimated by the professional valuer at fair value based on an income approach using the rental value of the property.	• We assessed management's valuer to be competent, capable and objective; • The valuation method remains consistent with the prior year; • We reviewed the completeness and accuracy of the underlying information provided to the valuer used to determine the estimation. We have so far not identified any significant discrepancies; • We confirmed consistency of the estimate and the reasonableness of changes against data produced by our valuers; • We have agreed the valuation report to the fixed asset register and the statement of accounts. • Subject to satisfactory resolution of matters identified on page 4, we are satisfied that the key estimates and judgements underlying the revaluation estimate for land and building is reasonable.	Green

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Assessment

- Red: We disagree with the estimation process or judgements that underpin the estimate and consider the estimate to be potentially materially misstated
- Amber: We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider optimistic
- Yellow: We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider cautious
- Green: We consider management's process is appropriate and key assumptions are neither optimistic or cautious

Significant findings – key estimates and judgements

Accounting area	Summary of management's policy	Auditor commentary	Assessment
Net pension liability – £37,266m	The Council recognises and discloses the defined benefit obligations in accordance with the measurement and presentational requirements of IAS 19 Employee Benefits. The Council uses Hymans Robertson LLP to provide actuarial valuations of the Council's assets and liabilities derived from the scheme. A material uncertainty was disclosed by an investment manager for pooled property investments held by the pension fund administrator and underlying the net pension liability at 31 March 2020 as a result of Covid-19. The Council had not disclosed this in the accounts. We discussed this with management, and it was agreed that information regarding the material uncertainty would be included in disclosures in Note 5 to the financial statements. The latest full actuarial valuation was completed in 2019. A roll forward approach is used in intervening periods which utilises key assumptions such as life expectancy ,discount rates ,salary growth and investment return .Given the significant value of the net pension fund liability, small changes in assumptions can result in significant valuation movements. There has been a £3.981m net actuarial gain during 2019/20.	• We assessed management's actuarial expert and concluded they are clearly competent, capable and objective in producing the estimate; • We carried out analytical procedures to conclude whether the Council's share of LGPS pension assets and liabilities was reasonable. We concluded the Council's share of assets and liabilities was analytically in line with our expectations; • We engaged an auditor's actuary expert to challenge the reasonableness of the estimation method used and the approach taken by the actuary to verity the completeness and accuracy of information used. We were satisfied that the actuary was provided with complete and accurate information about the workforce, and that the method applied was reasonable; • The auditors' expert provided us with indicative ranges for assumptions by which we have assessed the assumptions made by management's expert. As set out below all assumptions were within the expected range and were therefore considered reasonable:	

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Assumption	Actuary Value	PwC range	Assessment
Discount rate	2.3%	2.3%	
Pension increase rate	1.9%	1.8-2.0%	
Salary growth	1.9%	1.90-2.90%	
Life expectancy – Males currently aged 45 / aged 65	Aged 45: 22.5 years Aged 65: 21.6 years	Aged 45: 21.6-23.3 Aged 65: 20.5-22.2	
Life expectancy – Females currently aged 45 / 65	Aged 45: 25.3 years Aged 65: 23.9 years	Aged 45: 24.6-26.3 Aged 65:22.9-24.3	

- We reviewed the adjustments made as a result of the McCloud judgement and considered the impact of the 'other experience' adjustments arising from the triennial actuarial valuation. We confirmed there were no significant changes in 2019/20 to the valuation method.

Assessment

- We disagree with the estimation process or judgements that underpin the estimate and consider the estimate to be potentially materially misstated
- We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider optimistic
- We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider cautious
- We consider management's process is appropriate and key assumptions are neither optimistic or cautious

Significant findings – going concern

Our responsibility

As auditors, we are required to “obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern” (ISA (UK) 570).

Going concern commentary	Auditor commentary
Management's assessment process • Detailed budget setting and budget review/approval governance processes are undertaken in February 2020; • This includes consideration of the adequacy of reserves and the setting of a working balance level considered appropriate; • Subsequent to the start of the Covid-19 pandemic, detailed Covid-19 returns to government on cost/revenue impacts are being completed. The 2020/21 budget is being reforecast to incorporate known impacts, and the MTFS is being remodelled to reflect the uncertainty around COVID-19 impact; • The Council’s cash flow forecast is prepared annually in advance as part of budgetary preparations, and is then maintained periodically so that a 12 month forward forecast can be produced when necessary for review to ensure liquidity to meet obligations as they fall due; and • Balance sheet positions, including the cash position, is forecast over the MTFS for further management assurance over liquidity, taking into account capital investment plans and planned use of reserves, and forecast investment balances and borrowing needs for planning purposes.	Management have prepared the accounts on the going concern basis based on their assessment processes as documented adjacent: • You have a well-established financial planning framework and have set a balanced budget for 2020/21; • At 31 March 2020 the Council had total general fund and earmarked reserves of £18,040,000 (£18,976,000 at 31 March 2019); • The Council has updated its 5-year Medium Term Financial Plan to take account of the impact of the pandemic. The Council has sufficient general fund and earmarked reserves to cover contributions to support the revenue budget over the lifetime of the plan the council is forecasting over 5 years in the unlikely event that these all needed to be funded through use of reserves; • At the date of the audit, forward cash forecasts demonstrate that the Council has sufficient cash to cover forecast liabilities as they fall due and to remain in a positive cash position.
Work performed by the audit team – see adjacent	We have reviewed management’s process to assess the use of the going concern basis. We reviewed the 2020/21 budget and the reforecast MTFS, including the key assumptions, to confirm that they are reasonable in line with our knowledge of the Council and the sector. We documented the cash-flow forecasting process. We were satisfied through our review of these processes that management have in place adequate processes to continually assess the use of the going concern basis, and adequate financial governance and risk scenario planning processes to anticipate and mitigate events which might present a risk to going concern. We have not identified any material uncertainty over the going concern basis adopted. We concluded that management’s continued use of the going concern concept to prepare the financial statements remains appropriate.

Other matters for communication

We set out below details of other matters which we, as auditors, are required by auditing standards and the Code to communicate to those charged with governance.

Issue	Auditor commentary
Matters in relation to fraud	We have previously discussed the risk of fraud with the Audit Committee. We have not been made aware of any other incidents in the period and no other issues have been identified during the course of our audit procedures.
Matters in relation to related parties	We are not aware of any related parties or related party transactions which have not been disclosed.
Matters in relation to laws and regulations	You have not made us aware of any significant incidences of non-compliance with relevant laws and regulations and we have not identified any incidences from our audit work.
Written representations	A letter of representation has been requested from the Council, including specific representations in respect of the Group.
Confirmation requests from third parties	We requested from management permission to send confirmation requests in respect of your bank, investments and loans balances. This permission was granted for all institutions and the requests were sent. All of these requests were returned with positive confirmation.
Disclosures	Our review found some disclosure issues/omissions which are documented in Appendix B.
Audit evidence and explanations/significant difficulties	Except for the audit work outstanding on page 4, all information and explanations requested from management was provided.

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Other responsibilities under the Code

Issue	Commentary
Other information	We are required to give an opinion on whether the other information published together with the audited financial statements (including the Annual Governance Statement and Narrative Report), is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. We are still completing our checks in this area.
Matters on which we report by exception	We are required to report on a number of matters by exception in a numbers of areas: • If the Annual Governance Statement does not meet the disclosure requirements set out in the CIPFA/SOLACE guidance or is misleading or inconsistent with the other information of which we are aware from our audit; • If we have applied any of our statutory powers or duties. We have nothing to report on these matters.
Specified procedures for Whole of Government Accounts	We are required to carry out specified procedures (on behalf of the NAO) on the Whole of Government Accounts (WGA) consolidation pack under WGA group audit instructions. This work is not required as the Council does not exceed the threshold.
Certification of the closure of the audit	We intend to certify the closure of the 2019/20 audit of Hastings Borough Council in the audit report, as detailed in Appendix D.

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Value for Money - Introduction

Background to our VFM approach

We are required to satisfy ourselves that the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. This is known as the Value for Money (VFM) conclusion.

We are required to carry out sufficient work to satisfy ourselves that proper arrangements are in place at the Council. In carrying out this work, we are required to follow the NAO's Auditor Guidance Note 3 (AGN 03) issued in April 2020. AGN 03 identifies one single criterion for auditors to evaluate:

"In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people."

This is supported by three sub-criteria, as set out below:

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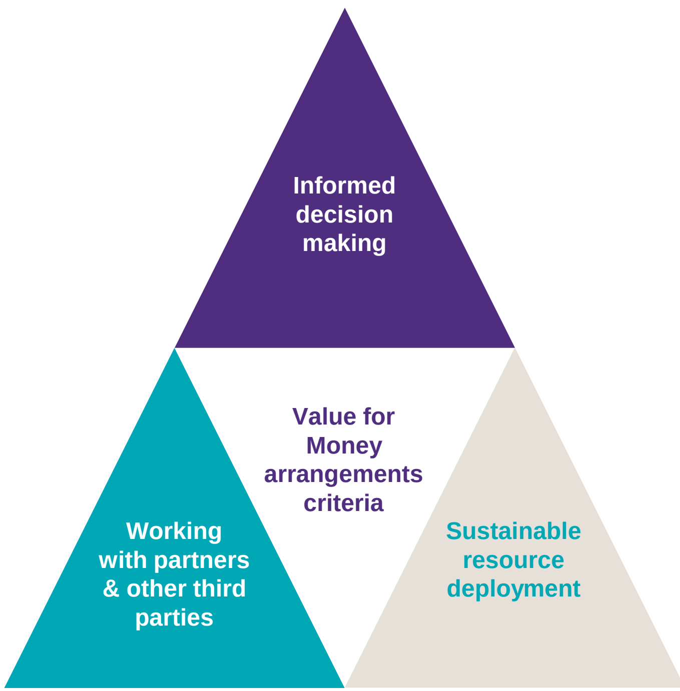

Risk assessment

We carried out an initial risk assessment in February 2020 and identified a significant risks in respect of specific areas of proper arrangements using the guidance contained in AGN03. We communicated these risks to you in our Audit Plan dated March 2020. The significant risk is shown on page 20.

We have continued our review of relevant documents up to the date of giving our report, and have not identified any further significant risks where we need to perform further work. In our plan Addendum which was issued in January 2021 subsequent to the impacts of the Covid-19 pandemic we reported that we had updated our VfM risk assessment to document our understanding of your arrangements to ensure critical business continuity in the current environment. We did not identify any new VfM risks in relation to Covid-19. We were satisfied that our work addressing the Medium Term Financial Sustainability risk would allow us to address the ways that Covid-19 has impacted on the Authority's medium term financial sustainability, how management are forecasting the impacts on future income and expenditure, and the arrangements that have been put in place by management to respond to these impacts

We carried out further work only in respect of the significant risks we identified from our initial and ongoing risk assessment. Where our consideration of the significant risks determined that arrangements were not operating effectively, we have used the examples of proper arrangements from AGN 03 to explain the gaps in proper arrangements that we have reported in our VFM conclusion.

Overall conclusion

Based on the work we performed to address the significant risks, we are satisfied that the Council had proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

The text of our report, which confirms this can be found at Appendix D.

Significant matters discussed with management

There were no matters where no other evidence was available or matters of such significance to our conclusion or that we required written representation from management or those charged with governance.

Value for Money - Introduction

Our work

AGN 03 requires us to disclose our views on significant qualitative aspects of the Council's arrangements for delivering economy, efficiency and effectiveness.

We have focused our work on the significant risk that we identified in the Council's arrangements, which was as follows:

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Medium term financial sustainability

Across the Local Government sector medium to long term financial plans are under strain due to reductions in central government funding along with increases in demand. In the 2017/18 and 2018/19 years the Council had deficit financial results on its provision of services. As at month 9 of the 2019/20 financial year, the revised budget shows a forecast service expenditure deficit of £262k, though after use of funding from the transition and other reserves the result is a £272k positive variance against the budget. The authority is responding to funding challenges in a variety of ways, through identifying efficiencies & new sources of funding, working with partners, and engaging in service redesign.

The Council set a balanced budget for 2020/21, composed of a £1.152m deficit result balanced by use of reserves. £1.8m of PIER savings have been identified the year, though these have been insufficient to close the budget gap and the authority expects to use reserves to balance the budget. The Medium Term Financial Strategy sets out expectations of funding shortfalls of between circa £500-800k for each of the 3 years in the Strategy through to 2023/24. There are savings and income generation plans in place which will mitigate some of the impact, but the expected results will entail use of the Council's current usable reserves which will be difficult to replenish. The authority continues to develop and implement regeneration plans to attract housing and investment into the area, and generate additional revenues.

With the recent changes to the overall majority in central government, this is likely to lead to ongoing uncertainty in local government funding, and therefore there is currently no reasonable estimate that can be made for the impact of the ongoing Fair Funding Review and potential changes to Business Rate retention leading to ongoing medium term budgetary uncertainty going forwards. (continued on next page)

Local Government reserves levels are under increased scrutiny with the high level of uncertainty over funding levels. At 31 March 2019 the usable reserves stood at £20.8m, a level which is considered by the Council to be sufficient to ensure the ongoing sustainability of the organisation.

The clear steep challenges in this area around uncertainty of ongoing funding levels and restricted means by which to increase revenue levels and maintain/increase useable reserves lead us to conclude that medium term financial sustainability is a significant risk for the authority.

Our work will primarily include:

- Reviewing performance in the current 2019/20 year against budget as a means of assessing the reasonableness of the authority’s budgeting methods;
- Reviewing management’s methods/processes in building the budget and Medium Term Financial Strategy;
- Understanding and challenging the key assumptions and estimates, particularly those that are highly judgemental, and comparing these to other authorities and our overall sector knowledge;
- Assessing and understanding how the authority sets the level of minimum reserves which should be held to maintain council services/funds through uncertainty, and concluding on whether the management considerations in setting the level are reasonable; and
- Discussion and consideration of the authorities regeneration/development plans and other areas of future uncertainty.

We have set out more detail on the risk we identified, the results and conclusions of the work we performed, and the recommendations we have made on pages 21-22.

Value for Money - Summary

Overview of 2019/20 performance

The financial resilience of the Council depends on its ability to balance income and expenditure, without over-reliance on reserves to fund the day to day cost of services. Your planning framework is based on a 5 year Medium Term Financial Plan (MTFP) which is aligned with the budget-setting process and updated annually. In recent years you have been proactive in responding to the implications of reductions in government funding, both by planning for financial savings and developing alternative sources of income.

Prior to the impacts of the pandemic, the Council, like most others, has in recent years experienced a significant increase in structural demand-led pressure budgets alongside reductions in government funding. The Council has responded to this by establishing Priority Income and Efficiency Review (PIER) savings schemes and focussing on generating new streams of revenue. In the 2018/19 year, we reviewed the processes, key assumptions and estimates underlying the production of the 2019/20 budget and the MTFP and we were satisfied that they were robust and would produce reasonably accurate forward forecasts. The Council initially set a budget for 2019/20 which required a contribution from reserves of £1.7m in order to close the budget gap between forecast income and expenditure. The impact of the Covid-19 pandemic on the Council's financial position in 2019/20 has been limited, with lockdown arrangements commencing in late March 2020 and most of the significant budgetary implications really starting to be felt by the Council from April/May 2020 onwards.

The final outturn position for the 2019/20 financial year was a deficit of £1.598m compared to the budget deficit of £1.798m. The Council achieved 98% of the £1.248m PIER savings target for the 2019/20 year. As at 31 March 2020 the Council's reserves totalled £17.61m with the General Reserve alone standing at £7.3m. This exceeds the minimum level of General and Capital reserves which management have considered and concluded should be £6m.

2020/21 – The Impact of the Pandemic

The real impact of Covid-19 on the Council's finances will be felt in 2020/21 onwards. In February, 2020 prior to the impact of Covid-19 being known, you had set a budget deficit of £1.182m which included a challenging savings plan target of £1.784m and additional cost pressures of £786k.

The impact of the pandemic means the Council faces additional pressures both from the loss of income and additional costs. The loss of income reflects the impact of wider economic conditions, including reduced income from car parks and commercial property.

The Council has had to significantly adapt its operation due to the impact of the pandemic on the local residents, inevitably leading to additional costs. These changes have included:

- Establishment of a Community Hub to support the most vulnerable residents;
- Adapting customer contact and communications due to the closure of Council offices to visitors;
- Significant additional costs of housing vulnerable homeless and those in unstable housing situations, along with increasing outreach service costs;
- Providing financial support to the operator of the Council's leisure facilities;
- Providing significant levels of financial support through Council Tax support grants and hardship funds to assist residents in paying their bills, and paying grants to businesses and business rate suspensions. Although a significant portion of this is reimbursed by government funding there is inevitably a portion of additional costs which will need to be borne directly by the Council.

The Council is also experiencing reduced collection rates for both NNDR and council tax, leading to a forecast deficit on the Collection Fund at 31 March 2021. This will have no financial impact in the current year, and councils are allowed to spread any 2020/21 deficit over a three year period. However, the need to meet the Council's share of the deficit will be an additional financial pressure in future years.

In October 2020 the Council set out its priorities and larger action plan for recovering from the impacts of the pandemic; set out how it would adapt to providing the services essential for the District and how business operations would restart and recover in a safe and sustainable way. This plan set out key actions for the Council through to the end of the 2020/21 year, key issues/risks and an Action Plan across the Council's services.

Value for Money - Summary

In terms of financial planning since the impact of Covid-19, the Council has been required to submit MHCLG Covid-19 income and expenditure pressures return every month since it was introduced in April 2020. This requires the Council to accurately report the additional income and expenditure impacts which are attributable to Covid-19. We have been provided with and reviewed examples of the return submissions and the Finance Team's detailed underlying working papers for the return. We were satisfied that the Finance Team had established a robust way to compile and report this data, and this data was being used in turn to inform forward forecasting of the year and medium term plans in the context of the pandemic.

The Finance Team have used the data analysis produced from the returns to set out estimates of the total increased costs and reduced income streams for the year, and during the year they have set out best-case, medium-case and worst case planning scenarios for the 2020/21 year position, as well as compiling analysis and forecast to support production of the revised MTFP.

At February 2021 the fully revised 2020/21 budget was reported, showing that after loss of income and increased expenditure was offset by additional funding, the deficit result reduced from the original forecast £1.182m to £0.756m, thereby reducing the anticipated use of reserves in the 2020/21 year.

The Medium Term Outlook

Despite the eventual favourable variance against the 2020/21 budget, the outlook over the 5 year MTFP period for the Council has become even more challenging. For 2021/22 the Council has only been able to set a balanced budget through the planned use of £1.592m of reserves. This would be funded from the Council's Resilience and Stability Reserve (£400,000) and the General Reserve (£1.192m) – leaving the General Reserves at a level which is just above the minimum level recommended by the Chief Financial Officer (£6m).

After extrapolating the anticipated economic shock impacts of the pandemic alongside Brexit, it is clear the Council has some particular downside risks where it is likely to be subject to greater volatility in income from non-domestic rates and expenditure on council tax support claims. There are also likely to be significant areas of other revenue streams which the Council has invested in which do not fully recognise their potential in the short term.

The forecasts over the years 2022/23 to 2024/25 are for a budget gap in the region of £2.5m. By the end of 2021/22 the Council would most likely be close to the minimum General Reserve position of £6m. If the subsequent deficits could not be closed by additional savings or increased income, then the Council could be forced to use further the General Reserve funds. If these funds are used this could lead the Council to need to make very difficult decisions around where to cut back services to achieve a balanced budget but also to restore reserves.

This forecast is subject to a great deal of uncertainty due to a lack of clarity on the Fair Funding Review, the promised introduction of the 75% Business Rate Retention Scheme, and what might replace the New Homes Bonus. This current forecast means that until there is further certainty on funding streams the Council will need to plan forward based on the assumption of continued reductions in funding, and therefore will need to prioritise its use of resources in areas that generate additional income or where costs can be reduced. This could prevent the Council from undertaking itself, or underwriting, the major redevelopment initiatives which have been part of the longer term plan for the area.

Whilst funding and increased demand is of overriding concern, there are still many positive initiatives being undertaken by the Council. The Council's existing programmes include a new hotel in Cornwallis Street, Harold Place redevelopment, units at Churchfields Industrial Estate, the town's Lower Tier and West Marina development are potentially valuable regeneration schemes.

We concluded that the risk we identified was sufficiently mitigated and that the Council has proper arrangements for securing economy, efficiency and effectiveness in the use of resources.

Independence and ethics

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Financial Reporting Council's Ethical Standard and confirm that we, as a firm, and each covered person, are independent and are able to express an objective opinion on the financial statements

We confirm that we have implemented policies and procedures to meet the requirements of the Financial Reporting Council's Ethical Standard and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements.

Further, we have complied with the requirements of the National Audit Office's Auditor Guidance Note 01 issued in May 2020 which sets out supplementary guidance on ethical requirements for auditors of local public bodies.

Details of fees charged are detailed in Appendix C.

Independence and ethics

Audit and Non-audit services

For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Council. The following non-audit services were identified which were charged from the beginning of the financial year to February 2021, as well as the threats to our independence and safeguards that have been applied to mitigate these threats.

	Fees £	Threats identified	Safeguards
Audit related			
Certification of the Housing Benefits Grant Claim	12,300	Self-Interest (because this is a recurring fee)	The level of this recurring fee taken on its own is not considered a significant threat to independence as the fee for this work is £12,300 in comparison to the total fee for the audit of £43,242 (planned fee, final fee TBC) and in particular relative to Grant Thornton UK LLP's turnover overall. Further, it is a fixed fee and there is no contingent element to it. These factors all mitigate the perceived self-interest threat to an acceptable level.
		Self review (because GT provides audit services)	To mitigate against the self review threat , the timing of certification work is done after the audit has completed, materiality of the amounts involved to our opinion and unlikelihood of material errors arising and the Council has informed management who will decide whether to amend returns for our findings and agree the accuracy of our reports on grants.

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These services are consistent with the group's policy on the allotment of non-audit work to your auditors. None of the services provided are subject to contingent fees.

Follow up of prior year recommendations

We identified the following issues in the audit of Hastings Borough Council's 2018/19 financial statements, which resulted in 5 recommendations being reported in our 2018/19 Audit Findings report. We have followed up on the implementation of our recommendations as follows:

Assessment	Issue and risk previously communicated	Update on actions taken to address the issue
✓	**Assurance over assets not revalued** We noted in our PPE valuation work we noted that management had not specifically prepared a working paper to address whether assets had been impaired during the year, or set out in detail their own assumptions and estimates of the potential movements in value for assets not revalued during the year. Although management do revalue all very high value assets the total of assets not revalued represent a material amount and a relatively small movement in the value of this total could be material to the accounts. In the absence of a detailed management working paper , we developed our own point estimate of the movement in values using information of possible variations provided by our own auditor's expert. We recommended that management strengthen future working papers in this area to provide a detailed assessment that can be audited.	Management has made use of the market review report issued by WHE expert valuer to assess assets not revalued during the year and provide a working paper with their assessment of the potential movements in value of assets not revalued.
✓	**Migration of ERP system** The working papers which were made available to evidence the correct migration of the system were of a poor quality, which meant that understanding the testing the migration took a lot of time for our audit team. We also found errors in the transition where items were misposted between codes, or were posted onto the old system after the new system had been adopted. These errors were later corrected, but again these issues made it more difficult for us to complete this work and gain sufficient assurance over the material correctness of the migration. We recommended that where system migrations take place in the future, for finance or other systems, management strengthen working papers to provide internal assurance around the completeness and accuracy of the migration, and for audit purposes.	There was no system migration during the year against which to assess this recommendation. Should there be a system migration in future years we will make further assessment of the systems and controls in place.

Assessment

✓ Action completed

X Not yet addressed

Follow up of prior year recommendations (continued)

Assessment	Issue and risk previously communicated	Update on actions taken to address the issue
X	**Supporting working papers to the accounts preparation** During the audit we found that there were not clear working papers to support each note in the accounts, and that sub-systems through which significant volume transactions in the accounts, such as Council Tax and Business Rates income and Housing Benefits expenditure, were not supported by clear reconciliations to provide assurance as the completeness and accuracy of accounting in the general ledger for transactions in these sub-systems. We recommended that management strengthen future working papers for their own internal assurance, and to support a more efficient audit.	Although there have been improvements year on year, our view is that there could still be further improvements to working papers. We would particularly recommend that balance sheet debtors and creditor working papers are improved.
X	**Review of debtors and creditors classifications** We noted in our debtors and creditors review and testing that there had not been a full review of balances to check classification and in some cases there was not a full understanding (due to turnover in the finance team) of what the balance related to. This took some time and investigation in order to get full explanations for balances and to complete our testing. We recommended that management strengthen future controls for review and reconciliation of debtor and creditor balances, and as mentioned above to produce clear reconciliations to subsystems.	Our view was that the debtor and creditor sub-ledger systems and the supporting working papers still require some additional review to ensure balance sheet reconciliations are clear. There were some instances of underlying listings not quite agreeing to the ledger balance and this making these balances more difficult to audit.
X	**Review of debtor existence** We noted in our debtors testing numerous errors which were generally small in monetary terms, where the debtor either did not exist (had been paid prior to year end) or the cut off treatment was incorrect. We recommended that management strengthen debtor reconciliation controls and introduces a review of the accrual process either to introduce a reasonable de-minimus for making accruals or ensures all accruals are correct through tightening review of cut off processes.	In completion of our debtor work we have encountered areas where we need to query the debtor existence; older debtors which did not have robust support, and debtors which appeared to be paid but did not have the payment matched against the debtor.

Assessment

- ✓ Action completed
- X Not yet addressed

Action Plan

We have identified 2 recommendations for the group as a result of issues identified during the course of our audit. We will report on progress on these recommendations during the course of the 2020/21 audit. The matters reported here are limited to those deficiencies that we have identified during the course of our audit and that we have concluded are of sufficient importance to merit being reported to you in accordance with auditing standards.

	Assessment	Issue and risk	Recommendations
1	●	**Estimates of provisions for impairments – underlying support for the estimates and associated judgements** Working papers for estimates for provisions for impairments in the accounts which constitute a material accounting estimate are not sufficiently clear to allow a clear understanding of the calculation of that estimate and the judgements underlying the calculation of the estimate. As a highly subjective estimate we would recommend that they are presented with a working paper which clearly sets out the rationale for the estimate and any changes to % rates of impairment which are applied. This will help the audit team in efficiently auditing these provisions, and also ensures that where team members change in the authority the trail for the estimate is also clear.	We recommend that management strengthen future working papers in this area to provide a more detailed explanation of the rationale for these sensitive accounting estimates. **Management response** Agreed with enhancements made to existing working papers
2	●	**Amendment to accounts following the initial draft** There were some amendments to the accounts made by the Authority after the draft was presented; 3 further draft versions of accounts were produced with the first 2 subsequent versions being due to amendments made by management as opposed to audit adjustments. The audit trail for these accounts changes was not clear.	We recommend that where the Authority team makes adjustments to the accounts, a log of accounts changes is kept which makes clear why the changes have been made and references into working papers. **Management response** Agreed with enhancements made to existing log.
3	●	**Updating useful economic lives in the fixed asset register** Some of the Useful Economic Lives for building assets which had been revalued by the professional valuer in year had not been updated in line with the advised useful lives. This meant that the depreciation charge had not been calculated/estimated in line with the useful lives as estimated. The impact was not material but was above our triviality threshold (see below)	We recommend that where the professional valuer advises useful lives for assets which are revalued that these are updated in the fixed asset register. **Management response** Agreed with updates made where applicable.

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Audit adjustments

We are required to report all non trivial misstatements to those charged with governance, whether or not the accounts have been adjusted by management.

Impact of adjusted misstatements

All adjusted misstatements are set out in detail below along with the impact on the key statements and the reported net expenditure for the year ending 31 March 2020.

Detail	Comprehensive Income and Expenditure Statement £'000	Statement of Financial Position £' 000	Impact on total net expenditure £'000
Vehicles, Plant and Equipment opening balances A difference of £218k was identified between the fixed asset register and the general ledger/accounts opening balances. Accumulated depreciation on a fully written-off asset had erroneously been written off as a disposal during 2018/19 thereby introducing this difference between the fixed asset register and the general ledger/accounts. Although this was immaterial, management have decided to adjust the value so that the fixed asset register and general ledger accounts opening balances agree.	Nil	Dr Vehicle, Plant and Equipment gross book value £218k Cr Accumulated Depreciation £218k	Nil
Difference on revaluation reserve A difference of £98k was identified between the value of the total value per the fixed asset register and per the professional valuer summary for one of the revalued Treatment centres. Through further enquiry of management it was noted that the fixed asset register kept the assets value as an even split where as the valuation report produced the value for the asset as a whole. As this will have an impact on revaluation movement and to prevent it being carried over to 2021 year, management has agreed to process an adjustment of the difference.	Nil	Dr revaluation reserve £98k Cr Land and Buildings gross book value £98k	Nil
Accrual of exit packages in Employee Remuneration A number of exit packages paid after the year end which related to the 2019/20 financial year had not been accrued into the year. To correct this an accrual of £321k additional exit package costs needed to be made, and the associated Note 21 Termination Benefits and Exit Packages also needed to be updated with all amounts paid.	Dr Employee Remuneration £321k	Cr Accruals £321k	£321k
Overall impact	**£321k**	**(£321k)**	**£321k**

Audit adjustments

Impact of adjusted misstatements (continued)

Detail	Comprehensive Income and Expenditure Statement £'000	Statement of Financial Position £' 000	Impact on total net expenditure £'000
Accrual of the audit fee in line with the proposed fee The accrual for the audit fee in the accounts was amended from £37k to the £43k proposed fee as in the Audit Plan. Although this amount is trivial this is amended due to the sensitivity of this disclosure in the accounts.	DR audit fee £6k	Cr Accruals £6k	£6k
Overall impact	**£327k**	**(£327k)**	**£327k**

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Audit adjustments

Impact of unadjusted misstatements

Detail	Comprehensive Income and Expenditure Statement £'000	Statement of Financial Position £' 000	Impact on total net expenditure £'000
Overstatement of the depreciation charge Some of the Useful Economic Lives for building assets which had been revalued by the professional valuer in year had not had been updated in line with the advised useful lives. This meant that the depreciation charge was overstated by £83k.	CR Depreciation Charge £83k	DR Accumulated Depreciation £83k	£83k
Overall impact	**(£83k)**	**£83k**	**£83k**

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Audit adjustments

Misclassification and disclosure changes

The table below provides details of misclassification and disclosure changes identified during the audit which have been made in the final set of financial statements.

Disclosure omission	Detail	Auditor recommendations	Adjusted?
Material uncertainty PPE valuation	As a result of the Covid-19 pandemic, the property market remains very uncertain. As a result of this, material uncertainties have been declared by the professional valuer relating to land and buildings. This material uncertainty was not appropriately disclosed in the draft accounts.	We have discussed this with management and recommended that the issue and a broad sensitivity analysis of potential variability in the PPE valuation is included within Note 5 Assumptions Made About The Future And Other Sources Major Sources of Estimation Uncertainty. **Management response** This was an agreed amendments to the accounts.	✓
Material uncertainty – pooled investment held by the pension fund administrator	As a result of the Covid-19 pandemic, the property market remains very uncertain. As a result of this, material uncertainties have been declared by an investment manager for pooled property investments held by the pension fund administrator and underlying the net pension liability. This material uncertainty was not appropriately disclosed in the draft accounts.	We have discussed this with management and recommended that the issue and a broad sensitivity analysis of potential variability in the net pension liability valuations is included within Note 5 Assumptions Made About The Future And Other Sources Major Sources of Estimation Uncertainty. **Management response** This was an agreed amendments to the accounts.	✓
Financial Instruments	During our work on Note 18 it was picked up and queried that loans and receivables at book value was stated as £10,006k and fair value as £0 which appeared unusual. Management reviewed Note 18 and revised the disclosure to book value as £4,997k and fair value as £5,003k. We were satisfied on review of supporting documentation that this was accurate. This did not require any adjustment to the balance sheet.	The note was updated in response to our query. **Management response** This was an agreed amendments to the accounts.	✓
Debtors note	During our work on Note 16 we observed that there was a material class of long term debtor (debtor loan owed by the subsidiary Hastings Housing Company Ltd. which should have been disclosed individually.	We recommended that the note was updated so that this material debtor was disclosed individually. **Management response** This was an agreed amendments to the accounts.	✓

Audit adjustments

Misclassification and disclosure changes (continued)

Disclosure omission	Detail	Auditor recommendations	Adjusted?
Financial Instruments – short term debtors	In the draft accounts, short term debtors did not include all the balances in the working papers. We discussed this with management and agreed that the total of £3,430k per the draft accounts needed to be updated to £3,997k.	We have discussed this with management and agreed this accounts update. **Management response** This was an agreed amendments to the accounts.	✓
Note 21 Termination Benefits and Exit Packages	The amounts of Termination Benefits and Exit Packages were understated by £349k in the draft accounts presented for audit. We recommended that this Note was updated to accurately reflect these items which are of increased interest to users of the accounts.	We have discussed this with management and agreed this accounts update. **Management response** This was an agreed amendments to the accounts.	✓
Note 16 reclassification of the debtor for the Syrian Resettlement Programme grant	This debtor of £698k was classified as a Trade Debtor, and should have been classified as an Other Debtor. We recommended that this was reclassified within the note.	We have discussed this with management and agreed this accounts update. **Management response** This was an agreed amendments to the accounts.	✓
Group accounts – Current Assets	There was a £320k error in the Short Term Debtors figure in the draft consolidated accounts. This needed to be increased by £320k in order to cast correctly to the total current assets below.	We have discussed this with management and agreed this accounts update. **Management response** This was an agreed amendments to the accounts.	✓
IFRS 16 disclosure	As discussed on page 11 Authorities should include disclosure of IFRS 16 as a standard which will be implemented and the expected date of implementation. As a minimum, we would expect audited bodies to disclose the title of the standard, the date of initial application and the nature of the changes in accounting policy for leases.	We have discussed this with management and agreed this accounts update. **Management response** This was an agreed amendments to the accounts.	✓

Audit adjustments

Misclassification and disclosure changes (continued)

Disclosure omission	Detail	Auditor recommendations	Adjusted?
Related Parties note	In the draft accounts the figures disclosed for the debt owed to the Council by Hastings Housing Company did not agree to the debt working paper balances.	We have discussed this with management and agreed this accounts update. **Management response** This was an agreed amendments to the accounts.	✓
Finance Lease minimum lease payments disclosure	Similarly to the 2018/19 year the total future minimum lease payments receivable under non-cancellable leases were calculated including contingent rentals. IFRS does not allow for the inclusion of contingent rentals in the disclosed amounts. The contingent rental received in year should be accounted for as income received in the year and disclosed separately.	We have discussed this with management and agreed this accounts update. **Management response** This was an agreed amendments to the accounts.	✓

Audit adjustments

Impact of prior year unadjusted misstatements

The table below provides details of adjustments identified during the prior year audit which had not been made within the final set of 2018/19 financial statements. We are satisfied that these remain immaterial taking into account the further unadjusted misstatements in the 2019/20 year above.

