

Audit Committee Agenda



**10.00 am Wednesday, 30 January 2019
Committee Room No. 2, Town Hall,
Darlington. DL1 5QT**

Members of the Public are welcome to attend this Meeting.

1. Introductions/Attendance at meeting
2. Declarations of Interest
3. To Approve the Minutes of the last meeting of this Committee held on 24 October 2018 (Pages 1 - 4)
4. Mid Year Risk Management Update Report 2018/19 –
Report of the Managing Director
(Pages 5 - 24)
5. Mid Year Prudential Indicators and Treasury Management Monitoring Report 2018/19 –
Report of the Managing Director
(Pages 25 - 40)
6. Prudential Indicators and Treasury Management Strategy Report 2019/20 –
Report of the Managing Director
(Pages 41 - 78)
7. Audit Services Annual Audit Plan 2018/19 - Progress Report –
Report of the Audit and Risk Manager
(Pages 79 - 96)
8. SUPPLEMENTARY ITEM(S) (if any) which in the opinion of the Chair of this Committee are of an urgent nature and can be discussed at this meeting.
9. Questions



Luke Swinhoe
Assistant Director Law and Governance

Tuesday, 22 January 2019

Town Hall
Darlington.

Membership

Councillors Baldwin, Crudass and McEwan

If you need this information in a different language or format or you have any other queries on this agenda please contact Shirley Burton, Democratic Manager, Resources Group, during normal office hours 8.30 a.m. to 4.45 p.m. Mondays to Thursdays and 8.30 a.m. to 4.15 p.m. Fridays E-Mail : shirley.burton@darlington.gov.uk or telephone 01325 405998

AUDIT COMMITTEE

24th October, 2018

PRESENT - Councillor Baldwin (in the Chair); Councillors Crudass and McEwan. (3)

APOLOGIES –

OFFICERS – Luke Swinhoe Assistant Director Law and Governance, Ian Miles Assistant Director Xentrall Shared Services, Peter Carrick, Finance Manager Central/Treasury Management, Peter McCann Information Security Manager, Joanne Skelton Health and Safety Manager and Andrew Barber, Audit and Risk Manager, Stockton Borough Council.

ALSO IN ATTENDANCE – Nicola Wright, Ernst and Young LLP

A13. DECLARATIONS OF INTEREST –There were no declarations of interest reported at the meeting.

A14. MINUTES - Submitted – The Minutes (previously circulated) of a meeting of this Audit Committee held on 26th July, 2018

RESOLVED – That the Minutes be approved as a correct record.

A15. ICT STRATEGY – IMPLEMENTATION PROGRESS REPORT – The Assistant Director Xentrall Shared Services submitted a report (previously circulated) on the progress in relation to the implementation of the approved ICT Strategy.

It was reported that the Strategy, which had been approved by the Chief Officers Board in 2017, focussed on three strategic priorities of ICT Governance and Service Development, ICT Strategic Architecture; and Council Service Development and Transformation.

Details of the progress against each of the strategic priorities was included in the submitted report.

RESOLVED – That the progress on the implementation of the ICT Strategy be noted.

A16. INFORMATION GOVERNANCE PROGRAMME PROGRESS REPORT - The Managing Director submitted a report (previously circulated) on the progress and planned developments of the Information Governance Programme.

It was reported that information governance remained an ‘above the line’ risk on the corporate register, however delivery of the programme would provide the reassurance required and would reduce the information risks to an acceptable level.

The submitted report outlined the most recent work undertaken, together with those areas of highest priority within the programme, with particular reference being made to the delivery of the compliance programme for GDPR and the effective utilisation of the HSCN link for data transfer and information sharing.

RESOLVED – That the progress on the Information Governance Programme be noted.

A17. CORPORATE HEALTH AND SAFETY REPORT 2017/18 – The Managing Director submitted a report (previously circulated) updating Members on the Authority's performance in relation to health and safety for the financial year 2017/18, which, overall showed an improvement on the previous year.

It was reported that health and safety continued to be a high priority for the Authority and the focus had again been to embed the health and safety management system and improve health and safety compliance.

A full review of the Corporate Health and Safety Policy had also been undertaken, which reflected the commitment of elected Members and senior management to health and safety within the organisation and that the Council's General Statement of Intent poster had also been updated and was displayed at various locations throughout the organisation.

RESOLVED – (a) That the 2017/18 achievements and health and safety performance statistics be noted.

(b) That the health and safety objectives for 2018/19 be noted.

A18. ETHICAL GOVERNANCE AND MEMBER STANDARDS – UPDATE REPORT – The Managing Director submitted a report (previously circulated) updating Members on issues relevant to Member standards and ethical governance.

The submitted report set out a number of datasets of ethical indicators to assist in monitoring the ethical health of the Authority and it was reported that, by reviewing and monitoring the indicators, it was anticipated that any unusual or significant changes in the volume of data recorded for the period concerned would alert the Authority to any deterioration in its ethical health and enable any necessary action to be taken at an early stage.

It was reported that there were no particular areas of concern that had been identified from reviewing the data.

RESOLVED – That the report and the statistical information contained therein be noted.

A19. ANNUAL AUDIT LETTER 2017/18 – The Managing Director submitted a report (previously circulated) together with a copy of the Annual Audit Letter for 2017/18.

It was reported that the Letter provided a high level summary of the results from the 2017/18 audit work undertaken by Ernst and Young LLP (EY), the Council's external auditors, for the benefit of Members and other interested parties and confirmed that the Council's accounts gave a true and fair view for the year ending 31 March, 2018 and that the Council had put in place proper arrangements to secure value for money in its use of resources.

RESOLVED – That the Annual Audit letter 2016/17 be noted.

A20. AUDIT SERVICES ANNUAL AUDIT PLAN 2018/19 – PROGRESS REPORT –
The Audit and Risk Manager submitted a report (previously circulated) outlining the progress against the 2018/19 Annual Audit Plan.

The submitted report outlined the progress to date on audit assignment work, consultancy/contingency activity and performance indicators.

RESOLVED – That the progress report against the 2017/18 Annual Audit Plan be noted.

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MID YEAR RISK MANAGEMENT UPDATE REPORT 2018/19

SUMMARY REPORT

Purpose of the Report

1. To update Members on the approach to and outcomes from the Council's Risk Management processes.

Summary

2. Positive progress continues to be made within the Authority regarding the management of key strategic risks and with the work undertaken by Officers to manage operational risk.

Recommendation

3. It is recommended this Risk Management Report be noted.

Reasons

4. The recommendation is supported to provide the Audit Committee with evidence to reflect on the Council's approach to Risk Management.

**Paul Wildsmith
Managing Director**

Background Papers

- (i) Council's Risk Management Strategy
- (ii) Corporate and Group Risk Registers
- (iii) Risk Management Report to Audit Committee July 2018

S17 Crime and Disorder	This report has no implications for crime and disorder
Health and Well Being	There is no specific health and well-being impact
Carbon Impact	There is no specific carbon impact
Diversity	There is no specific diversity impact.
Wards Affected	All wards are affected equally
Groups Affected	All groups are affected equally
Budget and Policy Framework	This report does not recommend a change to the Council's budget or policy framework
Key Decision	This is not a key decision
Urgent Decision	For the purpose of the 'call-in' procedure this does not represent an urgent matter
One Darlington: Perfectly Placed	There is no specific relevance to the strategy beyond a reflection on the Council's governance arrangements
Efficiency	Insurance premiums reflect the pro-active approach taken to risk management within the Council.
Impact on Looked After Children and Care Leavers	The report does not impact upon Looked After Children or Care Leavers.

MAIN REPORT

Background

5. Risk Management is an essential part of effective and efficient management and planning and it strengthens the ability of the Council to achieve its objectives and enhance the value of services provided. It is also an important element in demonstrating continuous improvement as well as being part of the Council's Local Code of Corporate Governance that reflects the requirements of the CIPFA / SOLACE Framework of Corporate Governance.

Information and Analysis

Strategic Risk Outcomes

6. A key element of the Council's planning process is that the areas of potential risk, which could adversely impact on the ability to meet objectives, are identified together with the officer responsible for managing that risk. These risks are plotted on to a standard likelihood and impact matrix with reference to management controls in place and working. The shaded part of the matrix signifies the area above the 'risk appetite line'. Risks in this region require further specific management i.e. are priorities for improvement that have an appropriate improvement action plan. Risk matrices, that reflect the updated Council structure from 1 June 2018, are attached at Appendices A-D and show the current Council Corporate and Group risks.

7. All risks are continually managed during the year by Corporate and Group Management Teams including any emerging risks identified. In addition, Assistant Directors are required to confirm in their Annual Assurance Statements that processes are in place to ensure that controls identified to support the positioning of risks on the risk matrices are in place and working.
8. The information that follows, provided by appropriate Group staff, details progress made on improvement actions for those risks identified as above the risk appetite line.
 - (a) **Corporate Risks (Appendix A)** – One corporate risk has been identified.

(C5) Council unable to meet its obligations under information governance agenda.

- (i) As reported to the October 2018 Audit Committee, the Council continues to make steady progress on the implementation of the information governance programme. The Council now has a fairly comprehensive record of its processing activities, with almost all service areas having completed an Information Asset Registers (IAR). These are live documents and will be reviewed at least annually. Having completed the IARs the Council has also made significant progress in ensuring all services have GDPR compliant privacy notices in place. These are available via the Council's [website](#). The Internal Audit Work Programme Template has now been updated to include questions aimed at gauging a services level of compliance with various aspects of GDPR/The Data Protection Act 2018. The Data Protection Officer (DPO) and the Principal Lawyer (Commercial) have updated the Council's procurement documents and Standard Terms and Conditions for the provision of services to ensure any new contracts with data processors are GDPR complainant and have advised IAOs to issue variation letters to those contractors who already process personal data on behalf of the Council. The Council has amendment the Information Security Incident Management Process to ensure decisions can be made and personal data breaches reported to the ICO, where appropriate, within the 72 hour time limit set in the GDPR. The revised process includes a standard and consistent risk assessment method. Since the October 2018 report the Council has implemented a Data Protection Impact Assessment Tool (DPIA) to ensure DPIAs are undertaken in all instances where they are legally required. The DPO has also issued advice on what the Council needs to do to ensure its CCTV is complainant with GDPR and the advice of the Surveillance Camera Commissioner's advice and met with the IAO earlier this month to progress that work.

- (b) **Children and Adults (now includes the Commissioning Group and Public Health) (Appendix B)** –five risks have been identified

(C & A1) Inability to contain placement costs for children looked after due to lack of sufficient in house placements.

- (i) A full Transformation and Efficiency programme is being delivered with the key objective of developing sufficient provision within or close to Darlington that meet the needs of the looked after children. This includes

in-house foster care, residential care and specialist provision for complex needs. Due to the changing complexities and the demand for placements not just locally, but also regionally and nationally, the work will be informed by other localities, and joint working will take place where this can add value.

(C & A 3b) Inability to recruit and retain sufficient qualified suitably experienced social workers in Adult Services impacts on cost and quality of service.

- (i) Challenges remain in recruiting into Team Manager, Senior Practitioner and experienced Social Worker posts in Adult Services. Availability of agency staff has also been limited. Actions have been taken to review job descriptions and grading of posts and this should improve recruitment outcomes. Market supplements are also in place.

(C & A 5) Failure to identify vulnerable schools and broker appropriate support to address needs.

- (i) Academies that are underperforming are discussed with the Regional Schools Commissioner (RSC) who has responsibility for academies in a regular termly meeting. Support is brokered or commissioned by the RSC for academies that are under-performing. Vulnerable schools are identified through review of performance data and other contextual information on a termly basis. The Local Authority has responsibility for its maintained schools. The recently established Education Strategy Group consisting of LA and Head representatives from primary, secondary and FE phases has agreed key strategic aims and is further developing the sector led improvement model in Darlington. This will identify support needs in individual schools and where capacity and expertise may be available in other settings.

(C & A 8) Increased demand for services impacts negatively on plans for budget efficiencies.

- (i) The Transformation Programme continues to remodel and redesign the way Adult Social Care is delivered in Darlington. All four key work streams contribute to how demand is being managed. There is a specific work stream that is redesigning the way enquiries are screened and dealt with, to improve efficiency and effectiveness of contacts. This is progressing well, with the online directory live from March 2018.
- (b) **Economic Growth Group (Appendix C)** – no risks have been identified as above the appetite line.
- (c) **Neighbourhood Services and Resources Group (Appendix D)** – no risks have been identified as above the appetite line

Operational Risk Outcomes

- 9. The Insurance Group continues to meet representatives of the Council's insurers to examine insurance claims. The Insurers are able to provide the Group with an

update in relation to trends and operational risks to enable continuous improvement to the safety culture within the organisation.