Detail	Comprehensive Income and Expenditure Statement £'000	Statement of Financial Position £' 000	Impact on total net expenditure £'000	Reason for not adjusting
Overprovision of operating expenses in the year We found an error where an operating expenditure accrual was overstated by £1,332.10. We assessed the potential impact of the error on total expenditure by calculating a potential extrapolation which assessed the maximum potential error to be £91k. As this is an estimated extrapolation we would not propose adjusting the accounts for this, and this is predominantly to give assurance that similar errors occurring in the operating expenditure population would not cause material misstatement.	(£91k)	£91k	(£91k)	This was an immaterial extrapolation
Unpaid leave accrual Management have chosen not to make an accrual for unpaid leave based on the estimate of the total liability at 31 March 2019 being immaterial to the accounts.	£206k	(£206k)	£206k	This was immaterial
Overall impact	**£115k**	**(£115k)**	**£115k**	

Fees

We confirm below our final fees charged for the audit and provision of non-audit services:

Audit fees	Proposed fee	Final fee
Council Audit	43,242	TBC
Total audit fees (excluding VAT)	**£43,242**	**£TBC**

There is additional work which was necessary to be carried out during the audit and Value for Money work due to the added complexities of the impact of Covid-19. We are still completing this work and the extent of this fee will be discussed and proposed to the Chief Finance Officer. All proposed fee variations would be communicated to the Audit Committee and is subject to Public Sector Audit Appointments (PSAA).

Non-audit fees for other services	Proposed fee	Final fee
Audit Related Services		
Certification of Housing Benefit Claim 2019/20	12,300	TBC
Total non- audit fees (excluding VAT)	**£12,300**	**£TBC**

We have not yet completed the work for this other service. We do not expect the final fee to differ from the proposed fees based on our estimate of the amount and complexity of the work involved.

Audit opinion

We anticipate we will provide the Group with an unmodified audit report:

Independent auditor's report to the members of Hastings Borough Council

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of Hastings Borough Council (the 'Authority') and its subsidiary (the 'group') for the year ended 31 March 2020 which comprise the Comprehensive Income and Expenditure Statement, Movement in Reserves Statement, the, the Balance Sheet, the Cash Flow Statement, the Housing Revenue Account Income and Expenditure Statement, the Movement on the Housing Revenue Account Statement, the Collection Fund Statement, Group Comprehensive Income and Expenditure Statement, the Group Movement in Reserves Statement, the, the Group Balance Sheet and the Group Cash Flow Statement and notes to the financial statements, including a summary of significant accounting policies. The notes to the financial statements include the EFA, Notes to the Core Statements, Policies and Judgements, Notes to the Housing Revenue Account Statement, Notes to the Collection Fund Statement and Notes to the Group Accounts. The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC code of practice on local authority accounting in the United Kingdom 2019/20.

In our opinion, the financial statements:

- give a true and fair view of the financial position of the group and of the Authority as at 31 March 2020 and of the group's expenditure and income and the Authority's expenditure and income for the year then ended;
- have been properly prepared in accordance with the CIPFA/LASAAC code of practice on local authority accounting in the United Kingdom 2019/20; and
- have been prepared in accordance with the requirements of the Local Audit and Accountability Act 2014.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the 'Auditor's responsibilities for the audit of the financial statements' section of our report. We are independent of the group and the Authority in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

The impact of macro-economic uncertainties on our audit

Our audit of the financial statements requires us to obtain an understanding of all relevant uncertainties, including those arising as a consequence of the effects of macro-economic uncertainties such as Covid-19 and Brexit. All audits assess and challenge the reasonableness of estimates made by the Chief Finance Officer and the related disclosures and the appropriateness of the going concern basis of preparation of the financial statements. All of these depend on assessments of the future economic environment and the group's and Authority's future operational arrangements.

Covid-19 and Brexit are amongst the most significant economic events currently faced by the UK, and at the date of this report their effects are subject to unprecedented levels of uncertainty, with the full range of possible outcomes and their impacts unknown. We applied a standardised firm-wide approach in response to these uncertainties when assessing the group's and Authority's future operational arrangements. However, no audit should be expected to predict the unknowable factors or all possible future implications for an authority associated with these particular events.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the Chief Finance Officer's use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the Chief Finance Officer has not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the group's or the Authority's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

In our evaluation of the Chief Finance Officer's conclusions, and in accordance with the expectation set out within the CIPFA/LASAAC code of practice on local authority accounting in the United Kingdom 2019/20 that the Authority's financial statements shall be prepared on a going concern basis, we considered the risks associated with the group's and Authority's operating activities, including effects arising from macro-economic uncertainties such as Covid-19 and Brexit. We analysed how those risks might affect the group's and Authority's financial resources or ability to continue operations over the period of at least twelve months from the date when the financial statements are authorised for issue. In accordance with the above, we have nothing to report in these respects.

However, as we cannot predict all future events or conditions and as subsequent events may result in outcomes that are inconsistent with judgements that were reasonable at the time they were made, the absence of reference to a material uncertainty in this auditor's report is not a guarantee that the Authority or group will continue in operation.

Emphasis of Matter – effects of Covid-19 on the valuation of land and buildings and property investments

We draw attention to Note 5 of the financial statements, which describes the effects of the Covid-19 pandemic on the valuation of the Authority's and group's land and buildings and the Authority's share of the pension fund's pooled property investments as at 31 March 2020. As, disclosed in note 5 to the financial statements the outbreak of Covid-19 has impacted global financial markets and market activity has been impacted, including property market activity such that capital and rental values may change rapidly in the short to medium term. A material valuation uncertainty was therefore disclosed in both the Authority's property valuer's report and the pension fund's pooled property investment valuation report. Our opinion is not modified in respect of this matter.

Other information

The Chief Finance Officer is responsible for the other information. The other information comprises the information included in the Statement of Accounts, the Narrative Report and the Annual Governance Statement other than the Authority and group financial statements and, our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge of the group and Authority obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

Other information we are required to report on by exception under the Code of Audit Practice

Under the Code of Audit Practice published by the National Audit Office on behalf of the Comptroller and Auditor General (the Code of Audit Practice) we are required to consider whether the Annual Governance Statement does not comply with the 'delivering good governance in Local Government Framework 2016 Edition' published by CIPFA and SOLACE or is misleading or inconsistent with the information of which we are aware from our audit. We are not required to consider whether the Annual Governance Statement addresses all risks and controls or that risks are satisfactorily addressed by internal controls.

We have nothing to report in this regard.

Audit opinion

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Opinion on other matter required by the Code of Audit Practice

In our opinion, based on the work undertaken in the course of the audit of the financial statements and our knowledge of the Authority gained through our work in relation to the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources, the other information published together with the financial statements in the Statement of Accounts and the Annual Governance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

Under the Code of Audit Practice, we are required to report to you if:

- we issue a report in the public interest under section 24 of the Local Audit and Accountability Act 2014 in the course of, or at the conclusion of the audit; or
- we make a written recommendation to the Authority under section 24 of the Local Audit and Accountability Act 2014 in the course of, or at the conclusion of the audit; or
- we make an application to the court for a declaration that an item of account is contrary to law under Section 28 of the Local Audit and Accountability Act 2014 in the course of, or at the conclusion of the audit; or;
- we issue an advisory notice under Section 29 of the Local Audit and Accountability Act 2014 in the course of, or at the conclusion of the audit; or
- we make an application for judicial review under Section 31 of the Local Audit and Accountability Act 2014, in the course of, or at the conclusion of the audit.

We have nothing to report in respect of the above matters.

Responsibilities of the Authority, the Chief Finance Officer and Those Charged with Governance for the financial statements

As explained more fully in the Statement of Responsibilities, the Authority is required to make arrangements for the proper administration of its financial affairs and to secure that one of its officers has the responsibility for the administration of those affairs. In this authority, that officer is the Chief Finance Officer. The Chief Finance Officer is responsible for the preparation of the Statement of Accounts, which includes the financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC code of practice on local authority accounting in the United Kingdom 2019/20, for being satisfied that they give a true and fair view, and for such internal control as the Chief Finance Officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Chief Finance Officer is responsible for assessing the group's and the Authority's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless there is an intention by government that the services provided by the Authority will no longer be provided.

The Audit, Finance and Governance Committee is Those Charged with Governance. Those charged with governance are responsible for overseeing the Authority's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Report on other legal and regulatory requirements - Conclusion on the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources

Conclusion

On the basis of our work, having regard to the guidance on the specified criterion issued by the Comptroller and Auditor General in April 2020, we are satisfied that the Authority put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2020.

Responsibilities of the Authority

The Authority is responsible for putting in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to review regularly the adequacy and effectiveness of these arrangements.

Auditor's responsibilities for the review of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources

We are required under Section 20(1)(c) of the Local Audit and Accountability Act 2014 to be satisfied that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. We are not required to consider, nor have we considered, whether all aspects of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

We have undertaken our review in accordance with the Code of Audit Practice, having regard to the guidance on the specified criterion issued by the Comptroller and Auditor General in April 2020, as to whether in all significant respects the Authority had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. The Comptroller and Auditor General determined this criterion as that necessary for us to consider under the Code of Audit Practice in satisfying ourselves whether the Authority put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2020.

We planned our work in accordance with the Code of Audit Practice. Based on our risk assessment, we undertook such work as we considered necessary to be satisfied that the Authority has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

Report on other legal and regulatory requirements - Certificate

We certify that we have completed the audit of the financial statements of the Hastings Borough Council in accordance with the requirements of the Local Audit and Accountability Act 2014 and the Code of Audit Practice.

Use of our report

This report is made solely to the members of the Authority, as a body, in accordance with Part 5 of the Local Audit and Accountability Act 2014 and as set out in paragraph 43 of the Statement of Responsibilities of Auditors and Audited Bodies published by Public Sector Audit Appointments Limited. Our audit work has been undertaken so that we might state to the Authority's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Authority and the Authority's members as a body, for our audit work, for this report, or for the opinions we have formed.

[Signature]

Darren Wells, Key Audit Partner
for and on behalf of Grant Thornton UK LLP, Local Auditor

London

[Date]

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Agenda Item 5

Report To:	**Audit Committee**
Date of Meeting:	**18 November 2021**
Report Title:	**External Audit Plan – Year ending 31 March 2021**
Report By:	**Peter Grace, Assistant Director Financial Services & Revenues (Chief Finance Officer)**
Key Decision:	**No**
Classification:	

Purpose of Report

To inform councillors of Grant Thornton's audit plan for the audit of the Council's accounts and Value for Money arrangements. The attached report from Grant Thornton highlights the risk based approach to the audit and the main risks they have identified.

Recommendation

1. **To accept the External Auditor's Audit Plan**

Reasons for Recommendations

The Audit Committee, as required by the Constitution, receives and notes the External Auditor's Audit Plan on behalf of the Council.

Introduction

1. This plan summarises the proposed audit work for the 2020/21 Statement of Account for Hastings Borough Council. It highlights the significant risks that impact on the audit and details the planned work in response to those risks.

2. The plan details changes to auditing requirement resulting from a new Code of Audit Practice which came into effect for 2020/21 and the revised approach to Value for money (VFM) auditing.

3. The audit fees for 2020/21 is yet to be confirmed however it will vary from the Public Sector Audit Appointments (PSAA) scale fee initially set due to a number of factors as discussed in the audit plan. The Department for Levelling Up, Housing and Communities (DLUHC) has committed an extra £15m funding to support the delivery of local audits in 2020/21 and are currently consulting on how the grant will be distributed. It is understood that the Council will receive some of this grant to support the 2020/21 audit fee.

Timetable of Next Steps

4. Please include a list of key actions and the scheduled dates for these:

Action	Key milestone	Due date (provisional)	Responsible
Not applicable – this is an information report for the public	-	-	-

Wards Affected

None.

Policy Implications

Reading Ease Score:

Have you used relevant project tools?: N/A

Please identify if this report contains any implications for the following:

Equalities and Community Cohesiveness	No
Crime and Fear of Crime (Section 17)	No
Risk Management	Yes
Environmental Issues & Climate Change	No
Economic/Financial Implications	Yes
Human Rights Act	No

Organisational Consequences	No
Local People's Views	No
Anti-Poverty	No
Legal	No

Additional Information

Appendix A – External Audit Plan - Year ending 31 March 2021.

Officer to Contact

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Grant Thornton

Hastings Borough Council audit plan

Year ending 31 March 2021

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Hastings Borough Council

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The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our audit planning process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect the Council or all weaknesses in your internal controls. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

Key matters

Factors

New Code of Audit Practice

On 1 April 2020, the National Audit Office introduced a new Code of Audit Practice which comes into effect from audit year 2020/21. The Code introduced a revised approach to the audit of Value for Money (VFM). These changes are explained in more detail on page 14 but the key points are that there are a new set of key criteria, there is more extensive reporting requirements and the replacement of the binary qualified approach to VFM conclusions, with far more sophisticated judgements on performance, as well as key recommendations on any significant weaknesses in arrangements identified during the audit.

Adoption of new auditing standards - Estimates

The Financial Reporting Council issued an updated ISA (UK) 540 (revised): Auditing Accounting Estimates and Related Disclosures which includes significant enhancements in respect of the audit risk assessment process for accounting estimates. As we explain in more detail on pages 9-11 this will require greater disclosure by the Council as well as additional work by the auditor.

Impact of Covid 19 pandemic

The outbreak of the Covid-19 coronavirus pandemic has had a significant impact on the normal operations of a large number of public sector organisations. The significance of the situation cannot be underestimated and the implications for individuals, organisations and communities remains highly uncertain. For our public sector audited bodies, we appreciate the significant responsibility and burden your staff have to ensure vital public services are provided. As far we can, our aim is to work with you in these unprecedented times, ensuring up to date communication and flexibility where possible in our audit procedures.

The Council has continued to face significant pressure in 2021-21 due to the Covid-19 pandemic. This included additional costs, resources required to process business grants to support the community and loss of income from sources such as parking and leisure facilities. This has impacted the Council's long and medium term budgetary plans, making it more challenging in the medium term to continue to achieve cost efficiencies and increased income streams which were planned to close the budget gaps. The Council is continuing to develop cost saving/income generation plans to ensure that services can be maintained while maintaining a sufficient level of reserves for security against potential future challenges.

Our response

- As a firm, we are absolutely committed to audit quality and financial reporting in the local government sector. Fee discussions are currently in progress between audit firms and PSAA. Our audit plan sets out the starting point based on the 2019/20 proposed audit fee recognising there are further additional cost pressures in 2020/21.
- As part of our planning work, we considered whether there were any risks of significant weakness in the council's arrangements for securing economy, efficiency and effectiveness in its use of resources that we needed to perform further procedures on.
- We will consider your arrangements for managing and reporting your financial resources as part of our work in completing our Value for Money work.
- The revisions to the standard have been incorporated into our audit approach and methodology. We have already identified the material accounting estimates likely to be impacted by the new auditing standard and will work with management to agree the information required and the disclosures required in the financial statements.
- At this time we have not identified a specific COVID-19 significant audit risk (as we did for Local Government audits in 2019/20 which covered a number of risks including the availability of Council staff to produce accounts and valuation uncertainties in relation to land and buildings). We will continue to assess this.
- We will consider the impact of Covid-19 as part of our value for money audit procedures.

Introduction and headlines

Purpose

This document provides an overview of the planned scope and timing of the statutory audit of Hastings Borough Council (the Council) for those charged with governance.

Respective responsibilities

The National Audit Office (the NAO) has issued a document entitled Code of Audit Practice (the Code). This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. Our respective responsibilities are also set out in the agreed Terms of Appointment and Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA), the body responsible for appointing us as auditor of Hastings Borough Council. We draw your attention to both of these documents.

Scope of our audit

The scope of our audit is set in accordance with the Code and International Standards on Auditing (ISAs) (UK). We are responsible for forming and expressing an opinion on the:

- Council [and group]'s financial statements that have been prepared by management with the oversight of those charged with governance (the Audit committee); and
- Value for Money arrangements in place at the Council for securing economy, efficiency and effectiveness in your use of resources.

The audit of the financial statements does not relieve management or the Audit and Governance of your responsibilities. It is the responsibility of the Council to ensure that proper arrangements are in place for the conduct of its business, and that public money is safeguarded and properly accounted for. We have considered how the Council is fulfilling these responsibilities.

Our audit approach is based on a thorough understanding of the Council's business and is risk based.

Group Audit

The Council is required to prepare group financial statements that consolidate the financial information of Hastings Housing Company Ltd.

Significant risks

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

- Management override of controls ;
- Valuation of land and buildings;
- Valuation of the pension fund net liability.

We will communicate significant findings on these areas as well as any other significant matters arising from the audit to you in our Audit Findings (ISA 260) Report.

Materiality

We have determined planning materiality to be £1,706k (PY £1,457k) for the group and £1,697k (PY £1,449k) for the Council, which equates to 2% (group)/1.99% (Council) of your prior year gross expenditure for the year. We are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. Clearly trivial has been set at £0.0863m for the group (PY £0.0728m) and £0.0849m for the Council (PY £0.0725).

Value for Money arrangements

Our risk assessment regarding your arrangements to secure value for money has not identified any risks of significant weakness. Notwithstanding this, the new VfM approach requires us to update our understanding of your arrangements against the expanded VfM scope, and we have however identified several areas of focus under this increased scope. The requirements of the new Code can be found on page 14.

Audit logistics

Our key deliverables are this Audit Plan, our Audit Findings Report and Auditor's Annual Report. Audit logistics and our team are detailed on page 16. Our planning visit took place in March and our final visit will take place in December 2021 – February 2022. Our fee for the audit are detailed on pages 17-18, and is subject to the Council delivering a good set of financial statements and working papers.

We have complied with the Financial Reporting Council's Ethical Standard (revised 2019) and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statement.

Group audit scope and risk assessment

In accordance with ISA (UK) 600, as group auditor we are required to obtain sufficient appropriate audit evidence regarding the financial information of the components and the consolidation process to express an opinion on whether the group financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

Component	Individually Significant?	Level of response required under ISA (UK) 600	Risks identified	Planned audit approach
Hastings Borough Council	Yes		• Refer to pages 6-9.	Full scope audit performed by Grant Thornton UK LLP
Hastings Housing Company Ltd	No		• Valuation of Investment property.	We will carry out: -specific scope procedures on Investment property; -substantive testing on other material balances not relating to significant risks of the group financial statements; -analytical review on remaining income/expenditure/assets and liabilities All to be performed by Grant Thornton LLP

Audit scope

- Audit of the financial information of the component using component materiality
- Audit of one more classes of transactions, account balances or disclosures relating to significant risks of material misstatement of the group financial statements
- Review of component's financial information
- Specified audit procedures relating to significant risks of material misstatement of the group financial statements
- Analytical procedures at group level

Significant risks identified

Significant risks are defined by ISAs (UK) as risks that, in the judgement of the auditor, require special audit consideration. In identifying risks, audit teams consider the nature of the risk, the potential magnitude of misstatement, and its likelihood. Significant risks are those risks that have a higher risk of material misstatement.

Risk	Risk relates to	Reason for risk identification	Key aspects of our proposed response to the risk
Revenue Recognition	Council	Under ISA (UK) 240 there is a rebuttable presumed risk that revenue may be misstated due to the improper recognition of revenue This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition. Having considered the risk factors set out in ISA240 and the nature of the revenue streams at the Authority, we have determined that the risk of fraud arising from revenue recognition can be rebutted for the Council's income, because: • there is little incentive to manipulate revenue recognition • opportunities to manipulate revenue recognition are very limited • the culture and ethical frameworks of local authorities, including Hastings Borough Council, mean that all forms of fraud are seen as unacceptable	This risk has been rebutted
Management over-ride of controls	Group and Council	Under ISA (UK) 240 there is a non rebuttable presumed risk that the risk of management override of controls is present in all entities. You face external scrutiny of your spending, and this could potentially place management under undue pressure in terms of how they report performance. We therefore identified management override of control, in particular journals, management estimates and transactions outside the course of business as a significant risk, which was one of the most significant assessed risks of material misstatement.	We will: • evaluate the design effectiveness of management controls over journals; • analyse the journals listing and determine the criteria for selecting high risk unusual journals; • test unusual journals recorded during the year and after the draft accounts stage for appropriateness and corroboration; • gain an understanding of the accounting estimates and critical judgements applied made by management and consider their reasonableness with regard to corroborative evidence; and • evaluate the rationale for any changes in accounting policies, estimates or significant unusual transactions.

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Significant risks identified (continued)

Risk	Risk relates to	Reason for risk identification	Key aspects of our proposed response to the risk
Valuation of land and buildings	Council	The Council revalue its land and buildings on a rolling five-yearly basis. This valuation represents a significant estimate by management in the financial statements due to the size of the numbers involved (£143.267m in 2019/20) and the sensitivity of this estimate to changes in key assumptions. Additionally, management will need to ensure the carrying value in the Councils financial statements is not materially different from the current value at the financial statements date, where a rolling programme is used. We therefore identified valuation of land and buildings, particularly revaluations and impairments, as a significant risk, which was one of the most significant assessed risks of material misstatement.	We will: • evaluate management's processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work; • evaluate the competence, capabilities and objectivity of the valuation expert; • write to the valuer to confirm the basis on which the valuation was carried out; • challenge the information and assumptions used by the valuer to assess completeness and consistency with our understanding, the valuer's report and the assumptions that underpin the valuation; • Consider whether or not to engage our own valuer to challenge the work of management's expert; • test revaluations made during the year to see if they had been input correctly into your asset register; and • evaluate the assumptions made by management for those assets not revalued during the year and how management has satisfied themselves that these are not materially different to current value at year end.
Valuation of the pension fund net liability	Council	The Council's pension fund net liability, as reflected in its balance sheet as the net defined benefit liability, represents a significant estimate in the financial statements. The pension fund net liability is considered a significant estimate due to the size of the numbers involved (£46.2m in 20/21) and the sensitivity of the estimate to changes in key assumptions. The estimate is complex. We focused the significant risk to assumptions used by the actuary. We therefore identified valuation of the Council's pension fund net liability as a significant risk, which was one of the most significant assessed risks of material misstatement.	We will: • update our understanding of the processes and controls put in place by management to ensure that the Council's pension fund net liability is not materially misstated and evaluate the design of the associated controls; • evaluate the instructions issued by management to their management expert (an actuary) for this estimate and the scope of the actuary's work; • assess the competence, capabilities and objectivity of the actuary who carried out the Council's pension fund valuation; • assess the accuracy and completeness of the information provided by the Council to the actuary to estimate the liability; • test the consistency of the pension fund asset and liability and disclosures in the notes to the core financial statements with the actuarial report from the actuary; • undertake procedures to confirm the reasonableness of the actuarial assumptions made by reviewing the report of the consulting actuary (as auditor's expert) and performing any additional procedures suggested within the report; and • obtain assurances from the auditor of East Sussex Pension Fund as to the controls surrounding the validity and accuracy of membership data; contributions data and benefits data sent to the actuary by the pension fund and the fund assets valuation in the pension fund financial statements.

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Significant risks identified (continued)

Risk	Risk relates to	Reason for risk identification	Key aspects of our proposed response to the risk
Valuation of Investment Properties in Hastings Housing Company Ltd	Group	Hastings Housing Company Ltd revalues its investment property on fair value basis. This valuation represents a significant estimate by management in the financial statements due to the size of the numbers involved (£5.4m in 20/21) and the sensitivity of this estimate to changes in key assumptions. Additionally, management will need to ensure the carrying value in the Councils financial statements is not materially different from the fair value at the financial statements date, where a rolling programme is used. We therefore identified valuation of investment property, particularly revaluations and impairments, as a significant risk, which was one of the most significant assessed risks of material misstatement.	We will: • evaluate management's processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work; • evaluate the competence, capabilities and objectivity of the valuation expert; • write to the valuer to confirm the basis on which the valuation was carried out; • challenge the information and assumptions used by the valuer to assess completeness and consistency with our understanding, the valuer's report and the assumptions that underpin the valuation; • test revaluations made during the year to see if they had been input correctly into your asset register; and • evaluate the assumptions made by management for those assets not revalued during the year and how management has satisfied themselves that these are not materially different to current value at year end.

Other risk identified

Risk	Risk relates to	Reason for risk identification	Key aspects of our proposed response to the risk
Error in expenditure recognition	Council	As most public bodies are net spending bodies, then the risk of material misstatement due to fraud related to expenditure recognition may be greater than the risk of fraud related to revenue recognition. There is a risk the Council may manipulate expenditure to budgets and set targets and we had regard to this when planning and performing our audit procedures. Management could defer recognition of expenditure by under-accruing for expenses that have been incurred during the period but which were not paid until after the year-end or not record expenses accurately in order to improve the financial results. Having considered the risk factors related to this risk and the nature of the expenditure streams at the Authority, we have determined that the risk of fraud arising from expenditure recognition can be rebutted for the Council's expenditure, because: • there is little incentive to manipulate expenditure recognition • opportunities to manipulate expenditure recognition are limited • the culture and ethical frameworks of local authorities, including Hastings Borough Council, mean that all forms of fraud are seen as unacceptable However we have identified that due to the level of estimation involved in the manual accruals of expenditure and the potential volume of accruals at year end there is an increased risk of error in expenditure recognition.	We will: • inspect transactions incurred around the end of the financial year to assess whether they had been included in the correct accounting period; • inspect a sample of accruals made at year end for expenditure but not yet invoiced to assess whether the valuation of the accrual was consistent with the value billed after the year; compare size and nature of accruals at year to the prior year to help ensure completeness and • investigate manual journals posted as part of the year end accounts preparation that reduces expenditure to assess whether there is appropriate supporting evidence for the reduction in expenditure.
Accounting for grant revenues and expenditure correctly	Council	The Council (similar to all other local authorities) has been the recipient of significant increased grant revenues in 2020/21 relating to Covid-19. Some of these grants relate to the Council, and others are grants which should be passed onto other entities. The Council will need to consider for each type of grant whether it is acting as agent or principal, and depending on that decision how the grant income and amounts paid out should be accounted for.	We will; Discuss with management and understand the different types of material grants received during 2020/21 and what the conditions are in the grant agreements; Understand the conditions for payment out to other entities; Therefore understand whether the Council should be acting as agent or principal for accounting purposes; and We will test material grant revenues to see whether the Council has accounted for these correctly.

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Accounting estimates and related disclosures

The Financial Reporting Council issued an updated ISA (UK) 540 (revised): *Auditing Accounting Estimates and Related Disclosures which* includes significant enhancements in respect of the audit risk assessment process for accounting estimates. We did not identify any issues or recommendation in our 2019/20 audit in relation to the Council's estimation process.

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Introduction

Under ISA (UK) 540 (Revised December 2018) auditors are required to understand and assess an entity's internal controls over accounting estimates, including:

- The nature and extent of oversight and governance over management's financial reporting process relevant to accounting estimates;
- How management identifies the need for and applies specialised skills or knowledge related to accounting estimates;
- How the entity's risk management process identifies and addresses risks relating to accounting estimates;
- The entity's information system as it relates to accounting estimates;
- The entity's control activities in relation to accounting estimates; and
- How management reviews the outcomes of previous accounting estimates.

As part of this process auditors also need to obtain an understanding of the role of those charged with governance, which is particularly important where the estimates have high estimation uncertainty, or require significant judgement.

Specifically do Audit Committee members:

- Understand the characteristics of the methods and models used to make the accounting estimates and the risks related to them;
- Oversee management's process for making accounting estimates, including the use of models, and the monitoring activities undertaken by management; and
- Evaluate how management made the accounting estimates?

Accounting estimates and related disclosures

Additional information that will be required

To ensure our compliance with this revised auditing standard, we will be requesting further information from management and those charged with governance during our audit for the year ended 31 March 2021.

Based on our knowledge of the Council we have identified the following material accounting estimates for which this is likely to apply:

- Valuations of land and buildings and Investment properties
- Depreciation
- Year end provisions and accruals, including NNDR appeals
- Credit loss and impairment allowances
- Valuation of defined benefit net pension fund liabilities
- Fair value estimates

The Council's Information systems

In respect of the Council's information systems we are required to consider how management identifies the methods, assumptions and source data used for each material accounting estimate and the need for any changes to these. This includes how management selects, or designs, the methods, assumptions and data to be used and applies the methods used in the valuations.

When the models used include increased complexity or subjectivity, as is the case for many valuation models, auditors need to understand and assess the controls in place over the models and the data included therein. Where adequate controls are not in place we may need to report this as a significant control deficiency and this could affect the amount of detailed substantive testing required during the audit.

If management has changed the method for making an accounting estimate we will need to fully understand management's rationale for this change. Any unexpected changes are likely to raise the audit risk profile of this accounting estimate and may result in the need for additional audit procedures.

We are aware that the Council uses management experts in deriving some of its more complex estimates, e.g. asset valuations and pensions liabilities. However, it is important to note that the use of management experts does not diminish the responsibilities of management and those charged with governance to ensure that:

- All accounting estimates and related disclosures included in the financial statements have been prepared in accordance with the requirements of the financial reporting framework, and are materially accurate;
- There are adequate controls in place at the Council (and where applicable its service provider or management expert) over the models, assumptions and source data used in the preparation of accounting estimates.

Estimation uncertainty

Under ISA (UK) 540 we are required to consider the following:

- How management understands the degree of estimation uncertainty related to each accounting estimate; and
- How management address this estimation uncertainty when selecting their point estimate.

For example, how management identified and considered alternative, methods, assumptions or source data that would be equally valid under the financial reporting framework, and why these alternatives were rejected in favour of the point estimate used.

The revised standard includes increased emphasis on the importance of the financial statement disclosures. Under ISA (UK) 540 (Revised December 2018), auditors are required to assess whether both the accounting estimates themselves and the related disclosures are reasonable.

Where there is a material uncertainty, that is where there is a significant risk of a material change to the estimated carrying value of an asset or liability within the next year, there needs to be additional disclosures. Note that not all material estimates will have a material uncertainty and it is also possible that an estimate that is not material could have a risk of material uncertainty.

Where there is material estimation uncertainty, we would expect the financial statement disclosures to detail:

- What the assumptions and uncertainties are;
- How sensitive the assets and liabilities are to those assumptions, and why;
- The expected resolution of the uncertainty and the range of reasonably possible outcomes for the next financial year; and
- An explanation of any changes made to past assumptions if the uncertainly is unresolved.

Planning enquiries

As part of our planning risk assessment procedures we have sent enquiries to management and to the Audit Committee. We would appreciate a prompt response to these enquires in due course.

Further information

Further details on the requirements of ISA (UK) 540 (Revised December 2018) can be found in the auditing standard on the Financial Reporting Council's website:

https://www.frc.org.uk/getattachment/0fa69c03-49ec-49ae-a8c9-cc7a2b65382a/ISA-(UK)-540_Revised-December-2018_final.pdf

Other matters

Other work

In addition to our responsibilities under the Code of Practice, we have a number of other audit responsibilities, as follows:

- We read your Narrative Report and Annual Governance Statement and any other information published alongside your financial statements to check that they are consistent with the financial statements on which we give an opinion and our knowledge of the Council.
- We carry out work to satisfy ourselves that disclosures made in your Annual Governance Statement are in line with requirements set by CIPFA.
- We carry out work on your consolidation schedules for the Whole of Government Accounts process in accordance with NAO group audit instructions.
- We consider our other duties under legislation and the Code, as and when required, including:
  - giving electors the opportunity to raise questions about your 2020/21 financial statements, consider and decide upon any objections received in relation to the 2020/21 financial statements;
  - issuing a report in the public interest or written recommendations to the Council under section 24 of the Local Audit and Accountability Act 2014 (the Act).
  - application to the court for a declaration that an item of account is contrary to law under section 28 or a judicial review under section 31 of the Act
  - issuing an advisory notice under section 29 of the Act
- We certify completion of our audit.

Other material balances and transactions

Under International Standards on Auditing, "irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance and disclosure". All other material balances and transaction streams will therefore be audited. However, the procedures will not be as extensive as the procedures adopted for the risks identified in this report.

Going concern

As auditors, we are required to obtain sufficient appropriate audit evidence regarding, and conclude on:

- whether a material uncertainty related to going concern exists; and
- the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements.

The Public Audit Forum has been designated by the Financial Reporting Council as a "SORP-making body" for the purposes of maintaining and updating Practice Note 10: Audit of financial statements and regularity of public sector bodies in the United Kingdom (PN 10). It is intended that auditors of public sector bodies read PN 10 in conjunction with (ISAs) (UK).

PN 10 has recently been updated to take account of revisions to ISAs (UK), including ISA (UK) 570 on going concern. The revisions to PN 10 in respect of going concern are important and mark a significant departure from how this concept has been audited in the public sector in the past. In particular, PN 10 allows auditors to apply a 'continued provision of service approach' to auditing going concern, where appropriate. Applying such an approach should enable us to increase our focus on wider financial resilience (as part of our VfM work) and ensure that our work on going concern is proportionate for public sector bodies. We will review the Council's arrangements for securing financial sustainability as part of our Value for Money work and provide a commentary on this in our Auditor's Annual Report (see page 14-15). We will also need to identify whether any material uncertainties in respect of going concern have been reported for the Council's subsidiaries/joint venture. If such a situation arises, we will consider our audit response for the group.

Materiality

The concept of materiality

Materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to the monetary misstatements but also to disclosure requirements and adherence to acceptable accounting practice and applicable law. Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Materiality for planning purposes

We have determined financial statement materiality based on a proportion of the gross expenditure of the group and Council for the financial year. In the prior year we used the same benchmark. Materiality at the planning stage of our audit is £1,697k (PY £1,457k in 2019/20) for the Council and £1,706k (PY £1,449k in 2019/20) for the Group, which equates to 2% (group)/1.99% (Council) of your 2020/21 gross expenditure for the year.

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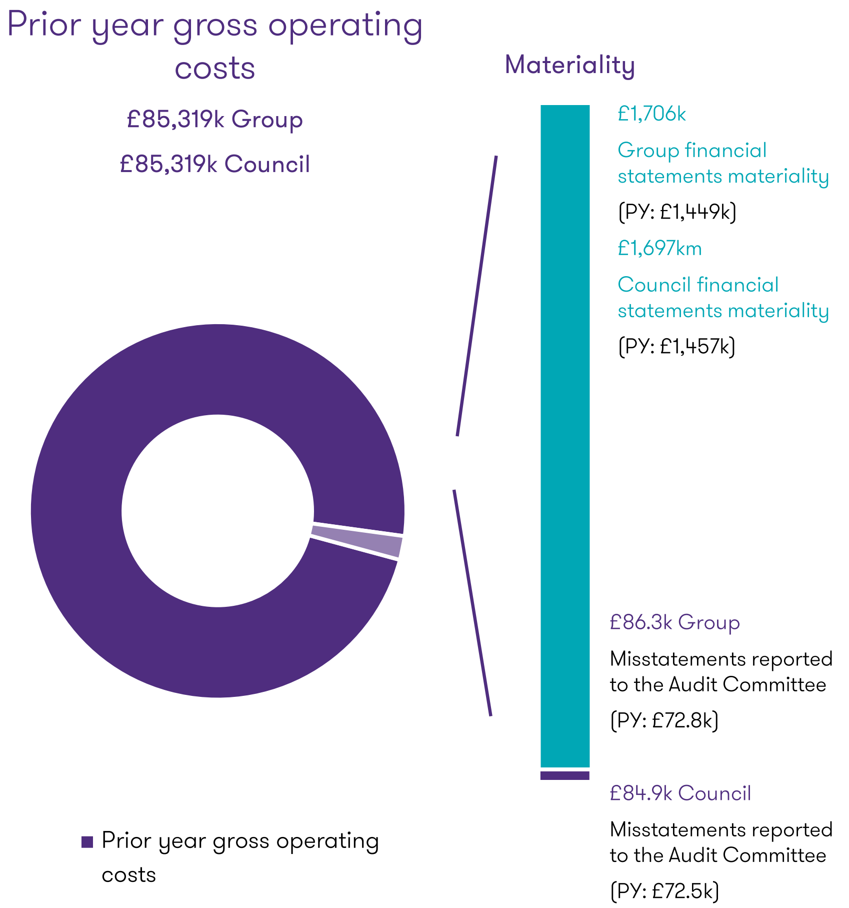
We design our procedures to detect errors in specific accounts at a lower level of precision which we have determined to be £0.05m for cash and cash equivalents and £20k for Senior officer remuneration disclosures.