10. At the last meeting of the Insurance Group, the Council's Insurer's reported that our claims experience was extremely favourable. In particular, Public Liability claims had a repudiation rate of 92.6% compared to 79% nationally.
11. The organisation has over 70 health and safety champions. Champions are Assistant Director (AD) appointed and receive health and safety training and meet regularly with AD's and play a key role in raising awareness, monitoring work practices and communicating health and safety messages.
12. The Corporate Health and Safety Policy has again been revised along with the General Statement of Intent. Employees with access to a PC will be able to access the Policy and through Academy 10 complete an assessment of understanding. Operational employees are issued with a Policy booklet and a tool box talk. The 'Think Safety' commitment poster has also been updated and signed by AD's and has been displayed within council buildings.
13. Violence and aggression, manual handling and slips, trips and falls continue to be the main accident kinds within the organisation. Measures to reduce the risks of injury and ill health in these areas include the ongoing implementation of arrangements such as; the Employee Protection Register, lone working devices and conflict management training. Moving and handling of people processes have been reviewed resulting in improved risks assessments procedures and the development of further training for key employee groups. We continue to promote the importance of near miss reporting corporately. A significant number of near miss reports relate to the potential for slip, trip and fall accidents, these are thorough investigated by management and appropriate action taken to reduce the risk of future accidents.
14. It was previously reported that a review of working practices had been completed by the Health and Safety Unit working with the Highway Construction Section and implementation has seen a reduction in the total amount of cable strikes noted by the service. Services are continuing to monitor this closely. Additional HSG47 training covering excavation works has previously been completed by all managers, site supervisors, foreman and operatives. During the quarter 1 May 2018 to 31 July 2018 there had been no cable strikes in the service area whilst undertaking excavation works. Health & Safety are happy that safe systems of work are embedded within the service area and will monitor during the next quarter (August to October 2018) before closing.
15. Following the three year programme to convert all Street Lighting lanterns to LED the Council is now saving approximately £368,000 per year on energy costs. The number of Street Lighting faults has reduced from 4,249 in 2012/2013 to 719 in the first six months of 2018/2019.
16. During the summer the Council carried out a £900k programme of Micro Surfacing. This process helps seal the road surface to prevent potholes forming. This year 103 streets totalling almost 13 miles of road were treated.
17. The annual Coarse Visual Inspection (CVI) of the unclassified road network was received from our survey contractor on 7 November. This has been processed and

is showing a Performance Indicator of 16% of the network requiring attention, compared with 22% in 2017/2018. This shows that the Micro Surfacing and other maintenance schemes have contributed to an overall improvement in network condition.

18. The Highway Asset Management team have been working with our software supplier to further develop the Council's United Kingdom Pavement Management System (UKPMS). By processing condition surveys & works records the system is able to produce prioritisation lists for roads as well as projecting condition & assigning treatments. This assists the engineers in determining which roads to include in future programmes of works.
19. Members will be aware of the several gale force storms throughout the summer. Due to trees being in full leaf, we have had trees and limbs fail. With a very high percentage being not foreseeable we have been or will likely be able to successfully defend compensation claims received.

Conclusion

20. The Council's pro-active approach to risk management continues to produce positive results for the Authority.

Outcome of Consultation

21. There has been no formal consultation in the preparation of this report.

RISK MATRIX
CORPORATE RISK REGISTER

Page 11

LIKELIHOOD	A Very High				
	B High				
	C Significant			5	
	D Low			3, 4, 15,16, 17	
	E Very Low		1		
	F Almost Impossible				
		IV Negligible	III Marginal	II Critical	I Catastrophic
IMPACT					

CORPORATE RISK REGISTER

Risk No.	Risk	Responsible Person	Movement in Period	Reason for Movement on Matrix	Progress on Action Plan for Risks Above the Appetite Line that have not moved
C1	Implementation of recommendations from the Capital Process Review is needed to improve effective capital project management	Ian Williams	None at E/III		
C3	Corporate Premises Risks	Ian Williams	None at D/II		
C4	Business Continuity Plans not in place or tested for key critical services.	Ian Williams	None at D/II		
C5	Council unable to meet its obligations under the information governance agenda.	Paul Wildsmith	None at C/II		See main body of report at paragraph 8 (a) i
C15	Not maximising the opportunity for Darlington Borough Council that is brought about by being part of the Combined Authority with devolved powers and new transport opportunities for the North.	Paul Wildsmith	Deleted from D/II	The Combined Authority is now embedded and Darlington Borough Council is well represented at Cabinet and the various Committees.	

Risk No.	Risk	Responsible Person	Movement in Period	Reason for Movement on Matrix	Progress on Action Plan for Risks Above the Appetite Line that have not moved
C16	Children's Services unable to exit DfE intervention arrangements following Ofsted's "Inadequate" judgement owing to failure to achieve the necessary service improvements	Suzanne Joyner	Deleted from D/II	Re-inspection completed, Ofsted judgement improved from Inadequate to Requires improvement to be Good, resulting in formal intervention ceasing.	
C17	Brexit could result in changes to laws, regulations, government policy or funding when/if the UK leaves the EU which could impact on Darlington Borough Council's ability to achieve its objectives.	Paul Wildsmith	Emerging Risk D/II	There remains a great degree of uncertainty around Brexit and the future relationship is yet to be defined.	

RISK MATRIX

CHILDREN, ADULTS AND PUBLIC HEALTH

LIKELIHOOD	A Very High				
	B High			8	
	C Significant		9a, 9b 10	1, 3b, 5	
	D Low			3a	
	E Very Low				
	F Almost Impossible				
		IV Negligible	III Marginal	II Critical	I Catastrophic
IMPACT					

CHILDREN, ADULTS AND PUBLIC HEALTH RISK REGISTER

Risk No.	Risk	Responsible Person	Movement in Period	Reason for Movement on Matrix	Progress on Action Plan for Risks Above the Appetite Line that have not moved
C&A 1	Inability to contain placement costs for children looked after due to lack of sufficient in house placements.	Jane Kochanowski	None at C/II		See main body of report at paragraph 8 (b) i
C&A 3a	Inability to recruit and retain sufficient qualified suitably experienced social workers in Children's Services impacts on cost and quality of service.	Jane Kochanowski/	Moved from C/II to D/II	All team manager and above are permanent staff in Children and Young People, and turnover is low at this level. We have recruited to all permanent social work vacancies. The vacancy rate is at 5% and as such is within normal range for the authority. Existing agency workers are covering maternity, sickness and temporary capacity where needed	See main body of report at paragraph 8 (b) ii
C&A 3b	Inability to recruit and retain sufficient qualified suitably experienced social workers in Adult Services impacts on cost and quality of service.	James Stroyan	None at C/II		
C&A 4	Insufficient school places to meet parental preferences and expansion of house building in the borough.	Tony Murphy	Deleted from to D/II	Pupil place planning procedures enacted to ensure sufficient capacity in the system	

Risk No.	Risk	Responsible Person	Movement in Period	Reason for Movement on Matrix	Progress on Action Plan for Risks Above the Appetite Line that have not moved
C&A 5	Failure to identify vulnerable schools and broker appropriate support to address needs	Tony Murphy	None at C/II		See main body of report at paragraph 8 (b) iii
C&A 6	Budget savings not realised through services promoting and supporting independence in the community	Suzanne Joyner	Deleted from C/II	Budget savings achieved in 2017/18. Currently underspending on 2018/19 budget.	
C&A 7	Delivery of the outcomes of the Better Care Fund Plan approved by NHS England is not achieved	Christine Shields	Deleted from D/II	Plan approved	
C&A 8	Increased demand for services impacts negatively on plans for budget efficiencies	James Stroyan	None at B/II		See main body of report at paragraph 8 (b) iv
Risk No.	Risk	Responsible Person	Movement in Period	Reason for Movement on Matrix	Progress on Action Plan for Risks Above the Appetite Line that have not moved

C&A 9a	Risk Reworded Market (Domiciliary Care Residential Care providers) failure following the Care Act/Living Wage	Christine Shields	None at C/III		
C&A 9b	Risk Reworded Market (Domiciliary Care Residential Care providers) for Vulnerable Families with Children (including SEND) experiences provider failure	Christine Shields	None at C/III		
C&A 10	The Deprivation of Liberty Safeguards Threshold changes significantly increases the amount of people deprived of their liberty resulting in potential for increased legal challenge	James Stroyan	None at C/III		

Risk No.	Risk	Responsible Person	Movement in Period	Reason for Movement on Matrix	Progress on Action Plan for Risks Above the Appetite Line that have not moved
C&A 12	Failure to re-procure an integrated sexual health service and impact of people accessing sexual health services	Miriam Davidson	Deleted from C/II	The new service was operational from August 2018 and has been successfully mobilised over a 12 week period. Mobilisation is successfully continuing and therefore the risk has reduced and can now be deleted.	
C&A 13	Changes to Education Funding, resulting in expected loss of grant income	Tony Murphy	Deleted from C/III	Education Support Grant reduction has minimal impact on DBC due to high level of academisation.	

RISK MATRIX

ECONOMIC GROWTH & NEIGHBOURHOOD SERVICES GROUP

LIKELIHOOD	A Very High				
	B High				
	C Significant		9		
	D Low			1, 7, 8, 13,14	
	E Very Low			12	
	F Almost Impossible				
		IV Negligible	III Marginal	II Critical	I Catastrophic
IMPACT					

ECONOMIC GROWTH GROUP RISK REGISTER

Risk No.	Risk	Responsible Person	Movement in Period	Reason for Movement on Matrix	Progress on Action Plan for Risks Above the Appetite Line that have not moved
EG & NS 1	Investment in regeneration projects is not delivered	Ian Williams	None at D/II		
EG & NS 7	Financial implications of Maintaining and conserving key capital assets within the borough	Guy Metcalfe, Pauline Mitchell, Dave Winstanley	None at D/II		
EG & NS 8	Ability to adequately address the affordable housing requirement	David Hand	None at D/II	.	
EG & NS 9	Delay to new Local Plan.	David Hand	None at C/III		
EG & NS 10	Complexity of delivering multiple Economic Growth sites to meet growing demands and ambitious timescales. (e.g. Central Park, Ingenium Park, Faverdale, Darlington Growth Hub, Morton Palms and other investment enquiry sites)	Dave Winstanley	Deleted from D/II	Multiple Economic Growth sites to meet growing demands and ambitious timescales delivered.	
Risk No.	Risk	Responsible Person	Movement in Period	Reason for Movement on Matrix	Progress on Action Plan for Risks Above the Appetite Line that have not moved

EG & NS 12	Planning Performance at risk of Standards Authority intervention	David Coates	None at E/II		
EG & NS 13 Previously RE 16	Significant impacts arising from the reduction in available cash/resources to the local economy, Council and businesses due to the impacts of Welfare Reform.	Pauline Mitchell	None at D/II		
EG & NS14 Previously RE 24	Risk Reworded Regulatory risks associated with provision of services including Street Scene Environmental services Building services (Gas Legionella etc.) and the Lifeline service	Ian Thompson /Pauline Mitchell	None at D/II		
EG & NS 15 and RE 25	Risk of legal challenge on decisions made at Group level	Ian Thompson /Pauline Mitchell	Deleted from D/III	Related to a particular issue which no longer presents a risk.	

RISK MATRIX

RESOURCES GROUP

LIKELIHOOD	A Very High				
	B High				
	C Significant		1, 2, 9		
	D Low		3, 5		
	E Very Low				
	F Almost Impossible				
		IV Negligible	III Marginal	II Critical	I Catastrophic
IMPACT					

RESOURCES GROUP RISK REGISTER

Risk No.	Risk	Responsible Person	Movement in Period	Reason for Movement on Matrix	Progress on Action Plan for Risks Above the Appetite Line that have not moved
RE1	VAT (Planning expenditure in terms of capital)	Elizabeth Davison	None at C/III		
RE2	Fraud in General	Andrew Barber	None at C/III		
RE3	ICT security arrangements inadequate	Ian Miles	None at D/III		
RE5	Increased sickness absence adversely affects service delivery	Elizabeth Davison	None at D/III		
RE9	Instability within financial markets adversely impacts on finance costs and investments	Elizabeth Davison	None at C/III		
RE16 Now EG & NS 13	Significant impacts arising from the reduction in available cash/resources to the local economy, Council and businesses due to the impacts of Welfare Reform.	Pauline Mitchell		Shown on Appendix C Risk Matrix	
Risk No.	Risk	Responsible Person	Movement in Period	Reason for Movement on Matrix	Progress on Action Plan for Risks Above the Appetite Line that have not moved

RE24 Now EG & NS14	Risk Reworded Regulatory risks associated with provision of services including Street Scene Environmental services Building services (Gas Legionella etc.) and the Lifeline service	Ian Thompson /Pauline Mitchell		Shown on Appendix C Risk Matrix	
RE 25 and EG & NS 15	Risk of legal challenge on decisions made at Group level	Elizabeth Davison/ Luke Swinhoe/ Ian Miles	Deleted from D/III	Related to a particular issue which no longer presents a risk.	