We reconsider planning materiality if, during the course of our audit engagement, we become aware of facts and circumstances that would have caused us to make a different determination of planning materiality.

Matters we will report to the Audit Committee

Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Audit Committee any unadjusted misstatements of lesser amounts to the extent that these are identified by our audit work. Under ISA 260 (UK) 'Communication with those charged with governance', we are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 (UK) defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria. In the context of the group and Council, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £86.3k group (PY £72.8k) and £84.9k Coin (PY £72.5k).

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



Value for Money arrangements

Revised approach to Value for Money work for 2020/21

On 1 April 2020, the National Audit Office introduced a new Code of Audit Practice which comes into effect from audit year 2020/21. The Code introduced a revised approach to the audit of Value for Money. (VFM)

There are three main changes arising from the NAO's new approach:

- A new set of key criteria, covering financial sustainability, governance and improvements in economy, efficiency and effectiveness
- More extensive reporting, with a requirement on the auditor to produce a commentary on arrangements across all of the key criteria, rather than the current 'reporting by exception' approach
- The replacement of the binary approach to VFM conclusions, with far more sophisticated judgements on performance, as well as key recommendations on any significant weaknesses in arrangements identified during the audit.

The Code require auditors to consider whether the body has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources. When reporting on these arrangements, the Code requires auditors to structure their commentary on arrangements under three specified reporting criteria. These are as set out on the right:

Improving economy, efficiency and effectiveness

Arrangements for improving the way the body delivers its services. This includes arrangements for understanding costs and delivering efficiencies and improving outcomes for service users.

Financial Sustainability

Arrangements for ensuring the body can continue to deliver services. This includes planning resources to ensure adequate finances and maintain sustainable levels of spending over the medium term (3-5 years)

Governance

Arrangements for ensuring that the body makes appropriate decisions in the right way. This includes arrangements for budget setting and management, risk management, and ensuring the body makes decisions based on appropriate information

Risks of significant VFM weaknesses

As part of our planning work, we considered whether there were any risks of significant weakness in the body's arrangements for securing economy, efficiency and effectiveness in its use of resources that we needed to perform further procedures on. We have not identified any risks of significant weaknesses from our initial planning work, however we have set out below areas of focus we intend to review to enable us to produce commentary on arrangements across all of the key criterial. We may need to make recommendations following the completion of our work. The potential different types of recommendations we could make are set out in the second table below.

Key areas of focus

The Local Government operating environment has been significantly impacted by the pandemic and the future funding regime remains uncertain and this lack of certainty will impact on the Council's ability for long term planning. Our Value for Money work will primarily focus on the aspects listed below, but may increase in scope as further work is performed

- The Council's governance arrangements in terms of managing risk, responding to the COVID-19 pandemic and capitalising on the benefits from the different models of service delivery and ways of working bought about by the pandemic;
- The Council's arrangements for setting the Medium-Term Financial Strategy and achieving financial sustainability specifically how the council plans to achieve a balanced budget in the medium-term financial plan;
- The entity's arrangements for improving economy, efficiency and effectiveness through benchmarking against similar organisations, learning from others, and through continued development and modernisation of services.
- The Council's arrangements for working with its key partners to deliver services more efficiently; and
- The Council's governance arrangement for it's key development projects, including income generation plans and capital strategy.

Potential types of recommendations

A range of different recommendations could be made following the completion of work on risks of significant weakness, as follows:

Statutory recommendation

Written recommendations to the body under Section 24 (Schedule 7) of the Local Audit and Accountability Act 2014. A recommendation under schedule 7 requires the body to discuss and respond publicly to the report.

Key recommendation

The Code of Audit Practice requires that where auditors identify significant weaknesses in arrangements to secure value for money they should make recommendations setting out the actions that should be taken by the body. We have defined these recommendations as 'key recommendations'.

Improvement recommendation

These recommendations, if implemented should improve the arrangements in place at the body, but are not made as a result of identifying significant weaknesses in the body's arrangements

Audit logistics and team

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Darren Wells, Key Audit Partner

Darren will be the main point of contact for the Chair and the Chief Executive and Members. Darren will share his knowledge and experience across the sector providing challenge, sharing good practice, providing pragmatic solutions and acting as a sounding board with Senior Board Members and the Audit Committee. Darren will ensure our audit is tailored specifically to you and is delivered efficiently. Darren will review all reports and the team's work focussing his time on the key risk areas to your audit.

Richmond Nyarko, Manager

Richmond will work with the senior members of the finance team ensuring early delivery of testing and agreement of accounting issues on a timely basis. Richmond will attend Audit Committees, undertake reviews of the team's work and draft reports, ensuring they remain clear, concise and understandable to all. they remain clear, concise and understandable to all. Richmond will work with Internal Audit to secure efficiencies and avoid duplication.

Thomas Pattison, Audit In-charge

Tom will be responsible for leading the onsite team and will be the day to day contact for the audit. Monitoring the deliverables, managing the query log with your finance team and highlighting any significant issues and adjustments

Audited body responsibilities

Where audited bodies do not deliver to the timetable agreed, we need to ensure that this does not impact on audit quality or absorb a disproportionate amount of time, thereby disadvantaging other audits. Where the elapsed time to complete an audit exceeds that agreed due to a client not meeting its obligations we will not be able to maintain a team on site. Similarly, where additional resources are needed to complete the audit due to a client not meeting their obligations we are not able to guarantee the delivery of the audit to the agreed timescales. In addition, delayed audits will incur additional audit fees.

Our requirements

To minimise the risk of a delayed audit, you need to ensure that you:

- produce draft financial statements of good quality by the agreed timetable you have agreed with us, including all notes, the Narrative Report and the Annual Governance Statement
- ensure that good quality working papers are available at the start of the audit, in accordance with the working paper requirements schedule that we have shared with you
- ensure that the agreed data reports are available to us at the start of the audit and are reconciled to the values in the accounts, in order to facilitate our selection of samples for testing
- ensure that all appropriate staff are available on site throughout (or as otherwise agreed) the planned period of the audit
- respond promptly and adequately to audit queries.

Audit fees

In 2017, PSAA awarded a contract of audit for Hastings Borough Council to begin with effect from 2018/19. The fee agreed in the contract was £35,742. Since that time, there have been a number of developments, particularly in relation to the revised Code and ISAs which are relevant for the 2020/21 audit.

As referred to on page 14, the 2020/21 Code introduces a revised approach to our VFM work. This requires auditors to produce a commentary on arrangements across all of the key criteria, rather than the current 'reporting by exception' approach. Auditors now have to make far more sophisticated judgements on performance, as well as issue key recommendations if any significant weaknesses in arrangements are identified during the audit. We will be working with the NAO and other audit firms to discuss and share learning in respect of common issues arising across the sector.

The new approach will be more challenging for audited bodies, involving discussions at a wider and more strategic level. Both the reporting, and the planning and risk assessment which underpins it, will require more audit time, delivered through a richer skill mix than in previous years.

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Additionally, across all sectors and firms, the FRC has set out its expectation of improved financial reporting from organisations and the need for auditors to demonstrate increased scepticism and challenge and to undertake additional and more robust testing, as noted in the number of revised ISAs issued by the FRC that are applicable to audits of financial statements commencing on or after 15 December 2019, as detailed in Appendix 1.

As a firm, we are absolutely committed to meeting the expectations of the FRC with regard to audit quality and public sector financial reporting. Our proposed work and fee for 2020/21, as set out below, is detailed overleaf. As part of its response to the Redmond Review issued in December 2020, MHCLG committed an extra £15m to support the delivery of local audit in 2020/21. We understand that the Council will receive a grant to support 2020/21 audit fees.. MHCLG are currently consulting on how the £15m grant will be distributed.

	Actual Fee 2018/19	Actual Fee 2019/20	Proposed fee 2020/21
Hastings Borough Council Audit	£43,742	£TBC	£TBC
Total audit fees (excluding VAT)	£43,742	£TBC	£TBC

Assumptions

In setting the above fees, we have assumed that the Council will:

- prepare a good quality set of accounts, supported by comprehensive and well-presented working papers which are ready at the start of the audit
- provide appropriate analysis, support and evidence to support all critical judgements and significant judgements made during the course of preparing the financial statements
- provide early notice of proposed complex or unusual transactions which could have a material impact on the financial statements.

Relevant professional standards

In preparing our fee estimate, we have had regard to all relevant professional standards, including paragraphs 4.1 and 4.2 of the FRC's Ethical Standard (revised 2019) which stipulate that the Engagement Lead (Key Audit Partner) must set a fee sufficient to enable the resourcing of the audit with partners and staff with appropriate time and skill to deliver an audit to the required professional and Ethical standards.

Audit fees – detailed analysis

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Scale fee published by PSAA	£35,742
Ongoing increases to scale fee first identified in 2019/20	
Raising the bar/regulatory factors	£2,500
Enhanced audit procedures for Property, Plant and Equipment	£1,750
Enhanced audit procedures for Pensions	£1,750
New Standards/developments in 2019/20	£1,500
Fee variance - additional work which was necessary to be carried out during the audit due to the added complexities of the impact of Covid-19.	TBC
Fee variance for overrunning audit	TBC
Baseline Audit fee 2019/20	**TBC**
New issues for 2020/21	
Additional work on Value for Money (VfM) under new NAO Code	£9,000
Increased audit requirements of revised ISAs	£6,500
Group accounts	£5,000
Proposed increase to agreed 2019/20 fee	£20,500
Total audit fees (excluding VAT)	**£TBC**

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Independence and non-audit services

Auditor independence

Ethical Standards and ISA (UK) 260 require us to give you timely disclosure of all significant facts and matters that may bear upon the integrity, objectivity and independence of the firm or covered persons. relating to our independence. We encourage you to contact us to discuss these or any other independence issues with us. We will also discuss with you if we make additional significant judgements surrounding independence matters.

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Financial Reporting Council's Ethical Standard (Revised 2019) and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements. Further, we have complied with the requirements of the National Audit Office's Auditor Guidance Note 01 issued in May 2020 which sets out supplementary guidance on ethical requirements for auditors of local public bodies.

We confirm that we have implemented policies and procedures to meet the requirements of the Ethical Standard. For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams and component audit firms providing services to the Council.

Other services

The following other services provided by Grant Thornton were identified.

The amounts detailed are fees agreed to-date for audit related and non-audit services to be undertaken by Grant Thornton UK LLP in the current financial year. These services are consistent with the Council's policy on the allotment of non-audit work to your auditors. Any changes and full details of all fees charged for audit related and non-audit related services by Grant Thornton UK LLP and by Grant Thornton International Limited network member Firms will be included in our Audit Findings report at the conclusion of the audit.

None of the services provided are subject to contingent fees.

Service	Fees £	Threats	Safeguards
Audit related			
Certification of Housing Benefit Subsidy claim	8,750	Self-Interest (because this is a recurring fee)	The level of this recurring fee taken on its own is not considered a significant threat to independence as the fee for this work is £8,750 in comparison to the total fee for the audit and in particular relative to Grant Thornton UK LLP's turnover overall. Further, it is a fixed fee and there is no contingent element to it. These factors all mitigate the perceived self-interest threat to an acceptable level.

Appendix 1: Revised Auditor Standards and application guidance

FRC revisions to Auditor Standards and associated application guidance

The following Auditing Standards and associated application guidance that were applicable to 19/20 audits, have been revised or updated by the FRC, with additional requirements for auditors for implementation in 2020/21 audits and beyond.

	Date of revision	Application to 2020/21 Audits
ISQC (UK) 1 – Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and other Assurance and Related Service Engagements	November 2019	✓
ISA (UK) 200 – Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (UK)	January 2020	✓
ISA (UK) 220 – Quality Control for an Audit of Financial Statements	November 2019	✓
ISA (UK) 230 – Audit Documentation	January 2020	✓
ISA (UK) 240 – The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements	January 2020	✓
ISA (UK) 250 Section A – Consideration of Laws and Regulations in an Audit of Financial Statements	November 2019	✓
ISA (UK) 250 Section B – The Auditor's Statutory Right and Duty to Report to Regulators od Public Interest Entities and Regulators of Other Entities in the Financial Sector	November 2019	✓

Appendix 1: Revised Auditor Standards and application guidance continued

	Date of revision	Application to 2020/21 Audits
ISA (UK) 260 – Communication With Those Charged With Governance	January 2020	✓
ISA (UK) 315 – Identifying and Assessing the Risks of Material Misstatement Through Understanding of the Entity and Its Environment	July 2020	
ISA (UK) 500 – Audit Evidence	January 2020	✓
ISA (UK) 540 – Auditing Accounting Estimates and Related Disclosures	December 2018	✓
ISA (UK) 570 – Going Concern	September 2019	✓
ISA (UK) 580 – Written Representations	January 2020	✓
ISA (UK) 600 - Special considerations – Audits of Group Financial Statements (Including the Work of Component Auditors)	November 2019	✓
ISA (UK) 620 – Using the Work of an Auditor's Expert	November 2019	✓
ISA (UK) 700 – Forming an Opinion and Reporting on Financial Statements	January 2020	✓

Appendix 1: Revised Auditor Standards and application guidance continued

	Date of revision	Application to 2020/21 Audits
ISA (UK) 701 – Communicating Key Audit Matters in the Independent Auditor's Report	January 2020	✓
ISA (UK) 720 – The Auditor's Responsibilities Relating to Other Information	November 2019	✓
Practice Note 10: Audit of Financial Statements of Public Sector Bodies in the United Kingdom	December 2020	✓

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Agenda Item 6

Report to:	**Audit Committee**
Date of Meeting:	**18 November 2021**
Report Title:	**Treasury Management Outturn Report for 2020-21**
Report By:	**Peter Grace (Chief Finance Officer)**

Purpose of Report

This report provides the opportunity for the Cabinet, Audit Committee and Council to scrutinise the Treasury Management activities and performance of the last financial year.

Recommendation(s)

1. **To consider the report – no recommendations are being made to amend the current Treasury Management Strategy as a result of this review.**

Reasons for Recommendations

To ensure that members are fully aware of the activities undertaken in the last financial year, that Codes of Practice have been complied with and that the Council's strategy has been effective in 2020-21.

Under the Code adopted the Full Council are required to consider the report and any recommendations made. There will be a further report forthcoming on Treasury Management covering a review of the current financial year i.e. the Mid-year review.

Introduction

1. This Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2020/21. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management, (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

2. The primary requirements of the Code are as follows:

   a. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

   b. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

   c. Receipt by the Full Council of an annual treasury management strategy report - including the annual investment strategy report for the year ahead, a mid-year review report (as a minimum) and an annual review report of the previous year.

   d. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

   e. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body which in this Council is the Audit Committee.

3. Treasury management in this context is defined as:

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

4. The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

5. Member training on treasury management issues was last undertaken on 2 February 2021 and prior to that on 15 January 2020 in order to support members' scrutiny role.

6. The figures provided in this report for 2020/21 are as yet unaudited and still subject to change.

7. This annual Treasury report covers

a. capital expenditure and financing 2020-21
b. overall borrowing need (the Capital Financing Requirement)
c. treasury position as at 31 March 2021
d. performance for 2020-21
e. the strategy for 2020-21
f. the economy and interest rates in 2020-21
g. borrowing rates in 2020-21
h. the borrowing outturn for 2020-21
i. debt rescheduling
j. compliance with treasury limits and Prudential Indicators
k. investment rates in 2020-21
l. investment outturn for 2020-21

Capital Expenditure and Financing 2020/21

8. The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

9. The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

Capital Programme Financing 2020/21	**Outturn 2020/21**	
	£'000's	£'000's
Expenditure:		**10,104**
Financed By:		
Borrowing		7,855
Grants:		
Disabled Facilities Grant	1,109	
Lower Bexhill Road Housing Site	693	
Country Park Interpretive Centre	337	
Harbour Arm and New Groynes	30	
Other Grants and Contributions	76	2,246
Reserves		0
Capital Receipts		3
	Total	**10,104**

Overall Borrowing Need (Capital Financing Requirement (CFR))

10. The Council’s underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council’s debt position. The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend.

11. Part of the Council’s treasury activities is to address the funding requirements for the Council's borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council’s cash position to ensure enough cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies, such as the Government, through the Public Works Loan Board (PWLB), the money markets, or by using temporary cash resources from within the Council.

12. The Council’s underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

13. The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

14. The Council’s 2020/21 MRP Policy was approved as part of the Treasury Management Strategy Report for 2020/21 by Council in February 2020.

15. The Council’s CFR for the year is shown below and represents a key prudential indicator. It includes leasing schemes on the balance sheet, which increase the Council’s borrowing need (albeit no borrowing of cash is required).

Table 2 CFR: General Fund	2019/20 Actual £000's	2020/21 Revised Estimate £000's	2020/21 Actual £000's
Opening balance	58,094	66,373	66,373
Add unfinanced capital expenditure	9,455	9,268	7,855
Less MRP	(1,176)	(1,499)	(1,499)
Closing balance	**66,373**	**74,142**	**72,729**

Note: Lease arrangements are excluded from the above table

16. Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

17. The Council's long term borrowing must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2020/21 plus the expected changes to the CFR over 2021/22 and 2022/23 from financing the capital programme. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs.

18. The table below highlights the Council's gross borrowing position (External Borrowing) against the CFR, which provides an indication of affordability for the Council. The Council has complied with this prudential indicator.

Table 3 CFR vs Borrowing Level	2019/20 Actual	2020/21 Revised Estimate	2020/21 Actual
	£000's	£000's	£000's
Capital Financing Requirement	66,373	74,142	72,729
External Borrowing	65,301	64,689	64,690
Net Internal/(External) Borrowing	***1,072***	**9,453**	**8,039**

Treasury Position as at 31 March 2021

19. The Council's debt and investment position at the beginning and the end of the year is shown in the tables that follow, namely: -

Table 4 **Investments**	**31 March 2020 Principal**	**31 March 2021 Principal**
Managed In-House	£17.683m	£23.318m
CCLA Managed Externally	£4.515m	£4.752m
Total Investments	£22.198m	£28.07m

Table 5 Debt	1 April 2020 Principal	Start Date	Maturity Date	31-Mar 2021 Principal	Rate
PWLB	£7,500,000	25/05/2007	01/02/2033	£7,500,000	4.80%
PWLB	£909,027	04/09/2014	02/09/2044	£909,027	3.78%
PWLB (Optivo)	£1,788,235	04/09/2014	02/09/2044	£1,788,235	3.78%
PWLB (FT) (Annuity)	£185,915	21/03/2016	20/03/2026	£156,196	1.66%
PWLB	£1,000,000	11/05/2016	11/05/2056	£1,000,000	2.92%
PWLB	£1,000,000	11/05/2016	11/05/2046	£1,000,000	3.08%
PWLB	£1,000,000	11/05/2016	09/05/2036	£1,000,000	3.01%
PWLB	£1,000,000	11/05/2016	11/05/2026	£1,000,000	2.30%
PWLB	£2,000,000	24/06/2016	24/06/2054	£2,000,000	2.80%
PWLB	£1,000,000	24/06/2016	23/06/2028	£1,000,000	2.42%
PWLB	£2,000,000	21/03/2017	21/03/2057	£2,000,000	2.53%
PWLB	£2,000,000	21/03/2017	19/09/2059	£2,000,000	2.50%
PWLB	£2,000,000	23/03/2017	23/03/2060	£2,000,000	2.48%
PWLB (Annuity)	£7,002,787	01/06/2017	01/06/2057	£6,889,020	2.53%
PWLB (Annuity)	£8,111,852	22/11/2017	22/11/2057	£7,987,864	2.72%
PWLB	£2,000,000	12/12/2018	12/06/2028	£2,000,000	1.98%
PWLB (Annuity)	£3,941,522	13/12/2018	13/12/2058	£3,881,544	2.55%
PWLB (Annuity)	£2,463,534	31/01/2019	31/01/2059	£2,426,128	2.56%
PWLB (Annuity)	£4,365,748	31/01/2019	31/01/2059	£4,320,356	2.56%
PWLB (Annuity)	£9,262,267	20/03/2019	20/03/2059	£9,121,014	2.54%
PWLB (Annuity)	£4,770,452	02/09/2019	02/09/2069	£4,710,543	1.83%
Total Debt	**£65,301,339**			**£64,689,926**	**2.82%**

Performance Measurement (2020-21)

20. Table 6 below compares the Estimated Interest Payable and Received and associated fees for the year 2020-21.

Table 6 Interest	2019 -20 Actual Outturn £000's	2020-21 Revised Budget £000's	2020-21 Actual Outturn (Unaudited) £000's
Gross Interest Payable	1,810	1,854	1,848
Gross Interest Received	(596)	(551)	(521)
Fees	10	10	10
Other (e.g. PWLB Discount)	(0)	(0)	(0)
Net Cost	1,224	1,313	1,337

21. The Council's longer term cash balances comprise, primarily, revenue and capital resources, although these will be influenced by cash flow considerations. The Council's core cash resources are detailed below and were in line with budget expectations.

The Strategy for 2020-21

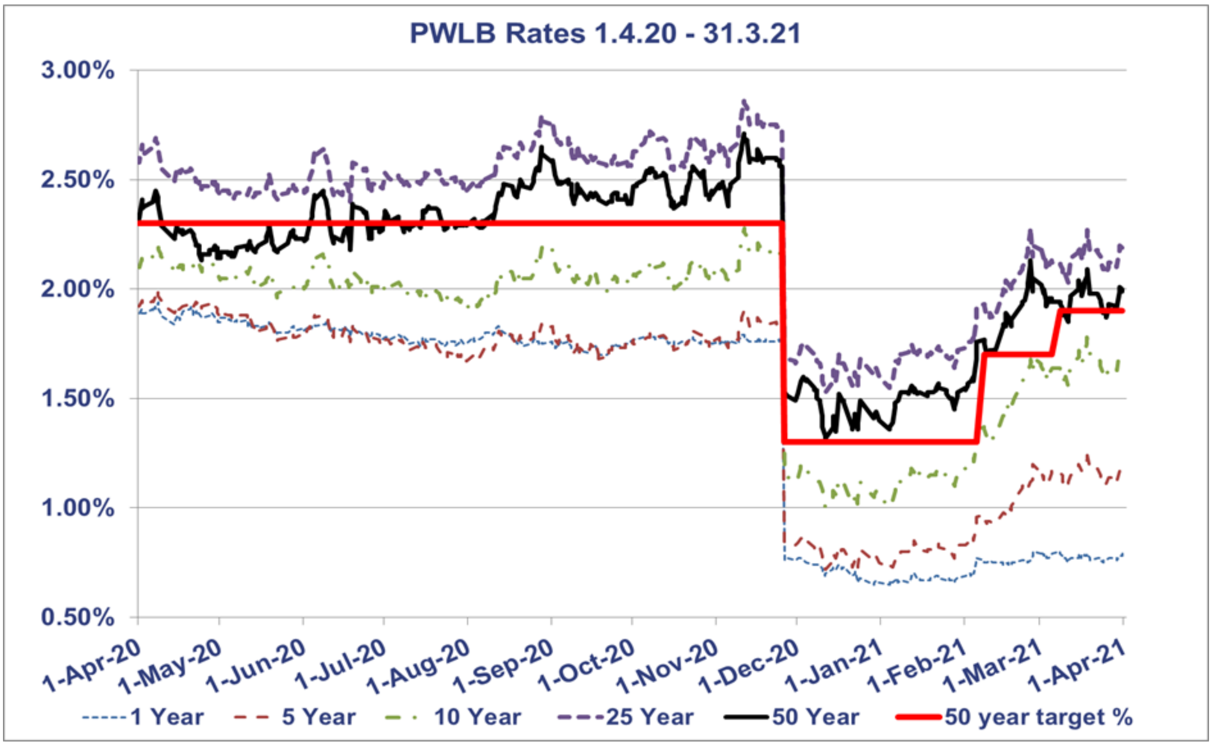
22. The general aim of the 2020-21 treasury management strategy was to minimise the costs of borrowing in both the short and longer term. In the short term it would consider avoiding new borrowing and using cash balances to finance new borrowing. However, to minimise longer term costs the Council needs to borrow when rates are at historically low levels. The timing of new borrowing is therefore important to minimise the overall costs to the Council.

23. Given that rates did not look set to increase it was recommended that new borrowing was only taken when necessary and internal balances were used to temporarily finance long life assets. If rates decreased, then opportunities to borrow may be taken. Given that the Council is increasingly using its reserves these need to be readily available and not subjected to unnecessary risk or exposure.

24. The strategy proved very effective for 2020/21 in that the Council had borrowed successfully in past years and had cash backed reserves in place with little internal borrowing as at March 2020 when the Covid-19 pandemic struck. This enabled the Council to avoid having to borrow at high rates of interest to cover day to day expenses and avoided any cash flow difficulties. It also enabled the Council to avoid borrowing for the whole of 2020/21. The Council can not avoid borrowing for long and will need to take advantage of the historically low interest rates currently in place.

Borrowing Rates in 2020-21

25. PWLB borrowing rates - the graph for PWLB maturity rates below shows, for a selection of maturity periods, the fluctuations in rates during the last financial year.



	1 Year	5 Year	10 Year	25 Year	50 Year
Low	0.65%	0.72%	1.00%	1.53%	1.32%
Date	04/01/2021	11/12/2020	11/12/2020	11/12/2020	11/12/2020
High	1.94%	1.99%	2.28%	2.86%	2.71%
Date	08/04/2020	08/04/2020	11/11/2020	11/11/2020	11/11/2020
Average	1.43%	1.50%	1.81%	2.33%	2.14%
Spread	1.29%	1.27%	1.28%	1.33%	1.39%

26. HM Treasury imposed two changes of margins over gilt yields for PWLB rates in 2019/20 without any prior warning. The first took place on 9th October 2019, adding an additional 1% margin over gilts to all PWLB period rates. That increase was then, at least partially, reversed for some forms of borrowing on 11th March 2020, but not for mainstream non-HRA capital schemes.

27. A consultation was then held with local authorities and on 25th November 2020, the Chancellor announced the conclusion to the review of margins over gilt yields for PWLB rates; the standard and certainty margins were reduced by 1% but a prohibition was introduced to deny access to borrowing from the PWLB for any local authority which had purchase of assets for yield in its three year capital

programme.

The new margins over gilt yields are as follows: -.

PWLB Standard Rate is gilt plus 100 basis points (G+100bps)

PWLB Certainty Rate is gilt plus 80 basis points (G+80bps)

28. There is likely to be only a gentle rise in gilt yields and PWLB rates over the next three years as Bank Rate is not forecast to rise from 0.10% by March 2024 as the Bank of England has clearly stated that it will not raise rates until inflation is sustainably above its target of 2%; this sets a high bar for Bank Rate to start rising.

Borrowing Outturn for 2020/21

29. No new long term borrowing was taken during the year, given the expectation of continuing low rates of interest. The Council has effectively used its reserves and balances to fund the Capital programme in 20/21 but will need to borrow in the near future. The investment rate achievable during the year was low, and whilst the borrowing rates are still low historically , they are high compared to the investment rates. The policy of “internal borrowing has saved the Council considerable monies in 2020-21 (every 1% difference on £7.855m is worth £78,550).

30. During 2020/21 there were debt repayments of £611,413 resulting in a total balance outstanding with the PWLB of £64,689,926 as at 31 March 2021.

Borrowing in advance of need

31. The Council has not borrowed more than, or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed.

32. The Council had a lower level of borrowing than its Capital Financing Requirement (CFR) at the 31 March 2021.

Debt Rescheduling

33. The Council has examined in the past the potential for making premature debt repayments in order to reduce borrowing costs as well as reducing counterparty risk by reducing investment balances. No rescheduling was undertaken during the year as the differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable. When last reviewed on the 27 September 2017 the early repayment cost of the £7.5m PWLB loan, maturing in 2033, would have amounted to £3,177,343.

Compliance with Treasury Limits

34. During the financial year the Council operated within the treasury limits and Prudential Indicators set out in the Council's annual Treasury Strategy Statement (Appendix 1).

Investment Rates in 2020-21

35. Investment rates for 3 months and longer were stable throughout most of the year with Bank Rate staying the same throughout 2020-21.

36. The Bank Rate was last reduced to 0.25% on 11 March 2020 and then to 0.1% on 19 March 2020.

37. The funds invested during the year were often available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the capital programme.

Investment Strategy

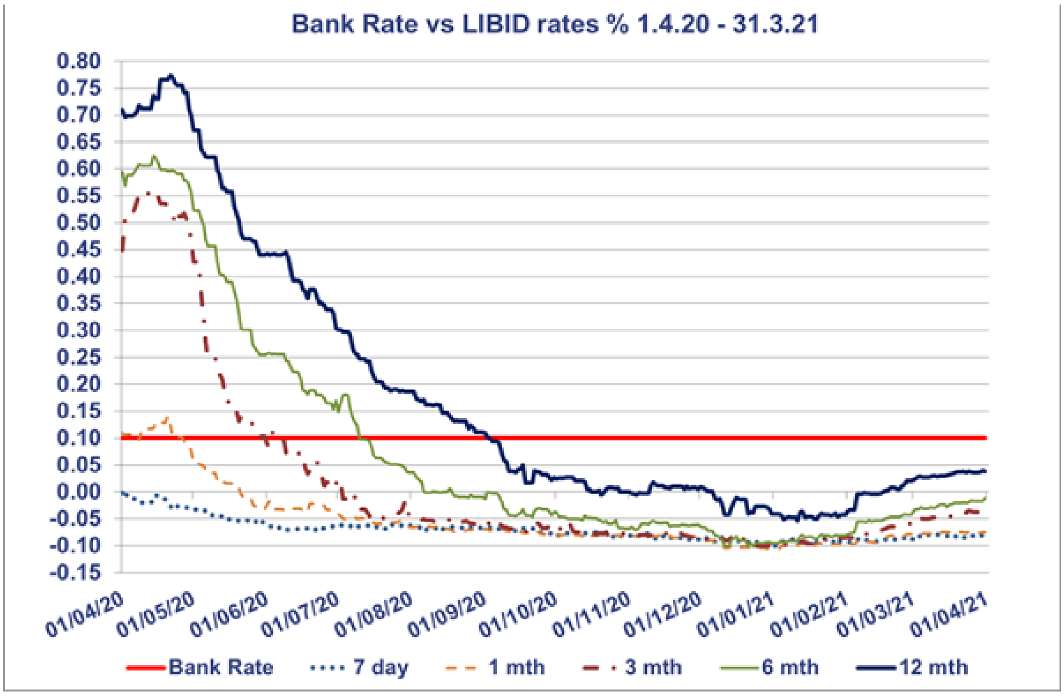
38. The strategy for 2020/21 was agreed at the Council meeting in February 2020. The Investment strategy did not change during the year given the already low interest rates, other than investing money for shorter periods to ensure there was sufficient monies available for cash flow purposes.

39. Investment returns which had been low during 2019/20, plunged during 2020/21 to near zero or even into negative territory. Most local authority lending managed to avoid negative rates and one feature of the year was the growth of inter local authority lending. The expectation for interest rates within the treasury management strategy for 2020/2,1 was that Bank Rate would continue at the start of the year at 0.75 % before rising to end 2022/23 at 1.25%.

40. This forecast was invalidated by the Covid-19 pandemic bursting onto the scene in March 2020 which caused the Monetary Policy Committee to cut Bank Rate in March, first to 0.25% and then to 0.10%, in order to counter the hugely negative impact of the national lockdown on large swathes of the economy. The Bank of England and the Government also introduced new programmes of supplying the banking system and the economy with massive amounts of cheap credit so that banks could help cash-starved businesses to survive the lockdown.

41. The Government also supplied huge amounts of finance to local authorities to pass on to businesses. This meant that for most of the year there was much

more liquidity in financial markets than there was demand to borrow, with the consequent effect that investment earnings rates plummeted.



	Bank Rate	7 day	1 mth	3 mth	6 mth	12 mth
High	0.10	0.00	0.14	0.56	0.62	0.77
High Date	01/04/2020	02/04/2020	20/04/2020	08/04/2020	14/04/2020	21/04/2020
Low	0.10	-0.10	-0.11	-0.10	-0.10	-0.05
Low Date	01/04/2020	31/12/2020	29/12/2020	23/12/2020	21/12/2020	11/01/2021
Average	0.10	-0.07	-0.05	0.01	0.07	0.17
Spread	0.00	0.10	0.25	0.66	0.73	0.83

42. While the Council has taken a cautious approach to investing, it is also fully appreciative of changes to regulatory requirements for financial institutions in terms of additional capital and liquidity that came about in the aftermath of the financial crisis. These requirements have provided a far stronger basis for financial institutions, with annual stress tests by regulators evidencing how institutions are now far more able to cope with extreme stressed market and economic conditions.

43. Investment balances have been kept to a minimum through the agreed strategy of using reserves and balances to support internal borrowing, rather than borrowing externally from the financial markets. External borrowing would have incurred an additional cost, due to the differential between borrowing and investment rates as illustrated in the charts shown above and below. Such an approach has also provided benefits in terms of reducing the counterparty risk exposure, by having fewer investments placed in the financial markets.

44. The revised budget in February 2021 forecast investment returns (including loans) of £551,000 whilst the actual outturn was £521,000. This is considered to be a very good outcome given the impact of Covid-19 and the reduction in the base rate to 0.1%.

45. The impact of Covid-19 has been significant on all investments and particularly the stock markets around the world. Hastings BC has not been immune, but the strategy of limiting the level of investments with different institutions, with different countries, and the amounts invested in property and other funds has stood the Council in a good position. Losses have been limited and the Council has had no issues in managing its cash flow.

46. **Investments: Property Fund & Diversified Income Fund (DIF)**

The return on the Property Fund investment (£2m with CCLA) was 11.73% net of fees to the end of June 2021 i.e. Capital gains and dividends. This compares to negative returns in the previous year. The net dividends received amounted to £84,002 in the financial year. The table below highlights the overall performance compared to previous years.

Long-term performance
Total return performance (net) 12 months to 30 June

	2021	2020	2019	2018	2017
The Local Authorities' Property Fund	+11.73%	-3.47%	+5.46%	+9.36%	+7.24%
Comparator Benchmark	+8.49%	-2.48%	+4.05%	+10.23%	+5.67%

The comparator benchmark is the MSCI/AREF UK Other Balanced Quarterly Property Fund Index.
Performance shown after management fees and other expenses. Past performance is not a reliable indicator of future results and future returns are not guaranteed.
Source: CCLA & MSCI/AREF

47. In addition to the £2m invested in the CCLA Property Fund the Council invested £3m in the CCLA Diversified Income Fund (DIF) during 2019/20. The net dividends received amounted to £90,138 in 2020-21.

48. At the 31st March 2021 the Property Fund had a capital value (Mid-Market price) of £1.911m and the DIF £2.84m. The yields have continued to be high, with the DIF yielding some 2.86% (July 2021) and the Property Fund 4.12% (July 2021).