**MID YEAR PRUDENTIAL INDICATORS AND TREASURY MANAGEMENT
MONITORING REPORT 2018/19**

SUMMARY REPORT

Purpose of the Report

1. This report seeks approval of the revised Treasury Management Strategy, Prudential Indicators and provides a half-yearly review of the Council's borrowing and investment activities. Audit Committee are requested to forward the revised Strategy and indicators to Cabinet and Council for their approval and note changes to the MTFP with regard to the Treasury Management Budget (Financing Costs).

Summary

2. The mandatory Prudential Code, which governs Council's borrowing, requires Council approval of controls, called Prudential Indicators, relating to capital spending and borrowing. Prudential Indicators are set in three statutory annual reports, a forward looking annual treasury management strategy, a backward looking annual treasury management report and this mid year update. The mid-year update follows Council's approval in February 2018 of the 2018/19 Prudential Indicators and Treasury Management Strategy.
3. The key objectives of the three annual reports are:
 - (a) to ensure the governance of the large amounts of public money under the Council's Treasury Management activities:
 - (i) Complies with legislation
 - (ii) Meets high standards set out in codes of practice
 - (b) To ensure that borrowing is affordable,
 - (c) To report performance of the key activities of borrowing and investments.
4. The key proposed revisions to Prudential Indicators relate to:
 - (a) The Operational Boundary will reduce to £300.653M and the Authorised Limit to £315.686M to allow for any additional cashflow requirement.
5. Investments now include £30m in property funds which are expected to increase our net return on investments by around £0.600m in future years.

Recommendation

6. It is recommended that :
- (a) The revised prudential indicators and limits within the report in Tables 1 to 6, 8 and 15 to 18 are examined.
 - (b) The reduction in the Treasury Management Budget (Financing Costs) of £0.590m shown in Table 12 is noted.
 - (c) That this report is forwarded to Council via Cabinet with comments from this committee, in order for the updated prudential indicators to be approved.

Reasons

7. The recommendations are supported by the following reasons :-
- (a) In order to comply with the Prudential Code for Capital Finance in Local Authorities;
 - (b) To inform Members of the performance of the Treasury Management function;
 - (c) To comply with the Local Government Act 2003;
 - (d) To enable further improvements to be made in the Council's Treasury Management function.

Paul Wildsmith
Managing Director

Background Papers

- (i) Capital Medium Term Financial Plan 2018/19
- (ii) Accounting records
- (iii) The Prudential Code for Capital Finance in Local Authorities

Peter Carrick: Extension 5401

S17 Crime and Disorder	This report has no implications for S17 Crime and Disorder.
Health and Well Being	This report has no implications for the Council's Health and Well Being agenda.
Carbon Impact	There are no carbon impact implications in this report.
Diversity	There are no specific implications for the Council's diversity agenda.
Wards Affected	All Wards.
Groups Affected	All Groups.
Budget and Policy Framework	This report must be considered by Council.
Key Decision	This is not an executive decision.
Urgent Decision	For the purposes of call in this report is not an urgent decision.

One Darlington: Perfectly Placed	This report has no particular implications for the sustainable Community Strategy.
Efficiency	The report refers to actions taken to reduce costs and manage risks.
Impact on Looked After Children and Care Leavers	This report does not impact on Looked After Children or Care Leavers

MAIN REPORT

Information and Analysis

8. This mid-year review report meets the regulatory framework requirement of treasury management. It also incorporates the needs of the Prudential Code to ensure monitoring of the capital expenditure plans and the Council's prudential indicators (PIs). The Treasury Strategy and the PIs were previously reported to Council on 22 February 2018.
9. This report concentrates on the revised positions for 2018/19. Future year's indicators will be revised when the impact of the MTFP 2019/20 onwards is known.
10. A summary of the revised headline indicators for 2018/19 is presented in **Table 1** below. More detailed explanations of each indicator and any proposed changes are contained in the report. The revised indicators reflect the movement in the Capital MTFP since its approval in February 2018 and the means by which it is financed.

Table 1 Headline Indicators

	2018/19 Original Estimate	2018/19 Revised Estimate
	£m	£m
Capital Expenditure (Tables 2 and 3)	38.972	35.877
Capital Financing Requirement (Table 4)	302.889	319.487
Operational Boundary for External Debt (Table 4)	301.653	300.653
Authorised Limit for External Debt (Table 6)	316.736	315.686
Ratio of Financing Costs to net revenue stream- General Fund (Table 15)	3.46%	3.03%
Ratio of Financing Costs to net revenue stream- Housing Revenue Account (HRA)(Table 15)	15.03%	15.04%

11. The capital expenditure plans and prudential indicators for capital expenditure are set out initially, as these provide the framework for the subsequent treasury management activity. The actual treasury management activity follows the capital framework and the position against the treasury management indicators is shown at the end.
12. The purpose of the report supports the objective in the revised CIPFA Code of Practice on Treasury Management and the Ministry of Housing, Communities and Local Government Investment Guidance which state that Members receive and adequately scrutinise the treasury service.

13. The underlying economic environment remains difficult for Councils and concerns over counterparty risk are still around. This background encourages the Council to continue investing over the shorter term and with high quality counterparties, the downside is that investment returns remain low.

Key Prudential Indicators

14. This part of the report is structured to update:
- (a) The Council's capital expenditure plans
 - (b) How these plans are financed
 - (c) The impact of the changes in the capital expenditure plans on the PI's and the underlying need to borrow
 - (d) Compliance and limits in place for borrowing activity
 - (e) Changes to the Annual Investment Strategy
 - (f) The revised financing costs budget for 2018/19

Capital Expenditure PI

15. **Table 2** shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the budget.

Table 2

Capital Expenditure by Service	2018/19 Original Estimate	2018/19 Revised Estimate
	£m	£m
General Fund	16.746	18.507
HRA	17.181	12.370
Total Estimated Capital Expenditure	33.927	30.877
Loans to Joint Ventures	5.000	5.000
Total	38.927	35.877

16. The changes to the 2018/19 capital expenditure estimates have been notified to Cabinet as part of the Capital Budget monitoring process (Quarterly Project Position Statement Report).
17. The current capital programme now stands at £49.877m but this includes a number of schemes that will be spent over a number of years not just in 2018/19. A reduction of £14.000m has been allowed for schemes which are known will be finalised in future years, but it is likely that other schemes will also slip into future years.

Impact of Capital Expenditure Plans

Changes to the financing of the Capital Programme

18. **Table 3** draws together the main strategy elements of the capital expenditure plans shown above, highlighting the original elements of the capital programme, and the expected financing arrangements of this capital expenditure. The borrowing element (Borrowing Need) increases the underlying indebtedness of the Council by

way of the Capital Financing Requirement (CFR). Borrowing need has increased for 2018/19 due to borrowing not required in previous years for slipped schemes but expected to be needed this year. This direct borrowing need may also be supplemented by maturing debt and other treasury requirements.

Table 3

Capital Expenditure	2018/19 Original Estimate	2018/19 Revised Estimate
	£m	£m
General Fund	16.746	28.507
HRA	17.181	12.370
Loans to Joint Ventures	5.000	5.000
Total Capital expenditure	38.927	35.877
Financed By:		
Capital Receipts - Housing	0.198	0.198
Capital Receipts –General Fund	3.511	5.678
Capital grants	12.735	7.863
Revenue Contributions - GF	0.000	1.600
Revenue Contributions - Housing	16.983	12.172
Total Financing	33.427	27.511
Borrowing Need	5.500	8.366

The Capital Financing Requirement (PI), External Debt (PI) and the Operational Boundary

19. **Table 4** shows the Capital Financing Requirement (CFR), which is the underlying external need to borrow for capital purposes. It shows the expected actual debt position over the period. This is called the Operational Boundary. The increase in Borrowing Need (Table 3) is around £2.9m and currently actual borrowing for the Council is £188.261m, it is proposed to set an actual borrowing figure of £288.000m this will accommodate the additional borrowing need and any debt requirements for cash flow purposes. Other Long term liabilities (the PFI scheme) will be added to give the revised operational boundary for 2018/19.

Prudential Indicator- External Debt/ Operational Boundary

Table 4

	2018/19 Original Estimate	2018/19 Revised Estimate
	£m	£m
Prudential Indicator- Capital Financing Requirement		
Opening CFR- Post Audit of Accounts	299.190	316.288
Closing CFR	302.889	319.487
CFR General Fund	115.640	132.238
CFR General Fund PFI/Leasing IFRS	12.653	12.653

CFR – Housing	69.596	69.596
CFR – Loans to RSL's	100.000	100.00
CFR – Loans to Joint Ventures	5.000	5.000
Total Closing CFR	302.889	319.487
Net Movement in CFR	3.699	3.199
Borrowing	289.000	288.000
Other long Term Liabilities	12.653	12.653
Total Debt 31 March- Operational Boundary	301.653	300.653

Limits to Borrowing Activity

20. The first key control over the treasury activity is a PI to ensure that over the medium term gross borrowing should not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and the next two financial years. As shown in table 5 below.

Table 5

	2018/19 Original Estimate £m	2018/19 Revised Estimate £m	2019/20 Revised Estimate £m	2020/21 Original Estimate £m
Gross borrowing	189.000	188.000	199.000	199.000
Loan Facility to RSL's	100.000	100.000	100.000	100.000
Plus Other Long Term Liabilities	12.653	12.653	11.498	10.358
Total Gross Borrowing	301.653	300.653	310.498	309.358
CFR* (year-end position)	302.889	319.487	326.703	324.934

* includes on balance sheet PFI schemes and finance leases and Loan Facility to RSLs

21. The Assistant Director Resources reports that no difficulties are envisaged for the current and future years in complying with this PI.
22. A further PI controls the overall level of borrowing, this is the Authorised Limit which represents the limit beyond which borrowing is prohibited and needs to be set and revised by Members. It reflects the level of borrowing which while not desirable, could be afforded in the short term, but is not sustainable in the longer term. The Authorised Limit is currently set 5% above the Operational Boundary to allow for any additional cashflow needs, the revised figure for 2018/19 has been raised by 5% of the new Operational Boundary total. Whilst it is not expected that borrowing would be at these levels this would allow additional borrowing to take place should market conditions change suddenly and swift action was required. This is a Statutory limit determined under section 3 (1) of the Local Government Act 2003.
23. It is proposed to move the Authorised Limit in Table 6 in line with the movement in the overall Capital Financing Requirement.

Table 6

Authorised Limit for External Debt	2018/19 Original Indicator £m	2018/19 Revised Indicator £m
Operational Boundary	301.653	300.653
Additional headroom to Capital Financing Requirement	15.083	15.033
Total Authorised Limit for External Debt	316.736	315.686

Interest Rate Forecasts Provided by Link Asset Services**Table 7**

	Bank Rate	PWLB rates for borrowing purposes*			
		5 year	10 year	25 year	50 year
	%	%	%	%	%
2018/19					
Dec 2018	0.75	1.80	2.30	2.70	2.50
March 2019	0.75	1.90	2.30	2.70	2.50
2019/20					
June 2019	1.00	2.00	2.40	2.80	2.60
Sept 2019	1.00	2.00	2.40	2.90	2.70
Dec 2019	1.00	2.10	2.50	2.90	2.70
March 2020	1.25	2.10	2.60	3.00	2.80
2020/21					
June 2020	1.25	2.20	2.70	3.10	2.90
Sept 2020	1.25	2.30	2.70	3.10	2.90
Dec 2020	1.50	2.30	2.80	3.20	3.00
March 2021	1.50	2.40	2.80	3.20	3.00

*PWLB rates above are for certainty rates (which are provided for those authorities that have disclosed their borrowing/capital plans to the government. Darlington Borough Council will be able to access these certainty rates which are 0.2% below PWLB's normal borrowing rates.

24. The flow of generally positive economic statistics after the end of the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, to 0.75%. However, the MPC emphasised again, that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary or contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years' time but they declined to give a medium term forecast. We do not think that the MPC will increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. We also feel that the MPC is more likely to wait until August 2019, than May 2019, before the next increase, to be followed by further increases of 0.25% in May and November 2020 to reach 1.5%. However, the cautious pace of even these limited increases is dependent on a reasonably orderly Brexit.

25. The overall balance of risks to economic growth in the UK is probably neutral.
26. The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.
27. The downside risks to current forecasts for UK gilt yields and PWLB rates currently include:
- (a) Bank of England monetary policy takes action too quickly over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
 - (b) A resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system, and due to the election in March of a government which has made a lot of anti-austerity noise. This is likely to lead to friction with the EU when setting the target for the fiscal deficit in the national budget. Unsurprisingly, investors have taken a dim view of this and so Italian bond yields have been rising.
 - (c) Austria, the Czech Republic and Hungary now form a strongly anti-immigration bloc within the EU while Italy, this year, has also elected a strongly anti-immigration government. In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position as a result of the rise of the anti-immigration AfD party. To compound this, the result of the Swedish general election in September 2018 has left an anti-immigration party potentially holding the balance of power in forming a coalition government. The challenges from these political developments could put considerable pressure on the cohesion of the EU and could spill over into impacting the euro, EU financial policy and financial markets.
 - (d) The imposition of trade tariffs by President Trump could negatively impact world growth. President Trump's specific actions against Turkey pose a particular risk to its economy which could, in turn, negatively impact Spanish and French banks which have significant exposures to loans to Turkey.
 - (e) Weak capitalisation of some European banks.
 - (f) Rising interest rates in the US could negatively impact emerging countries which have borrowed heavily in dollar denominated debt, so causing an investor flight to safe havens e.g. UK gilts.
 - (g) Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.
28. The upside risks to current forecasts for UK gilts and PWLB rates are:
- (a) President Trump's fiscal plans to stimulate economic expansion causing a significant increase in inflation in the US and causing further sell offs of government bonds in major western countries.

- (b) The Fed causing a sudden shock in financial markets through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of QE, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.
- (c) The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- (d) UK inflation, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

Treasury Management Strategy 2018/19 and Annual Investment Strategy Update

29. In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. As from 2019/20, all local authorities will be required to prepare a Capital Strategy which is intended to provide the following: -

- (a) a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- (b) an overview of how the associated risk is managed
- (c) the implications for future financial sustainability

30. A report setting out our Capital Strategy will be taken to Council via Cabinet before 31st March 2019.

Debt Activity during 2018/19

31. The expected net borrowing need is set out in table 8

Table 8

	2018/19 Original Estimate £M	2018/19 Revised Estimate £M
CFR (year-end position) from Table 4	302.889	319.487
<u>Less</u> other long term liabilities PFI and finance leases	12.653	12.653
Net adjusted CFR (net year end position)	290.236	306.834
Expected Borrowing	289.000	288.000
(Under)/ Over borrowing	(1.236)	(18.834)
Expected Net movement in CFR	3.699	6.565
Expected Net Movement in CFR represented by		
Net financing need for the year from table 3	5.500	8.366

Less MRP General Fund		
Less MRP Housing	0.629	0.629
Less MRP relating to finance leases including PFI	1.172	1.172
Movement in CFR (Net Borrowing Need)	3.699	6.565

32. The following new borrowing has been taken to date.

Table 9

Date Taken	Term	Amount £m	Interest Rate	Purpose	Lender
25 th July 2018	2 Year	£5.000	0.80%	Property Funds	Other Local Authority
8 th August 2018	9 months	£5.000	0.70%	General	Other Local Authority
31 st August 2018	1 Year	£3.500	1.00%	Property Funds	Other Local Authority
31 st August 2018	5 Year	£5.000	1.82%	Joint Ventures	PWLB
18 th October 2018	1 Year	£5.000	1.05%	General	Other Local Authority
20 th December 2018	1 year	£4.000	1.00%	Rescheduling	Other Local Authority
20 th December 2018	2 years	£5.000	1.45%	Rescheduling	Other Local Authority
20 th December 2018	1 year	£5.000	1.10%	Rescheduling	Other Local Authority
21 st December 2018	42 Years	£5.000	2.47%	Rescheduling	PWLB
21 st December 2018	43 years	£5.000	2.46%	Rescheduling	PWLB
21 st December 2018	44 years	£5.000	2.46%	Rescheduling	PWLB
21 st December	45 years	£6.000	2.46%	Rescheduling	PWLB
21 st December 2018	46 years	£6.250	2.45%	Rescheduling	PWLB
Total		64.750			

33. The amount borrowed by the Council now stands at £188.261M, this excludes any loans to RSL's or additional cashflow loans which may be required.

34. There will still be an element of under-borrowing by the Council at the end of March 2019.

Debt Rescheduling

35. Debt rescheduling opportunities have been very limited in the current economic climate given the consequent structure of interest rates, and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010.
36. During the current financial year, however, the following debt rescheduling opportunity arose and was undertaken.
37. As Members are aware the Council has held a number of Lender Option Borrower Option (LOBO's) since 2006, two of which were classified as 'Inverse LOBO's' whereby the interest rate paid was linked to the prevailing '10 year swap rate' which meant that the higher the interest rate (linked to base rate) the less the Council paid in interest payments and vice versa.
38. An opportunity to redeem the 2 inverse LOBO's arose in December 2018 whereby even with the associated cost of the premium for early settlement the savings to the Council in cash terms are £26.740m over the remaining 42 years of the loans and £12.658m at NPV discounted rates.

Annual Investment Strategy 2018/19

Investment Portfolio

39. In accordance with the Code, it is the Council's priority to ensure security of Capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. It is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous years as rates are very low and in line with the current 0.75% Bank Rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis together with other risks which could impact on the creditworthiness of banks prompts a low risk strategy. Given this risk environment investment returns are likely to remain low.

Treasury Management Activity from 1st April 2018 to 30th November 2018

40. Current investment position – The Council held £49.824m of investments at 30/11/2018 and this is made up of the following types of investment.

Table 10

Sector	Country	Up to 1 year £m
Banks	UK	2.000
Building Societies	UK	0.000
AAA Money Market Funds	Sterling Funds	17.890
Property Funds - CCLA	UK	10.000
Hermes		9.934
Lothbury	UK	10.000
Total		49.824

Short Term Cashflow Investments

41. Cash balances are invested on a daily basis to maximise the benefit of temporary surplus funds. These include investments in Money Market Funds, the Government's Debt Management Office and bank short term notice accounts. A total of 31 investments were made in the period 1st April 2018 to 30th September 2018 totalling c£60m these were for short periods of up to 100 days and earned interest of £30,657 on an average balance of £13.841m which equated to an annual average interest rate of 0.46%

Longer Term Capital Investments Excluding Property Funds

42. The Council's reserves and capital receipts are invested for varying periods up to the maximum permitted time period which is currently 2 years for part Nationalised banks and 12 months for other counterparties. The investments have been at an average level of £2.681m to date. Some individual loans have matured and been renewed during this period. The longer term investments have earned interest of £37,943 for the first six months of 2018/19 at an average rate of 0.74%.

Investment returns measured against the Service Performance Indicators

43. The target for our investment returns is to better or at least match a number of external comparators, this performance indicator is also known as yield benchmarking. As can be seen from Table 11, the short and long term investment achievements are above market expectations.

Table 11

	Cashflow Investments %
Darlington Borough Council - Actual	0.75
External Comparators	
London Interbank Bid Rate 7 day	0.43
London Interbank Bid Rate 3 months	0.61
London Interbank Bid Rate one year	0.87

Treasury Management Budget

44. There are three main elements within the Treasury Management Budget:-
- (a) Longer term capital investments interest earned – a cash amount of which earns interest and represents the Councils revenue balances, unused capital receipts, reserves and provisions, this will now include Property Funds.
 - (b) Cash flow interest earned – since becoming a unitary council in 1997, the authority has consistently had a positive cash flow. Unlike long term capital investments it does not represent any particular sum but it is the consequence of many different influences such as receipt of grants, the relationship between debtors and creditors, cashing of cheques and payments to suppliers.
 - (c) Debt serving costs – this is the principal and interest costs on the Council's long term debt to finance the capital programme.

Table 12 - Changes to the Financing Costs Budget 2018/19

	£m	£m
Original Financing Costs Budget 2018/19		0.915
Less reduced Repayment of Principal	(0.064)	
Less reduced Interest payments paid on debt	(0.337)	
Add reduced interest earned on Investments	0.045	
Less increased returns on Property Funds and Commercial Ventures	(0.123)	
Less saving on rescheduling LOBO's	(0.111)	
Revised Treasury Management Budget 2018/19		0.325

45. The majority of the savings in Financing Costs relate to the reduced interest payments on debt than originally budgeted for. A further £0.123m of income will be received as interest from loans from commercial ventures. Additionally savings of £0.064m have been due to debt principal (MRP) and interest payments on debt being lower than expected. There is also a current year saving of £0.111m on the rescheduling of the previously mentioned LOBO's.
46. This statement concludes that the Treasury Management budget is forecast to achieve an improvement of £0.590m in 2018/19, these savings in finance costs will be returned to Council balances.

Risk Benchmarking

47. A regulatory development is the consideration and approval of security and liquidity benchmarks. Yield benchmarks are currently widely used to assess investment performance and these are shown in Table 10. Discrete security and liquidity benchmarks are also requirements of member reporting.
48. The following reports the current position against the benchmarks originally approved.
49. **Security** – The Council's maximum security risk benchmarks for the current portfolio of investments, when compared to historic default tables were set as follows;

0.077% historic risk of default when compared to the whole portfolio

Table 13

Maximum	Benchmark 2018/19	Actual July	Actual November
Year 1	0.077%	0.008%	0.004%

N.B. this excludes Property Funds

50. The counterparties that we use are all high rated therefore our actual risk of default based on ratings attached to counterparties is very low.

51. **Liquidity** – In respect of this area the Council set liquidity facilities/ benchmark to maintain
- (a) Bank overdraft - £0.100M
 - (b) Liquid short term deposits of a least £3.000M available within a weeks notice
 - (c) Weighted Average Life benchmark is expected to be 0.4 years with a maximum of 1 year
52. The Assistant Director Resources can report that liquidity arrangements have been adequate for the year to date as shown in Table 13

Table 14

	Benchmark 2018/19	Actual June	Actual October
Weighted Average Life	0.4 – 1 year	0.18 years	0.16 years

53. The figures are for the whole portfolio so include both longer term fixed investments currently up to 2 years as well as cash flow investments deposited with Money Market funds on a call basis (i.e. can be drawn on without notice).

Treasury Management Indicators

54. **Actual and estimates of the ratio of financing costs to net revenue stream –** This indicator identifies the trend in the cost of capital (financing costs net of interest and investment income) against the net revenue stream. The reduction in % relates to reduced financing costs for General Fund of £0.443M.

Table 15

	2018/19 Original Indicator	2018/19 Revised Indicator
General Fund	3.46%	3.03%
HRA	15.03%	15.04%

Treasury Management Prudential indicators

55. **Upper Limits on Variable Rate Exposure** – This indicator identifies a maximum limit for variable interest rates based upon the debt position net of investments.
56. **Upper Limits on Fixed Rate Exposure** – Similar to the previous indicator this cover a maximum limit on fixed interest rates.
57. Historically for a number of years this Council has used these percentages; together they give flexibility to the treasury management strategy allowing the Council to take advantage of both fixed and variable rates in its portfolio whilst ensuring that its exposure to variable rates is limited.

Table 16

	2018/19 Original Indicator	2018/19 Revised Indicator
Limits on fixed interest rates	100%	100%
Limits on variable interest rates	40%	40%

58. **Maturity Structures of Borrowing** - These gross limits are set to reduce the Council's exposure to large fixed rate loans (those instruments which carry a fixed interest for the duration of the instrument) falling due for refinancing. The higher limits for longer periods reflect the fact that longer maturity periods give more stability to the debt portfolio.

Table 17**Maturity Structures of Borrowing**

	2018/19 Original indicator	2018/19 Actual to Date	2018/19 Revised Indicator
Under 12 months	25%	5.7%	30%
12 months to 2 years	40%	3.1%	40%
2 years to 5 years	60%	10.9%	60%
5 years to 10 years	80%	5.7%	80%
10 years and above	100%	77.6%	100%

59. **Total Principal Funds Invested** – These limits are set having regard to the amount of reserves available for longer term investment and show the limits to be placed on investments with final maturities beyond 1 year. This limit allows the authority to invest for longer periods if they give better rates than shorter periods. It also allows some stability in the interest returned to the Authority.

Table 18**Principal Funds Invested**

	2018/19 Original Indicator	2018/19 Revised Indicator
Maximum principal sums invested greater than 1 year	£50m	£30m

Conclusion

60. The prudential indicators have been produced to take account of the Council's borrowing position. The key borrowing indicator (the Operational Boundary) is £300.653m to include any possible loans to RSL's. The Council's return on investments has been good, exceeding both of the targets. Based on the first seven months of 2018/19 the Council's borrowing and investments is forecast to achieve an improvement of £0.590m on the approved 2018/19 budget.

61. The Council's treasury management activities comply with the required legislation and meet the high standards set out in the relevant codes of practice.

Outcome of Consultation

62. No consultation was undertaken in the production of this report.

PRUDENTIAL INDICATORS AND TREASURY MANAGEMENT STRATEGY REPORT 2019/20

SUMMARY REPORT

Purpose of the Report

1. This report requests Audit Committee to review and scrutinise the following prior to forwarding to Cabinet and Council for their approval and adoption :-
 - (a) The Prudential Indicators and Limits for 2019/20 to 2021/22 relating to capital expenditure and Treasury Management activity.
 - (b) A policy statement relating to the Minimum Revenue Provision.
 - (c) The Treasury Management Strategy 2019/20, which includes the Annual Investment Strategy for 2019/20
2. The report outlines the Council's prudential indicators for 2019/20 – 2021/22 and sets out the expected treasury operations for this period. It fulfils key legislative and guidance requirements:
 - (a) The reporting of the **prudential indicators** setting out the expected capital activities and treasury management prudential indicators included as treasury indicators in the CIPFA Treasury Management Code of Practice
 - (b) The Council's **Minimum Revenue Provision (MRP) Policy**, which sets out how the Council will pay for capital assets through revenue each year.
 - (c) The **treasury management strategy** statement which sets out how the Council's treasury service will support capital decisions taken above, the day to day treasury management and the limitations on activity through treasury prudential indicators.
 - (d) The key indicator is the **authorised limit**, the maximum amount of debt the Council could afford in the short term, but which is not sustainable in the longer term.
 - (e) The **investment strategy** which sets out the Council's criteria for choosing the investment counterparties and limiting exposures to the risk of loss.
3. The information contained in the report regarding the Councils expenditure plans, Treasury Management and Prudential Borrowing activities indicate that they are:-
 - (a) Within the statutory framework and consistent with the relevant codes of practice.