49. The Property Fund and DIF are both longer term investments (5 years plus) and it has always been well understood that the capital values can go up as well as down. The impact of Covid-19 on the values and the subsequent recovery has been reported previously. Since March 2021 the Capital value of the DIF has recovered even further to £2.997m (a gain of £156,764 since March). The Property Fund capital value has also recovered further since March 2021 from £1.911m to £2.03m (a gain of £92,060).

Investment Outturn for 2020-21

50. Cash balances fluctuated widely during the year. The Council, at times received considerable additional monies from the government to distribute to businesses and this was held in readily accessible bank accounts but gained little or no

interest. Whilst much of the money was distributed, the Council still has some balances to distribute e.g. Test and Trace and, at the time of writing, the Additional Restrictions Grant, whilst some balances have been returned to the government.

51. The average rate of return for the year on the investments made was 0.53% (excluding CCLA investments). The higher return reflecting investments made prior to Covid-19 and reductions in base rates. The total interest earned for the year was £26,086 (excluding the CCLA monies). The comparable performance indicator is the uncompounded 7-day LIBID rate which was – 0.0706% (Minus). These returns also exclude the interest received on loans e.g. Hastings Housing company, Optivo, Foreshore Trust.

52. The table below provides a snapshot of the investments/deposits held at 31 March 2021 (excluding those with CCLA).

Counterparty	Rate/ Return (%)	Start Date	End Date	Principal (£)	Term
NatWest	0.05			6,147	Call
Australia and NZ BCG Ltd	0.05	14/01/2021	14/04/2021	5,000,000	Fixed
DBS Bank ltd , London	.04	14/01/2021	14/04/2021	5,000,000	Fixed
Flintshire County Council	0.15	23/03/2021	23/06/2021	5,000,000	Fixed
Barclays				4,999,995	Call
Lloyds Gen				3,311,947	Call
			Total	**23,318,089**	

53. In addition to the investments the Council has a few loans in place, namely as at 31 March 2021: -

Counterparty	Rate/ Return (%)	Start Date	End Date	Principal O/S * (£)	Term
Amicus/Optivo	3.78	04/09/2014	02/09/2044	1,788,235	Fixed
The Source	2.43	17/12/2015	17/12/2025	13,253	Fixed
Foreshore Trust	1.66	21/03/2016	20/03/2026	156,196	Annuity

*Note: these are the balances outstanding – assuming all repayments are made

Loans to Hastings Housing Company Ltd

54. Hastings Housing Company, wholly owned by the Council, has two loan facilities with the Council, a revenue loan, and a capital loan. The rate chargeable on the

revenue loan is calculated monthly and stood at 4.69% at the end of March 2020 – this loan has now been repaid to the Council.

55. The Capital loan rate is based on the rate prevailing at the time of the advance and is fixed for the period of the loan. The value of the capital loan was £5,489,398 at the end of March 2021. The interest rates are determined in accordance with EU rules.

56. The debt costs (principal and interest) incurred by the Council in making advances to the housing company are covered by the interest repayments from the housing company. The interest receivable by the Council amounted to £249,581in 2020-21 (unaudited).

Other Issues

Local Authority Capital Finance Framework & CIPFA Codes

57. The government published a policy paper on 28 July 2021 entitled "Local Authority Capital Finance Framework; planned improvements". This paper outlines the ways in which government will look to increase scrutiny and also the control over the capital system.

58. The Chartered Institute of Public Finance and Accountancy, (CIPFA), issued a revised Treasury Management Code and Cross Sectoral Guidance Notes, and a revised Prudential Code in 2017. A new Financial Management Code has been issued which applies to all authorities. There is a requirement that Council's comply with the Code from 1 April 2021; much of the Code relates to proper financial management arrangements being in place across the authority. The adherence to the various codes relating to Treasury Management form an important aspect of complying with the Financial Management Code.

59. A new Capital Strategy was considered and agreed by full council in February 2021. High value projects, such as the Town Deal and development on the lower tier site on Bexhill Road are likely to necessitate wholesales changes to the Council's Capital Strategy and the Treasury Management Strategy, this will be at the same time as the government are looking to increase controls and potentially set limits on what levels authorities can prudently borrow up to.

Minimum Revenue Provision (MRP) guidance

60. The last government (MHCLG) MRP guidance was issued on 2 February 2018. This focused particularly on expenditure relating to purchasing non-financial asset investments and the periods over which debt was required to be repaid.

61. The government have advised that they will be reviewing the legislation to ensure that adequate provisions are made to repay all debt incurred. Consultation is expected in the early autumn of 2021.

Public Work Loans Board (PWLB) – Changes to Lending criteria

62. The government announced changes to lending criteria in November 2020. In brief it resulted in the prevention of borrowing purely for monetary gain/yield. This has arisen as a number of authorities have been viewed as taking to high a level of borrowing and risk and therefore acting imprudently given their size and responsibilities.

63. Further announcements have been made this summer by both the Government and Cipfa in terms of further legislation and guidance with regard to the Prudential Code, and potential caps on borrowing. The information supplied to the government is increasing and from September 2021 there will be increased complexity and a longer application process to secure loans from the PWLB.

Financial Implications

64. The security of the Council's monies remains the top priority within the strategy, along with liquidity – being able to access sufficient money as and when required. Investment rates available in the market have continued to be at historically low levels during the last year.

65. No new borrowing was undertaken in the year, albeit that the Capital expenditure incurred will need to be funded through borrowing shortly. The use of the Council's reserves and balances to temporarily fund the Capital expenditure has resulted in significant savings to the Council.

66. The Council has acquired some property assets in the year that will result in ongoing financing costs, but these will be offset by increased income or reductions in costs that the Council would otherwise incur e.g. by reducing temporary accommodation costs by more than the costs of borrowing.

67. The Council has carefully considered the overall levels of borrowing being undertaken against the size of the Council's budget and its unencumbered assets, along with the affordability of the debt commitments as and when income streams potentially reduce – as unfortunately tested by the recent Covid-19 crisis. At no time during the year has cash flow been an issue for the Council.

68. The effective management of the Council's cash flow, reserves, and investments remains of critical importance. The increasing governance in this area, as well as the increasing sums involved will necessitate more staff resources being required to manage and report on this critical area.

69. The forthcoming changes to the Prudential Code (Cipfa), and potentially new borrowing limits as well as further changes to Treasury Management will increase the controls and reporting requirements. Any limits on borrowing could potentially impact significantly on the Council's plans.

Timetable of Next Steps

70. Please include a list of key actions and the scheduled dates for these:

Action	Key milestone	Due date (provisional)	Responsible
Audit Committee	Report	18 November 2021	Chief Finance Officer
Cabinet	Report	6 September 2021	Chief Finance Officer
Full Council	Report	13 October 2021	Chief Finance Officer

Wards Affected

Ashdown, Baird, Braybrooke, Castle, Central St. Leonards, Conquest, Gensing, Hollington, Maze Hill, Old Hastings, Ore, Silverhill, St. Helens, Tressell, West St. Leonards, Wishing Tree

Implications

Please identify if this report contains any implications for the following:

Equalities and Community Cohesiveness	No
Crime and Fear of Crime (Section 17)	No
Risk Management	No
Environmental Issues	No
Economic/Financial Implications	Yes
Human Rights Act	No
Organisational Consequences	No
Local People's Views	No
Anti-Poverty	No
Climate Change	No

Additional Information

Treasury Management and Annual Investment Strategy 2020/21
CIPFA - Treasury Management Code of Practice
CIPFA - The Prudential Code
Appendix 1 – Prudential Indicators
Appendix 2 – Capital Expenditure 2020-21 (and amounts financed by borrowing)

Officer to Contact

Officer Name: Peter Grace
Officer Email Address; pgrace@hastings.gov.uk

APPENDIX 1 Prudential Indicators

The Council's Capital expenditure plans are the key driver of treasury management activity. The output of the Capital expenditure plans (detailed in the budget) is reflected in the prudential indicators below.

TREASURY MANAGEMENT PRUDENTIAL INDICATORS	2019/20	2020/21	2021/22	2022/23	2023/24
	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt					
borrowing	95,000	110,000	110,000	110,000	110,000
other long term liabilities	5,000	5,000	5,000	5,000	5,000
TOTAL	100,000	115,000	115,000	115,000	115,000
Operational Boundary for external debt					
borrowing	85,000	105,000	105,000	105,000	105,000
other long term liabilities	5,000	5,000	5,000	5,000	5,000
TOTAL	90,000	110,000	110,000	110,000	110,000

The Council's external borrowing at 31 March 2021 amounted to £64,689,926 which is well within approved borrowing limits.

Interest Rate Exposures	**2020/21** **Upper**	**2021/22** **Upper**	**2022/23** **Upper**
Limits on fixed interest rates based on **net** debt	100%	100%	100%
Limits on variable interest rates based on **net** debt	100%	100%	100%
Limits on fixed interest rates: · Debt only · Investments only	 100% 100%	 100% 100%	 100% 100%
Limits on variable interest rates · Debt only · Investments only	 30% 100%	 30% 100%	 30% 100%

Maturity Structure of fixed interest rate borrowing 2020/21		
	lower	**Upper**
Under 12 Months	0%	100%
12 months to 2 years	0%	100%
2 years to 5 years	0%	100%
5 years to 10 years	0%	100%
10 years to 20 years	0%	100%
20 years to 30 years	0%	100%
30 years to 40 years	0%	100%
40 years to 50 years	0%	100%

Maturity Structure of variable interest rate borrowing 2020/21		
	lower	**Upper**
Under 12 Months	0%	30%
12 months to 2 years	0%	30%
2 years to 5 years	0%	30%
5 years to 10 years	0%	30%
10 years to 20 years	0%	10%
20 years to 30 years	0%	10%
30 years to 40 years	0%	10%
40 years to 50 years	0%	10%

Affordability prudential indicator - Ratio of financing costs to net revenue stream

This indicator assesses the affordability of the capital investment plans. It provides an indication of the impact of the capital investment plans on the Council's overall finances This indicator identifies the trend in the cost of capital (borrowing and other long-term obligation costs net of investment income) against the net revenue stream.

Prudential Indicator: Financing Cost to Net Revenue Stream	2019/20 Actual	2020/21 Rev.Est	2020/21 Outturn	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Financing Costs	£'000	£'000	£'000	£'000	£'000	£'000
1. Interest Charged to General Fund	1,810	1,854	1,848	2,115	2,326	2,414
2. Interest Payable under Finance Leases and any other long term liabilities	-	-	-	-	-	-
3. Gains and losses on the repurchase or early settlement of borrowing credited or charged to the amount met from government grants and local taxpayers	0	0	0	0	0	0
4. Interest and Investment Income	-580	-551	-521	-608	-671	-660
5. Amounts payable or receivable in respect of financial derivatives	-	-	-	-	-	-
6. MRP, VRP	1,176	1,499	1,499	1,723	1,873	2,533
7. Depreciation/Impairment that are charged to the amount to be met from government grants and local taxpayers	-	-	-	-	-	-
Total	2,406	2,802	2,826	3,230	3,528	4,287
Net Revenue Stream						
Amount to be met from government grants and local taxpayers	13,329	13,063	14,845	14,018	13,156	13,372
Ratio						
Financing Cost to Net Revenue Stream	**18%**	**21%**	**19%**	**23%**	**27%**	**32%**

This prudential indicator shows that the ratio of financing costs to the net revenue stream is generally increasing. This is not unexpected given that the Council agreed a programme for over £50m of Capital expenditure over the period 2017/18 to 2021/22 - thus increasing borrowing costs.

Appendix 2

Capital Expenditure financed by borrowing in 2020-21 (unaudited)

Capital Expenditure 2020-21	**2020-21 Actual**	**Financed By Borrowing**
	£	**£**
Private Sector Renewal Support	4,973	
Disabled Facilities Grant	1,109,385	
Restoration of Pelham Crescent/ Pelham Arcade	8,693	1,586
Work on Harbour Arm and New Groynes	29,924	
Public Realm	14,914	
Country Park - Interpretive Centre	562,306	224,923
Playgrounds Upgrade Programme	43,943	31,943
Conversion of 12/13 York Buildings	418,616	418,616
Buckshole and Shornden Reservoirs	113,935	113,935
Development of 311-323 Bexhill Rd (Aldi & Others)	5,063,796	5,063,796
Priory Street Multi Storey Car Park	145,049	145,049
Temporary Homelessness Accommodation	1,691,544	1,691,544
DSO Waste and Cleansing service - Depot Works & Equipment	2,870	2,870
Lower Bexhill Road	692,822	
Churchfields Business Centre	40,612	
Development / Furbishment of Lacuna Place	32,825	32,825
Cornwallis Street Development	30,000	30,000
Harold Place Restaurant Devt	5,250	5,250
Electric Vehicle Infrastructure	42,043	42,043
Priory Street Works (LED lighting/Gates/rewiring)	50,365	50,365
Totals	**10,103,864**	**7,854,744**

Agenda Item 7

Agenda Item No:

Report to: **Audit Committee**

Date of Meeting: **18 November 2021**

Report Title: **Treasury Management Mid-Year Report 2021-22**

Report By: **Peter Grace**
Chief Finance Officer

Purpose of Report

This report advises the Audit Committee of the Treasury Management activities and performance during the current year. It provides the opportunity to review the Treasury Management Strategy and make appropriate recommendations to Cabinet and Council to take account of any issues or concerns that have arisen since approving it in February 2021.

Recommendation

Audit Committee agree the Mid-Year report.

Reasons for Recommendations

The Code of Practice on Treasury Management requires, as a minimum, a mid-year review of the Treasury Management Strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved (February 2021). It is a requirement of the Code of Practice that the Mid-year review is considered by Cabinet, Audit Committee and full Council.

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Background

1. In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. These require all local authorities to prepare a Capital Strategy which is to provide the following: -

    1. a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
    2. an overview of how the associated risk is managed; the implications for future financial sustainability.
    3. The implications for future financial sustainability.

2. CIPFA is again looking at revising the Prudential Code and Treasury Management Code and is at an advanced stage of agreeing the new Codes. On 21 September 2021 CIPFA began its stage 2 consultation phase for measures to strengthen both codes with the consultation ending on 16th November 2021.These follow “ongoing concerns over local authority commercial investments”, CIPFA said.

3. The Prudential Code is used to ensure that capital finance decisions are sustainable, while the Treasury Management Code sits alongside to provide a framework for risk management. Measures proposed in the consultations include how to define proportionate commercial investment in the context of local authority regeneration work.

4. The proposed revisions will strengthen both codes with a greater focus on climate and environmental, social and governance risks when making financial decisions. There is also guidance on CIPFA’s stance that borrowing for investment return, or debt for yield, is an imprudent activity that puts public money at undue risk.

5. The key changes being brought forward in these consultations clarify and update CIPFA’s position on local authority commercial investment. The revised code will emphasise that any borrowing made solely for the purpose of financial return constitutes imprudent activity, while also taking into account the realities that accompany regeneration activities.

6. For the Treasury Management Code the key changes impact on Treasury Management Practices and Treasury Indicators:

    - TMP1 Risk Management
    - TMP2 Performance Management
    - TMP6 Reporting Requirements and Management Information Arrangements
    - TMP8 Cash and Cash Flow Management
    - TMP10 Training and Qualifications

7. Further details on the changes to the codes and their impact will be reported once the final revised Codes have been agreed. The requirements are expected to apply for the next financial year and as such the Treasury Management Strategy for 2022/23 would need to comply with the requirements.

8. The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure in combination with funding from reserves. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

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

10. Accordingly, 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."

11. Covid-19 has again highlighted the fundamental requirement for local authorities to have proper and effective Treasury Management Practices and Policies in place. The Council has been able to sustain its services throughout this period, has not experienced undue difficulties in managing major cash flows, and retained sufficient reserves (given government assistance) throughout the period.

Introduction

12. The CIPFA Code of Practice on Treasury Management (revised 2017) was adopted by this Council in February 2018.

13. The primary requirements of the Code are as follows:

    - Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
    - Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
    - Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.
    - Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
    - Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Audit Committee.

14. This mid-year report has been prepared in compliance with CIPFA's Code of Practice on Treasury Management, and covers the following:

- An economic update for the first part of the 2021/22 financial year;
- A review of the Treasury Management Strategy Statement and Annual Investment Strategy;
- The Council's capital expenditure (prudential indicators);
- A review of the Council's investment portfolio for 2021/22;
- A review of the Council's borrowing strategy for 2021/22;
- A review of any debt rescheduling undertaken during 2021/22;
- A review of compliance with Treasury and Prudential Limits for 2021/22.

15. **The Committee will need to determine whether there are any issues that require the amendment of the Council's Treasury Management Strategy or Investment Policy and that they therefore wish to draw to the attention of Council.**

16. The Council has increased its levels of income generation over the last few years and this has entailed new borrowing over long periods, with consequent risks in terms of asset valuations, credit worthiness, cash and reserve fund availability. Such risks cannot be considered in isolation of all the issues facing the Council now and potentially in the future. The Council strengthened its reserves when taking on these additional risks and the level of reserves have to date proven more than adequate to cope with the immediate effects of Covid-19, increased expenditure levels and reduced income. However, additional cost pressures are being experiences e.g. homelessness, which will reduce reserves to below minimum recommended levels unless additional government funding is received or the Council takes action to reduce its costs.

17. The Cabinet will consider a similar mid-year report at their meeting on 4 January 2022 as will full Council.

Economic Update

18. At the Monetary Policy Committee (MPC) meeting on 24 September 2021 members voted unanimously to leave Bank Rate unchanged at 0.10% and made no changes to the programme of quantitative easing purchases due to finish by the end of this year at a total of £895bn; two MPC members voted to stop the last £35bn of purchases as they were concerned that this would add to inflationary pressures. The MPC meeting on 2 November again agreed to make no change in the bank base rate.

19. There was a major shift in the tone of the MPC's minutes at this meeting from the previous meeting in August which had majored on indicating that some tightening in monetary policy was now on the horizon, but also not wanting to stifle economic recovery by too early an increase in Bank Rate. In his press conference after the August MPC meeting, Governor Andrew Bailey said, "the challenge of avoiding a steep rise in unemployment has been replaced by that of ensuring a flow of labour into jobs" and that "the Committee will be monitoring closely the incoming evidence regarding developments in the labour market, and particularly unemployment, wider measures of slack, and underlying wage pressures." In other words, it was flagging up a potential

danger that labour shortages could push up wage growth by more than it expects and that, as a result, CPI inflation would stay above the 2% target for longer. It also discounted sharp increases in monthly inflation figures in the pipeline in late 2021 which were largely propelled by events a year ago e.g., the cut in VAT in August 2020 for the hospitality industry, and by temporary shortages which would eventually work their way out of the system: in other words, the MPC had been prepared to look through a temporary spike in inflation.

20. So, in August the country was just put on alert. However, this time the MPC's words indicated there had been a marked increase in concern that more recent increases in prices, particularly the increases in gas and electricity prices in October and due again next April, are, indeed, likely to lead to faster and higher inflation expectations and underlying wage growth, which would in turn increase the risk that price pressures would prove more persistent next year than previously expected. Indeed, to emphasise its concern about inflationary pressures, the MPC pointedly chose to reaffirm its commitment to the 2% inflation target in its statement; this suggested that it was now willing to look through the flagging economic recovery during the summer to prioritise bringing inflation down next year. This is a reversal of its priorities in August and a long way from words at earlier MPC meetings which indicated a willingness to look through inflation overshooting the target for limited periods to ensure that inflation was 'sustainably over 2%'. Indeed, whereas in August the MPC's focus was on getting through a winter of temporarily high energy prices and supply shortages, believing that inflation would return to just under the 2% target after reaching a high around 4% in late 2021, now its primary concern is that underlying price pressures in the economy are likely to get embedded over the next year and elevate future inflation to stay significantly above its 2% target and for longer.

21. Financial markets are now pricing in a first increase in Bank Rate from 0.10% to 0.25% in February 2022, but this looks ambitious as the MPC has stated that it wants to see what happens to the economy, and particularly to employment once furlough ends at the end of September. At the MPC's meeting in February it will only have available the employment figures for November: to get a clearer picture of employment trends, it would need to wait until the May meeting when it would have data up until February. At its May meeting, it will also have a clearer understanding of the likely peak of inflation.

22. COVID-19 vaccines. These have been the game changer which have enormously boosted confidence that life in the UK could largely return to normal during the summer after a third wave of the virus threatened to overwhelm hospitals in the spring. With the household saving rate having been exceptionally high since the first lockdown in March 2020, there is plenty of pent-up demand and purchasing power stored up for services in hard hit sectors like restaurants, travel and hotels. The big question is whether mutations of the virus could develop which render current vaccines ineffective, as opposed to how quickly vaccines can be modified to deal with them and enhanced testing programmes be implemented to contain their spread.

Interest rate forecasts

23. The Council's treasury advisor, Link Group, provided the following forecasts on 29th September 2021 (PWLB rates are certainty rates, gilt yields plus 80bps):

Link Group Interest Rate View 29.9.21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
BANK RATE	0.10	0.10	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.75
3 month ave earnings	0.10	0.10	0.20	0.20	0.30	0.40	0.50	0.50	0.60	0.70
6 month ave earnings	0.20	0.20	0.30	0.30	0.40	0.50	0.60	0.60	0.70	0.80
12 month ave earnings	0.30	0.40	0.50	0.50	0.50	0.60	0.70	0.80	0.90	1.00
5 yr PWLB	1.40	1.40	1.50	1.50	1.60	1.60	1.60	1.70	1.70	1.70
10 yr PWLB	1.80	1.80	1.90	1.90	2.00	2.00	2.00	2.10	2.10	2.10
25 yr PWLB	2.20	2.20	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.60
50 yr PWLB	2.00	2.00	2.10	2.20	2.20	2.20	2.20	2.30	2.30	2.40

24. The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March 2020 to cut Bank Rate to 0.10%, it has left Bank Rate unchanged at its subsequent meetings.
25. As shown in the forecast table above, one increase in Bank Rate from 0.10% to 0.25% has now been included in quarter 2 of 2022/23, a second increase to 0.50% in quarter 2 of 23/24 and a third one to 0.75% in quarter 4 of 23/24. These forecasts are now being refined on a regular basis – with the lack of an increase in November 2021 taking the market by surprise.

Significant risks to the interest rate forecasts

- COVID vaccines do not work to combat new mutations and/or new vaccines take longer than anticipated to be developed for successful implementation.
- The pandemic causes major long-term scarring of the economy.
- The Government implements an austerity programme that supresses Gross Domestic Product (GDP) growth.
- The MPC tightens monetary policy too early – by raising Bank Rate or slowing/stopping quantitative easing.
- The MPC tightens monetary policy too late to ward off building inflationary pressures.
- Major stock markets e.g. in the US, become increasingly judged as being over-valued and susceptible to major price corrections. Central banks become increasingly exposed to the "moral hazard" risks of having to buy shares and corporate bonds to reduce the impact of major financial market sell-offs on the general economy.

The Council's Treasury Position – 30 September 2021

Borrowing

26. The Council's debt and investment position at the 30 September 2021 was as follows:

Table 1 – Borrowing

Debt	1 April 2021 Principal	Start Date	Maturity Date	30 Sept 2021 Principal	Rate
PWLB	£7,500,000	25/05/2007	01/02/2033	£7,500,000	4.80%
PWLB	£909,027	04/09/2014	02/09/2044	£909,027	3.78%
PWLB (Optivo)	£1,788,235	04/09/2014	02/09/2044	£1,788,235	3.78%
PWLB (FT) (Annuity)	£156,196	21/03/2016	20/03/2026	£141,151	1.66%
PWLB	£1,000,000	11/05/2016	11/05/2056	£1,000,000	2.92%
PWLB	£1,000,000	11/05/2016	11/05/2046	£1,000,000	3.08%
PWLB	£1,000,000	11/05/2016	09/05/2036	£1,000,000	3.01%
PWLB	£1,000,000	11/05/2016	11/05/2026	£1,000,000	2.30%
PWLB	£2,000,000	24/06/2016	24/06/2054	£2,000,000	2.80%
PWLB	£1,000,000	24/06/2016	23/06/2028	£1,000,000	2.42%
PWLB	£2,000,000	21/03/2017	21/03/2057	£2,000,000	2.53%
PWLB	£2,000,000	21/03/2017	19/09/2059	£2,000,000	2.50%
PWLB	£2,000,000	23/03/2017	23/03/2060	£2,000,000	2.48%
PWLB (Annuity)	£6,889,020	01/06/2017	01/06/2057	£6,831,054	2.53%
PWLB (Annuity)	£7,987,864	22/11/2017	22/11/2057	£7,924,603	2.72%
PWLB	£2,000,000	12/12/2018	12/06/2028	£2,000,000	1.98%
PWLB (Annuity)	£3,881,544	13/12/2018	13/12/2058	£3,850,980	2.55%
PWLB (Annuity)	£2,426,128	31/01/2019	31/01/2059	£2,407,065	2.56%
PWLB (Annuity)	£4,320,356	31/01/2019	31/01/2069	£4,297,224	2.56%
PWLB (Annuity)	£9,121,014	20/03/2019	20/03/2059	£9,049,039	2.54%
PWLB (Annuity)	£4,710,543	02/09/2019	02/09/2069	£4,680,177	1.83%
Total Debt	**£64,689,926**			**£64,378,555**	2.82%

27. At the 30 September 2021 the Council had debt amounting to £64.38m (PWLB debt). The Council has not taken on any more debt in the year (as at 29 October 2021).

28. The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's debt position. The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend.

29. Part of the Council's treasury activities is to address the funding requirements for the Council's borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced

through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets) or utilising temporary cash resources within the Council.

30. The Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

31. The total CFR can also be reduced by:
    - the application of additional capital financing resources (such as unapplied capital receipts); or
    - charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

32. The Council's 2021/22 MRP Policy was approved as part of the Treasury Management Strategy Report for 2021/22 by Council in February 2021.

33. The Council's CFR for the year is shown below and represents a key prudential indicator. It includes leased items on the balance sheet, which increase the Council's borrowing need (albeit no additional borrowing is actually required against such items).

Table 2 CFR: General Fund	**2020/21 Actual £000's**	**2021/22 Estimate £000's**
Opening balance	66,372	72,683
Add unfinanced capital expenditure	7,811	3,841
Less MRP	(1,500)	(1,668)
Closing balance	**72,683**	**74,856**

34. Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

35. The Council's long term borrowing must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2021/22 plus the expected changes to the CFR over 2022/23 and 2023/24 from financing the capital programme. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2021/22.

Table 3 Internal Borrowing	2020/21 Actual £000's	2021/22 Estimate As at 31/10/21 £000's
Capital Financing Requirement	72,683	74,856
External Borrowing	64,690	67,904
Net Internal Borrowing	**7,993**	**6,952**

36. The table above highlights the Council's gross borrowing position against the CFR, which provides an indication of affordability for the Council. The Council has complied with this prudential indicator.

Investments in 2021-22

37. Table 4 below provides a snapshot of the investments and deposits held on 30 September 2021. The level of investments can fluctuate significantly on a day to day basis, given the level of funding received, precept payments, grants payable and receivable, salaries and wages, etc.

38. In addition to the investments there was £4,101,037 in the Lloyds current account which was being held for Business Grant payments (and repayments back to the government) and other funding potentially required at short notice in relation to COVID-19.

39. The Council also had longer term investments with CCLA in a property fund and Diversified Income Fund.

Table 4 – Investments and deposits (Other than Lloyds)

Counterparty	Interest Rate	Start Date	End Date	Principal	Term
Barclays Corporate	0.40%	-	-	£5,000,000	Call
NatWest	0.01%	-	-	£6,147	Call
Australia & NZ BCG Ltd	0.09%	14/07/2021	14/10/2021	£5,000,000	Fixed
Goldman Sachs	0.17%	14/07/2021	31/12/2021	£5,000,000	Fixed
DBS Bank Ltd, London	0.09%	20/08/2021	22/11/2021	£5,000,000	Fixed
Helaba Landesbank Hessen	0.09%	16/09/2021	16/12/2021	£5,000,000	Fixed
TOTAL				**£25,006,147**	

40. As at 30 September 2021 three longer term loans are outstanding – loans made to other organisations.

Table 5 – Loans to Other Organisations

Counterparty	Interest Rate	Start Date	End Date	Principal O/S	Term
Amicus (Optivo)	3.78%	04/09/2014	02/09/2044	£1,788,235	Fixed
The Source	2.43%	17/12/2015	17/12/2025	£13,254	Fixed
Foreshore Trust	1.66%	21/03/2016	20/03/2026	£141,150	Annuity

41. Borrowing from the PWLB was taken to fund the Amicus Horizon (now Optivo) loan (£1,788,235- Maturity loan) and the loan to the Foreshore Trust (£300,000 originally borrowed – Annuity loan); these correspond to PWLB loans in Table 1 above.

42. The overall investment performance for the first 6 months of 2021/22 provided an average return of 0.16% (0.55% including CCLA) (2020/21 0.66%).

43. The total interest receivable for the first 6 months is £24,975.65 (£100,769 including CCLA) (2020/21 £43,628). These figures exclude the interest receivable in respect of the three loans to other organisations and the housing company detailed below.

Loans to Hastings Housing Company Ltd

44. Hastings Housing Company repaid the revenue loan and interest due to the Council in September 2020. It still has a capital loan of £5,489,398 outstanding. The capital loan interest rate is based on the rate prevailing at the time of the advance and is fixed for the period of the loan. The borrowing costs incurred by the Council in making advances to the housing company are covered by the interest repayments.

The Council's Capital Position (Prudential Indicators)

45. This part of the report is structured to provide updates on:

- The Council's capital expenditure plans;
- How these plans are being financed;
- The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and
- Compliance with the limits in place for borrowing activity.

Prudential Indicator for Capital Expenditure

46. This table shows the revised estimates for capital expenditure for 2021/22.

Table 6 Capital Expenditure (Net) by Service	2021/22 Original Estimate (net) £'000	2021/22 Revised Estimate (net) £'000
Corporate Resources	11,693	2,402
Operational Services	1,088	1,439
Total Capital Expenditure (Net)	**12,781**	**3,841**

Capital Expenditure – Financing

47. The new Capital schemes, approved since the budget, will generally be financed by borrowing, unless Capital receipts from the sale of assets are available.

48. The larger schemes in the capital programme which are expected to require financing in 2021/22 from borrowing include:-

(1) Buckshole Reservoir Works

(2) Priory Street Works

(3) Electric vehicles and infrastructure

(4) 12/13 York Buildings

(5) Priory Meadow

(6) Cornwallis Street Development

(7) Churchfield Business Centre

(8) Lacuna Place Development / Refurbishment

(9) Harold Place Development

(10) Castleham Car Park Resurfacing

(11) Playground upgrades

(12) Next Steps Accommodation Pathway

(13) Country Park Visitors Centre

(14) Energy – Solar Panels

Impact on the prudential indicators

49. The Capital Financing Requirement has continued to increase. It is expected to reach some £74.9m by April 2022. The position at 31 October 2021 is shown in Table 3 above, and highlights that there would be an underlying financing requirement of some £6.9m by the year end if limited further borrowing is undertaken. The option of using capital receipts, once received, in lieu of external borrowing is expected to be beneficial to the Council.

Compliance with the limits in place for borrowing activity.

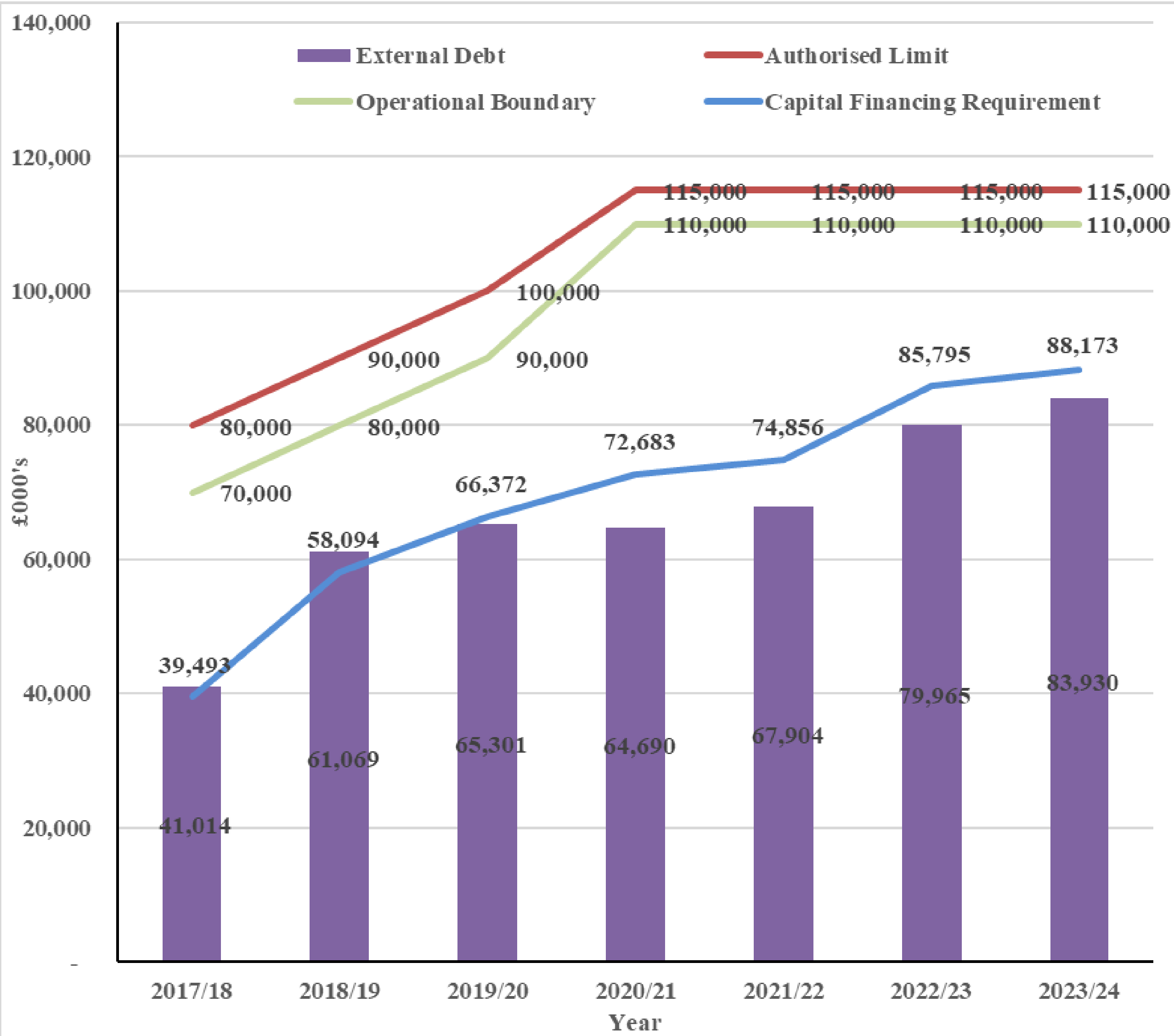
50. The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a

capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2021/22 and next two financial years.

51. A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited; this is set by full Council and can only be revised by full Council. It reflects the level of borrowing which, while not desired, could be afforded in the short term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3(1) of the Local Government Act 2003.

52. The graph below shows that the Council is operating within its approved borrowing limits.

Graph: Estimated CFR/ Debt and Debt boundaries at year end



Borrowing Strategy

53. The Council now has some £64.4m of PWLB debt and could potentially borrow up to a level of £74.9m (estimated CFR at 31 March 2022). This figure does not take account of any new capital spending in future years which could potentially be funded by new borrowing.

54. The interest rate forecasts from the Council's treasury advisers identify that there is potential for interest rate increases at a gradual rate from June 2022. Whilst the borrowing rates are attractive on a historical basis the difference between the return on investment and the cost of borrowing remains – the additional revenue cost falling on the Council taxpayer.

55. The Council's corporate plans require substantial new borrowing by the Council in the future and play a part in the consideration as to when to borrow and the level of internal borrowing. Given the historically low interest rates and the ability of the Council to look at other investment opportunities which are providing higher returns than the cost of borrowing e.g. property funds, there has been a much stronger case for reducing the level of internal funding in order to ensure a lower level of borrowing risk in the future.

56. Commercial investments (including commercial property) are not part of cashflow management or prudent treasury risk management, and they do not directly help deliver service outcomes. Leveraged investment is a form of speculation, which chooses to take on additional risk in order to earn a profit, much as an investment bank or property company might do. A local authority has powers to borrow and invest 'for the prudent management of its financial affairs' (Local Government Act 2003 sections 1 and 12). It is CIPFA's view that throughout the public services the priority for treasury management is to protect capital rather than to maximise return. The magnified risks of leveraged investments, and the fact that they put public money at unnecessary risk, mean that borrowing in order to invest for the primary purpose of earning a return is not in CIPFA's view a prudent use of public funds. Regeneration, and investing for economic development purposes, particularly within the boundary of the local authority is still permitted.

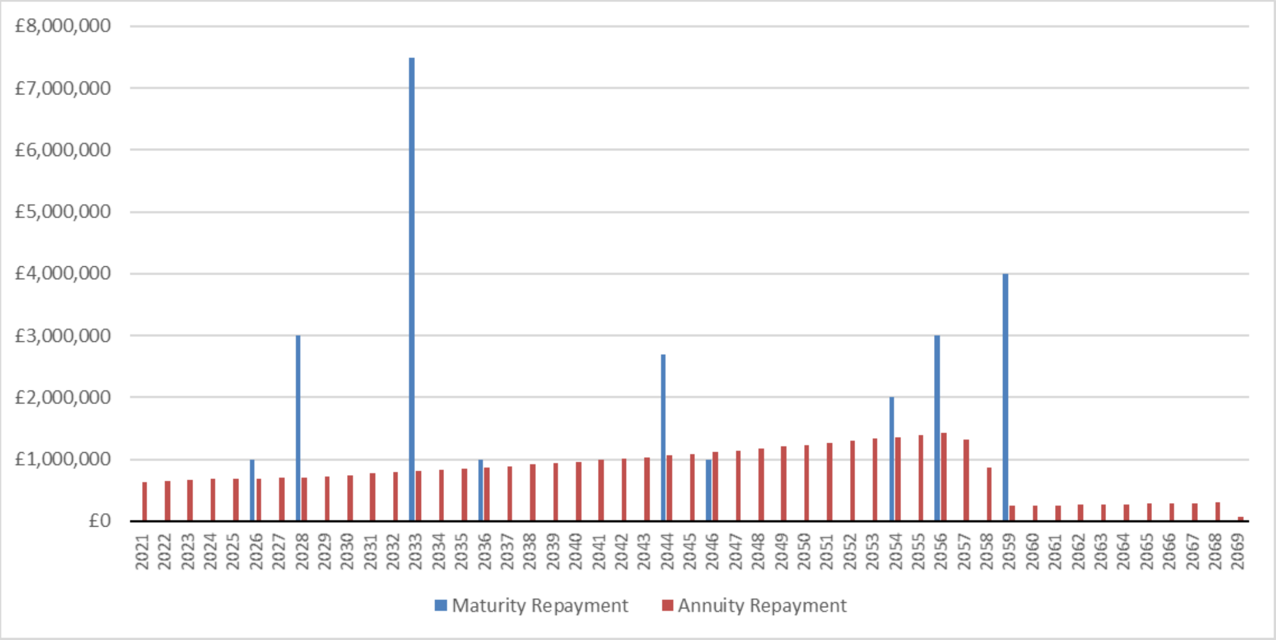
57. CIPFA has updated the prudential Code guidance and released a statement on borrowing to invest. The Code says that authorities must not borrow to invest for the primary purpose of financial return, but it is not always straightforward to identify if the authority is borrowing for this purpose or not. Any authority which is a net borrower and which is holding or considering investments of a long term nature must consider whether it is in effect borrowing to invest.

58. The Code's statement that authorities 'must not borrow to invest for the primary purpose of financial return' is not intended to require the forced sale of existing commercial investments, whether commercial properties or financial investments. Selling these investments and using the proceeds to net down debt does, however, reduce treasury risks on both sides of the balance sheet and is therefore an option which should be kept under review, especially if new long term borrowing is being considered. Code paragraph 53 also makes it clear that where an authority has existing commercial properties, the Code's requirement that an authority must not borrow to invest for the primary purpose of financial return, is not intended to prevent

authorities from appropriate capital repair, renewal or updating of existing properties. The Council has, and continues to hold, a large number of industrial units and other properties within the borough which provide substantial income for the Council – without which the Council would be unsustainable in its current form.

Debt Maturity

59. The Graph below shows the profile of when debt (loans from the PWLB) become repayable. Blue lines indicate maturity loans and red lines indicate annuity loans.



60. The Council will need to carefully consider the structure and timing of any new borrowing to ensure debt does not exceed the CFR in the years ahead.

Debt Rescheduling

61. The Council keeps under review the potential for making premature debt repayments in order to reduce borrowing costs as well as reducing counterparty risk by reducing investment balances. However, the cost of the early repayment premiums that would be incurred and the increase in risk exposure to significantly higher interest rates for new borrowing, continue to make this option unattractive. When reviewed on the 27 September 2017 the early repayment cost of the £7.5m (4.8%) PWLB loan, maturing in 2033, would amount to £3,177,343. No debt rescheduling is being contemplated at present as the interest rate differences are even greater than when last considered. It is understood that the Treasury may review their policy in this area.

Investment Strategy

62. Priority is given to security and liquidity of investments in order to reduce counterparty risk to the maximum possible extent.

63. The Council has a limit of £5m with any one institution (rated A or above, supported by Government, and given a blue (12 month) rating by Link Group). This generally represents a level of up to 20% of the investment portfolio with any one institution or

group at any one time. It is also necessary, at times, to invest sums of this size in order to attract the larger institutions which have the higher credit ratings.

64. The world economic climate, along with Brexit, has led to a number of downgrades to banks' credit ratings, making it increasingly difficult to spread investments across a number of institutions. The Chief Finance Officer has the authority to amend the limits if necessary, to ensure that monies can be placed with appropriate institutions.

65. The net cost to the Council of borrowing, investment interest and fees will be reviewed as part of the budget setting process.

Property Fund

66. It was agreed in February 2017 that the option for diversification of some of the investments into a property fund be undertaken with CCLA in the sum of £2m. The investment being in respect of the Council's reserves that are not required for a period of at least 5 years in order that any fall in values and entry costs into such funds can be covered. The £2m was invested in April 2017 and the performance from June 2020 is detailed below:

CCLA – LA's Property Prices and Dividend yields

End of	Sep-21	Aug-21	Jul-21	Jun-21	May-21	Apr-21	Mar-21	Dec-20	Sep-20	Jun-20
Offer Price p	335.31	331.68	328.54	324.18	319.93	314.43	313.45	306.91	302.56	303.14
Net Asset Value p	314.11	310.71	307.77	303.69	299.70	294.55	293.63	287.50	283.43	283.97
Bid Price p	309.24	305.89	303.00	298.98	295.06	289.98	289.08	283.05	279.04	279.57
Dividend* on XD Date p	2.69	-	-	2.87	-	-	2.98	3.74	3.10	2.80
Dividend* - Last 12 Months p	12.28	12.69	12.69	12.69	12.63	12.63	12.63	12.26	12.37	12.72
Dividend Yield on NAV %	4.04	4.08	4.12	4.18	4.21	4.29	4.30	4.49	4.37	4.48
Fund Size £m	1282.50	1282.50	1270.40	1253.50	1232.90	1211.60	1202.90	1172.60	1155.80	1158.00

67. The dividend yield is around 4.1% on the net asset value, which results in quarterly cash dividends of around £17,525. Full year dividends are estimated at around £71,200.

Property Fund Capital Value

Units (651,063)	Sep-21	Aug-21	Jul-21	Jun-21	May-21	Apr-21	Mar-21	Dec-20	Sep-20	Jun-20
Mid Market Price(£)	2,022,918	2,022,918	2,003,777	1,977,213	1,951,236	1,917,706	1,911,716	1,871,806	1,845,308	1,848,824
Bid Price (£)	1,991,537	1,991,537	1,972,721	1,946,548	1,921,026	1,887,952	1,882,093	1,842,834	1,816,726	1,820,177

68. The Capital value has increased by 7.97% between April 2017 and September 2021 and is now above that of the original investment. At the end of September 2021 the mid-market value is £2,022,918. It is important that this is continued to be viewed as a longer term investment (5 years plus).

Diversified Income Fund

69. It was agreed in February 2019 that a sum of £3m would be made available for further diversification of the Council's investments. £1m was invested on 26 July 2019 and a further £2m investment was made on 24 September 2019 into the CCLA Diversified Income Fund. Anticipated returns were around 3% with the added advantage of much

higher liquidity than the property fund.

70. The capital value has decreased by 0.7% from the initial investment and was valued at £2,979,093 at the end of September 2021. The quarterly dividend yield was 2.6% for September (£15,571). This compares to a dividend yield of 2.9% in June 2021 (£24,043). The annualised dividend for the last 12 months is 4.04%. It should be remembered that this is a long term investment and prices can go up and down – as the impact of the pandemic has highlighted.

Compliance with Treasury Limits

71. As a result of Covid-9, the potential unknown impacts on foreign countries, their economies and banks along with the high levels of funding for business rate grants being provided by the government, the limits for balances held with Lloyds bank were raised substantially – approved by the Chief Finance officer in compliance with the Council's Treasury Management Practices. The council was thus able to manage, for example the £27,782,000 received in respect of business support grants for the first lockdown period. The Council has continued to hold some grant monies in 2021/22. The money has been held in either a call account or the general bank account. Exceeding the normal approved limits is a decision that is not taken lightly, and whilst the investment return achieved will have been lower than otherwise may have been the case, the need for security has been considered to be more important – as was the ability to use the funds as and when necessary i.e. to pay out the grants.

72. The Prudential Indicators have been complied with - reproduced in Appendix 1 for reference.

Financial Implications

73. The Council’s 2021/22 budget included an estimated return on investments of 0.2% (excluding CCLA funds). The Bank Base Rate was 0.75% from 2 August 2018 and remained at that level until it fell to 0.25% on 11 March 2020 and then to 0.1% on 19 March 2020.

74. The Council’s actual average rate of return for the year to 30 September 2021 was 0.16% (0.55% including the CCLA investments).

Future Changes

75. The Treasury Management Code of Practice (CIPFA) and the Prudential Code for Capital Finance were revised in late 2017/18, and the requirement for a new strategic planning document introduced – the “Capital Strategy” which seeks to bridge the perceived gaps in understanding between the Capital programme, funding thereof and Treasury Management. This was agreed by full Council in February 2021 and will be reviewed and updated annually.

76. The 2022/23 Treasury Management Strategy suite of reports will be considered by the Audit Committee on the 13 January 2022 and thereafter considered by Cabinet on 7 February 2022 and Budget Council on 16 February 2022 in conjunction with the budget papers and Corporate plan.

Risk Management

77. The Council continues to face serious risks in terms of volatility in its income streams, expenditure and future funding. Business rates and property income are susceptible during economic recessions and business rate appeals for example can have sudden and significant impacts. The Council has seen a massive increase in its homelessness expenditure this year, along with a significant reduction in collection rates for business rates. Income from sales fees and charges e.g. car park income, remains at risk. Where there is more risk and volatility in income streams the Council will need to ensure that it maintains sufficient reserves to ensure the Council's ability to deliver key services is not jeopardised.

78. The Council spreads its risk on investments by limiting the amount of monies with any one institution or group and limiting the timeframe of the exposure. In determining the level of the investment and period the Council considers formal credit ratings (Fitch) along with its own advisers (Link Group) ratings advice.

79. The security of the principal sum remains of paramount importance to the Council.

80. To date the strategy of externalising debt has been successful. The fact that the Council's reserves were cash backed meant that there was no need to borrow at high interest rates when funds were required during Covid. Currently the Council has not borrowed externally as it may wish to finance Capital expenditure from capital receipts and avoid borrowing costs. It is thus borrowing internally i.e. temporarily using its cash balances/reserves to fund the expenditure.

81. The investments made in the Property Fund (CCLA) and the Diversified Investment Fund (CCLA), totalling £5m are currently showing good returns. The risks currently faced in achieving a sustainable Council budget mean that no further long term investments can be made. However, there are no reasons to sell the current investments at this time.

Timetable of Next Steps

1. Please include a list of key actions and the scheduled dates for these:

Action	**Key milestone**	**Due date (provisional)**	**Responsible**
Review and revise Annual Treasury Management Strategy & Capital Strategy	Setting of 2022/23 Budget	February 2022	Chief Finance Officer
Treasury Management Outturn Report to Cabinet	Close of 2021/22 accounts	July 2022	Chief Finance Officer

Wards Affected

None

Area(s) Affected

None

Implications

Relevant project tools Applied? N/A

Climate change implications considered? N/A

Please identify if this report contains any implications for the following:

Equalities and Community Cohesiveness	No
Crime and Fear of Crime (Section 17)	No
Risk Management	Yes
Environmental Issues	No
Economic/Financial Implications	Yes
Human Rights Act	No
Organisational Consequences	No
Local People's Views	No
Anti-Poverty	No

Additional Information

Appendix 1: Prudential Indicators

Appendix 2: Economic Update from Link Group

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APPENDIX 1 - Prudential Indicators

The Council’s Capital expenditure plans are the key driver of treasury management activity. The output of the Capital expenditure plans (detailed in the budget) is reflected in the prudential indicators below.

TREASURY MANAGEMENT PRUDENTIAL INDICATORS	2019/20	2020/21	2021/22	2022/23	2023/24
	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt					
borrowing	95,000	110,000	110,000	110,000	110,000
other long term liabilities	5,000	5,000	5,000	5,000	5,000
TOTAL	100,000	115,000	115,000	115,000	115,000
Operational Boundary for external debt					
borrowing	85,000	105,000	105,000	105,000	105,000
other long term liabilities	5,000	5,000	5,000	5,000	5,000
TOTAL	90,000	110,000	110,000	110,000	110,000

The Council’s external borrowing at 30 September 2021 amounted to £64,378,555 which is well within approved borrowing limits.

Interest Rate Exposures	**2020/21** **Upper**	**2021/22** **Upper**	**2022/23** **Upper**
Limits on fixed interest rates based on **net** debt	100%	100%	100%
Limits on variable interest rates based on **net** debt	100%	100%	100%
Limits on fixed interest rates: · Debt only · Investments only	 100% 100%	 100% 100%	 100% 100%
Limits on variable interest rates · Debt only · Investments only	 30% 100%	 30% 100%	 30% 100%
Maturity Structure of fixed interest rate borrowing 2021/22			
		Lower	**Upper**
Under 12 Months		0%	100%
12 months to 2 years		0%	100%
2 years to 5 years		0%	100%
5 years to 10 years		0%	100%
10 years to 20 years		0%	100%
20 years to 30 years		0%	100%
30 years to 40 years		0%	100%
40 years to 50 years		0%	100%
Maturity Structure of variable interest rate borrowing 2021/22			
		Lower	**Upper**
Under 12 Months		0%	30%
12 months to 2 years		0%	30%
2 years to 5 years		0%	30%
5 years to 10 years		0%	30%
10 years to 20 years		0%	10%
20 years to 30 years		0%	10%
30 years to 40 years		0%	10%
40 years to 50 years		0%	10%

Affordability prudential indicator - Ratio of financing costs to net revenue stream

This indicator assesses the affordability of the capital investment plans. It provides an indication of the impact of the capital investment plans on the Council's overall finances This indicator identifies the trend in the cost of capital (borrowing and other long-term obligation costs net of investment income) against the net revenue stream.

Prudential Indicator: Financing Cost to Net Revenue Stream	2020/21 Actual	2021/22 Revised Estimate	2022/23 Estimate	2023/24 Estimate	2024/25 Estimate
Financing Costs	£'000	£'000	£'000	£'000	£'000
1. Interest Charged to General Fund	1,836	2,115	2,326	2,414	2,535
2. Interest Payable under Finance Leases and any other long term liabilities	-	-	-	-	-
3. Gains and losses on the repurchase or early settlement of borrowing credited or charged to the amount met from government grants and local taxpayers	-	-	-	-	-
4. Interest and Investment Income	-522	-609	-671	-661	-674
5. Amounts payable or receivable in respect of financial derivatives	-	-	-	-	-
6. Minimum Revenue Provision (MRP) / Voluntary Revenue Provision (VRP)	1,500	1,668	1,764	2,268	2,268
7. Depreciation/Impairment that are charged to the amount to be met from government grants and local taxpayers	-	-	-	-	-
Total	2,814	3,174	3,418	4,021	4,129
Net Revenue Stream Amount to be met from government grants and local taxpayers	16,332	14,845	14,018	13,318	13,184
Ratio **Financing Cost to Net Revenue Stream**	**17%**	**21%**	**24%**	**30%**	**31%**

Note: Outturn figures are unaudited

This prudential indicator shows that the ratio of financing costs to the net revenue stream is increasing. This is not unexpected given that the Council agreed a programme for over £54m of Capital expenditure over the period 2020/21 to 2023/24 - thus increasing borrowing costs.

APPENDIX 2 - Economic Update from Link Group

Further details from our treasury management advisors, Link Group, to accompany the economic update in the body of the report are shown below:

1. US. See comments below on US treasury yields.

2. EU. The slow role out of vaccines initially delayed economic recovery in early 2021 but the vaccination rate has picked up sharply since then. After a contraction in GDP of -0.3% in Q1, Q2 came in with strong growth of 2%, which is likely to continue into Q3, though some countries more dependent on tourism may struggle. Recent sharp increases in gas and electricity prices have increased overall inflationary pressures but the ECB is likely to see these as being only transitory after an initial burst through to around 4%, so is unlikely to be raising rates for a considerable time.

3. German general election. With the CDU/CSU and SDP both having won around 24-26% of the vote in the September general election, the composition of Germany's next coalition government may not be agreed by the end of 2021. An SDP-led coalition would probably pursue a slightly less restrictive fiscal policy, but any change of direction from a CDU/CSU led coalition government is likely to be small. However, with Angela Merkel standing down as Chancellor as soon as a coalition is formed, there will be a hole in overall EU leadership which will be difficult to fill.

4. China. After a concerted effort to get on top of the virus outbreak in Q1 2020, economic recovery was strong in the rest of the year; this enabled China to recover all the initial contraction. During 2020, policy makers both quashed the virus and implemented a programme of monetary and fiscal support that was particularly effective at stimulating short-term growth. At the same time, China's economy benefited from the shift towards online spending by consumers in developed markets. These factors helped to explain its comparative outperformance compared to western economies during 2020 and earlier in 2021. However, the pace of economic growth has now fallen back after this initial surge of recovery from the pandemic and China is now struggling to contain the spread of the Delta variant through sharp local lockdowns - which will also depress economic growth. There are also questions as to how effective Chinese vaccines are proving. In addition, recent regulatory actions motivated by a political agenda to channel activities into officially approved directions, are also likely to reduce the dynamism and long-term growth of the Chinese economy.

5. Japan. 2021 has been a patchy year in combating Covid. However, after a slow start, nearly 50% of the population are now vaccinated and Covid case numbers are falling. After a weak Q3 there is likely to be a strong recovery in Q4. The Bank of Japan is continuing its very loose monetary policy but with little prospect of getting inflation back above 1% towards its target of 2%, any time soon: indeed, inflation was negative in July. New Prime Minister Kishida has promised a large fiscal stimulus package after the November general election – which his party is likely to win.

6. World growth. World growth was in recession in 2020 but recovered during 2021 until starting to lose momentum more recently. Inflation has been rising due to increases in gas and electricity prices, shipping costs and supply shortages, although these should subside during 2022. It is likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China to supply products, and vice versa. This is likely to reduce world growth rates from those in prior decades.

7. Supply shortages. The pandemic and extreme weather events have been highly disruptive of extended worldwide supply chains. At the current time there are major queues of ships unable to unload their goods at ports in New York, California and China. Such issues have led to mis-distribution of shipping containers around the world and have contributed to a huge increase in the cost of shipping. Combined with a shortage of semi-conductors, these issues have had a disruptive impact on production in many countries. Many western countries are also hitting up against a difficulty in filling job vacancies. It is expected that these issues will be gradually sorted out, but they are currently contributing to a spike upwards in inflation and shortages of materials and goods on shelves.

8. The MPC's forward guidance on its intended monetary policy on raising Bank Rate versus selling (quantitative easing) holdings of bonds is as follows: -

    1. Placing the focus on raising Bank Rate as "the active instrument in most circumstances".
    2. Raising Bank Rate to 0.50% before starting on reducing its holdings.
    3. Once Bank Rate is at 0.50% it would stop reinvesting maturing gilts.
    4. Once Bank Rate had risen to at least 1%, it would start selling its holdings.

9. The overall balance of risks to economic growth in the UK is looking more difficult, including residual risks from Covid and its variants - both domestically and their potential effects worldwide.

Forecasts for Bank Rate

10. Bank Rate is not expected to go up fast after the initial rate rise as the supply potential of the economy has not generally taken a major hit during the pandemic, so should be able to cope well with meeting demand without causing inflation to remain elevated in the medium-term, or to inhibit inflation from falling back towards the MPC's 2% target after the surge to around 4% towards the end of 2021. Three increases in Bank rate are forecast in the period to March 2024, ending at 0.75%. However, these forecasts may well need changing within a relatively short time frame for the following reasons: -
    - There are increasing grounds for viewing the economic recovery as running out of steam during the summer and now into the autumn. This could lead into stagflation which would create a dilemma for the MPC as to which way to face.
    - Will some current key supply shortages e.g., petrol and diesel, spill over into causing economic activity in some sectors to take a significant hit?
    - Rising gas and electricity prices in October and next April and increases in other prices caused by supply shortages and increases in taxation next April, are already going to deflate consumer spending power without the MPC having to take any action on Bank Rate to cool inflation. Then we have the Government's

upcoming budget in October, which could also end up in reducing consumer spending power.

- On the other hand, consumers are sitting on around £200bn of excess savings left over from the pandemic so when will they spend this sum, in part or in total?
- There are 1.6 million people coming off furlough at the end of September; how many of those will not have jobs on 1st October and will, therefore, be available to fill labour shortages in many sectors of the economy? So, supply shortages which have been driving up both wages and costs, could reduce significantly within the next six months or so and alleviate the MPC's current concerns.
- There is a risk that there could be further nasty surprises on the Covid front, on top of the flu season this winter, which could depress economic activity.

11. In summary, with the high level of uncertainty prevailing on several different fronts, it is likely that these forecasts will need to be revised again soon - in line with what the new news is.

12. It also needs to be borne in mind that Bank Rate being cut to 0.10% was an emergency measure to deal with the Covid crisis hitting the UK in March 2020. At any time, the MPC could decide to simply take away that final emergency cut from 0.25% to 0.10% on the grounds of it no longer being warranted and as a step forward in the return to normalisation. In addition, any Bank Rate under 1% is both highly unusual and highly supportive of economic growth.

Forecasts for PWLB rates and gilt and treasury yields

13. As the interest forecast table for PWLB certainty rates above shows, there is likely to be a steady rise over the forecast period, with some degree of uplift due to rising treasury yields in the US.

14. There is likely to be exceptional volatility and unpredictability in respect of gilt yields and PWLB rates due to the following factors: -

- How strongly will changes in gilt yields be correlated to changes in US treasury yields?
- Will the Fed take action to counter increasing treasury yields if they rise beyond a yet unspecified level?
- Would the MPC act to counter increasing gilt yields if they rise beyond a yet unspecified level?
- How strong will inflationary pressures turn out to be in both the US and the UK and so impact treasury and gilt yields?
- How will central banks implement their new average or sustainable level inflation monetary policies?
- How well will central banks manage the withdrawal of QE purchases of their national bonds i.e., without causing a panic reaction in financial markets as happened in the "taper tantrums" in the US in 2013?
- Will exceptional volatility be focused on the short or long-end of the yield curve, or both?

15. The forecasts are also predicated on an assumption that there is no break-up of the Eurozone or EU within our forecasting period, despite the major challenges that are looming up, and that there are no major ructions in international relations, especially between the US and China / North Korea and Iran, which have a major impact on international trade and world GDP growth.

Gilt and treasury yields

16. Since the start of 2021, there has been a lot of volatility in gilt yields, and hence PWLB rates. During the first part of the year, US President Biden's, and the Democratic party's determination to push through a $1.9trn (equivalent to 8.8% of GDP) fiscal boost for the US economy as a recovery package from the Covid pandemic was what unsettled financial markets. However, this was in addition to the $900bn support package already passed in December 2020 under President Trump. This was then followed by additional Democratic ambition to spend further huge sums on infrastructure and an American families plan over the next decade which are caught up in Democrat / Republican haggling. Financial markets were alarmed that all this stimulus, which is much bigger than in other western economies, was happening at a time in the US when: -

- A fast vaccination programme has enabled a rapid opening up of the economy.
- The economy had already been growing strongly during 2021.
- It started from a position of little spare capacity due to less severe lockdown measures than in many other countries. A combination of shortage of labour and supply bottle necks is likely to stoke inflationary pressures more in the US than in other countries.
- And the Fed was still providing monetary stimulus through monthly QE purchases.

17. These factors could cause an excess of demand in the economy which could then unleash stronger and more sustained inflationary pressures in the US than in other western countries. This could then force the Fed to take much earlier action to start tapering monthly QE purchases and/or increasing the Fed rate from near zero, despite their stated policy being to target average inflation. It is notable that some Fed members have moved forward their expectation of when the first increases in the Fed rate will occur in recent Fed meetings. In addition, more recently, shortages of workers appear to be stoking underlying wage inflationary pressures which are likely to feed through into CPI inflation. A run of strong monthly jobs growth figures could be enough to meet the threshold set by the Fed of "substantial further progress towards the goal of reaching full employment". However, the weak growth in August, (announced 3.9.21), has spiked anticipation that tapering of monthly QE purchases could start by the end of 2021. These purchases are currently acting as downward pressure on treasury yields. As the US financial markets are, by far, the biggest financial markets in the world, any trend upwards in the US will invariably impact and influence financial markets in other countries. However, during June and July, longer term yields fell sharply; even the large non-farm payroll increase in the first week of August seemed to cause the markets little concern, which is somewhat puzzling, particularly in the context of the concerns of many commentators that inflation may not be as transitory as the Fed is expecting it to be. Indeed, inflation pressures and erosion of surplus economic capacity look much

stronger in the US than in the UK. As an average since 2011, there has been a 75% correlation between movements in 10 year treasury yields and 10 year gilt yields. This is a significant UPWARD RISK exposure to our forecasts for longer term PWLB rates. However, gilt yields and treasury yields do not always move in unison.

18. There are also possible DOWNSIDE RISKS from the huge sums of cash that the UK populace have saved during the pandemic; when savings accounts earn little interest, it is likely that some of this cash mountain could end up being invested in bonds and so push up demand for bonds and support their prices i.e., this would help to keep their yields down. How this will interplay with the Bank of England eventually getting round to not reinvesting maturing gilts and then later selling gilts, will be interesting to keep an eye on.

19. There is a balance of upside risks to forecasts for medium to long term PWLB rates.

A new era – a fundamental shift in central bank monetary policy

20. One of the key results of the pandemic has been a fundamental rethinking and shift in monetary policy by major central banks like the Fed, the Bank of England and the ECB, to tolerate a higher level of inflation than in the previous two decades when inflation was the prime target to bear down on so as to stop it going above a target rate. There is now also a greater emphasis on other targets for monetary policy than just inflation, especially on 'achieving broad and inclusive "maximum" employment in its entirety' in the US before consideration would be given to increasing rates.

- The Fed in America has gone furthest in adopting a monetary policy based on a clear goal of allowing the inflation target to be symmetrical, (rather than a ceiling to keep under), so that inflation averages out the dips down and surges above the target rate, over an unspecified period of time.
- The Bank of England has also amended its target for monetary policy so that inflation should be 'sustainably over 2%' and the ECB now has a similar policy.
- For local authorities, this means that investment interest rates and very short term PWLB rates will not be rising as quickly or as high as in previous decades when the economy recovers from a downturn and the recovery eventually runs out of spare capacity to fuel continuing expansion.
- Labour market liberalisation since the 1970s has helped to break the wage-price spirals that fuelled high levels of inflation and has now set inflation on a lower path which makes this shift in monetary policy practicable. In addition, recent changes in flexible employment practices, the rise of the gig economy and technological changes, will all help to lower inflationary pressures.
- Governments will also be concerned to see interest rates stay lower as every rise in central rates will add to the cost of vastly expanded levels of national debt; (in the UK this is £21bn for each 1% rise in rates). On the other hand, higher levels of inflation will help to erode the real value of total public debt.

Agenda Item No:

Report to: **Audit Committee**

Date of Meeting: **18 November 2021**

Report Title: **CIPFA Financial Management Code**

Report By: **Peter Grace**
Chief Finance Officer

Purpose of Report

In October 2019 the Chartered Institute of Public Finance and Accountancy (CIPFA) published "The CIPFA Financial Management Code". The purpose of the report is to provide Members with an overview of the Management Code, along with the initial self-assessment that has been undertaken by officers to identify compliance and areas for further consideration.

Recommendation

The Committee agree the outcome of the self-assessment to demonstrate compliance with the CIPFA Financial Management Code; The areas identified in the review where improvements can be made being considered by the Council's Corporate Management Team.

Reasons for Recommendations

To comply with CIPFA guidance on the Financial Management Code and ensure Members are aware of the position of the Council with regard to it's self-assessment and the future work that needs to be done to ensure higher scoring in future assessments.

Background

1. In October 2019 the Chartered Institute of Public Finance and Accountancy (CIPFA) published a Financial Management Code (FM Code) to support good practice in financial management and to assist local authorities in demonstrating their financial sustainability and would for the first time set standards of financial management for local authorities in the UK.

2. The FM Code has been introduced because the exceptional financial circumstances faced by local authorities have revealed concerns about fundamental weaknesses in financial management, particularly in relation to organisations that may be unable to maintain services in the future. There is much good practice across the sector, but the failures of a small number threatens stakeholders' confidence in local government as a whole. Most importantly, the financial failure of just one local authority is one too many because it brings with it a risk to the services on which local people rely.

3. The FM Code is designed to support good practice in financial management and to assist local authorities in demonstrating their financial sustainability. For the first time the FM Code sets out the standards of financial management for local authorities.

4. The FM Code requires authorities to demonstrate that the processes they have in place satisfy the principles of good financial management, which is an essential part of ensuring that public sector finances are sustainable.

5. The council has reviewed current working practises against the FM Code by way of a self-assessment, which has identified areas in which further action is required to ensure full compliance.

6. The Code is to be applied from the year 2020/21 with a view to full compliance the following year.

The CIPFA Financial Management Code

7. The CIPFA FM Code is based on a series of principles supported by specific standards and statements of practice considered necessary to provide the strong foundation to:

    - financially manage the short, medium and long-term finances
    - manage financial resilience to meet unforeseen demands on services
    - financially manage unexpected shocks in their financial circumstances.

8. The FM Code is consistent with other established CIPFA codes and statements in being based on principles rather than prescription. This code incorporates their existing requirements on local government so as to provide a comprehensive picture of financial management in the authority.

9. Each local authority must demonstrate that the requirements of the code are being satisfied. The FM Code states that: "CIPFA considers application of the FM Code to be a collective responsibility of each authority's organisational leadership team". The leadership team is defined as elected Members, the Chief Finance Officer (CFO) and their professional colleagues in the leadership team.

10. It is for all the senior management team to work with elected members in ensuring compliance with the FM Code and so demonstrate the standard of financial management to be expected of a local authority. In doing this the statutory role of the section 151 officer will not just be recognised but also supported to achieve the combination of leadership roles essential for good financial management.

11. The Code requires that a local authority demonstrate that its processes satisfy the principles of good financial management for an authority of its size, responsibilities and circumstances and sought to rely on the local exercise of professional judgement backed by appropriate reporting. The principles are designed to assist in determining whether, in applying standards of financial management a local authority is financially sustainable:

    1) Organisational leadership – demonstrating a clear strategic direction based on a vision in which financial management is embedded into organisational culture.

    2) Accountability – based on medium term financial planning which drives the annual budget process supported by effective risk management, quality supporting data and whole life costs.

    3) Financial management is undertaken with transparency at its core using consistent, meaningful and understandable data, reported frequently with evidence of periodic officer action and elected member decision making.

    4) Adherence to professional standards is promoted by the leadership team and is evidenced.

    5) Sources of assurance are recognised as an effective tool mainstreamed into financial management and includes political scrutiny and the results of both external audit, internal audit and inspection.

    6) The long term sustainability of local services is at the heart of all financial management process and is evidenced by prudent use of public resources.

12. Demonstrating this compliance is the collective responsibility of elected members, the chief finance officer and their professional colleagues in the leadership team.

13. To enable authorities to test their conformity with the principles of good financial management the FM Code translates these principles into Financial Management Standards. There are 17 separate standards (A to Q) as detailed in Appendix 1 along with our self-assessment of achievement.

Compliance

14. Compliance will typically be demonstrated by documenting compliance by way of a self-assessment.

15. **Appendix 1** sets out an initial self-assessment against the financial management standards, undertaken by officers and details how compliant the council is against the requirements of this code. It also highlights any areas that need improvement to ensure full compliance.

16. In assessing compliance with the code the following criteria, set out in the table below has been applied using a RAG rating format:

RAG Rating	Number of Standards	Definition
RED	0	Significant improvements are required to comply with the code
AMDER	2	Moderate improvements are required to comply with the code
GREEN	15	Compliant / Minor improvements are required to comply with the code

17. It is pleasing to note that the initial self-assessment concludes that there are no significant improvements to be made. Out of the 17 standards the council is compliant with 15 and moderate improvements are required for the other two standards.

18. The two Standards assigned an amber rating are:

    M - The authority uses an appropriate documented option appraisal methodology to demonstrate the value for money of its decisions.

    N - The leadership team takes action using reports enabling it to identify and correct emerging risks to its budget strategy and financial sustainability.

19. It is not that we do not comply in all significant respects. However, the Management Team will need to give consideration to the adoption of an appropriate documented option appraisal methodology to demonstrate value for money. Regarding emerging risks, the Management Team will need to consider establishing a regular review of emerging risks at risk meetings and documenting this appropriately.

20. It is clearly of upmost importance that an organisation can demonstrate and evidence good practice in financial management and as such welcome a Code against which practice can be judged.

Legal Implications

21. Local government finance in the UK is governed by primary legislation, regulation and professional standards as supported by regulation.

22. Since these are minimum standards, CIPFA's judgement is that compliance with them is obligatory if a local authority is to meet its statutory responsibility for sound financial administration.