- (b) Prudent, affordable and sustainable.
- (c) An integral part of the Council's Revenue and Capital Medium Term Financial Plans.

Recommendation

- 4. It is recommended that the Audit Committee examine the following and pass on any comments to the Council via Cabinet in order that they approve them:-
 - (a) The Prudential Indicators and limits for 2019/20 to 2021/22 summarised in Tables 1 and 2.
 - (b) The Minimum Revenue Provision (MRP) statement (paragraphs 37 - 41).
 - (c) The Treasury Management Strategy 2019/20 to 2021/22 as summarised in paragraphs 45 to 70.
 - (d) The Annual Investment Strategy 2019/20 contained in paragraphs 71 to 112.

Reasons

- 5. The recommendations are supported by the following reasons :-
 - (a) In order to comply with the Prudential Code for Capital Finance in Local Authorities and the Department for Communities and Local Government (CLG) guidance on investments.
 - (b) To comply with the requirements of the Local Government Act 2003.
 - (c) To approve a framework for officers to work within when making investment decisions.

**Paul Wildsmith
Managing Director**

Background Papers

- (i) Annual Statement of Account 2017/18
- (ii) Draft Capital MTFP 2019/20 to 2022/23
- (iii) Link Asset Services Economic Report Dec 2018

Peter Carrick : Extension 5401

S17 Crime and Disorder	This report has no implications for S 17 Crime and Disorder.
Health and Well Being	This report has no implications for the Council's Health and Well being agenda.
Carbon Impact	This report has no implications for the Council's Carbon Emissions.
Diversity	This report has no implications for the Council's Diversity agenda.
Wards Affected	All Wards
Groups Affected	All Groups
Budget and Policy Framework	This report must be considered by Council.
Key Decision	This is not an executive decision
Urgent Decision	For the purposes of call in this report is not an urgent decision.
One Darlington: Perfectly Placed	This report has no particular implications for the sustainable Community Strategy.
Efficiency	The report refers to actions taken to reduce costs and manage risks.
Impact on Looked After Children and Care Leavers	This report has no impact on Looked After Children or Care Leavers.

MAIN REPORT

Information and Analysis

Background

6. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in counterparties or instruments commensurate with the Council's risk appetite, providing adequate liquidity initially before considering investment return.
7. The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.
8. The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

9. Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure), and are separate from the day to day treasury management activities.
10. CIPFA defines treasury management as:

“The management of the local authority’s investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”
11. Revised reporting is required for the 2019/20 reporting cycle due to revisions of the MHCLG Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The capital strategy is being reported separately alongside the 2019/20 MTFP.

Reporting requirements

Capital Strategy

12. The revised 2017 CIPFA Prudential and Treasury Management Codes require, for 2019-20, all local authorities to prepare an additional report, a capital strategy report, which will provide the following:
 - (a) a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
 - (b) an overview of how the associated risk is managed
 - (c) the implications for future financial sustainability
13. The aim of this capital strategy is to ensure that all elected members on the full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.
14. This capital strategy is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the former. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the policy and commercialism investments usually driven by expenditure on an asset. The capital strategy will show:
 - (a) The corporate governance arrangements for these types of activities;
 - (b) Any service objectives relating to the investments;
 - (c) The expected income, costs and resulting contribution;
 - (d) The debt related to the activity and the associated interest costs;
 - (e) The payback period (MRP policy);
 - (f) For non-loan type investments, the cost against the current market value;
 - (g) The risks associated with each activity

15. Where a physical asset is being bought, details of market research, advisers used, (and their monitoring), ongoing costs and investment requirements and any credit information will be disclosed, including the ability to sell the asset and realise the investment cash.
16. Where the Council has borrowed to fund any non-treasury investment, there should also be an explanation of why borrowing was required and why the MHCLG Investment Guidance and CIPFA Prudential Code have not been adhered to.
17. If any non-treasury investment sustains a loss during the final accounts and audit process, the strategy and revenue implications will be reported through the same procedure as the capital strategy.
18. To demonstrate the proportionality between the treasury operations and the non-treasury operation, high-level comparators are shown throughout this report.

Treasury Management Reporting

19. The Council is required by legislation to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals. These reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Audit Committee.

Prudential and Treasury Indicators and Treasury Strategy (this report)

20. The first, and most important report is forward looking and covers:
 - (a) The capital plans (including prudential indicators);
 - (b) A minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
 - (c) The treasury management strategy, (how the investments and borrowings are to be organised), including treasury indicators; and
 - (d) An investment strategy, (the parameters on how investments are to be managed).

A Mid Year Treasury Management Report

21. This will update members with the progress on the capital position, amending prudential indicators as necessary, and whether the treasury function is meeting the strategy or whether any policies require revision.

An Annual Treasury Report

22. This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Treasury Management Strategy for 2019/20

23. The strategy for 2019/20 covers two main areas:
- (a) Capital Issues:
- (i) the capital expenditure plans and the prudential indicators;
 - (ii) the minimum revenue provision (MRP) policy.
- (b) Treasury Management Issues:
- (i) the current treasury position;
 - (ii) treasury indicators which will limit the treasury risk and activities of the Council;
 - (iii) prospects for interest rates;
 - (iv) the borrowing strategy;
 - (v) policy on borrowing in advance of need;
 - (vi) debt rescheduling;
 - (vii) the investment strategy;
 - (viii) creditworthiness policy; and
 - (ix) policy on use of external service providers.
24. These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, MHCLG MRP Guidance, the CIPFA Treasury Management Code and the MHCLG Investment Guidance.
25. A summary of the key prudential indicators and limits are contained in Tables 1 and 2 and further details are contained further on in this report.

Table 1 – Capital Expenditure and Borrowing

	2018/19 Revised	2019/20 Estimated	2020/21 Estimated	2021/22 Estimated
Capital Expenditure Table 3 and 4	£35.877m	£34.149m	£15.146m	£13.133m
Capital financing requirement Table 5	£319.487m	£326.703m	£324.934m	£323.179m
Ratio of financing costs to net revenue stream – General Fund See paragraph 43/44 Table 6	3.03%	2.74%	2.98%	3.03%
Ratio of financing costs to net revenue stream – HRA See paragraph 43/44 Table 6	15.03%	17.48%	16.72%	18.15%
Operational boundary for external debt Table 8	£300.653m	£310.498m	£309.358m	£308.232m
Authorised limit for external debt Table 9	£315.686m	£326.023m	£324.826m	£323.644m

Table 2 – Treasury Management

	2019/20 Upper Limit	2020/21 Upper Limit	2021/22 Upper Limit
Limits on fixed interest rates	100%	100%	100%
Limits on variable interest rates	40%	40%	40%
Maximum principal sums invested > 364 days	£50m	£50m	£50m
Maturity Structure of fixed interest rate borrowing 2019/20			
	Lower Limit	Upper Limit	
Under 12 months	0%	40%	
12 months to 2 years	0%	50%	
2 years to 5 years	0%	60%	
5 years to 10 years	0%	80%	
10 years and above	0%	100%	

Training

26. The CIPFA code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training in treasury management. This especially applies to Members responsible for scrutiny. Training was undertaken by a number of Members during 2 sessions held in March 2018 and further training will be arranged as required. The training needs of treasury management officers are periodically reviewed.

Treasury Management Consultants

27. The Council uses Link Asset Services, Treasury solutions as its external treasury management advisors. The Council recognises that responsibility for treasury decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisors.
28. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The officers of the Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented and subject to regular review.

The Capital Prudential Indicators 2019/20– 2021/22

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

Capital Expenditure

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

Table 3 Capital Expenditure

	2018/19 Revised £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
General Fund	18.507	7.615	5.512	3.999
HRA	12.370	22.534	9.634	9.134
Estimated Capital Expenditure	30.877	30.149	15.146	13.133
Loans Facility to Registered Social Landlords (RSL's)	0.000	0.000	0.000	0.000
Loans to Joint Ventures	5.000	4.000	0.000	0.000
Total	35.877	34.149	15.146	13.133

31. The financing need above excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments.
32. The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a financing need (borrowing).

Table 4 Financing of the Capital Programme

	2018/19 Revised £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
General Fund	18.507	7.615	5.512	3.999
HRA	12.370	22.534	9.634	9.134
Loans to RSL's	0.000	0.000	0.000	0.000
Loans to Joint Ventures	5.000	4.000	0.000	0.000
Total Capital	35.877	34.149	15.146	13.133
Financed by:				
Capital receipts- General Fund	5.678	1.686	1.863	0.350
Capital receipts Housing	0.198	0.200	0.222	0.234
Capital grants	7.863	5.929	3.649	3.649
Revenue Contributions - GF	1.600	0.000	0.000	0.000
Revenue Contributions (Housing)	12.172	10.634	9.412	8.900
Total excluding borrowing	27.511	18.449	15.146	13.133

Borrowing need	8.366	15.700	0.000	0.000
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The Council's Borrowing Need (the Capital Financing Requirement)

33. The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.
34. The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each asset life, and so changes the economic consumption of capital assets as they are used.
35. The CFR includes any other long-term liabilities (e.g. PFI schemes, finance leases) brought onto the balance sheet. Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of schemes include a borrowing facility by the PFI or lease provider and so the Council is not required to separately borrow for these schemes. The Council currently has £12.653m of such schemes within the CFR.
36. The Council is asked to approve the CFR projections below:

Table 5 – CFR Projections

	2018/19 Revised £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
CFR – General Fund	132.238	137.238	137.238	137.238
CFR – PFI and Finance leases	12.653	11.498	10.358	9.232
CFR - housing	69.596	68.967	68.338	67.709
CFR Loans to RSL's	100.000	100.000	100.000	100.000
CFR Loans to Joint Ventures	5.000	9.000	9.000	9.000
Total CFR	319.487	326.703	324.934	323.179
Movement in CFR	20.297	7.216	(1.769)	(1.755)

MRP Policy Statement

37. The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP). It is also allowed to undertake additional voluntary payments if desired (voluntary revenue provision - VRP).
38. MHCLG regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision.

39. It is proposed that Darlington Borough Council's MRP policy statement for 2019/20 will be:
- (a) For Capital expenditure incurred before 1 April 2008 and expenditure which was granted through credit approvals since that date MRP will be calculated on an annuity basis (2%) over 50 years or the useful life of the asset.
 - (b) Capital Expenditure from 1 April 2008 for all unsupported borrowing MRP will be based on the estimated life of the assets, repayments will be on an annuity basis (2%)
 - (c) Repayments relating to the PFI scheme will be based on the life of the asset of 60 years from 1st April 2008 on an annuity basis (2%).
 - (d) Where MRP has been overcharged in previous years, the recovery of the overcharge will be affected by reducing the MRP charges, due in full or in part for 2019/20 and in future years, which would otherwise have been made. The MRP adjustment for 2019/20 and in future years charge will be done in such a way as to ensure that:-
 - (i) the total MRP after applying the adjustment will not be less than zero in any financial year,
 - (ii) the cumulative amount adjusted for will never exceed the amount over-charged,
 - (iii) the extent of the adjustment will be reviewed on an annual basis.
40. There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made.
41. Repayments included in annual PFI or finance leases are applied as MRP.

Affordability Prudential Indicators

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

Estimates of the ratio of financing costs to net revenue stream.

43. 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.

Table 6 - Ratio of financing costs to net revenue stream

	2018/19 Revised £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
General Fund	3.03%	2.74%	2.98%	3.03%
HRA	15.03%	17.48%	16.72%	18.15%

44. The estimates of financing costs include current commitments and the proposals in this year's MTFP report.

Treasury Management Strategy

Borrowing

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

Under Borrowing position

46. Over the last ten years the Council had maintained an underborrowed position i.e. the amount of our gross external borrowing has been less than our balance sheet Capital Financing Requirement. This strategy has served the Council well in a period where returns on investment have been low and borrowing costs have been relatively high. This has also meant that we have had less in the form of investments and so reduced counterparty risk. To support the MTFP for 2017/18 and onwards it was agreed that longer term investments would be pursued. These would give a return over and above the cost of any additional borrowing that would be taken. Following due diligence the Council has now invested in 3 Property Funds, £10 million in each fund and these are expected to bring a net return of around 2.5% over the life of the MTFP. Additional borrowing of £25m has been undertaken which has resulted in the underborrowed position being reduced.