Timetable of Next Steps

1. Please include a list of key actions and the scheduled dates for these:

Action	Key milestone	Due date (provisional)	Responsible
Review compliance of Council to the FM Code for 2021/22	Close of 2021/22 accounts	November 2022	Chief Finance Officer

Wards Affected

None

Area(s) Affected

Good practice in financial management is relevant across all areas of the Council's business.

Implications

Relevant project tools Applied? Yes

Have you checked this report for plain English and readability? Yes. This has been done as far as possible considering the complex financial issues involved. Flesch-Kincaid grade level 15.1.

Climate change implications considered? N/A

Please identify if this report contains any implications for the following:

Equalities and Community Cohesiveness	No
Crime and Fear of Crime (Section 17)	No
Risk Management	Yes
Environmental Issues	No
Economic/Financial Implications	Yes
Human Rights Act	No
Organisational Consequences	Yes
Local People's Views	No
Anti-Poverty	No

Additional Information

Appendix 1: Self-Assessment of FM Code 2021/22

Appendix 2: CIPFA Financial Management Code

Appendix 3: The Seven Characteristics of Good Governance - Centre for Government and Security

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Appendix 1 - CIPFA Financial Management Code Self Assessment

FM Code Heading / Reference:	How Hastings Borough Council Complies	Areas for improvement / RAG Rating
LEADERSHIP		**Overall Assessment: GREEN**
A. The leadership team is able to demonstrate that the services provided by the authority provide value for money.	• The Management Team of the Council includes senior representatives from a variety of disciplines, including the Managing Director, S151 Officer, Monitoring Officer and Assistant Directors. • Business cases proposals are brought to Management Team for discussion and challenge. • Key financial decisions are discussed collectively at Management Team and with respective elective members through informal briefings and at Cabinet and Full Council. • The advice of the CFO is taken into account in decision-making. • All reports to both Management Team and Committees are expected to be shared with Financial Services prior to wider consideration so that timely advice on financial considerations can be given. • The Constitution, incorporating the Financial Procedure Rules and Contract Procedure Rules set out the framework for financial decision-making, arrangement for financial management and control, tendering processes and decision making for contracts. Contracts are monitored. • A robust quarterly budget monitoring process is in place, which provides regular updates to Management Team in terms of compliance with the budget monitoring requirements. This is supported by quarterly budget monitoring reports to the Cabinet and Overview and Scrutiny Committee which are discussed and challenged in the public arena. • Performance and Finance Monitoring Quarterly Reports are taken to Overview and Scrutiny Committee on a quarterly basis. • The council has effective internal audit and risk management functions, with reporting to Senior Management and Members. • The council has in place a Audit Committee to provide robust challenge and scrutiny to the council's financial management and risk and governance processes, or ensure best use of public funds. • External Audit assessment of VFM as part of the financial statements which is formally reported to the Finance & Audit Committee. • Arrangements in place to formally consider significant partnerships and shared service arrangements.	**GREEN** • External Auditors have yet to give their opinion on VFM aspects in respect of the 2019-20 financial accounts. • Quarterly finance reports reporting performance against the budget have been delayed recently due to the amount and complexity of work in terms of pandemic response. Verbal updates have been given at meetings.

Appendix 1 - CIPFA Financial Management Code Self Assessment

FM Code Heading / Reference:	How Hastings Borough Council Complies	Areas for improvement / RAG Rating
B. The authority complies with the CIPFA Statement on the Role of the Chief Finance Officer in Local Government.	• The council has a qualified and experienced S151 officer in place as specified in this CIPFA statement. • The CFO is part of the Management Team to enable advice to be given at a strategic level. Financial proposals are considered collectively and then discussed with Elected Members as appropriate. The advice of the CFO is taken into account in decision-making. • The CFO is available to all Members to give advice on financial matters relating to the Council. • The Audit Committee • Council's Constitution lists various delegations. • The review of the council's Annual Governance Statement (AGS) includes a specific statement from the S151 Officer confirming the actions that they take in order to comply with the CIPFA Statement on the Role of the Chief Finance Officer in Local Government • Annual budget setting report contains a statement from the CFO on the robustness of the estimates and the adequacy of the reserves when considering the Budget and Council Tax.	GREEN
O. The leadership team monitors the elements of its balance sheet that pose a significant risk to its financial sustainability.	• The council has a Treasury Management Strategy and Capital strategy in place, performance against which is monitored on a regular basis through updates to the Audit Committee, as stipulated by reporting requirements in this area. •Financial monitoring statements are provided to the council's senior management team and Members on a quarterly basis along with the council's Management The quarterly reports provide a narrative to identify any areas of concern. • Management Team considers financial information on key areas on a periodic basis. • The Operational Risk register for the council includes a specific risk around the ongoing financial viability and investment risk to the council which includes specific activities that are undertaken to manage and monitor this risk. • Annual balance sheet review undertaken by the councils treasury management advisors, Link Group.	GREEN

Appendix 1 - CIPFA Financial Management Code Self Assessment

FM Code Heading / Reference:	How Hastings Borough Council Complies	Areas for improvement / RAG Rating
ACCOUNTABILITY		**Overall Assessment: GREEN**
D. The authority applies the CIPFA/SOLACE Delivering Good Governance in Local Government Framework (2016).	• Internal control framework assessed annually as part of the Internal Audit annual opinion which is reported to the Audit Committee. This also forms part of the council's overall assessment of Governance and is published alongside the Annual Governance Statement. An action plan is produced to respond to any weaknesses in or opportunities to further enhance control arrangements. • A robust framework is in place through the Annual Governance Statement which assesses the council's approach to governance against the CIPFA standards on an annual basis. • Statutory Monitoring Officer in place supported by the committee framework. • Committees are supported by the democratic services team who provide administrative and secretariat support.	**GREEN**
P. The Chief Finance Officer has personal and statutory responsibility for ensuring that the statement of accounts produced by the local authority complies with the reporting requirements of the Code.	• The CFO and Finance Team have a good working relationship with External Audit and have an open dialogue to ensure that material matters that could affect the presentation of the statements of account are shared at the earliest opportunity. • The Council has a project timetable in place to ensure that key tasks are identified to ensure the delivery of the draft statements of account on a timely basis. • The Council produces a succinct and informative Narrative Report intended to effectively communicate the authority's activities and achievements, its financial position and performance, to its stakeholders. • The Statement of Accounts for the council includes an introduction from the Chief Finance Officer stating compliance with the CIPFA Code of Practice on Local Authority Accounting. • Externally audited annual financial statements are made available publicly on the council's website. • The council keeps its budget position under constant review and has demonstrated that it is willing to review and amend its budget as necessary to ensure financial viability, including via the use of revised in year budgets.	**GREEN** • Final Accounts timetable needs to be reviewed and updated.

Appendix 1 - CIPFA Financial Management Code Self Assessment

FM Code Heading / Reference:	How Hastings Borough Council Complies	Areas for improvement / RAG Rating
Q. The presentation of the final outturn figures and variations from budget allows the leadership team to make strategic financial decisions.	• Quarterly monitoring reports are presented to the council's Management Team, Cabinet and the Overview and Scrutiny Committee enabling strategic financial decisions to be made throughout the year. • Financial viability assessments and financial modelling are used to inform strategic financial decisions. • The budget setting papers that are presented to Cabinet and Full Council provide a clear update against the Medium-Term Financial Strategy setting out the financial position of the council, and provides details of variations as necessary to enable robust strategic financial decision making.	**GREEN** • External Audit sign off of the financial statements for 2019/20 and 2020/21 is outstanding.
TRANSPARENCY		**Overall Assessment: AMBER**
L. The authority has engaged where appropriate with key stakeholders in developing its long-term financial strategy, medium-term financial plan and annual budget.	• Stakeholder engagement informed the development of the current Corporate Plan to ensure clear priority is given to those services that the Council are statutorily required to do or are of most value to those with a key interest in the borough. • Stakeholder engagement is also considered in key projects or initiatives pursued by the Council. • The financial strategy of the Council is discussed and shaped by the CFO, Management Team, Leader of the Council and other key Members. • Engagement with Members through the budget setting and monitoring process takes place; all papers are provided in the public arena and proposed budgets are discussed with all Members in more detail at specific political group meetings to enable robust challenge. • Assistant Directors and Service managers are consulted during the budget process with findings presented to Management Team and Cabinet. • The draft financial statements are open to challenge by Members as well as the general public and the public inspection period is advertised on the Councils website. The Medium Term Financial Strategy is regularly presented to Members and Management Team for review and discussion. • The Corporate Plan Draft Annual Update and Draft Budget are put out for public consultation each year. • Business cases and project initiation documents are considered by Management Team, and Members where required, for projects, especially those requiring a financial contribution.	**GREEN**

Appendix 1 - CIPFA Financial Management Code Self Assessment

FM Code Heading / Reference:	How Hastings Borough Council Complies	Areas for improvement / RAG Rating
M. The authority uses an appropriate documented option appraisal methodology to demonstrate the value for money of its decisions.	• The Council has in place template business case and project initiation documents. These are completed and considered by Management Team, and Members where required, for projects, especially those requiring a financial contribution. • All reports to Committees include a section for consideration of Economic/Finance & Risk implications. • Documented minutes are available on Hastings Borough Council's web page showing outcomes of decisions made by its various committees. • Value for money is considered in all business case documents in order to be able to demonstrate how specific decisions will demonstrate value for money.	**AMBER** • Whilst consideration is given to value for money in various ways across the council, this is not consistent in terms of an 'option appraisal' methodology. This is something that should be considered moving forward.

Appendix 1 - CIPFA Financial Management Code Self Assessment

FM Code Heading / Reference:	How Hastings Borough Council Complies	Areas for improvement / RAG Rating
STANDARDS		**Overall Assessment: GREEN**
H. The authority complies with the CIPFA Prudential Code for Capital Finance in Local Authorities.	• The council has a Capital Strategy in place, which is reviewed annually to ensure it remains fit for purpose and in line with other key strategic documents of the council and is published on the council's website. The Strategy covers capital expenditure, treasury management investments, as well as commercial activity and property investment decisions. • The council has an Investment Strategy in place which is reviewed annually as part of the Treasury Management Strategy, publicly available on the council's website. • Treasury Management mid-year review reported to Audit Committee in line with the requirements of the Prudential Code. • The council has in place a Medium-term Financial Strategy to ensure the long-term financial strategies are translated into plans to aid budget setting. This is reviewed as part of the budget setting process, with operational business plans developed for the coming financial year to ensure they are aligned.	**GREEN**
J. The authority complies with its statutory obligations in respect of the budget setting process.	• The Financial Services Team has a budget work programme in place which takes account of dates set out in statute and draws on interactions with key stakeholders, including budget holders and senior management. This programme includes reporting of significant budget items to Management Team for discussion and consideration, as well as budget discussions with the Managing Director and Leader of the Council. This ensures ownership of the budget by the whole leadership team. • The council conducts an annual review of working balances and reserves to assess its financial sustainability as required by Section 25 of the Local Government Act 2003. This is presented as part of the budget setting reports to Cabinet and Full Council.	**GREEN**

Appendix 1 - CIPFA Financial Management Code Self Assessment

FM Code Heading / Reference:	How Hastings Borough Council Complies	Areas for improvement / RAG Rating
K. The budget report includes a statement by the chief finance officer on the robustness of the estimates and a statement on the adequacy of the proposed financial reserves	• This statement is included as part of the budget process which includes details of earmarked reserves. • Key stakeholders of reserves are consulted as part of the budget process which helps ensure adequacy and relevance. • Levels of working balances and general reserves have been agreed with members. • The budget setting report contains the statement required under Section 25 of the Local Government Act 2003 on the robustness of the estimates and a statement on the adequacy of the proposed financial reserves.	GREEN
ASSURANCE		**Overall Assessment: AMBER**
C. The leadership team demonstrates in its actions and behaviours responsibility for governance and internal control.	• The Council follows the CIPFA/SOLACE guidance entitled 'Delivering Good Governance in Local Government (Guidance Note for English Authorities) • The Councils Constitution sets out how it will carry out its functions, and the procedures and processes in place to deliver its corporate objectives. This is reviewed periodically to confirm it remains fit for purpose. • A robust framework is in place through the Annual Governance Statement to assess the Council's approach to governance against on an annual basis and identify any areas for improvement. • Internal controls are implemented and monitored by management and reviewed by internal audits. • Monitoring Officer is in place to ensure and advise on compliance with legal and governance arrangements for the authority. The Monitoring Officer also attends all management Team meetings to provide a legal overview. • All formal reports to Management Team and Members include a standard appendix which requires consideration to be given to the implications of the report and any associated decisions required. • Budget monitoring reports are produced for all areas and discussed with senior managers regularly.	GREEN

Appendix 1 - CIPFA Financial Management Code Self Assessment

FM Code Heading / Reference:	How Hastings Borough Council Complies	Areas for improvement / RAG Rating
F. The authority has carried out a credible and transparent financial resilience assessment.	• The council conducts an annual review of working balances and reserves to assess its financial sustainability as required by Section 25 of the Local Government Act 2003. As part of this review, the council will assess its historic and planned use of reserves and working balances and use data sources such as the CIPFA Financial Resilience Index to benchmark itself against others, albeit this is only an indicator of sustainability. • The council has a robust Medium Term Financial Strategy in place, which is published on the website. • External Audit conduct an annual audit of the council's accounts and overall financial standing which, to date, have not raised any concerns regarding resilience.	**GREEN**
N. The leadership team takes action using reports enabling it to identify and correct emerging risks to its budget strategy and financial sustainability.	• The Council has mechanisms in place to capture changes in government policy direction/new legislation, including monthly legislative updates, attendance at professional groups and bodies etc. • Management Team considers financial and other management information on key areas on a periodic basis to identify changes in risks. • Management Team meetings will identify and consider emerging risks and put in place action to understand, manage and/or mitigate such risks as appropriate.	**AMBER** Consider introduction of a quarterly risk management working group to discuss emerging risks.

Appendix 1 - CIPFA Financial Management Code Self Assessment

FM Code Heading / Reference:	How Hastings Borough Council Complies	Areas for improvement / RAG Rating
SUSTAINABILITY		Overall Assessment: GREEN
E. The financial management style of the authority supports financial sustainability.	• The council has a number of mechanisms in place to enable thorough management of financial and budgetary information: - Decisions with financial elements being presented to Management Team before being progressed further. - Budget monitoring - Financial statements made available to key staff - Budget setting process - Finance Performance Indicators are monitored These arrangements place accountability with budget holders, Service Managers, Assistant Directors and Directors to manage the financial resources associated with their areas of responsibility within the framework of the Financial Standing Orders and the Constitution. • The Finance function is viewed as an approachable and key support service of the Council and are engaged in key corporate projects and work streams, as well as providing advice and guidance to individual departments. • The authority thinks innovatively and this is embedded in the Corporate Plan. It has a history of addressing financial issues head on, particularly with the Priority Income and Efficiency Reviews (PIER) that has been in place for a number of years to address the challenging financial times facing the council.	GREEN
G. The authority understands its prospects for financial sustainability in the longer term and has reported this clearly to Members.	• The council has in place a number of key documents and strategies which have been presented to Council, Cabinet and/or Audit Committee: - MTFP in place - Capital Strategy in place - Treasury Management / Investment Strategy in place • Financial sustainability is considered annually as part of the budget setting process in which all Members are involved, with quarterly, in year updates provided to Cabinet and the Overview and Scrutiny Committee through budget monitoring reports and other specific reports are required. The council has a robust Medium Term Financial Strategy in place, which is published on the website.	GREEN

Appendix 1 - CIPFA Financial Management Code Self Assessment

FM Code Heading / Reference:	How Hastings Borough Council Complies	Areas for improvement / RAG Rating
I. The authority has a rolling multi-year medium-term financial plan consistent with sustainable service plans.	• The Council has in place a multi-year financial plan covering, at a high level, performance against the approved budget for the current year plus projections covering a further two years. This is a 'live' document that is updated on an ongoing basis to reflect decisions taken by the council or issues identified through budget monitoring to ensure this continues to support service delivery. • The MTFS is formally considered by Management Team and Members during the year and at budget setting. • The MTFS is used to model and understand the impacts of government policy and significant decisions to be taken by the Council.	**GREEN**

The Chartered Institute of Public Finance & Accountancy

financial management code

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. Our 14,000 members work throughout the public services, in national audit agencies, in major accountancy firms, and in other bodies where public money needs to be effectively and efficiently managed. As the world's only professional accountancy body to specialise in public services, CIPFA's qualifications are the foundation for a career in public finance. We also champion high performance in public services, translating our experience and insight into clear advice and practical services. Globally, CIPFA shows the way in public finance by standing up for sound public financial management and good governance.

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Executive summary

The tightening fiscal landscape has placed the finances of local authorities under intense pressure. Where finance in local government works well there is often a common understanding and ownership of issues supported by good financial management.

While organisations have done much to transform services, shape delivery and streamline costs, for these approaches to be successful it is crucial to have good financial management embedded as part of the organisation. Good financial management is an essential element of good governance and longer-term service planning, which are critical in ensuring that local service provision is sustainable.

The Financial Management Code (FM Code) is designed to support good practice in financial management and to assist local authorities in demonstrating their financial sustainability. For the first time the FM Code sets out the standards of financial management for local authorities.

Local government finance in the UK is governed by primary legislation, regulation and professional standards as supported by statutory provision. The general financial management of a local authority, however, has not until now been supported by a professional code. The FM Code has been introduced because the exceptional financial circumstances faced by local authorities have revealed concerns about fundamental weaknesses in financial management, particularly in relation to organisations that may be unable to maintain services in the future. There is much good practice across the sector, but the failures of a small number threatens stakeholders' confidence in local government as a whole. Most importantly, the financial failure of just one local authority is one too many because it brings with it a risk to the services on which local people rely.

This publication has several components. The first is an introduction explaining how the FM Code applies a principles-based approach and how it relates to other statutory and good practice guidance on the subject. This is a good starting point for those new to the FM Code.

This introduction is followed by the CIPFA Statement of Principles of Good Financial Management. These six principles have been developed by CIPFA in collaboration with senior leaders and practitioners who work within or have a stake in good local authority financial management. These principles are the benchmarks against which all financial management should be judged. CIPFA's view is that all financial management practices should comply with these principles.

To enable authorities to test their conformity with the CIPFA Statement of Principles of Good Financial Management, the FM Code translates these principles into financial management standards. These financial management standards will have different practical applications according to the different circumstances of each authority and their use should therefore reflect this. The principle of proportionality is embedded within this code and reflects a non-prescriptive approach.

The purpose of the FM Code itself is to establish the principles in a format that matches the financial management cycle and supports governance in local authorities. A series of financial management standards set out the professional standards needed if a local authority is to meet the minimal standards of financial management acceptable to meet fiduciary duties to taxpayers, customers and lenders. Since these are minimum standards, CIPFA's judgement is that compliance with them is obligatory if a local authority is to meet its statutory responsibility for sound financial administration. Beyond that, CIPFA members must comply with it as one of their professional obligations.

While the statutory local authority budget setting process continues to be on an annual basis, a longer-term perspective is essential if local authorities are to demonstrate their financial sustainability. Short-termism runs counter to both sound financial management and sound governance.

Reflecting on the importance of longer term financial planning, one of the objectives of the FM Code is to support organisations to demonstrate that they have the leadership, capacity and knowledge to be able to plan effectively. This must be balanced against retaining the integrity of the annual budget preparation process when the need to make difficult decisions may threaten its integrity.

CIPFA recognises that local authorities may need additional practical guidance on some aspects of the FM Code. Such 'hands on' guidance will be produced by CIPFA to meet practitioner demand.

Contents

Introduction

The Financial Management Code (FM Code) is designed to support good practice in financial management and to assist local authorities in demonstrating their financial sustainability. The FM Code therefore for the first time sets the standards of financial management for local authorities.

One of the strengths of UK local government is its diversity, with authorities having a different organisational culture – even those of the same size and type. It is this that allows a close relationship between local authorities and the communities that they serve. Its style of financial management should reflect, for example, its reliance on local tax income or scope to utilise additional grant or generate trading income. This code is therefore not prescriptive.

The FM Code is based on a series of principles supported by specific standards which are considered necessary to provide the strong foundation to:

- financially manage the short, medium and long-term finances of a local authority
- manage financial resilience to meet unforeseen demands on services
- manage unexpected shocks in their financial circumstances.

The FM Code is consistent with other established CIPFA codes and statements in being based on principles rather than prescription. This code incorporates their existing requirements on local government so as to provide a comprehensive picture of financial management in the authority.

Each local authority (and those bodies designated to apply the FM Code) must demonstrate that the requirements of the code are being satisfied. Demonstrating this compliance with the FM Code is a collective responsibility of elected members, the chief finance officer (CFO) and their professional colleagues in the leadership team. It is for all the senior management team to work with elected members in ensuring compliance with the FM Code and so demonstrate the standard of financial management to be expected of a local authority. In doing this the statutory role of the section 151 officer will not just be recognised but also supported to achieve the combination of leadership roles essential for good financial management.

While CIPFA has provided leadership, the development of the FM Code reflects a recognition that self-regulation by the sector must be the preferred response to the financial management failures that have the potential to damage the reputation of the sector as a whole. The FM Code has sought therefore to rely on the local exercise of professional judgement backed by appropriate reporting. To ensure that self-regulation is successful, compliance with the FM Code cannot rest with the CFO acting alone.

Significantly, the FM Code builds on established CIPFA Prudential and Treasury Management Codes which require local authorities to demonstrate the long-term financial sustainability of their capital expenditure, associated borrowing and investments. The introduction of the Prudential Framework based on the CIPFA codes enabled local authorities to make their own capital finance decisions on matters that had hitherto been subject to central government control. The FM Code should not be considered in isolation and accompanying tools, including the use of objective quantitative measures of financial resilience, should form part of the suite of evidence to demonstrate sound decision making.

The CIPFA Statement of Principles of Good Financial Management

The FM Code applies a principle-based approach. It does not prescribe the financial management processes that local authorities should adopt. Instead, this code requires that a local authority demonstrates that its processes satisfy the principles of good financial management for an authority of its size, responsibilities and circumstances. Good financial management is proportionate to the risks to the authority's financial sustainability posed by the twin pressures of scarce resources and the rising demands on services. The FM Code identifies these risks to financial sustainability and introduces an overarching framework of assurance which builds on existing best practice but for the first time sets explicit standards of financial management. These are minimum standards, which for many in the sector are self-evident. Recent experience in some local authorities suggests, however, that they are by no means universally achieved.

The underlying principles that inform the FM Code have been developed in consultation with senior practitioners from local authorities and associated stakeholders. The principles have been designed to focus on an approach that will assist in determining whether, in applying standards of financial management, a local authority is financially sustainable.

- Organisational **leadership** – demonstrating a clear strategic direction based on a vision in which financial management is embedded into organisational culture.
- **Accountability** – based on medium-term financial planning that drives the annual budget process supported by effective risk management, quality supporting data and whole life costs.
- Financial management is undertaken with **transparency** at its core using consistent, meaningful and understandable data, reported frequently with evidence of periodic officer action and elected member decision making.
- Adherence to professional **standards** is promoted by the leadership team and is evidenced.
- Sources of **assurance** are recognised as an effective tool mainstreamed into financial management, including political scrutiny and the results of external audit, internal audit and inspection.
- The long-term **sustainability** of local services is at the heart of all financial management processes and is evidenced by prudent use of public resources.

The FM Code has been developed and tested in partnership with a range of different types of local authorities. However, given the diversity of UK local government, it is not possible (or desirable) for the FM Code to anticipate all eventualities. If any doubt arises as to whether or how the FM Code should be applied, then reference should be made to these Principles of Good Financial Management to establish whether the proposed financial management practice is acceptable. A financial management practice that conflicts with one or more of these principles will not be acceptable if not explicitly ruled out by the financial management standards contained in the FM Code.

The applicability and structure of the Financial Management Code

CIPFA's intention is that the Financial Management Code (FM Code) will have the same scope as the *Prudential Code for Capital Finance in Local Authorities* (CIPFA, 2017), which promotes the financial sustainability of local authority capital expenditure and associated borrowing. So, although the FM Code does not have legislative backing, it applies to all local authorities, including police, fire, combined and other authorities, which:

- in England and Wales are defined in legislation for the purposes of Part 1 of the Local Government Act 2003
- in Scotland are defined in legislation for the purposes of Part 7 of the Local Government in Scotland Act 2003, or to the larger bodies (such as integration joint boards) to which Section 10 of this Act applies
- in Northern Ireland are defined in legislation for the purposes of Part 1 of the Local Government Finance Act (Northern Ireland) 2011.

While the FM Code applies to all local authorities, it recognises that some have different structures and legislative frameworks. Where compliance with this code is not possible, adherence to the principles is still considered appropriate.

In addition to its alignment with the *Prudential Code for Capital Finance in Local Authorities* (CIPFA, 2017), the FM Code also has links to the *Treasury Management in the Public Sector Code of Practice and Cross Sectoral Guidance Note* (CIPFA, 2017) and the annual *Code of Practice on Local Authority Accounting in the United Kingdom*. In this way the FM Code supports authorities by re-iterating in one place the key elements of these statutory requirements.

Although it may be expressed differently across the different jurisdictions of the UK, the FM Code is also further supported by statutory requirement, or all local authorities to have sound financial management.

Section 151 of the Local Government Act 1972 requires that every local authority in England and Wales should "... make arrangements for the proper administration of their financial affairs and shall secure that one of their officers has responsibility for the administration of those affairs."

Section 95 of the Local Government (Scotland) Act 1973 substantially repeats these words for Scottish authorities.

In Northern Ireland, Section 54 of the Local Government Act (Northern Ireland) 1972 requires that "a council shall make safe and efficient arrangements for the receipt of money paid to it and the issue of money payable by it and those arrangements shall be carried out under the supervision of such officer of the council as the council designates as its chief finance officer."

CIPFA's judgement is that compliance with the FM Code will assist local authorities to demonstrate that they are meeting these important legislative requirements.

In addition to the requirements of primary legislation and associated CIPFA Codes, an authority's prudent and proper financial management is informed by a framework of professional codes of practice and guidance, including:

- the CIPFA *Statements of Professional Practice (SOPP) (including ethics)*
- the CIPFA *Statement of the Role of the Chief Financial Officer*
- the CIPFA *Statement on the Role of the Chief Financial Officer in Local Government*
- the CIFFA *Statement on the Role of the Chief Finance Officer of the Police and Crime Commissioner and the Chief Finance Officer of the Chief Constable*.

CIPFA considers the application of the FM Code to be a professional responsibility of all its members, regardless of their role in the financial management process. More specifically, the FM Code clarifies CIPFA's understanding of how CFOs should satisfy their statutory responsibility for good financial administration. The responsibilities of the CFO are both statutory and professional. Notwithstanding these specific expectations of CIPFA members, the primary purpose of the FM Code is to establish how the CFO – regardless of whether or not they are a CIPFA member – should demonstrate that they are meeting their statutory responsibility for sound financial administration.

The code has clear links to a number of value for money characteristics such as sound governance at a strategic, financial and operational level, sound management of resources and use of review and options appraisal. Where an overriding duty of value for money exists, this serves to give indirect statutory support to important elements of this code.

The manner in which compliance with the FM Code is demonstrated will be proportionate to the circumstances of each local authority. Importantly, however, contextualising the FM Code cannot be done according only to the size of the authority but also according to the complexity and risks in its financial arrangements and service delivery arrangements.

CIPFA considers application of the FM Code to be a collective responsibility of each authority's organisational leadership team.

CIPFA believes that this FM Code merits the type of statutory backing given to some other CIPFA codes and furthermore there is support for this approach within local government and its stakeholders. Equally, however, CIPFA recognises that such backing demands enabling primary legislation that at present has not been identified. CIPFA will continue to work with the jurisdictions of the different parts of the UK to provide statutory backing to the FM Code. At present it is difficult to envisage circumstances in which the absence of statutory backing for the FM Code would provide a reason for non-compliance.

APPLICATION DATE

Local authorities are required to apply the requirements of the FM Code with effect from 1 April 2020. This means that the 2020/21 budget process provides an opportunity for assessment of elements of the FM Code before April 2020 and to provide a platform for good financial management to be demonstrable throughout 2020/21. Local authorities will need to ensure that their governance and financial management style are fit in advance for this purpose. CIPFA has also considered the ambition within this code, the timescale and of course the wider resource challenges facing local authorities. Consequently CIPFA considers that the implementation date of April 2020 should indicate the commencement of a shadow year and that by 31 March 2021, local authorities should be able to demonstrate that they are working towards full implementation of the code. The first full year of compliance with the FM Code will therefore be 2021/22. Earlier adoption is of course encouraged.

It is the duty of each local authority to adhere to the principles of financial management. To enable authorities to test their conformity with the CIPFA Principles of Good Financial Management, the FM Code translates these principles into financial management standards. These financial management standards will have different practical applications according to the different circumstances of each authority.

The structure of the FM Code

The CIPFA financial management standards are presented and explained in Sections 1 to 7 of the FM Code.

Sections 1 and 2 address important contextual factors which need to be addressed in the first instance if sound financial management is to be possible. The first deals with the responsibilities of the CFO and leadership team, the second with the authority's governance and financial management style. From a professional perspective, these factors are the most challenging to codify as they largely concern 'soft skills' and behaviours. Nonetheless, it will be seen that even for these factors, there are recognised standards of best practice that authorities must adopt if their organisational culture is to be favourable for sound financial management. A 'tick box' compliance with these standards alone, however, will not be sufficient if they do not promote the behaviours necessary for good financial management.

The remaining Sections 3 to 7 address the requirements of the financial management cycle, with Section 3 stating the need for a long-term approach to the evaluation of financial sustainability. To make well informed decisions all these elements of the cycle need to be fit for purpose. The development of a high-quality long-term financial strategy will not itself promote financial sustainability if, for example, the authority's annual budget setting process (Section 4), stakeholder engagement and business cases (Section 5) and performance monitoring arrangements (Section 6) are inadequate. The cycle is completed by Section 7, which shows how high-quality financial reporting supports the financial management cycle by ensuring that it rests on sound financial information.

CIPFA's expectation is that authorities will have to comply with all the financial management standards if they are to demonstrate compliance with the FM Code. It is again most important that practitioners recognise that, while compliance with the CIPFA financial management standards is obligatory, the FM Code is not prescriptive about how this is achieved.

In the accompanying guidance notes CIPFA sets out practices that local authorities can adopt to ensure compliance with the FM Code. These practices are not prescribed by the FM Code, but rather offered as a starting point for local authorities needing to raise their approach to financial management to the minimum standard set out in the FM Code. CIPFA may issue support and clarify application of the FM Code. Authorities can develop their own good practice and are encouraged to do so.

As high-level statements, the overarching CIPFA financial management standards apply to the police service. CIPFA recognises, however, that this type of organisation has in some respects different practices from other local authorities. In addition, the creation of bespoke combined authorities means that some flexibility is required in the application of the FM Code for their circumstances. This may be achieved by applying some standards to each of the component bodies and others directly to the combined authority itself. In all cases, when an authority has unique governance arrangements the CIPFA Principles of Financial Management should be used to resolve any doubt about the application of articular financial management standards.

Financial management standards are to be guided by proportionality. It is appropriate for different financial management approaches to apply to high-value/high-risk items that alone may determine the financial sustainability of the organisation as distinct from low-value/low-risk items. In satisfying the demands of the financial management standards it may be appropriate to apply different standard practices according to the scale and risks of each category of income or expenditure. The intention is that authorities demonstrate a rigorous approach to the assessment and mitigation of risk so that financial management expertise is deployed effectively given the circumstances faced by the authority.

Nonetheless, in acknowledging the need for proportionality in applying some aspects of the FM Code, an authority still needs to recognise that when aggregated, a failure to manage individual low-value/low-risk items may still threaten financial sustainability. The FM Code seeks to promote the good financial management of the standard, typical or familiar local authority activities just as much as it promotes the good financial management of the unusual, exceptional and unfamiliar. Essentially, the FM Code recognises that getting the routine business right is crucial for good financial management.

The CIPFA financial management standards

Summary table of CIPFA financial management standards

FM standard reference	CIPFA financial management standards
	Section 1: The responsibilities of the chief finance officer and leadership team
A	The leadership team is able to demonstrate that the services provided by the authority provide value for money.
B	The authority complies with the CIPFA *Statement on the Role of the Chief Finance Officer in Local Government.*
	Section 2: Governance and financial management style
C	The leadership team demonstrates in its actions and behaviours responsibility for governance and internal control.
D	The authority applies the CIPFA/SOLACE *Delivering Good Governance in Local Government: Framework* (2016).
E	The financial management style of the authority supports financial sustainability.
	Section 3: Long to medium-term financial management
F	The authority has carried out a credible and transparent financial resilience assessment.
G	The authority understands its prospects for financial sustainability in the longer term and has reported this clearly to members.
H	The authority complies with the CIPFA *Prudential Code for Capital Finance in Local Authorities.*
I	The authority has a rolling multi-year medium-term financial plan consistent with sustainable service plans.
	Section 4: The annual budget
J	The authority complies with its statutory obligations in respect of the budget setting process.
K	The budget report includes a statement by the chief finance officer on the robustness of the estimates and a statement on the adequacy of the proposed financial reserves.
	Section 5: Stakeholder engagement and business plans
L	The authority has engaged where appropriate with key stakeholders in developing its long-term financial strategy, medium-term financial plan and annual budget.
M	The authority uses an appropriate documented option appraisal methodology to demonstrate the value for money of its decisions.
	Section 6: Monitoring financial performance
N	The leadership team takes action using reports enabling it to identify and correct emerging risks to its budget strategy and financial sustainability.
O	The leadership team monitors the elements of its balance sheet that pose a significant risk to its financial sustainability.
	Section 7: External financial reporting
P	The chief finance officer has personal and statutory responsibility for ensuring that the statement of accounts produced by the local authority complies with the reporting requirements of the *Code of Practice on Local Authority Accounting in the United Kingdom.*
Q	The presentation of the final outturn figures and variations from budget allows the leadership team to make strategic financial decisions.

FM Code

Leadership	Accountability	Transparency	Standards	Assurance	Sustainability
A. The leadership team is able to demonstrate that the services provided by the authority provide value for money.	**D**. The authority applies the CIPFA/SOLACE *Delivering Good Governance in Local Government: Framework* (2016).	**L**. The authority has engaged where appropriate with key stakeholders in developing its long-term financial strategy, medium-term financial plan and annual budget.	**H**. The authority complies with the CIPFA *Prudential Code for Capital Finance in Local Authorities*.	**C**. The leadership team demonstrates in its actions and behaviours responsibility for governance and internal control.	**E**. The financial management style of the authority supports financial sustainability.
B. The authority complies with the CIPFA *Statement on the Role of the Chief Finance Officer in Local Government*.	**P**. The chief finance officer has personal and statutory responsibility for ensuring that the statement of accounts produced by the local authority complies with the reporting requirements of the Code.	**M**. The authority uses an appropriate documented option appraisal methodology to demonstrate the value for money of its decisions.	**J**. The authority complies with its statutory obligations in respect of the budget setting process.	**F**. The authority has carried out a credible and transparent financial resilience assessment.	**G**. The authority understands its prospects for financial sustainability in the longer term and has reported this clearly to members.
O. The leadership team monitors the elements of its balance sheet that pose a significant risk to its financial sustainability.	**Q**. The presentation of the final outturn figures and variations from budget allows the leadership team to make strategic financial decisions.		**K**. The budget report includes a statement by the chief finance officer on the robustness of the estimates and a statement on the adequacy of the proposed financial reserves.	**N**. The leadership team takes action using reports enabling it to identify and correct emerging risks to its budget strategy and financial sustainability.	**I**. The authority has a rolling multi-year medium-term financial plan consistent with sustainable service plans.