Current Portfolio Position

47. The Council's expected treasury portfolio position at 31 March 2019, with forward projections are summarised below at Table 7. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

Table 7 - Gross Borrowing to CFR

	2018/19 Revised £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
Debt at 31 March	183.000	188.000	188.000	188.000
Loans to RSL's	100.000	100.000	100.000	100.000
Loans to Joint Ventures	5.000	9.000	9.000	9.000
Other long-term liabilities (OLTL)	12.653	11.498	10.358	9.232
Gross Actual debt at 31 March	300.653	308.498	307.358	306.232
The Capital Financing Requirement from Table 5	319.487	326.703	324.934	323.179
Under / (over) borrowing	18.834	18.205	17.576	16.947

48. Within the Prudential Indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2019/20 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that the borrowing is not undertaken for revenue purposes.
49. The Assistant Director Resources reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This takes into account current commitments, existing plans, and proposals in this budget report.

Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary

50. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

Table 8 - Operational Boundary

	2018/19 Revised £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
Debt from Table 7	288.000	297.000	297.000	297.000
Other long term liabilities	12.653	11.498	10.358	9.232
Prudential Borrowing for leasable assets	0.000	1.000	1.000	1.000
Prudential Borrowing under Directors Delegated Powers	0.000	1.000	1.000	1.000
Operational Boundary	300.653	310.498	309.358	308.232

The Authorised Limit for external debt

51. This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term:
52. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.
53. The Council is asked to approve the following Authorised Limit:

Table 9 – Authorised Limit

	2018/19 Revised £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
Operational Boundary	300.653	310.498	309.358	308.232
Additional Headroom 5%	15.033	15.525	15.468	15.412
Authorised Limit	315.686	326.023	324.826	323.644

54. It is proposed that the additional headroom for years 2019/20 to 2021/22 is 5% above the operational boundary this would allow for any additional cashflow needs throughout the years.
55. Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is currently £74.394m and is included within both the Operational Boundary and the Authorised Limit:

Table 10 – HRA Debt Limit

	2018/19 Revised £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
HRA debt cap *	74.394	74.394	74.394	74.394
HRA CFR	69.596	68.967	68.338	67.709
HRA Headroom	4.798	5.427	6.056	6.685

***Note - Abolition of HRA debt cap.** In October 2018, the Prime Minister announced a policy change of abolition of the HRA debt cap and the applicable date was 29.10.2018.

Prospects for Interest Rates

56. The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives Link Asset Services's central view for future interest rates and the economic background to that view is shown at Appendix 1.

Table 11

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including *certainty rate adjustment)			
		5 year	10 year	25 year	50 year
Mar 2019	0.75	1.90	2.30	2.70	2.50
Jun 2019	1.00	2.00	2.40	2.80	2.60
Sep 2019	1.00	2.00	2.40	2.90	2.70
Dec 2019	1.00	2.10	2.50	2.90	2.70
Mar 2020	1.25	2.10	2.60	3.00	2.80
Jun 2020	1.25	2.20	2.70	3.10	2.90
Sep 2020	1.25	2.30	2.70	3.10	2.90
Dec 2020	1.50	2.30	2.80	3.20	3.00
Mar 2021	1.50	2.40	2.80	3.20	3.00
Jun 2021	1.75	2.40	2.90	3.30	3.10
Sep 2021	1.75	2.50	2.90	3.30	3.10
Dec 2021	1.75	2.60	3.00	3.40	3.20
Mar 2022	2.00	2.60	3.00	3.40	3.20

* *The certainty rate adjustment is a reduced rate by 0.20% for those councils like Darlington Borough Council who have submitted more detail on future borrowing requirement to the Treasury*

Investment and borrowing rates

57. Investment returns are likely to remain low during 2019/20 but on a gently rising trend over the next few years.
58. Borrowing interest rates have been volatile so far in 2018/19 and whilst they were on a rising trend during the first half of the year, they have back tracked since then until early January. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when the Council may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.
59. There will remain a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

Borrowing Strategy

60. The Council is currently maintaining an under-borrowed position although this has reduced from previous years. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue to be considered.
61. Against this background and the risks within the economic forecast, caution will be adopted with the 2019/20 treasury operations. The Assistant Director

Resources will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- (a) If it was felt that there was a significant risk of a sharp FALL in long and short term rates (eg due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
- (b) If it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

Treasury Management Limits on Activity

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

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

Table 12 Interest Rate Exposure

	2019/20	2020/21	2021/22
	Upper	Upper	Upper
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	40%	40%	40%
Maturity Structure of fixed interest rate borrowing 2019/20			
		Lower	Upper
Under 12 months		0%	40%
12 months to 2 years		0%	50%
2 years to 5 years		0%	60%
5 years to 10 years		0%	80%
10 years and above		0%	100%

Policy on Borrowing in Advance of Need

63. The CFR Determines the Council's need to borrow. Any decision to borrow in advance of need will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds through its investment strategy.
64. Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

Debt Rescheduling

65. As short-term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long-term debt to short-term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).
66. The reasons for any rescheduling to take place will include:
 - (a) the generation of cash savings and/or discounted cash flow savings;
 - (b) helping to fulfil the treasury strategy;
 - (c) enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).
67. Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.
68. All rescheduling will be reported to Committee at the earliest meeting following its action.
69. An opportunity arose in December 2018 to repay 2 of the Council's Lender Option Borrower Options (LOBO's) loans early and even taking account of the associated premium for early settlement the savings to the Council in cash terms are £26.740m over the remaining 42 years and £12.658m at discounted rates.

Municipal Bond Agency

70. It is possible that the Municipal Bond Agency will be offering loans to local authorities in the future. The Agency hopes that the borrowing rates will be lower than those offered by the Public Works loans Board (PWLB). This Council may make use of this new source of borrowing as and when appropriate.

Annual Investment Strategy

Investment and Creditworthiness Policy

71. The MHCLG and CIPFA have extended the meaning of ‘investments’ to include both financial and non-financial investments. This report deals solely with financial investments, and non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy.
72. The Council’s investment policy has regard to the following:
 - (a) MHCLG’s Guidance on Local Government Investments (“the Guidance”)
 - (b) CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 (“the CIPFA TM Code”)
 - (c) CIPFA Treasury Management Guidance Notes 2018
73. The Council’s investment priorities will be security first, liquidity second and then yield (return).
74. In accordance with the above guidance from MHCLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
75. Further, the Council’s officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this the Council will engage with its advisors to maintain a monitor on market pricing such as “Credit Default Swaps” and overlay that information on top of the credit ratings. This is encapsulated within the credit methodology provided by the advisors, Link Asset Services.
76. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
77. The intention of the strategy is to provide security of investment and minimisation of risk.
78. Investment instruments identified for use in the financial year are listed in **Appendix 2** under the ‘Specified’ and ‘Non-Specified’ Investments categories. Counterparty limits will be as set through the Council’s Treasury Management Practices – Schedules.
 - (a) Specified investments are those with a high level of credit quality and subject to a maturity limit of one year.
 - (b) Non-specified investments are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by Members and officers before being authorised for use.

Investment Counterparty Selection Criteria

79. The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle the Council will ensure that:
- (a) It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections below; and
 - (b) It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.
80. The Assistant Director Resources will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either Specified or Non-Specified (See appendix 2 for definitions) as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.
81. The rating criteria use the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution will fall outside the lending criteria. This is in compliance with a CIPFA Treasury Management Panel recommendation in March 2009 and the CIPFA Treasury Management Code of Practice.
82. Credit rating information is supplied by Link Asset Services, our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating Outlooks (notification of a longer term bias outside the central rating view) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.
83. Any investment in Property Funds/ Corporate Bond Funds/ Asset Backed Investment Products will be subject to due diligence for each and every fund considered. The maximum amount invested in any one fund will be £20million with a maximum of £50million total for all funds.
84. The criteria for providing a pool of high quality investment counterparties (both Specified and Non-specified investments) is:

- (a) Banks 1 - good credit quality – the Council will only use banks which:
 - (i) are UK banks; and have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):
 - (ii) Fitch Short Term equivalent – F1
 - (iii) Fitch Long term equivalent – A-
- (b) Banks 2 - Non UK banks based on the following very high quality criteria using a lowest common denominator approach and only where sovereign ratings are AAA.
 - (i) Fitch Short Term equivalent – F1+
 - (ii) Fitch Long Term equivalent – AA-
- (c) Banks 3 – Part nationalised UK banks – Royal Bank of Scotland. This bank can be included if it continues to be part nationalised or it meets the ratings in Banks 1 above.
- (d) Banks 4 – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
- (e) Building societies -The Council will use all societies which meet the ratings for the bank outlined above and have assets in excess of £1,000m.
- (f) Money Market Funds (MMFs) CNAV AAA
- (g) Money Market Funds (MMF's) LNVAV AAA
- (h) Money Market Funds (MMF's) VNAV AAA
- (i) Ultra-Short Dated Bond Funds AAA
- (j) UK Government (including gilts, Treasury Bills and the Debt Management Office)
- (k) Local authorities, parish councils etc
- (l) Supranational institutions
- (m) Housing associations
- (n) Property Funds, Corporate Bond Funds and Asset Backed Investment Products.

85. A limit of £50m will be applied to the use of Non-Specified investments.

Use of additional information other than credit ratings

86. Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

Time and monetary limits applying to investments.

87. The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both Specified and Non-Specified Investments)
88. In order to determine time limits for investments the Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moodys and Standard and Poors. The credit ratings of counterparties are supplemented with the following overlays:
- (a) credit watches and credit outlooks from credit rating agencies;
 - (b) Credit Default Swap price spreads to give early warning of likely changes in credit ratings;
 - (c) sovereign ratings to select counterparties from only the most creditworthy countries.
89. The Council will therefore use the following durational bands when applying time limits to investments
- (a) Yellow Maximum 2 years *This only relates to AAA rated government debt or its equivalent
 - (b) Purple Maximum 2 years
 - (c) Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
 - (d) Orange 1 year
 - (e) Red 6 months
 - (f) Green 3 months

Table 13 – Time and monetary limits applying to investments

	Fitch Long term Rating (or equivalent)	Money Limit	Time Limit
Banks 1 category high quality	AA-	£5m	Maximum of 2 years Suggested duration using Link Asset Services colour coding (CDS adjusted with manual override)
Banks 1 category medium quality	A	£4m	Maximum of 1 year Suggested duration using Link Asset Services colour coding (CDS adjusted with manual override)
Banks 1 category lower quality	A-	£3m	Maximum of 1 year Suggested duration using Link Asset Services colour coding (CDS adjusted with manual override)
Banks 2 Non UK (Only where sovereign ratings are AAA)	AA-	£3m	Maximum of 1 year Suggested duration using Link Asset Services colour coding (CDS adjusted with manual override)
Banks 3 category – part nationalised	N/A	£5m	Maximum of 1 years
Banks 4 category – Council's banker (not meeting Banks 1, 2 and 3)		£3m	1 day
DMADF (Debt Management Office)	AAA	unlimited	6 months
UK Government Treasury Bills	UK sovereign rating	unlimited	Maximum of 1 year
Local authorities	N/A	£5m per Local Authority	Up to 2 years
Money market Funds (CNAV, LVNAV & VNAV) and Ultra Short Dated Bond Funds	AAA	£5m per Fund	liquid
Property Funds, Corporate Bond Funds and other Asset backed Investment products	Non Rated Due Diligence required	£20m per Fund	10 years

90. In addition to sterling deposits either on a fixed term call or notice basis deposits in banks or Building Societies which meet our criteria, may be made via certificates of deposits where appropriate.

91. The proposed criteria for Specified and Non-Specified investments are shown in Appendix 2 for approval.
92. All credit ratings will be monitored daily. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services creditworthiness service.
 - (a) if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
 - (b) in addition to the use of credit ratings the Council will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.
93. Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on government support for banks and the credit ratings of that government support.

Investment Strategy

In-house funds

94. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.
 - (a) If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping the most investments as being short term or variable.
 - (b) Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

Investment returns expectations

95. On the assumption that the UK and EU agree a Brexit deal in spring 2019, then Bank Rate is forecast to increase steadily but slowly over the next few years to reach 2.00% by quarter 1 2022. Bank Rate forecasts for financial year ends (March) are:
 - (a) 2018/19 0.75%
 - (b) 2019/20 1.25%
 - (c) 2020/21 1.50%
 - (d) 2021/22 2.00%

96. The suggested budgeted investment earnings rates for returns on investments placed for periods up to about 3 months during each financial year are as follows:-

- (a) 2018/19 0.75%
- (b) 2019/20 1.00%
- (c) 2020/21 1.50%
- (d) 2021/22 1.75%
- (e) 2022/23 1.75%
- (f) 2023/24 2.00%
- (g) Later years 2.50%

97. The overall balance of risks to economic growth in the UK is probably neutral.

98. The balance of risks to increases in Bank Rate and shorter term PWLB rates are probably also even and are dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

Investment treasury indicator and limit

99. Total principal funds invested for greater than 365 days. These limits are set with regard to the Council’s liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

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

Table 14 – Maximum Principal sums invested

	2019/20	2020/21	2021/22
Principal sums invested greater than 365 days	£50m	£50m	£50m

101. For its cash flow generated balances, the Council will seek to utilise its instant access accounts, 15 and 30 day notice accounts, money market funds and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

Investment Risk Benchmarking

102. These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. They relate to Investments that are not Property Funds. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report.

103. Security - The Council’s maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

0.077% historic risk of default when compared to the whole portfolio.

104. Liquidity – in respect of this area the Council seeks to maintain:
- (a) Bank overdraft - £0.100m
 - (b) Liquid short term deposits of at least £3.000m available with a week’s notice
 - (c) Weighted Average Life benchmark is expected to be 1 year.
105. Yield - local measures of yield benchmarks are:
- (a) Investments – Short Term- cashflow investment rate returned against comparative interest rates
 - (b) Investments – Longer term – capital investment rates returned against comparative average rates
106. And in addition that the security benchmark for each individual year is:

Table 15 - Security Benchmark

	1 year	2 years
Maximum	0.077%	0.077%

Note: This benchmark is an average risk of default measure, and would not constitute an expectation of loss against a particular investment.

107. The above reported benchmarks for Security Liquidity and Yield all relate to Deposits with Banks and Money Market Funds but would not relate to Property Funds.
108. It is proposed that property funds will be benchmarked for performance against the IPD All Balanced Fund index which is the universe of all property funds, data for this can be provided by our Treasury Management advisors Link Asset Services.

End of year investment report

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

Policy on the use of external service providers

110. The Council uses Link Asset Services as its external treasury management advisors. The company provides a range of services which include:
- (a) Technical support on treasury matters, capital finance issues and the drafting of Member reports;
 - (b) Economic and interest rate analysis;
 - (c) Debt services which includes advice on the timing of borrowing;

- (d) Debt rescheduling advice surrounding the existing portfolio;
 - (e) Generic investment advice on interest rates, timing and investment instruments;
 - (f) Credit ratings from the three main rating agencies and other market information on counterparties.
111. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.
112. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

Outcome of Consultation

113. No consultation was undertaken in the production of this report.

Economic Background provided by Link Asset Services

1. **GLOBAL OUTLOOK. World growth** has been doing reasonably well, aided by strong growth in the US. However, US growth is likely to fall back in 2019 and together with weakening economic activity in China and the eurozone, overall world growth is likely to weaken.
2. **Inflation** has been weak during 2018 but, at long last, unemployment falling to remarkably low levels in the US and UK has led to a marked acceleration of wage inflation. The US Fed has therefore increased rates nine times and the Bank of England twice. However, the ECB is unlikely to start raising rates until late in 2019 at the earliest.
3. **KEY RISKS - central bank monetary policy measures**
Looking back on nearly ten years since the financial crash of 2008 when liquidity suddenly dried up in financial markets, it can be assessed that central banks' monetary policy measures to counter the sharp world recession were successful. The key monetary policy measures they used were a combination of lowering central interest rates and flooding financial markets with liquidity, particularly through unconventional means such as Quantitative Easing (QE), where central banks bought large amounts of central government debt and smaller sums of other debt.
4. The key issue now is that that period of stimulating economic recovery and warding off the threat of deflation is coming towards its close. A new period is well advanced in the US, and started more recently in the UK, of reversing those measures i.e. by raising central rates and (for the US) reducing central banks' holdings of government and other debt. These measures are now required in order to stop the trend of a reduction in spare capacity in the economy, and of unemployment falling to such low levels that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets. In particular, a key risk is that because QE-driven purchases of bonds drove up the price of government debt, and therefore caused a sharp drop in income yields, this also encouraged investors into a search for yield and into investing in riskier assets such as equities. Consequently, prices in both bond and equity markets rose to historically high valuation levels simultaneously. This meant that both asset categories were exposed to the risk of a sharp downward correction and we have indeed, seen a sharp fall in equity values in the last quarter of 2018. It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. They need to balance their timing to neither squash economic recovery, by taking too rapid and too strong action, or, conversely, let inflation run away by taking action that was too slow and/or too weak. **The potential for central banks to get this timing and strength of action wrong are now key risks.** At the time of writing, (early January 2019), financial markets are very concerned that the Fed is being too aggressive with its policy for raising interest rates and was likely to cause a recession in the US economy
5. The world economy also needs to adjust to a sharp change in liquidity creation over the last five years where the US has moved from boosting liquidity by QE purchases,

to reducing its holdings of debt, (currently about \$50bn per month). In addition, the European Central Bank ended QE purchases in December 2018.

6. **UK.** The flow of positive economic statistics since the end of the first quarter of 2018 has shown that pessimism was overdone about the poor growth in quarter 1 when adverse weather caused a temporary downward blip. Quarter 1 at 0.1% growth in GDP was followed by a return to 0.4% in quarter 2 and by a strong performance in quarter 3 of +0.6%. However, growth in quarter 4 is expected to weaken significantly.
7. At their November quarterly inflation meeting, the MPC repeated their well-worn phrase that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years time but declined to give a medium term forecast. However, with so much uncertainty around Brexit, they warned that the next move could be up or down, even if there was a disorderly Brexit. While it would be expected that Bank Rate could be cut if there was a significant fall in GDP growth as a result of a disorderly Brexit, so as to provide a stimulus to growth, they warned they could also raise Bank Rate in the same scenario if there was a boost to inflation from a devaluation of sterling, increases in import prices and more expensive goods produced in the UK replacing cheaper goods previously imported, and so on. In addition, the Chancellor could potentially provide fiscal stimulus to support economic growth, though at the cost of increasing the budget deficit above currently projected levels.
8. It is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. Getting parliamentary approval for a Brexit agreement on both sides of the Channel will take well into spring 2019. However, in view of the hawkish stance of the MPC at their November meeting, the next increase in Bank Rate is now forecast to be in May 2019 (on the assumption that a Brexit deal is agreed by both the UK and the EU). The following increases are then forecast to be in February and November 2020 before ending up at 2.0% in February 2022.
9. **Inflation.** The Consumer Price Index (CPI) measure of inflation has been falling from a peak of 3.1% in November 2017 to 2.3% in November 2018. In the November Bank of England quarterly inflation report, inflation was forecast to still be marginally above its 2% inflation target two years ahead, (at about 2.1%), given a scenario of minimal increases in Bank Rate. This inflation forecast is likely to be amended upwards due to the Bank's report being produced prior to the Chancellor's announcement of a significant fiscal stimulus in the Budget; this is likely to add 0.3% to GDP growth at a time when there is little spare capacity left in the economy, particularly of labour.
10. As for the labour market figures in October 2018, unemployment at 4.1% was marginally above a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high in July, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to 3.3%, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates less CPI inflation), earnings are currently growing by about 1.0%, the highest level since 2009. This increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. This

tends to confirm that the MPC was right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy.

11. In the political arena, there is a risk that the current Conservative minority government may be unable to muster a majority in the Commons over Brexit. However, our central position is that Prime Minister May's government will endure, despite various setbacks, along the route to reaching an orderly Brexit in March 2019. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary and fiscal policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.
12. **USA.** President Trump's massive easing of fiscal policy is fuelling a, (temporary), boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2%, (annualised rate), in quarter 1 to 4.2% in quarter 2 and 3.5%, (3.0% y/y), in quarter 3, but also an upturn in inflationary pressures. The strong growth in employment numbers and the reduction in the unemployment rate to 3.9%, near to a recent 49 year low, has fed through to an upturn in wage inflation which hit 3.2% in November, however, CPI inflation overall fell to 2.2% in November and looks to be on a falling trend to drop below the Fed's target of 2% during 2019. The Fed has continued on its series of increases in interest rates with another 0.25% increase in December to between 2.25% and 2.50%, this being the fifth increase in 2018 and the ninth in this cycle. However, they did also reduce their forecast for further increases from three to two. This latest increase compounded investor fears that the Fed is over doing the rate and level of increases in rates and that it is going to cause a US recession as a result. There is also much evidence in previous monetary policy cycles, of the Fed's series of increases doing exactly that. Consequently, we have seen stock markets around the world plunging under the weight of fears around the Fed's actions, the trade war between the US and China, an expectation that world growth will slow, Brexit etc.
13. The tariff war between the US and China has been generating a lot of heat during 2018, but it is not expected that the current level of actual action would have much in the way of a significant effect on US or world growth. However, there is a risk of escalation if an agreement is not reached soon between the US and China. The results of the mid-term elections are not expected to have a material effect on the economy.
14. **Eurozone.** Growth was 0.4% in quarters 1 and 2 but fell back to 0.2% in quarter 3, though this was probably just a temporary dip. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of nearly 2% for 2018, the horizon is less clear than it seemed just a short while ago. Having halved its quantitative easing purchases of debt in October 2018 to €15bn per month, the European Central Bank ended all further purchases in December 2018. The ECB is forecasting inflation to be a little below its 2% top limit through the next three years so it may find it difficult to warrant a start on raising rates by the end of 2019 if the growth rate of the EU economy is on a weakening trend.
15. **China.** Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock

of unsold property, and to address the level of non-performing loans in the banking and credit systems. Progress has been made in reducing the rate of credit creation, particularly from the shadow banking sector, which is feeding through into lower economic growth. There are concerns that official economic statistics are inflating the published rate of growth.

16. **Japan** - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. It is likely that loose monetary policy will endure for some years yet to try to stimulate growth and modest inflation.
17. **Emerging countries.** Argentina and Turkey are currently experiencing major headwinds and are facing challenges in external financing requirements well in excess of their reserves of foreign exchange. However, these countries are small in terms of the overall world economy, (around 1% each), so the fallout from the expected recessions in these countries will be minimal.

INTEREST RATE FORECASTS

18. The interest rate forecasts provided by Link Asset Services in paragraph 3.2 are predicated on an assumption of an agreement being reached on Brexit between the UK and the EU. In the event of an orderly non-agreement exit, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall. If there was a disorderly Brexit, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.
19. The balance of risks to the UK
 - The overall balance of risks to economic growth in the UK is probably neutral.
 - The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.
20. One risk that is both an upside and downside risk, is that all central banks are now working in very different economic conditions than before the 2008 financial crash as there has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed for ten years since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore either over or under do increases in central interest rates.
21. **Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:**
 - Brexit – if it were to cause significant economic disruption and a major downturn in the rate of growth.

- Bank of England monetary policy takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the Eurozone sovereign debt crisis, possibly in Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system, and due to the election in March of a government which has made a lot of anti-austerity noise. The EU rejected the initial proposed Italian budget and demanded cuts in government spending which the Italian government has refused. However, a fudge was subsequently agreed but only by delaying the planned increases in expenditure to a later year. The rating agencies have started on downgrading Italian debt to one notch above junk level. If Italian debt were to fall below investment grade, many investors would be unable to hold it. Unsurprisingly, investors are becoming increasingly concerned by the words and actions of the Italian government and consequently, Italian bond yields have risen – at a time when the government faces having to refinance large amounts of debt maturing in 2019.
- Weak capitalisation of some European banks. Italian banks are particularly vulnerable; one factor is that they hold a high level of Italian government debt - debt which is falling in value. This is therefore undermining their capital ratios and raises the question of whether they will need to raise fresh capital to plug the gap.
- **German minority government.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD party and showed a sharp fall in support for the CDU. As a result, the SPD is reviewing whether it can continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party's convention in December 2018. However, this makes little practical difference as she is still expected to aim to continue for now as the Chancellor. However, there are five more state elections coming up in 2019 and EU parliamentary elections in May/June; these could result in a further loss of electoral support for both the CDU and SPD which could also undermine her leadership.
- **Other minority eurozone governments.** Spain, Portugal, Ireland, Netherlands and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile. Sweden is also struggling to form a government due to the anti-immigration party holding the balance of power, and which no other party is willing to form a coalition with. The Belgian coalition collapsed in December 2018 but a minority caretaker government has been appointed until May EU wide general elections.
- **Austria, the Czech Republic and Hungary** now form a strongly anti-immigration bloc within the EU while Italy, this year, has also elected a strongly anti-immigration government. Elections to the EU parliament are due in May/June 2019.
- Further increases in interest rates in the US could spark a sudden flight of investment funds from more risky assets e.g. shares, into bonds yielding a much improved yield. Throughout the last quarter of 2018, we saw a

sharp fall in equity markets but this has been limited, as yet. Emerging countries which have borrowed heavily in dollar denominated debt, could be particularly exposed to this risk of an investor flight to safe havens e.g. UK gilts.