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SECTION 1

The responsibilities of the chief finance officer and leadership team

Local authorities in the UK use different democratic models. While the committee and the cabinet system are the most common there are also a number of direct elected mayors in England. Regardless of the model, responsibility for corporate financial sustainability rests with those responsible for making executive decisions with the support of their professional advisors. Elected members need to work effectively with officers and other stakeholders to make difficult decisions and to identify and deliver savings when required.

While the legislative context differs across the different jurisdictions of the UK, all local authorities must deliver value for money. This is an overarching requirement that informs the application of the other financial management standards in the FM Code.

Financial Management Standard A

The leadership team is able to demonstrate that the services provided by the authority provide value for money.

The role of the leadership team

The delivery of value for money will ultimately be dependent on decisions made by elected members. It is for the leadership team to ensure that the authority's governance arrangements and style of financial management promote financial sustainability. It is the elected members who are held to account by local people when a local authority fails, but an important element of collective decision making is to understand the risks and appreciate the different statutory responsibilities of those involved. Good financial management is the responsibility of the whole leadership including the relevant elected members. It is the responsibility of the senior officers within the management team to enact this.

The FM Code follows the practice of the CIPFA *Statement of the Role of the Chief Financial Officer in Local Government* in referring to this collective group of elected member and officers with this collective financial responsibility as the leadership team. In local authorities, therefore, the concept of the 'leadership team' will include executive committees, elected mayors, portfolio holders with delegated powers and other key committees of the authority and senior officers.

In the police service this leadership is provided by police and crime commissioners and chief constables, which operate jointly according to the policing protocol, which requires the maintenance of an efficient force.

The role of the chief finance officer

The statutory of the role of the chief finance officer (CFO) is a distinctive feature of local government in the UK (except in Northern Ireland). This role cannot be performed in isolation and requires the support of the other members of the leadership team.

The leadership team must recognise that while statutory responsibility for the financial management of the authority rests with the CFO, the CFO is reliant on the actions of the leadership team, both collectively and individually as elected members and senior officers. A situation in which the CFO is forced to act in isolation is characteristic of authorities in which financial management has failed and financial sustainability is threatened.

Equally, the CFO must ensure that they fulfil their personal legal and professional responsibilities in the public interest and in recognition of the other statutory service responsibilities of the authority. In the leadership team the CFO must provide timely, relevant and reliable financial advice, in accordance with the law and professional standards.

It is important to appreciate that while the section 151 or similar legislative provisions require the authority to appoint a suitably qualified officer responsible for the proper administration of its affairs, responsibility for proper financial administration still rests ultimately with elected members. The local authority itself has a statutory responsibility for maintaining a system of internal control including the management of risk, an effective internal audit and preparing annual accounts.

CIPFA has issued its *Statement on the Role of the Chief Financial Officer in Local Government*. This statement sets out CIPFA's understanding of the role to support both the CFO and local authorities.

Financial Management Standard B

The authority complies with the CIPFA *Statement on the Role of the Chief Financial Officer in Local Government*.

For the purposes of the FM Code, the CIPFA *Statement on the Role of the Chief Finance Officer of the Police and Crime Commissioner* and the *Chief Finance Officer of the Chief Constable* (2012) should be substituted for references to the CIPFA *Statement on the Role of the Chief Financial Officer in Local Government.*

CIPFA's *Statement on the Role of the Chief Financial Officer in Local Government* describes the roles and responsibilities of the CFO. It sets out how the requirements of legislation and professional standards should be fulfilled by the CFO as they carry out their duties. The statement is designed to assist those carrying out the role to meet its specific responsibilities while at the same time reiterating CIPFA's *Statement of Professional Practice* with which all CIPFA members are required to comply. The statement also requires that if different organisational arrangements are adopted the reasons should be explained publicly in the authority's annual governance statement, together with how they deliver the same impact.

SECTION 2

Governance and financial management style

Without good governance a local authority cannot make the changes necessary for it to remain financially sustainable. As such, financial sustainability must be underpinned by the robust stewardship and accountability to be expected of public bodies. Good governance gains the trust of taxpayers and other funders by giving them confidence that money is being properly spent. Good governance ensures better informed and longer-term decision making and therefore is essential for good financial management.

Good governance

Responsibility for good governance also rests with the leadership team. The team must ensure that there are proper arrangements in place for governance and financial management, including a proper scheme of delegation that ensures that frontline responsibility for internal and financial control starts with those who have management roles. This delegation ensures that those responsible for the delivery of services are also explicitly held responsible for the financial management of the associated expenditure and income. Nonetheless, it is for the leadership team to demonstrate that the authority always meets exacting standards of probity, accountability and demonstrable efficiency in the use of public resources.

The CFO is not the only officer with specific statutory responsibilities for good governance. The head of paid service (in practice the chief executive) is responsible for the proper recruitment and organisation of a local authority's staff. The monitoring officer has the specific duty to ensure that the council, its officers and its elected members maintain the highest standards of conduct in all they do (the legal basis of the head of paid service's role is found in Section 4 of the Local Government and Housing Act 1989 and that of the monitoring officer in Section 5 of the same act).

All parts of the governance structure of an organisation play an important role, but the audit committee is a key component, providing independent assurance over governance, risk and internal control arrangements. It provides a focus on financial management, financial reporting, audit and assurance that supports the leadership team and those with governance responsibilities.

Good governance is evidenced by actions and behaviours as well as formal documentation and processes. The tone and action at the top are critical in this respect, and rest with the leadership team – both senior officers and elected members, as well as the CFO. A successful leadership team has a culture of constructive challenge that excludes an optimism bias in favour of a realism bias and is built on a rigorous examination of goals, underlying assumptions and implementation plans.

The Committee on Standards in Public Life has set out *Seven Principles of Public Life* which it believes should apply to all in the public services (often referred to as the Nolan Principles). The last of the Nolan Principles – that holders of public office should promote and support these principles by leadership and example – is especially relevant to the leadership team.

Financial Management Standard C

The leadership team demonstrates in its actions and behaviours responsibility for governance and internal control.

By international standards, local government in the UK is distinguished by high standards of governance. Citizens expect financial accountability, press and parliamentary scrutiny, integrity and the absence of corruption. These expectations are largely met, but local authorities should guard against complacency.

The CIPFA/IFAC *International Framework: Good Governance in the Public Sector* (Annex A to this FM Code) is intended to encourage sustainable service delivery and improved accountability by establishing a benchmark for aspects of good governance in the sector. The application of this international framework in the context of UK local government is reinforced by specific regulatory requirements and sector specific guidance. The CIPFA/SOLACE *Delivering Good Governance in Local Government: Framework* (2016 edition) supports local authorities in developing and maintaining their own codes of governance and to discharge their accountability for the proper conduct of business.

Financial Management Standard D

The authority applies the CIPFA/SOLACE *Delivering Good Governance in Local Government: Framework* (2016).

This CIPFA/SOLACE framework recommends that the review of the effectiveness of the system of internal control that local authorities in England, Wales, Scotland and Northern Ireland are required to undertake by their respective accounts and audit regulations should be reported in an annual governance statement.

Financial management style

The financial management challenges faced by many local authorities are unprecedented in recent history and show no signs of easing. This is significant because it means that different styles of financial management are necessary. Financial sustainability will not be achieved by continuing with the behaviours of the past since these do not meet the demands of the present – or the future, which may be even more challenging. To remain financially sustainable authorities need to develop their financial management capabilities.

Financial Management Standard E

The financial management style of the authority supports financial sustainability.

CIPFA believes that the strength of financial management within an organisation can be assessed by a hierarchy of three 'financial management (FM) styles':

- delivering accountability
- supporting performance
- enabling transformation.

These different styles are used in the CIPFA Financial Management Model to describe the different standards of financial management which may be found in local authorities. They represent a hierarchy in which enabling transformation is only achieved by a financial management style that supports performance and which in turn delivers accountability. Once these basic foundations have been soundly established, authorities need to move up through a hierarchy of financial management styles in response to increasing risk. This is especially important as risks have increased for many local authorities; on the one hand reduced expenditure leaves less margin for error while on the other hand, in seeking to generate new income, local authorities take on unfamiliar risks.

This hierarchy of financial management styles loosely maps onto the now deeply embedded recognition of the necessity for economy, efficiency and effectiveness to achieve value for money. In delivering accountability the finance team ensures that their authorities spend less and so achieve economy. In supporting performance, the finance team works with the authority to spend well by maximising the output from goods or services and so achieves efficiency. Finally, in enabling transformation the finance team supports the effective use of public money.

CIPFA recognises that while the highest standards of financial management should be the expectation, in practice some local authorities are at different stages of development. In these circumstances, compliance with the FM Code may initially be achieved by credible proposals to raise financial standards beyond the basic delivery of accountability.

The first two sections of this code have addressed the pre-conditions that must be satisfied for sound financial management. The following sections turn to the practical operation of the successive stages of the financial management cycle.

SECTION 3

Medium to long-term financial management

While the statutory local authority budget setting process continues to be on an annual basis (see Section 4) a longer-term perspective is essential if local authorities are to demonstrate their financial sustainability. Short-termism runs counter to both sound financial management and sound governance.

CIPFA does not believe however that the time horizon of local authority financial planning is determined by the time horizon of the financial support from central government. The greater the uncertainty about future central government policy then the greater the need to demonstrate the long-term financial resilience of the authority given the risks attached to its core funding.

An authority must ensure that while the formal publication of the medium-term financial plan (MTFP) may only reflect government settlements, it is the responsibility of the leadership of the organisation, including elected members, senior management and the section 151, to have a long-term financial view acknowledging financial pressures.

Authorities with a high level of capital investment and associated external borrowing should adopt a correspondingly long-term approach. The Prudential Code requires that a local authority capital strategy sets out the long-term context in which capital expenditure and investment decisions are made. For example all authorities with PFI, service contracts and other similar contractual arrangements will need to demonstrate their ability to finance these arrangements over the whole period of the contracts. Housing Revenue Account (HRA) business plans in England and Wales are already based on a 30-year time horizon.

Financial resilience and long-term financial strategy

If an authority has not tested and demonstrated its long-term financial resilience then its financial sustainability remains an open question. Authorities must critically evaluate their financial resilience. It is possible that the existing strategy is financially sustainable, but this must still have been tested and demonstrated in a financial resilience assessment.

In this financial resilience assessment the authority must test the sensitivity of its financial sustainability given alternative plausible scenarios for the key drivers of costs, service demands and resources. It will require an analysis of future demand for key services and consideration of alternative options for matching demand to resources. Testing will focus on the key longer-term revenues and expenses and the key risks to which the authority will be exposed.

With an awareness that risks will vary, consideration should be given to tools such as the Financial Resilience Index that may help organisations identify these pressure points. Without such stress testing an authority cannot be regarded as financially sustainable and will be deemed to have failed that test.

Financial Management Standard F

The authority has carried out a credible and transparent financial resilience assessment.

Having carried out the finance resilience assessment, the authority will need to demonstrate how the risks identified have informed a long-term financial strategy. A local authority needs an over-arching strategic vision of how it intends to deliver outputs and achieve outcomes for which it is responsible. This should include a statement that sets out both the vision and the underlying strategy, together with the mix of interventions that the organisation will adopt in delivering services to achieve the intended outcomes. In many cases a basis for this will already exist in a corporate plan.

A key part of the strategy should be a visioning exercise to understand the potential shape of services in the future. It will need to be sufficiently comprehensive to offer a convincing demonstration that the authority has identified a way of achieving financial sustainability. At the same time it needs to provide a relatively fixed point of reference which is subject to periodic review and to revision and fundamental change only when it is no longer fit for purpose.

Financial Management Standard G

The authority understands its prospects for financial sustainability in the longer term and has reported this clearly to members.

CIPFA is not at present being prescriptive about the time period of this long-term financial strategy. Different authorities will face different levels of political and financial stability which may have become embedded in different management cultures. However, CIPFA would promote ambition and stress the need for a financial strategy that matches the requirement for a strategic approach to service planning. The underlying key demand cost drivers, especially those linked to the age profile of the community, can be foreseen at least in broad terms for a decade and more ahead.

The Prudential Code for Capital Finance in Local Authorities

The statutory requirements of the Prudential Code underpins elements of the long and medium-term financial management considered in this section of the FM Code. While the minimum requirement is for three-year rolling capital and investment plans, *The Prudential Code for Capital Finance in Local Authorities* (2017 edition) stresses that a longer-term approach is necessary to ensure that capital strategy and asset management plans are sustainable.

Financial Management Standard H

The authority complies with the CIPFA *Prudential Code for Capital Finance in Local Authorities.*

One of the requirements of the Prudential Code is a capital strategy. This capital strategy is a fundamental component of good financial management. It should set out how the organisation is currently managing its assets and more importantly its future plans linked to available resources. Balance sheet management in local authorities is about the better management of assets and liabilities to support service delivery and capital strategy. A long-term vision is needed for the configuration of service delivery and investment properties because timely asset disposals and/or investments will be dependent on complex interdependencies.

A long-term vision should also be reflected in any commercial investment activity undertaken by the organisation. Guided by the Prudential Code and relevant guidance on borrowing for acquisitions of commercial properties, a local authority should not put public money and services at risk.

Practical medium-term financial planning

CIPFA does not anticipate that a long-term financial strategy would provide sufficient detail to shape the annual budget setting process. Local authorities will need to translate their long-term financial strategies into a medium-term financial plan (MTFP) for budget setting.

The MTFP is the mechanism or framework by which the annual budget process relates directly to the long-term strategy establishing the financial sustainability of the authority. While not prescriptive about time frame, the MTFP should support financially sustainable decision making.

Importantly, performance against the plan will enable recent success and/or failures in delivering financial objectives to be taken into account in the annual budget process. A symptom of financial stress is the emergence of unanticipated overspends in recent years from the MTFP. While the long-term strategy needs to be a stable point of reference, the MTFP needs to be rolled forward annually to ensure that it reflects the latest detailed information. By taking this approach to medium-term financial planning the annual budget is aligned to longer-term goals.

The MTFP should enable the leadership team to have confidence in its long-term strategy for its financial sustainability. Importantly, financial and operational plans must be demonstratively aligned to the strategy at all levels. Without clear service plans it is impossible to place the forecast within the context of currently agreed policies and their implications for future demand and resources.

Financial Management Standard I

The authority has a rolling multi-year medium-term financial plan consistent with sustainable service plans.

SECTION 4

The annual budget

One of the objectives of this FM Code is to end the practice by which the annual budget process has often become the focal point if not the limit of local authority financial planning. However the annual budget preparation process needs to be protected at a time when the need to make difficult decisions may threaten its integrity.

Local authorities need to ensure that they are familiar with the legislative requirements of the budget setting process. In times of routine business compliance this is relatively straightforward, but in times of financial stress there may be pressures for delay or obfuscation in budget setting. These difficulties can be acute when council tax setting is reliant on decisions by independent precepting bodies. In these circumstances it is likely that the CFO will need to work closely with the chief executive, monitoring officer and the leadership team to ensure statutory processes and a timetable necessary to set a legal budget are understood. The monitoring officer is the custodian of the constitution, which acts as a safeguard to prevent councillors and officers from getting into legal difficulties in the exercise of their role and uphold and ensure fairness in decision making.

Financial Management Standard J

The authority complies with its statutory obligations in respect of the budget setting process.

The annual report setting out the proposed budget for the coming year is a key document for the authority. It will also demonstrate compliance with CIPFA's Prudential Code (Financial Management Standard H). The best budget plans are those owned and articulated by the whole leadership team and senior managers, not simply the CFO.

Reserves are acknowledged in statute. Local authorities are directed to have regard to the level of reserves when considering their budget requirement. Consequently, reserves are a recognised and intrinsic part of financial planning and budget setting. The assessment of 'adequate' and 'necessary' levels of reserves is a matter for local authorities to determine. It is the responsibility (with statutory backing in England and Wales) of the CFO to advise the local authority on the appropriate level of reserves and the robustness of the estimates.

Financial Management Standard K

The budget report includes a statement by the chief finance officer on the robustness of the estimates and a statement on the adequacy of the proposed financial reserves.

The budget report should include details of the earmarked reserves held, and explain the purpose of each reserve, together with the estimated opening balances for the year, details of planned additions/withdrawals and the estimated closing balances.

A well-managed authority, with a prudent approach to budgeting, should be able to operate with a level of general reserves appropriate for the risks (both internal and external) to which it is exposed. Compliance with the FM Code will give important reassurance that the authority's financial management processes and procedures are able to manage those risks. These should be maintained at a level appropriate for the profile of the authority's cash flow and the prospect of having to meet unexpected events from within its own resources. Even where, as part of their wider role, auditors have to report on an authority's financial position, it is not their responsibility to prescribe the optimum or minimum level of reserves for individual authorities or authorities in general.

The successful execution of the annual budget will depend on both the good governance and internal controls already codified in Section 2 as well as financial monitoring addressed in Section 6.

SECTION 5

Stakeholder engagement and business cases

Financial sustainability requires citizens to understand that resources are not limitless and that decisions have to be made about both the relative priority of different services and the balance between service provision and taxation levels. The leadership team collectively has an important role in reviewing priorities to enable resources to be redirected from areas of lesser priority; it is not possible to rely principally on pro rata cuts to generate the savings necessary for financial sustainability in an era of austerity.

The leadership team needs to challenge not only how services are delivered, but also what is delivered. These decisions must be made with a clear understanding of the statutory requirements and of wider legal implications of any decisions.

Stakeholder engagement

Stakeholder consultation can help to set priorities and reduce the possibility of legal or political challenge late in the change process. Stakeholder consultation helps to encourage community involvement not just in the design of services but in their ongoing delivery. This is especially the case when a local authority adopts an enabling approach to public service delivery which, along with the active involvement of the third sector, may facilitate future reductions in service costs.

Financial Management Standard L

The authority has engaged where appropriate with key stakeholders in developing its long-term financial strategy, medium-term financial plan and annual budget.

Business cases

Financial sustainability will be dependent upon difficult and often complex decisions being made. The authority's decisions must be informed by clear business cases based on the application of appropriation option appraisal techniques. Professional accountants can be expected to comply with the IFAC/PAIB Project and Investment Appraisal for Sustainable Value Creation reproduced in Annex B to this FM Code.

Financial Management Standard M

The authority uses an appropriate documented option appraisal methodology to demonstrate the value for money of its decisions.

It is the responsibility of the CFO to ensure that all material decisions are supported by an option appraisal which in its rigour and sophistication is appropriate for the decision being made. It is likely that the authority's documented option appraisal methodology will include a relatively simplistic approach for decisions of low value and/or low risk.

SECTION 6

Performance monitoring

To remain financially sustainable an authority must have timely information on its financial and operational performance so that policy objectives are delivered within budget. Early information about emerging risks to its financial sustainability will allow it to make a carefully considered and therefore effective response.

Financial Management Standard N

The leadership team takes action using reports enabling it to identify and correct emerging risks to its budget strategy and financial sustainability.

Significant unplanned overspends and/or carrying forward undelivered savings into the following year might be a sign that an authority is not translating its policy decisions into actions. It also creates the conditions for further financial pressures and possible service reductions in subsequent years. However, the warning signs could also be in other non-financial performance measures, such as backlogs and other indications that current resources are not matching the expectations of service users. These trends should inform the decisions taken on the medium and long-term financial planning addressed by Section 3 of this code.

It is a requirement of this code that authorities should more closely monitor the material elements of their balance sheet that may give indications of a departure from financial plans. This is especially important for local authorities with significant commercial asset portfolios. Legislation requires local authorities to maintain adequate accounting records of their assets and liabilities. Regulations also require that the appropriate (chief finance) officer certifies or confirms that the statements of accounts provide a true and fair view of the financial position (ie the amounts in the balance sheet) of the authority at 31 March in the year of account.

Financial Management Standard O

The leadership team monitors the elements of its balance sheet which pose a significant risk to its financial sustainability.

Contingencies and commitments are monitored to identify any items where a balance sheet provision may have crystallised. Key drivers of provisions (eg asset decommissioning decisions, legal claims, reorganisation activities) should be monitored to identify whether an actual or constructive obligation has arisen. Finally, cash flow is managed through application of *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes* (CIPFA, 2017).

SECTION 7

External financial reporting

Taxpayers and citizens have a legitimate stake in understanding how public money has been used in providing the functions and services of the authority. The audited statements of account, which present the authority's financial position and financial performance, play an integral part in demonstrating this to them. The statutory accounts provide a secure base for financial management. They support accountability and thus good financial management by allowing the users of the financial statements and other stakeholders to do the following:

- Discover how much is spent in a year on services and whether this has increased or decreased from previous years.
- Consider the indebtedness of an organisation and how that might impact on future taxpayers.
- Recognise the value and therefore usefulness of the assets that the organisations hold.
- Assess what the future commitments and liabilities are, for example, for pensions or leases, and again how these are likely to impact on future generations and taxpayers.

CIPFA's *Statement on the Role of the Chief Finance Officer in Local Government* sets out the chief finance officer's statutory responsibilities for producing the accounts and maintaining the financial records for those accounts. The CIPFA Statement requires that the statements of account are published on a timely basis to communicate the authority's activities and achievements, its financial position and performance. It also requires certification of the accounts by the chief finance officer. The confirmation that the accounts present a 'true and fair' view is one of the fundamental roles of the statutory chief finance officer. Across the UK the *Code of Practice on Local Authority Accounting in the United Kingdom* produced by the CIPFA/LASAAC Local Authority Code Board establishes proper (accounting) practices under which that 'true and fair' view will need to be confirmed/certified.

Financial Management Standard P

The chief finance officer has personal and statutory responsibility for ensuring that the statement of accounts produced by the local authority complies with the reporting requirements of the *Code of Practice on Local Authority Accounting in the United Kingdom.*

The statutory and professional frameworks for the production and publication of the accounts underpin their importance and demonstrate that they have a key part to play in accountability to taxpayers and other stakeholders in showing how public money is used. Financial reporting therefore should not take place in a vacuum. The financial statements provide the accountability link between planned performance, resources used and the outcomes – financial and more – that are achieved. The authority, its management and the CFO both in its financial statements and the narrative reports that accompany them must provide the user with the links between the consumption of resources and the value that has been created.

It is key to ensure that the authority and its leadership understand how effectively its resources have been utilised during the year, including a process which explains how material variances from initial and revised budgets to the outturn reported in the financial statements have arisen and been managed. The success of these arrangements will be demonstrated by the ability of the leadership team to make decisions from them. In some circumstances this will lead to a reappraisal of the achievability of the long-term financial strategy and the financial resilience of the authority (see Section 3).

Financial Management Standard Q

The presentation of the final outturn figures and variations from budget allows the leadership team to make strategic financial decisions.

Annex A

IFAC/CIPFA GUIDANCE ON IMPLEMENTING THE PRINCIPLES FOR GOOD GOVERNANCE IN THE PUBLIC SECTOR (EXTRACT)

Principles for good governance in the public sector

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

The fundamental function of good governance in the public sector is to ensure that entities achieve their intended outcomes while acting in the public interest at all times.

Acting in the public interest requires:

A. Behaving with integrity, demonstrating strong commitment to ethical values, and respecting the rule of law.

B. Ensuring openness and comprehensive stakeholder engagement.

In addition to the overarching requirements for acting in the public interest in principles A and B, achieving good governance in the public sector also requires effective arrangements for:

C. Defining outcomes in terms of sustainable economic, social, and environmental benefits.

D. Determining the interventions necessary to optimise the achievement of the intended outcomes.

E. Developing the entity's capacity, including the capability of its leadership and the individuals within it.

F. Managing risks and performance through robust internal control and strong public financial management.

G. Implementing good practices in transparency, reporting, and audit to deliver effective accountability.

Annex B

IFAC/PAIB PROJECT AND INVESTMENT APPRAISAL FOR SUSTAINABLE VALUE CREATION

Extract from IFAC website.

Principles in project and investment appraisal

The key principles underlying widely accepted good practice are:

A. When appraising multi-period investments, where expected benefits and costs and related cash inflows and outflows arise over time, the time value of money should be taken into account in the respective period.

B. The time value of money should be represented by the opportunity cost of capital.

C. The discount rate used to calculate the NPV [net present value] in a DCF [discounted cash flow] analysis, should properly reflect the systematic risk of cash flows attributable to the project being appraised, and not the systematic risk of the organisation undertaking the project.

D. A good decision relies on an understanding of the business and should be considered and interpreted in relation to an organisation's strategy and its economic, social, environmental, and competitive position as well as market dynamics.

E. Project cash flows should be estimated incrementally, so that a DCF analysis should only consider expected cash flows that could change if the proposed investment is implemented. The value of an investment depends on all the additional and relevant changes to potential cash inflows and outflows that follow from accepting an investment.

F. All assumptions used in undertaking DCF analysis, and in evaluating proposed investment projects, should be supported by reasoned judgment, particularly where factors are difficult to predict and estimate. Using techniques such as sensitivity analysis to identify key variables and risks helps to reflect worst, most likely and best case scenarios, and therefore can support a reasoned judgment.

G. A post-completion review or audit of an investment decision should include an assessment of the decision making process and the results, benefits, and outcomes of the decision.

H. Capital and revenue reports need to be closely linked so there is an understanding of how each capital scheme is financed, and in particular which require revenue contributions.

Borrowing costs need to be spelt out. Low interest rates are not in themselves a compelling reason to borrow. Capital budgets should be clear about how individual schemes are financed and which ones add pressure to revenue.

Glossary

Accounting standards	Rules set by the International Accounting Standards Boards that set out how transactions are to be shown in an organisation's accounts.
Annual statement of accounts	The statement of accounts presents the authority's transactions on an annual basis as of 31 March of the relevant year of account. The complete set of financial statements in the annual accounts for local authorities comprises: ■ comprehensive income and expenditure statement for the period ■ movement in reserves statement for the period ■ balance sheet as at the end of the period ■ cash flow statement for the period, and ■ notes, comprising significant accounting policies and other explanatory information.
Asset management plan	Asset management plans align the asset portfolio with the needs of the organisation.
Audit committee	A special committee of the council that reviews the financial management and accounts of the council.
Balance sheet	A financial statement presenting a summary of the authority's financial position as of 31 March each year. In its top half it contains the assets and liabilities held or accrued. As local authorities do not have equity shares, the bottom half is comprised of reserves that show the location of the authority's net worth between its usable and unusable reserves.
Capital budget	The money a council plans to spend on investing in new buildings, infrastructure and other equipment.
Capital financing charges	The amount a council has to pay to support its borrowing to pay for the purchase of major assets.
Capital receipt	The money a council receives for selling assets that can only be used to repay debt or for new capital expenditure.
Chief financial officer	The most senior finance person in a council responsible for ensuring the proper financial management of the council.
CIPFA FM Model	The CIPFA FM Model is the tool that helps public service organisations apply their financial resources to achieve their goals.
Code of Practice on Local Authority Accounting in the United Kingdom	A code produced by the CIPFA/LASAAC Local Authority Code Board. It specifies the principles and practices of accounting required to give a 'true and fair' view of the financial position, financial performance and cash flows of a local authority, including the group accounts where a local authority has material interests in subsidiaries, associates or joint ventures. The Local Authority Accounting Code is established as a proper practice by the four relevant administrations across the UK.
Earmarked reserve	Money set aside for future use on a specific area of expenditure. It remains a part of the general reserves of the authority.

Financial management	Financial management encompasses all the activities within an organisation that are concerned with the use of resources and that have a financial impact. CIPFA has defined financial management for public bodies as "the system by which the financial aspects of a public body's business are directed and controlled to support the delivery of the organisation's goals".
General fund balance (also council fund or police fund)	The general fund is the statutory fund into which all the receipts of an authority are required to be paid and out of which all liabilities of the authority are to be met, except to the extent that statutory rules might provide otherwise. The general fund balance therefore summarises the resources that the authority is statutorily empowered to spend on its services or on capital investment (or the deficit of resources that the council is required to recover) at the end of the financial year.
Governance	The framework by which a council can gain assurance that it is setting and achieving its objectives and ensuring value for money in the proper way.
Housing Revenue Account (HRA)	An account used to record the income and expenditure related to council housing.
IFAC (International Federation of Accountants)	IFAC is the global organisation for the accountancy profession dedicated to serving the public interest by strengthening the profession and contributing to the development of strong international economies. CIPFA is a member.
Internal audit	An internal review of the organisation's systems to give assurance that they are appropriate and being complied with.
Leadership team	Executive committees, elected mayors, portfolio holders with delegated powers and other key committees of the authority. In the police service this leadership is provided by police and crime commissioners and chief constables.
Non-domestic rates	A tax paid by local businesses to their council.
Public Sector Internal Audit Standards	These standards, which are based on the mandatory elements of the Institute of Internal Auditors (IIA) International Professional Practices Framework (IPPF), are intended to promote further improvement in the professionalism, quality, consistency and effectiveness of internal audit across the public sector.
Provision	A provision is a present liability whose timing or amount of settlement is uncertain. For example, it may be a charge for liabilities that are known to exist, but have to be estimated.
Prudential Code	A code produced by CIPFA that councils are required to follow when deciding upon their programme for capital expenditure.
Revenue budget	The amount that a council spends on its day-to-day running of services through the financial year.
Ringfencing	A term for the earmarking of money (eg a grant or fund) for one particular purpose, so as to restrict its use to that purpose.
Society of Local Authority Chief Executives (SOLACE)	SOLACE's purpose is to develop the highest standards of leadership in local government and the wider public sector.
Treasury management	CIPFA has adopted the following as its definition of treasury management activities: ■ the management of the organisation's borrowing, investments and cash flows ■ its banking ■ money market and capital market transactions ■ the effective control of the risks associated with those activities ■ the pursuit of optimum performance consistent with those risks.

Treasury Management Code	A professional and statutory code produced by CIPFA that councils are required to follow in managing their treasury management activity.
Treasury management strategy	An annual document approved by full council that sets out how a council will manage its cash and borrowings.

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Governance Risk and Resilience Framework

The seven characteristics

If you plan to use this material to support you to reflect on governance in your own authority, we recommend that you visit www.cfgs.org.uk/governancerisk, where you will find information to help you.

This material can be used to support individual and collective reflection. It is not a checklist; it should be used to better understand where risks might arise and what mitigation can be put in place to best manage those risks.

1. Extent of recognition of individual and collective responsibility for good governance

Positive behaviours	Negative behaviours
Strong relationships between the principal statutory officers and the political leadership, because: ▪ There is continuity of member and officer leaderships (and succession planning is managed well); ▪ Statutory officer positions (particularly that of the MO) are occupied by credible, senior people; ▪ Early financial and legal discussion is considered fundamental to effective decision-making.	Weak relationships between the principal statutory officers and the political leadership, because: ▪ There is no succession planning and changes in personnel are not managed; ▪ People in key statutory positions are interims or temporary appointments (for longer than is strictly necessary); ▪ People in key statutory positions (particularly the MO) may not be regular SMT attendees; ▪ The MO may lack appropriate legal support (they may not be a lawyer but this in itself is not a negative sign);

Positive behaviours	Negative behaviours
	▪ Financial and legal matters are treated as box-ticking elements of the decision-making process.
Strong, independently backed whistleblowing systems which employees know how to use if needed.	A lack of effective whistleblowing systems (which may exist on paper but not in practice).
Strong audit systems – ▪ Robust and mutually supportive relationship between the council and its external auditor; ▪ Audit Committee leads on oversight of the adequacy and effectiveness of risk management, meeting frequently to discuss impact of financial stresses and pressures; ▪ Annual Governance Statement complies with legal requirements, and is the culmination of a meaningful, member-led review exercise designed to stress-test both the governance framework and the health of the control environment.	Weak audit systems – ▪ External auditor engages with the council using junior staff; ▪ Audit Committee meets infrequently, and takes no active role in risk management; ▪ Annual Governance Statement is generic in tone and content.
Management is not hierarchical – alongside line management arrangements sit clearly understood lines of accountability and ownership which help the council to deal with cross-cutting matters.	Lengthy or complicated management hierarchy which dilutes ownership, responsibility and obfuscates difficult messages from the front line.
Straightforward corporate approach to programme and project management, possibly with oversight from a corporate programme board and SMT.	Programme management which obscures clear lines of accountability and elides collective responsibility.
Debriefs from major projects and major decisions are a part of	A blame culture, where responsibility for difficult issues frequently shifts

Positive behaviours	Negative behaviours
standard operating procedure and are expected to show up weaknesses and shortcomings which need to be collectively owned.	between departments and individuals; frequent minor or major departmental reorganisations; top-down mindset.
A clear-sighted sense of where shortcomings within the council may cause problems, and trying to bolster capacity and resilience to mitigate the risk of future problems. An approach to learning framed by clear and robust ethical principles, which are articulated and understood.	Failures excused by external circumstances / matters beyond the council's control; Proposals to learn lessons from failure ignored or implemented in a minimalist way, with a focus on processes rather than culture and behaviours. Ethics are understood only in the abstract.

2. Awareness of political dynamics

Positive behaviours	Negative behaviours
The role and presence of politics is understood and accepted; it is recognised that councillors are politicians and that their political skills bring unique credibility, legitimacy and perspective to decision-making. Officers while apolitical are aware of political dynamics and manage them sensitively, operating confidently in the political space. Use of the LGA Member Code of Conduct and the “Seven Principles of Public Life” to explore and understood how political dynamics impact on councillor activities, with the Code used as a springboard for discussion.	Assertions of the need to be “non-political” – an unwillingness to engage in constructive political debate. LGA Code of Conduct and other material integrated into the constitution wholesale without discussion. Ethical principles are minimised or ignored.
Officers act as objectively as possible, being diligent in drawing together a full spectrum of evidence on which councillors can make informed decisions. Officers understood how their own subjectivity and biases influences their work; councillors understand how their beliefs and ideologies influences their own perceptions.	Debate is discouraged, particularly within the leading political group – there is seen as a single political approach to which all need to be signed up. Officers are treated with suspicion – for example by opposition parties who see them as having been “captured” by the executive.

3. How the council looks to the future to set its decision-making priorities

Positive behaviours	Negative behaviours
Corporate plan which clearly links long term aspirations with medium and short term activity to meet those aspirations. Plan also clearly prioritises, with a justification for that prioritisation clear to see. Trade-offs inherent in such plans are flagged, understood and acknowledged, especially where they engage with matters which are politically contentious.	Poor quality corporate plan. This might be a plan which is really just a programme management document, or one whose priorities are set so vaguely that everything is a priority (for example, where everything the council does is somehow engineered to be part of a corporate priority).
Risk awareness and management is part of every decision.	Risk management that is incomplete or 'tick box'.
Directors and senior decision-making councillors have the time and space to think clearly and with confidence about the long term – the fact that this thinking is happening is communicated with the wider organisation.	Fixation on project management as a proxy for strategic thinking – directors and senior members spend a lot of time on the industry of programme and project management.
Internal and external communication which is frank, candid and mature. Comms which have a consistency derived from the presence of a common understanding of the council and of the area, and the challenges and opportunities that both face.	Unrealistic optimism, in public statements from the executive and internal communications, which does not align either with internal plans, or with a sound understanding of the wider context. In the context of planning for the future, this could be described as the sense that "something will turn up".
Meaningful thinking and action on what long term pressures and opportunities might mean for the council's operating model. People throughout the organisation being prepared to innovate to handle these pressures and opportunities, with this preparation being informed realism born of an accurate understanding of the organisation's capacity and abilities.	A preoccupation with novelty and innovation as a proxy for meaningful conversations about the future and the council's response to it, including a faddish approach to innovation which is not aligned with the strategic direction of the authority

Positive behaviours	Negative behaviours
Sufficient people in the organisation with strategic skills and responsibilities. This may involve a traditional corporate core alongside individuals in different parts of the council who combined functional specialisms with the ability to think strategically; in particular, individuals with political awareness. It is also likely to include succession and business continuity planning for management of senior vacancies, and ensuring the council does not rely on interim appointments for a sustained period.	A small or non-existent corporate core. This is likely to include few or no policy or research specialists, or specialists in corporate communications, lawyers, financial professionals with corporate responsibility; people who might be expected to protect and support key components of the governance framework. Preparation for the future is seen as divorced from the council as a democratic, political institution. Many senior posts may be filled on an interim basis, possibly in anticipation of a promised organisational restructure.

4. Officer and councillor roles

Positive behaviours	Negative behaviours
Ethics is front and centre in how officers and members work together. The “Seven Principles of Public Life” are understood, and lived in practice; they act as the bedrock of positive behaviours.	The authority may have an ethical or values framework but an understanding of it is absent. People rely on rigid adherence to rules and checklists as a substitute for exercising responsible, personal and professional judgement of behaviours.
Councillor, and officer, conduct is taken seriously. People support each other to model good behaviour. This is based on mutual respect despite the presence of robust argument and debate. The importance of political disagreement is understood.	Conduct is treated performatively; exhortations on “civility” are used to quash dissent and disagreement. Conduct complaints are tit-for-tat and may involve both officers and members. Conduct which is clearly unacceptable is a regular feature of public meetings, with poor behaviour often directed towards officers who are not able to answer back. Resolution of complaints and concerns may be inadequate, with disciplinary systems not working well leading to a sense that certain individuals can act inappropriately with impunity.
Business is carried out through appropriate formal and informal means, in a way that is transparent and understood and which adheres to consistent rules. Not everyone is involved in decision-making, but the way that decisions are made, by whom and at what time is clear, allowing accountability for those decisions to be tracked.	A lot of business transacted in informal meetings between officers and members – for example Director/Cabinet Member meetings, which may not be effectively recorded. This leads to a lack of clarity on exactly who is responsible for making decisions, despite what the scheme of delegation might say.
Senior councillor decision-makers “front up” major strategies and decisions, owning tough judgements and trade-offs.	A lack of member ownership of big issues. Decisions may pass through member structures, but in a “tick box” way which provides little or no opportunity for influence.
Within a clear and consistent scheme of delegation, senior officers have the freedom to	Overt, ongoing member involvement in operational matters in a way that takes up significant officer time, and that

Positive behaviours	Negative behaviours
manage operational matters; councillors retain oversight (including through scrutiny) and matters which might be causing concern escalate to members effectively. Predictability in in-year accounting – necessary changes to the in-year budget managed with a clear paper trail and using established principles, overseen by the s151 officer and with the roles and responsibilities of others clearly understood.	may involve member micromanagement. Poor behaviours may be involved; officers may be subject to member bullying. A looseness in the management of budget changes (where senior officers and members are not sighted on emerging issues) or unreasonable exercise of control – neither of which may align with the scheme of delegation. Unexpected non-emergency virements, large underspends and overspends not addressed.
Councillors are kept informed of and engaged in emerging issues – through briefings and discussions between members and officers – and are similarly made aware of major forthcoming decisions. A “no surprises” approach is taken with the members corps on all matters of corporate importance.	Infrequent or non-existent member briefings on matters of importance. Information is guarded and only shared with a small selection of hand-picked people.
The way that relationships between councillors and officers is mediated is appropriate and relevant to the situation. Senior officers are available to councillors and junior officers work with them to resolve local issues. Councillors liaise and communicate appropriately with officers at all levels.	Officer and member relationships are over-mediated (through members being expected to push requests and communication through a central mailbox or person) or under-mediated (members making continual, scattergun requests of officers, using up significant amount of senior officer time). Senior officers may be high handed and dismissive towards members’ requests for information.
Councillors lead in setting the organisation’s risk tolerance and risk appetite. Risk is discussed frankly and openly across the organisation. Officers develop plans and strategies which reflect an understanding of risk, its consequences and mitigation.	No meaningful discussion of risk by either members or officers, or by the two groups together; views of risks and risk appetite are largely personal, and differ significantly between members and officers as the issue isn’t discussed.

Positive behaviours	Negative behaviours
Personal development is built into day-to-day work, and the appraisal process. Councillors lead and direct their own development objectives; councillor activity (particularly in scrutiny) is designed around this issue. Development includes a focus on "soft" skills – particularly relational skills and political awareness.	Poor quality or non-existent training and development, including: ▪ No meaningful staff or member development programme; ▪ Member training limited to formal induction, and training required to carry out statutory duties; ▪ Officer training focusing on "cramming" for professional certification, CPD points or accreditation; ▪ Training and development entirely distinct to the day-job with little management follow-through; ▪ Training generally of a poor quality, delivered in-house or by a "trusted" external consultant to an outdated formula.

5. How the council's real situation compares to its sense of itself

Positive behaviours	Negative behaviours
Council has a clear sense of the experiences of, and outcomes for, local people.	Official council data providing a skewed and inaccurate picture (perhaps evidenced by significant numbers of member queries or complaints on matters where the council insists performance is good*)*
Robust performance management system which sits as part of a system by which the council collects and uses information more generally, tied into improvement activity, supportive of the council's Best Value duties.	No effective performance management system – dominance of the form and process of scorecards and information monitoring without assurance on data quality or improvement action. The council's duties to ensure continuous improvement are elided and not taken seriously.
There is a clear sense of who the council's "nearest neighbours" are on key issues and attempts are made to ensure that this understanding influences how decisions are developed and made.	A preoccupation with the council's uniqueness or distinctiveness – either as an institution, or in terms of the area it serves, with that perceived distinctiveness used as a reason to do or not do certain things.
Engagement with the wider sector – through institutional membership of a range of sector bodies, networking at senior and junior level, and the use of insight gained in this way (including using good practice / nearest neighbour information intelligently) to influence the way decisions are made. This may also include a positive, proactive and welcoming attitude to external challenge.	Little serious effort made to look out to the examples of others – little senior attendance at external conferences, little involvement with national institutions like the LGA (no recent corporate peer challenge has been carried out, for example). Attempts are made to uncritically transpose national "best practice" into local operations, or to ignore best practice entirely. Adverse external opinion (from CQC, Ofsted, the LGA or others) is either explained away or subject to unambitious "action plans" which are not effectively prioritised, and which are soon abandoned.
Risk is understood, and an awareness of it is shared throughout the organisation. Risk appetite and tolerance are set, and owned, by councillors.	No meaningful risk registers at a corporate level, or risk registers which appear to some to downplay risks. Risk registers and associated

Positive behaviours	Negative behaviours
	information tightly managed, and seen only by a select few.
Systems are regularly stress-tested; the principal statutory officers (and councillors) scenario-plan as part of their approach to risk to understand where the greatest risks of failure exist and how these can be mitigated.	Political and organisational unwillingness to countenance the possibility of failure.
Risk mitigation is planned based on existing resources and an understanding of current organisational capacity – risks and mitigation activity are “owned” and monitored carefully, including being escalated where necessary.	Risk mitigation vague, resting on unproven assumptions and relying on magical thinking about how solutions will emerge.
Swift action to address problems as they emerge – groups of officers and members work across organisational boundaries to understand problems and tackle them and their impacts.	Procrastination, strategically and operationally – a sense that “crisis” will bring about innovative solutions by concentrating minds; sweating the organisation’s human assets for minimal return.
Continuing to invest in corporate capacity to change and transform – ensuring that the organisation remains flexible enough to be able to take difficult decisions quickly and confidently.	Buying time by reducing capacity to deal with future problems – endless firefighting. Lacking capacity to invest in major change when it is needed leads to a paucity of ambition, or ambition which cannot be met, or a tacit sense of “managed decline”.

6. Quality of local (external) relationships

Positive behaviours	Negative behaviours
Communication is treated as a strategic function of the authority. The council “thinks out loud”, bringing local people and partners into conversations about the future of the area, and participating in conversations held by others in the places those conversations are happening.	Communicating being mainly operational, and on the council’s terms (both with partners and the public). Public “consultation” is managed by a comms team with little community engagement experience, or alternatively by service-level officers who lack the skill and backing to do it effectively.
The information on which decisions are based are published, and added to, publicly. Statutory documents are published promptly and are easy to access. The council invites challenge on its plans – by engaging in dialogue on those plans in a way that feels meaningful and relevant to local people. This often results in a significant change in approach.	Communication, particularly with the public, feeling performative and mainly about broadcasting the council’s “line” on an issue, with no real interest in changing the council’s approach other than on minor operational points. Members of the public challenging the paucity and poor quality of consultations are dismissed as “difficult” or troublemakers. The council has a poor FOI and complaints record.
The council and its partners work together as equals, developing a common framework of priorities which everyone works to meet. Discussions of risks happens with partners candidly; strong relationships mean that partners support each other. The council does not feel it has to be centre stage.	Priorities are not aligned with those of partners; partnership discussion is mainly about negotiation around competing objectives. Relationships are performative and superficial, focused on the council thinking what it, as an institution, can get out of partners.
Where possible and necessary, budgets are pooled and/or managed jointly between organisations, backed by strong governance arrangements. The statutory, and other, duties of individual organisations are considered as part of this process.	Tussles over budgets (with budgets possibly weaponised where the council funds certain partners and their activities, particularly where partners are third sector bodies or there is otherwise a power imbalance).
The council communicates its intentions – short and long term – to its key partners. The political	Partners (and the council) frequently surprised by unexpected actions of others.

Positive behaviours	Negative behaviours
dynamics within which the council operates are well understood by partners.	

7. The state of member oversight through scrutiny and audit

Positive behaviours	Negative behaviours
Scrutiny uses self-evaluation, and periodic external review, to provide a check on effectiveness, with this feeding into the scrutiny Annual Report. Audit Committee is active and engaged and takes an overview of the systems of control, audit and governance.	No regular process by which scrutiny members/officers reflect on the role and impact of the function. Audit Committee receives reports but work is tightly focused on financial controls or other aspects of operational management, and does not consider the overall systems of governance or make links between elements of it.
Executive works actively with scrutiny to ensure that councillor oversight is as effective as possible; executive/scrutiny protocol in place which supports meaningful dialogue.	Executive attitude to scrutiny one of exasperation – wanting it to be "good" in the abstract but unable or unwilling to put the proactive measures in place to make this happen (scrutiny's effectiveness being seen as a matter for scrutiny alone).
Scrutiny prioritises its work driven by a sense of the need to add value and can clearly demonstrate the impact of what it does.	Scrutiny members kept occupied with "busywork" – lots of scrutiny activity without any real sense of its impact.
Development needs of scrutiny and audit chairs well-understood – chairs are independent-minded and confident in exercise a leadership role, and command the confidence of their peers.	Weak or poorly-skilled members in chairing positions.
Leadership positions in scrutiny shared across parties; all parties have an opportunity to influence scrutiny's future direction and priorities.	All scrutiny leadership positions (chairs and vice-chairs) held by members of the same party.
Culture of scrutiny is challenging and robust, but thoughtful and reflective, focusing on issues of most critical local importance rather than what may be expedient from a party political perspective.	Member disengagement evidenced by overt political behaviours and a hobby-horse approach to work programming (ie members choosing to look at items that interest them rather than those which are of importance to the council and community).

Agenda Item 9

Agenda Item No:

Report To: **Audit Committee**

Date of Meeting: **18 November 2021**

Report Title: **External Auditor Appointment**

Report By: **Peter Grace,**

Assistant Director – Financial Services and Revenues (Chief Finance Officer)

Key Decision: **N**

Purpose of Report

This report sets out proposals for appointing the external auditor to the Council for the accounts for the five-year period from 2023/24.

Recommendation

1. The Audit Committee recommends that the Council accepts Public Sector Audit Appointments' invitation to opt into the sector-led option for the appointment of external auditors for five financial years from 1 April 2023.

Reasons for Recommendations

An external auditor for the audit of the accounts for 2023/24 must be appointed before the end of 2022. The council needs to let Public Sector Audit Appointments (PSAA) know if it wants to opt into the sector-wide procurement conducted by PSAA by 11 March 2022. The decision of Full Council is required.

Background and summary

1. The current auditor appointment arrangements cover the period up to and including the audit of the 2022/23 accounts. The Council opted into the ‘appointing person’ national auditor appointment arrangements established by PSAA for the period covering the accounts for 2018/19 to 2022/23.

2. PSAA is now undertaking a procurement for the next appointing period, covering audits for 2023/24 to 2027/28. During Autumn 2021 all local government bodies need to make important decisions about their external audit arrangements from 2023/24. They have options to arrange their own procurement and make the appointment themselves or in conjunction with other bodies, or they can join and take advantage of the national collective scheme administered by PSAA.

3. The report concludes that the sector-wide procurement conducted by PSAA will produce better outcomes and will be less burdensome for the Council than a procurement undertaken locally because:

   - collective procurement reduces costs for the sector and for individual authorities compared to a multiplicity of smaller local procurements;

   - if it does not use the national appointment arrangements, the Council will need to establish its own auditor panel with an independent chair and independent members to oversee a local auditor procurement and ongoing management of an audit contract;

   - it is the best opportunity to secure the appointment of a qualified, registered auditor - there are only nine accredited local audit firms, and a local procurement would be drawing from the same limited supply of auditor resources as PSAA’s national procurement; and

   - supporting the sector-led body offers the best way of to ensuring there is a continuing and sustainable public audit market into the medium and long term.

4. If the Council wishes to take advantage of the national auditor appointment arrangements, it is required under the local audit regulations to make the decision at full Council. The opt-in period started on 22 September 2021 and closes on 11 March 2022. To opt into the national scheme from 2023/24, the Council needs to return completed opt-in documents to PSAA by 11 March 2022.

Procurement of External Audit for the period 2023/24 to 2027/28

5. Under the Local Government Audit & Accountability Act 2014 (“the Act”), the council is required to appoint an auditor to audit its accounts for each financial year. The council has three options;

   - To appoint its own auditor, which requires it to follow the procedure set out in the Act.

- To act jointly with other authorities to procure an auditor following the procedures in the Act.

- To opt into the national auditor appointment scheme administered by a body designated by the Secretary of State as the 'appointing person'. The body currently designated for this role is Public Sector Audit Appointments Limited (PSAA).

6. In order to opt into the national scheme, a council must make a decision at a meeting of the Full Council.

The Appointed Auditor

7. The auditor appointed at the end of the procurement process will undertake the statutory audit of accounts and Best Value assessment of the council in each financial year, in accordance with all relevant codes of practice and guidance. The appointed auditor is also responsible for investigating questions raised by electors and has powers and responsibilities in relation to Public Interest Reports and statutory recommendations.

8. The auditor must act independently of the council and the main purpose of the procurement legislation is to ensure that the appointed auditor is sufficiently qualified and independent.

9. The auditor must be registered to undertake local audits by the Financial Reporting Council (FRC) employ authorised Key Audit Partners to oversee the work. As the report below sets out there is a currently a shortage of registered firms and Key Audit Partners.

10. Auditors are regulated by the FRC, which will be replaced by a new body with wider powers, the Audit, Reporting and Governance Authority (ARGA) during the course of the next audit contract.

11. Councils therefore have very limited influence over the nature of the audit services they are procuring, the nature and quality of which are determined or overseen by third parties.

Appointment by the Council itself or jointly

12. The Council may elect to appoint its own external auditor under the Act, which would require the council to;

- Establish an independent auditor panel to make a stand-alone appointment. The auditor panel would need to be set up by the Council itself, and the members of the panel must be wholly or a majority of independent members as defined by the Act. Independent members for this purpose are independent appointees, excluding current and former elected members (or officers) and their close families and friends. This means that elected members will not have a majority input to assessing bids and choosing to which audit firm to award a contract for the Council's external audit.

- Manage the contract for its duration, overseen by the Auditor Panel.

13. Alternatively, the Act enables the Council to join with other authorities to establish a joint auditor panel. Again, this will need to be constituted of wholly or a majority of independent appointees. Further legal advice would be required on the exact constitution of such a panel having regard to the obligations of each Council under the Act and the Council would need to liaise with other local authorities to assess the appetite for such an arrangement.

The national auditor appointment scheme

14. PSAA is specified as the ‘appointing person’ for principal local government under the provisions of the Act and the Local Audit (Appointing Person) Regulations 2015. PSAA let five-year audit services contracts in 2017 for the first appointing period, covering audits of the accounts from 2018/19 to 2022/23. It is now undertaking the work needed to invite eligible bodies to opt in for the next appointing period, from the 2023/24 audit onwards, and to complete a procurement for audit services. PSAA is a not-for-profit organisation whose costs are around 4% of the scheme with any surplus distributed back to scheme members.

15. In summary the national opt-in scheme provides the following:

- the appointment of a suitably qualified audit firm to conduct audits for each of the five financial years commencing 1 April 2023;
- appointing the same auditor to other opted-in bodies that are involved in formal collaboration or joint working initiatives to the extent this is possible with other constraints;
- managing the procurement process to ensure both quality and price criteria are satisfied. PSAA has sought views from the sector to help inform its detailed procurement strategy;
- ensuring suitable independence of the auditors from the bodies they audit and managing any potential conflicts as they arise during the appointment period;
- minimising the scheme management costs and returning any surpluses to scheme members;
- consulting with authorities on auditor appointments, giving the Council the opportunity to influence which auditor is appointed;
- consulting with authorities on the scale of audit fees and ensuring these reflect scale, complexity, and audit risk; and
- ongoing contract and performance management of the contracts once these have been let.

Pressures in the current local audit market and delays in issuing opinions

16. Much has changed in the local audit market since audit contracts were last awarded in 2017. At that time the audit market was relatively stable, there had been few changes in audit requirements, and local audit fees had been reducing over a long period. 98% of those bodies eligible opted into the national scheme and attracted very competitive bids from audit firms. The resulting audit contracts took effect from 1 April 2018.

17. During 2018 a series of financial crises and failures in the private sector year led to questioning about the role of auditors and the focus and value of their work. Four independent reviews were commissioned by Government: Sir John Kingman's review of the Financial Reporting Council (FRC), the audit regulator; the Competition and Markets Authority review of the audit market; Sir Donald Brydon's review of the quality and effectiveness of audit; and Sir Tony Redmond's review of local authority financial reporting and external audit. The recommendations are now under consideration by Government, with the clear implication that significant reforms will follow. A new audit regulator (ARGA) is to be established, and arrangements for system leadership in local audit are to be introduced. Further change will follow as other recommendations are implemented.

18. The Kingman review has led to an urgent drive for the FRC to deliver rapid, measurable improvements in audit quality. This has created a major pressure for audit firms to ensure full compliance with regulatory requirements and expectations in every audit they undertake. By the time firms were conducting 2018/19 local audits during 2019, the measures they were putting in place to respond to a more focused regulator were clearly visible. To deliver the necessary improvements in audit quality, firms were requiring their audit teams to undertake additional work to gain deeper levels of assurance. However, additional work requires more time, posing a threat to the firms' ability to complete all their audits by the target date for publication of audited accounts. Delayed opinions are not the only consequence of the FRC's drive to improve audit quality. Additional audit work must also be paid for. As a result, many more fee variation claims have been needed than in prior years.

19. This situation has been accentuated by growing auditor recruitment and retention challenges, the complexity of local government financial statements and increasing levels of technical challenges as bodies explore innovative ways of developing new or enhanced income streams to help fund services for local people. These challenges have increased in subsequent audit years, with Covid-19 creating further significant pressure for finance and audit teams.

20. None of these problems is unique to local government audit. Similar challenges have played out in other sectors, where increased fees and disappointing responses to tender invitations have been experienced during the past two years.

The invitation

21. PSAA is now inviting the Council to opt in for the second appointing period, for 2023/24 to 2027/28, along with all other eligible authorities. Based on the level of opt-ins it will enter into contracts with appropriately qualified audit firms and appoint a suitable firm to

be the Council's auditor. Details relating to PSAA's invitation are provided in Appendix A to this report.

The next audit procurement

22. The prices submitted by bidders through the procurement will be the key determinant of the value of audit fees paid by opted-in bodies. PSAA will:

- seek to encourage realistic fee levels and to benefit from the economies of scale associated with procuring on behalf of a significant number of bodies;

- continue to pool scheme costs and charge fees to opted-in bodies in accordance with the published fee scale as amended following consultations with scheme members and other interested parties (pooling means that everyone within the scheme will benefit from the prices secured via a competitive procurement process – a key tenet of the national collective scheme);

- continue to minimise its own costs, around 4% of scheme costs, and as a not-for-profit company will return any surplus funds to scheme members. In 2019 it returned a total £3.5million to relevant bodies and in 2021 a further £5.6million was returned.

23. PSAA will seek to encourage market sustainability in its procurement. Firms will be able to bid for a variety of differently sized contracts so that they can match their available resources and risk appetite to the contract for which they bid. They will be required to meet appropriate quality standards and to reflect realistic market prices in their tenders, informed by the scale fees and the supporting information provided about each audit. Where regulatory changes are in train which affect the amount of audit work suppliers must undertake, firms will be informed as to which developments should be priced into their bids.

24. The scope of a local audit is fixed. It is determined by the Code of Audit Practice (currently published by the National Audit Office)[1], the format of the financial statements (specified by CIPFA/LASAAC) and the application of auditing standards regulated by the FRC. These factors apply to all local audits irrespective of whether an eligible body decides to opt into PSAA's national scheme or chooses to make its own separate arrangements. The requirements are mandatory; they shape the work auditors undertake and have a bearing on the actual fees required.

25. There are currently nine audit providers eligible to audit local authorities and other relevant bodies under local audit legislation. This means that a local procurement exercise would seek tenders from the same firms as the national procurement exercise, subject to the need to manage any local independence issues. Local firms cannot be invited to bid. Local procurements must deliver the same audit scope and requirements as a national procurement, reflecting the auditor's statutory responsibilities.

[1] MHCLG's Spring statement proposes that overarching responsibility for Code will in due course transfer to the system leader, namely ARGA, the new regulator being established to replace the FRC.

Assessment of options and officer recommendation

26. If the Council did not opt in there would be a need to establish an independent auditor panel to make a stand-alone appointment. The auditor panel would need to be set up by the Council itself, and the members of the panel must be wholly or a majority of independent members as defined by the Act. Independent members for this purpose are independent appointees, excluding current and former elected members (or officers) and their close families and friends. This means that elected members will not have a majority input to assessing bids and choosing to which audit firm to award a contract for the Council's external audit.

27. Alternatively, the Act enables the Council to join with other authorities to establish a joint auditor panel. Again, this will need to be constituted of wholly or a majority of independent appointees. Further legal advice would be required on the exact constitution of such a panel having regard to the obligations of each Council under the Act and the Council would need to liaise with other local authorities to assess the appetite for such an arrangement.

28. These would be more resource-intensive processes to implement for the council, and without the bulk buying power of the sector-led procurement would be likely to result in a more costly service. It would also be more difficult to manage quality and independence requirements through a local appointment process. The council is unable to influence the scope of the audit and the regulatory regime inhibits the council's ability to affect quality.

29. The Council and its auditor panel would need to maintain ongoing oversight of the contract. Local contract management cannot, however, influence the scope or delivery of an audit.

30. The national offer provides the appointment of an independent auditor with limited administrative cost to the council. By joining the scheme, the council would be acting with other councils to optimise the opportunity to influence the market that a national procurement provides.

31. The recommended approach is therefore to opt in to the national auditor appointment scheme.

The way forward

32. Regulation 19 of the Local Audit (Appointing Person) Regulations 2015 requires that a decision to opt in must be made by a meeting of the Council (meeting as a whole) i.e. Full Council, except where the authority is a corporation sole.

33. The Council then needs to respond formally to PSAA's invitation in the form specified by PSAA by the close of the opt-in period (11 March 2022).

34. PSAA will commence the formal procurement process in early February 2022. It expects to award contracts in August 2022 and will then consult with authorities on the

appointment of auditors so that it can make appointments by the statutory deadline of 31 December 2022.

Risk Management

35. The principal risks are that the Council:

- fails to appoint an auditor in accordance with the requirements and timing specified in local audit legislation; or
- does not achieve value for money in the appointment process.

36. These risks are considered best mitigated by opting into the sector-led approach through PSAA.

Legal implications

37. Section 7 of the Local Audit and Accountability Act 2014 requires a relevant Council to appoint a local auditor to audit its accounts for a financial year not later than 31 December in the preceding year.

38. Section 8 governs the procedure for appointment including that the Council must consult and take account of the advice of its auditor panel on the selection and appointment of a local auditor. Section 8 provides that where a relevant Council is a local Council operating executive arrangements, the function of appointing a local auditor to audit its accounts is not the responsibility of an executive of the Council under those arrangements.

39. Section 12 makes provision for the failure to appoint a local auditor. The Council must immediately inform the Secretary of State, who may direct the Council to appoint the auditor named in the direction or appoint a local auditor on behalf of the Council.

40. Section 17 gives the Secretary of State the power to make regulations in relation to an 'appointing person' specified by the Secretary of State. This power has been exercised in the Local Audit (Appointing Person) Regulations 2015 (SI 192) and this gives the Secretary of State the ability to enable a sector-led body to become the appointing person. In July 2016 the Secretary of State specified PSAA as the appointing person.

Financial Implications

41. There is a risk that current external audit fee levels could increase when the current contracts end. It is clear that the scope of audit has increased, requiring more audit work. There are also concerns about capacity and sustainability in the local audit market. The current external audit scale fee is £36,000, as determined by PSAA. Where more or less work is required than is envisaged in the scale fee, a fee variation process will apply. The variations process will ensure that fees for additional work cannot be invoiced until agreed with the audited body and approved by PSAA.

42. Opting into a national scheme provides maximum opportunity to ensure fees are as realistic as possible, while ensuring the quality of audit is maintained, by entering into a large scale collective procurement arrangement.

43. If the national scheme is not used some additional resource may be needed to establish an auditor panel and conduct a local procurement. Until a procurement exercise is completed it is not possible to state what, if any, additional resource may be required for audit fees from 2023/24.

Timetable of Next Steps

44. Please include a list of key actions and the scheduled dates for these:

Action	**Key milestone**	**Due date (provisional)**	**Responsible**
Inform PSAA of our chosen option	Decision at Audit Committee	11 March 2022	Chief Finance Officer

Wards Affected

None

Area(s) Affected

None

Implications

Relevant project tools applied? Yes

Have you checked this report for plain English and readability? Yes. This has been done as far as possible considering the complex financial issues involved. Flesch-Kincaid grade level 13.9.

Climate change implications considered? N/A

Please identify if this report contains any implications for the following:

Equalities and Community Cohesiveness	No
Crime and Fear of Crime (Section 17)	No
Risk Management	No
Environmental Issues	No
Economic/Financial Implications	Yes
Human Rights Act	No
Organisational Consequences	No

Local People's Views	No
Anti-Poverty	No

Additional Information

Appendix 1: Hastings Borough Council invitation to opt into the national scheme for auditor appointments from April 2023

Officer to Contact

Simon Jones
simon.jones@hastings.gov.uk
Senior Finance Projects Officer
01424 451532

22 September 2021

To: Ms Hartnell, Chief Executive
Hastings Borough Council

Copied to: Mr Grace, S151 Officer
Councillor Rankin, Chair of Audit Committee or equivilent

Dear Ms Hartnell,

Invitation to opt into the national scheme for auditor appointments from April 2023

I want to ensure that you are aware the external auditor for the audit of your accounts for 2023/24 has to be appointed before the end of December 2022. That may seem a long way away but, as your organisation has a choice about how to make that appointment, your decision-making process needs to begin soon.

We are pleased that the Secretary of State has confirmed PSAA in the role of the appointing person for eligible principal bodies for the period commencing April 2023. Joining PSAA's national scheme for auditor appointments is one of the choices available to your organisation.

In June 2021 we issued a draft prospectus and invited your views and comments on our early thinking on the development of the national scheme for the next period. Feedback from the sector has been extremely helpful and has enabled us to refine our proposals which are now set out in the scheme prospectus and our procurement strategy. Both documents can be downloaded from our website which also contains a range of useful information that you may find helpful.

The national scheme timetable for appointing auditors from 2023/24 means we now need to issue a formal invitation to you to opt into these arrangements. In order to meet the requirements of the relevant regulations, we also attach a form of acceptance of our invitation which you must use if your organisation decides to join the national scheme. We have specified the five consecutive financial years beginning 1 April 2023 as the compulsory appointing period for the purposes of the regulations which govern the national scheme.

Given the very challenging local audit market, we believe that eligible bodies will be best served by opting to join the scheme and have attached a short summary of why we believe that is the best solution both for individual bodies and the sector as a whole.

I would like to highlight three matters to you:

1. if you opt to join the national scheme, we need to receive your formal acceptance of this invitation by Friday 11 March 2022;

18 Smith Square, London, SW1P 3HZ

2. the relevant regulations require that, except for a body that is a corporation sole (e.g. a police and crime commissioner), the decision to accept our invitation and to opt in must be made by the members of the authority meeting as a whole e.g. Full Council or equivalent. We appreciate this will need to be built into your decision-making timetable. We have deliberately set a generous timescale for bodies to make opt in decisions (24 weeks compared to the statutory minimum of 8 weeks) to ensure that all eligible bodies have sufficient time to comply with this requirement; and

3. if you decide not to accept the invitation to opt in by the closing date, you may subsequently make a request to opt in, but only after 1 April 2023. We are required to consider such requests and agree to them unless there are reasonable grounds for their refusal. PSAA must consider a request as the appointing person in accordance with the Regulations. The Regulations allow us to recover our reasonable costs for making arrangements to appoint a local auditor in these circumstances, for example if we need to embark on a further procurement or enter into further discussions with our contracted firms.

If you have any other questions not covered by our information, do not hesitate to contact us by email at ap2@psaa.co.uk. We also publish answers to frequently asked questions on our website.

If you would like to discuss a particular issue with us, please send an email also to ap2@psaa.co.uk, and we will respond to you.

Yours sincerely

Tony Crawley
Chief Executive

Encl: Summary of the national scheme

Why accepting the national scheme opt-in invitation is the best solution

Public Sector Audit Appointments Limited (PSAA)

We are a not-for-profit, independent company limited by guarantee incorporated by the Local Government Association in August 2014.

We have the support of the LGA, which in 2014 worked to secure the option for principal local government and police bodies to appoint auditors through a dedicated sector-led national body.

We have the support of Government; MHCLG's Spring statement confirmed our appointment because of our "strong technical expertise and the proactive work they have done to help to identify improvements that can be made to the process".

We are an active member of the new Local Audit Liaison Committee, chaired by MHCLG and attended by key local audit stakeholders, enabling us to feed in body and audit perspectives to decisions about changes to the local audit framework, and the need to address timeliness through actions across the system.

We conduct research to raise awareness of local audit issues, and work with MHCLG and other stakeholders to enable changes arising from Sir Tony Redmond's review, such as more flexible fee setting and a timelier basis to set scale fees.

We have established an advisory panel, which meets three times per year. Its membership is drawn from relevant representative groups of local government and police bodies, to act as a sounding board for our scheme and to enable us to hear your views on the design and operation of the scheme.

The national scheme for appointing local auditors

In July 2016, the Secretary of State specified PSAA as an appointing person for principal local government and police bodies for audits from 2018/19, under the provisions of the Local Audit and Accountability Act 2014 and the Local Audit (Appointing Person) Regulations 2015. Acting in accordance with this role PSAA is responsible for appointing an auditor and setting scales of fees for relevant principal authorities that have chosen to opt into its national scheme. 98% of eligible bodies made the choice to opt-in for the five-year period commencing in April 2018.

We will appoint an auditor for all opted-in bodies for each of the five financial years beginning from 1 April 2023.

We aim for all opted-in bodies to receive an audit service of the required quality at a realistic market price and to support the drive towards a long term competitive and more sustainable market for local audit. The focus of our quality assessment will include resourcing capacity and capability including sector knowledge, and client relationship management and communication.

What the appointing person scheme from 2023 will offer

We believe that a sector-led, collaborative, national scheme stands out as the best option for all eligible bodies, offering the best value for money and assuring the independence of the auditor appointment.

The national scheme from 2023 will build on the range of benefits already available for members:

- transparent and independent auditor appointment via a third party;
- the best opportunity to secure the appointment of a qualified, registered auditor;
- appointment, if possible, of the same auditors to bodies involved in significant collaboration/joint working initiatives, if the parties believe that it will enhance efficiency;
- on-going management of any independence issues which may arise;
- access to a specialist PSAA team with significant experience of working within the context of the relevant regulations to appoint auditors, managing contracts with audit firms, and setting and determining audit fees;
- a value for money offer based on minimising PSAA costs and distribution of any surpluses to scheme members - in 2019 we returned a total £3.5million to relevant bodies and more recently we announced a further distribution of £5.6m in August 2021;
- collective efficiency savings for the sector through undertaking one major procurement as opposed to a multiplicity of smaller procurements;
- avoids the necessity for local bodies to establish an auditor panel and undertake an auditor procurement, enabling time and resources to be deployed on other pressing priorities;
- updates from PSAA to Section 151 officers and Audit Committee Chairs on a range of local audit related matters to inform and support effective auditor-audited body relationships; and
- concerted efforts to work with other stakeholders to develop a more sustainable local audit market.

We are committed to keep developing our scheme, taking into account feedback from scheme members, suppliers and other stakeholders, and learning from the collective post-2018 experience. This work is ongoing, and we have taken a number of initiatives to improve the operation of the scheme for the benefit of all parties.

Importantly we have listened to your feedback to our recent consultation, and our response is reflected in the scheme prospectus.

Opting in

The closing date for opting in is 11 March 2022. We have allowed more than the minimum eight-week notice period required, because the formal approval process for most eligible bodies is a decision made by the members of the authority meeting as a whole [Full Council or equivalent], except police and crime commissioners who are able to make their own decision.

We will confirm receipt of all opt-in notices. A full list of eligible bodies that opt in will be published on our website. Once we have received an opt-in notice, we will write to you to request information on any joint working arrangements relevant to your auditor appointment, and any potential independence matters which may need to be taken into consideration when appointing your auditor.

Local Government Reorganisation

We are aware that reorganisations in the local government areas of Cumbria, Somerset, and North Yorkshire were announced in July 2021. Subject to parliamentary approval shadow elections will take place in May 2022 for the new Councils to become established from 1 April 2023. Newly established local government bodies have the right to opt into PSAA's scheme under Regulation 10 of the Appointing Person Regulations 2015. These Regulations also set out that a local government body that ceases to exist is automatically removed from the scheme.

If for any reason there is any uncertainty that reorganisations will take place or meet the current timetable, we would suggest that the current eligible bodies confirm their acceptance to opt in to avoid the requirement to have to make local arrangements should the reorganisation be delayed.

Next Steps

We expect to formally commence the procurement of audit services in early February 2022. At that time our procurement documentation will be available for opted-in bodies to view through our e-tendering platform.

Our recent webinars to support our consultation proved to be popular, and we will be running a series of webinars covering specific areas of our work and our progress to prepare for the second appointing period. Details can be found on our website and in the scheme prospectus.

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