- There are concerns around the level of US corporate debt which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many large corporations being downgraded to a BBB credit rating, close to junk status. Indeed, 48% of total investment grade corporate debt is now rated at BBB. If such corporations fail to generate profits and cash flow to reduce their debt levels as expected, this could tip their debt into junk ratings which will increase their cost of financing and further negatively impact profits and cash flow.
- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

22. Upside risks to current forecasts for UK gilt yields and PWLB rates

- **Brexit** – if both sides were to agree a compromise that removed all threats of economic and political disruption.
- **The Fed causing a sudden shock in financial markets** through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of QE, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- **UK inflation**, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

1. The MHCLG issued Investment Guidance in 2018, and this forms the structure of the Council's policy below. These guidelines do not apply to either trust funds or pension funds which operate under a different regulatory regime.
2. The key intention of the Guidance is to maintain the current requirement for Councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council adopted the Code on 21st March 2002 and will apply its principles to all investment activity. In accordance with the Code, the Assistant Director Resources has produced its Treasury Management Practices (TMPs). This part, TMP 1(1), covering investment counterparty policy requires approval each year.

Annual Investment Strategy

3. The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of the following:
 - a) The strategy guidelines for choosing and placing investments, particularly non-specified investments.
 - b) The principles to be used to determine the maximum periods for which funds can be committed.
 - c) Specified investments that the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
 - d) Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.
4. The investment policy proposed for the Council is:

Strategy Guidelines

5. The main strategy guidelines are contained in the body of the treasury strategy statement.

All Investments

6. The criteria for providing a pool of high quality investment counterparties (both Specified and Non-specified investments) is:
 - (a) Banks 1 - good credit quality – the Council will only use banks which:
 - i. are UK banks; and have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):
 - a. Fitch Short Term equivalent – F1
 - b. Fitch Long term equivalent – A-
 - (b) Banks 2 Non UK banks based on the following very high quality criteria using a lowest common denominator approach and only where sovereign ratings are AAA.
 - a. Fitch Short Term equivalent – F1+
 - b. Fitch Long Term equivalent – AA-
 - (c) Banks 3 – Part nationalised UK banks – Lloyds Bank Group and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.
 - (d) Banks 4 – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
 - (e) Building societies The Council will use all societies which:
 - i. meet the ratings for banks outlined above and have assets in excess of £1,000m
 - (f) Money Market Funds (CNAV, LVNAV & VNAV) AAA
 - (g) Ultra Short Dated Bond Funds AAA
 - (h) UK Government (including gilts Treasury Bills and the Debt Management Office)
 - (i) Local authorities, parish councils etc
 - (j) Supranational institutions
 - (k) Property Funds ,Corporate Bond Funds and Asset Backed Investment Products
7. A limit of £50M will be applied to the use of Non-Specified investments.

Specified Investments

8. These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:
 - (a) The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).
 - (b) Supranational bonds of less than one year's duration.
 - (c) A local authority, housing association, parish council or community council.
 - (d) Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category f. above, this covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor's, Moody's and/or Fitch rating agencies.
 - (e) A body that is considered of a high credit quality (such as a bank or building society). For category a and b this covers bodies with a minimum short term rating of F1 (or the equivalent) as rated by Standard and Poor's, Moody's and/or Fitch rating agencies.

9. Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the time and amount of monies which will be invested in these bodies. These criteria are:

	Fitch Long term Rating (or equivalent)	Money Limit	Time Limit
Banks 1 category high quality	AA-	£5M	Maximum of 2 years Suggested duration using Link Asset Services colour coding (CDS adjusted with manual override)
Banks 1 category medium quality	A	£4M	Maximum of 1 year Suggested duration using Link Asset Services colour coding (CDS adjusted with manual override)
Banks 1 category lower quality	A-	£3M	Maximum of 1 year Suggested duration using Link Asset Services colour coding (CDS adjusted with manual override)
Banks 2 Non UK (only where sovereign ratings are AAA)	AA-	£3M	Maximum of 1 year Suggested duration using Link Asset Services colour coding (CDS adjusted with manual override)
Banks 3 category – part nationalised	N/A	£5M	Maximum of 1 year
Banks 4 category – Council's banker (not meeting Banks 1,2 and3)		£3M	1 day
DMADF (Debt Management Office)	AAA	unlimited	6 months
Local authorities	N/A	£5M per Local Authority	Up to 1 years
Money market Funds (CNAV, LVNAV & VNAV) and Ultra Short Dated Bond Funds	AAA	£5M per Fund	liquid

10. The Council will therefore use the following durational bands supplied by Link Asset Service's creditworthiness service when applying time limits to investments

- a. Yellow Maximum 2 years *This only relates to AAA rated government debt or its equivalent
- b. Purple Maximum 2 years
- c. Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- d. Orange 1 year
- e. Red 6 months
- f. Green 3 months

Non-Specified Investments

11. Non-specified investments are any other type of investment (i.e. not defined as Specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non specified investments would include any sterling investments with:

	Non Specified Investment Category	Limit (£ or %)
a.	<p>Supranational Bonds greater than 1 year to maturity (a) Multilateral development bank bonds - These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Reconstruction and Development Bank etc.). (b) A financial institution that is guaranteed by the United Kingdom Government (e.g. National Rail, The Guaranteed Export Finance Company {GEFCO})</p> <p>The security of interest and principal on maturity is on a par with the Government and so very secure. These bonds usually provide returns above equivalent gilt edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.</p>	AAA long term ratings
b.	<p>Gilt edged securities with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.</p>	
c.	<p>The Council's own banker if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible.</p>	£3m
d.	<p>Building societies not meeting the basic security requirements under the specified investments. The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings.</p>	£5m
e.	<p>Any bank or building society that has a minimum long term credit rating of AA-, for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).</p>	£5m
f.	<p>Local Authorities</p>	£5m per authority
g.	<p>Property Funds, Corporate Bond Funds and Other Asset backed Investment products The use of these instruments can be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any fund it may consider using</p>	£20m per Fund

12. Within categories c and d, and in accordance with the Code, the Council has developed additional criteria to set the overall amount of monies which will be invested in these bodies. Time limits will be applied to banks using the

creditworthiness service provided by Link Asset Services. And for part-nationalised banks will be up to 2 years.

13. Time limits for Property Funds, Corporate Bond Funds and Asset Backed Investment Products will be up to 10 Years, Local Authorities up to 2 years.

The Monitoring of Investment Counterparties

14. The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Link Asset Services as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Assistant Director Resources, and if required new counterparties which meet the criteria will be added to the list.

AUDIT SERVICES ANNUAL AUDIT PLAN 2018/19 – PROGRESS REPORT

SUMMARY REPORT

Purpose of the Report

1. To provide Members with a progress report against the 2018/19 Annual Audit Plan in accordance with Audit Services' role and terms of reference.

Summary

2. The report outlines progress to date on audit assignment work, consultancy/contingency activity and performance indicators.
3. The shared service was a new service beginning 1 April 2017 and brought together two teams from different organisations as well as a new approach to delivering the audit opinion.
4. In relation to Audit Services' performance a detailed report is provided with good progress to date.

Recommendation

5. It is recommended that the progress report against the 2018/19 Annual Audit Plan be noted.

Reasons

6. The recommendation is supported to provide the Audit Committee with evidence to reflect on the Council's governance arrangements.

**Andrew Barber
Audit and Risk Manager**

Background Papers

- (i) Internal Audit Charter
- (ii) Audit Assignment Executive Summaries

S17 Crime and Disorder	Other than any special investigation work there is no crime and disorder impact.
Health and Well Being	There is no specific health and well being impact.
Carbon Impact	There is no specific carbon impact.
Diversity	There is no specific diversity impact.
Wards Affected	All wards are affected equally.
Groups Affected	All groups are affected equally.
Budget and Policy Framework	This report does not affect the budget or policy framework.
Key Decision	This is not a key decision.
Urgent Decision	This is not an urgent decision.
One Darlington: Perfectly Placed	There is no specific relevance to the strategy beyond a reflection on the Council's governance arrangements.
Efficiency	There is no specific efficiency impact.
Impact on Looked After Children and Care Leavers	Does this report impact on Looked After Children or Care Leavers

MAIN REPORT

Information and Analysis

7. The Annual Audit Plan for 2018/19 was approved by the Audit Committee in March 2018 and the Service was formally implemented on 1 April 2017.
8. The report should be considered in the context of fulfilling the function to monitor the adequacy and effectiveness of the Council's internal control environment and the Internal Audit service provided.
9. Appendix 1 provides members with detailed feedback on the performance of the service and the position in relation to completion of the audit plan.
10. The audit team is now at full capacity with the vacancy filled in May 2018.
11. In line with good practice, at an appropriate time, Audit Services follow up with Managers progress on implementation of audit recommendations agreed in audit reports.
12. In addition, at the request of clients, consultancy work has been undertaken on specific projects. This time is recorded against Advice and Guidance in the attached appendix. So far to date this has been limited to day to day queries
13. The Shared Service has also responded to routine requests from Groups for advice and guidance on operational matters.

Outcome of Consultation

14. There was no formal consultation undertaken in production of this report.

**INTERNAL AUDIT
AUDIT COMMITTEE UPDATE REPORT
2018/19**

1 AUDIT PROGRESS

- 1.1 The plan, approved on 26 March 2018, was based on an audit assessment of risk which uses a number of factors to determine the likelihood of issues occurring including an understanding of the full scope of systems in operation, major change, concerns/external interest and results of previous audit work. It then assesses the impact any issues may have on the council's strategic objectives, reputation, financial plans, assets and also the potential impact on individuals and/or the environment.

Audit Progress by Service Group

Department	Planned Audits	Cancelled Audits	Unplanned Audits	Revised Audits	Complete	In Progress	Under Review	Drafts Issued	Not Started	Ready to Start
Children's and Adult Services	17	0	0	17	1	6	1	1	6	2
Economic Growth & Neighbourhood Services	18	0	0	18	6	6	0	0	5	1
Resources	6	0	0	6	1	2	0	2	1	0
Law & Governance	5	0	0	5	3	0	0	0	2	0
Schools	1	0	0	1	1	0	0	0	0	0
Xentrall	16	0	0	16	5	6	0	0	5	0
Corporate	14	0	0	14	2	10	0	1	0	1
Contingency	6	0	0	6	0	6	0	0	0	0
SBC Only	2	0	0	2	0	1	0	1	0	0
TVCA Only	3	0	0	3	0	2	0	0	0	1
Totals	88	0	0	88	19	39	1	5	19	5

Actual Days Compared to Planned Days

- 1.2 The tables below show an alternative view of the number of planned days v actual days taken and the projected available resources to complete the plan.
- 1.3 The Audit Plan is constantly revised during the year to take account of changing requirements. Amendments to the Plan agreed on 26 March 2018 can be summarised as follows:

2018/19 Planned Audits Amalgamated/Cancelled/Deferred

None

2018/19 Unplanned Audits Added to the Plan

None

1.4 Counter Fraud

Since the last update both the website and intranet have been updated with a fully revised fraud page. This provides some useful videos and tips on identifying and preventing fraud as well as links to other resources.

The National Fraud Initiative data has been submitted with results expected in February 2019.

2 AUDIT OUTPUT

Engagement Opinions

2.1 For each audit carried out Internal Audit provides an overall conclusion as to whether a sound system of internal control is being maintained. Each opinion is either “Full”, “Substantial”, “Moderate”, “Limited”, or “No” assurance depending on the conclusions reached and the evidence to support those conclusions. “Full” and “substantial” assurance normally indicates that the area under review has a reliable system of internal control.

2.2 These individual opinions are summarised below:-

Opinion	Definition	No.	%
Full Assurance	A sound system of internal controls is currently being applied which will ensure the system achieves its objectives. Whilst not essential there may still be scope for these controls to be enhanced in some areas.	9	47
Substantial Assurance	Overall there is a sound system of internal controls that are operating effectively. The system should achieve its objectives but there are areas where internal controls need to be improved.	10	53
Moderate Assurance	A reasonably sound system of internal controls is being applied, however, there are weaknesses which may put some of the system objectives at risk.	0	0
Limited Assurance	There is either a limited system of internal controls being applied, or there are significant weaknesses in the controls in place, which are posing a substantial risk to the achievement of system objectives.	0	0
No Assurance	The system of internal controls in place is failing and system objectives are not being met. Urgent management attention is required.	0	0
N/A	This classification covers audit work within a small part of a system. Providing an opinion on this work would misrepresent the system as a whole.	0	0
Total		19	

2.3 An analysis of the recommendations supporting these opinions by priority is shown below:-

Priority	Definition	No.	%
Critical	Actions that must be taken immediately to manage significant risks that are likely to prevent the Authority achieving one or more of its corporate objectives.	0	0
High	Actions that should be taken as a matter of priority due to the issues identified posing a substantial risk to the achievement of service/system objectives.	7	20
Medium	Required actions to reduce the risk of systems failing to achieve their objectives.	22	63
Low	Beneficial to the improvement of internal controls, which will support the achievement of objectives.	6	17
Total		35	

Details of Audits by Service Group

2018/19

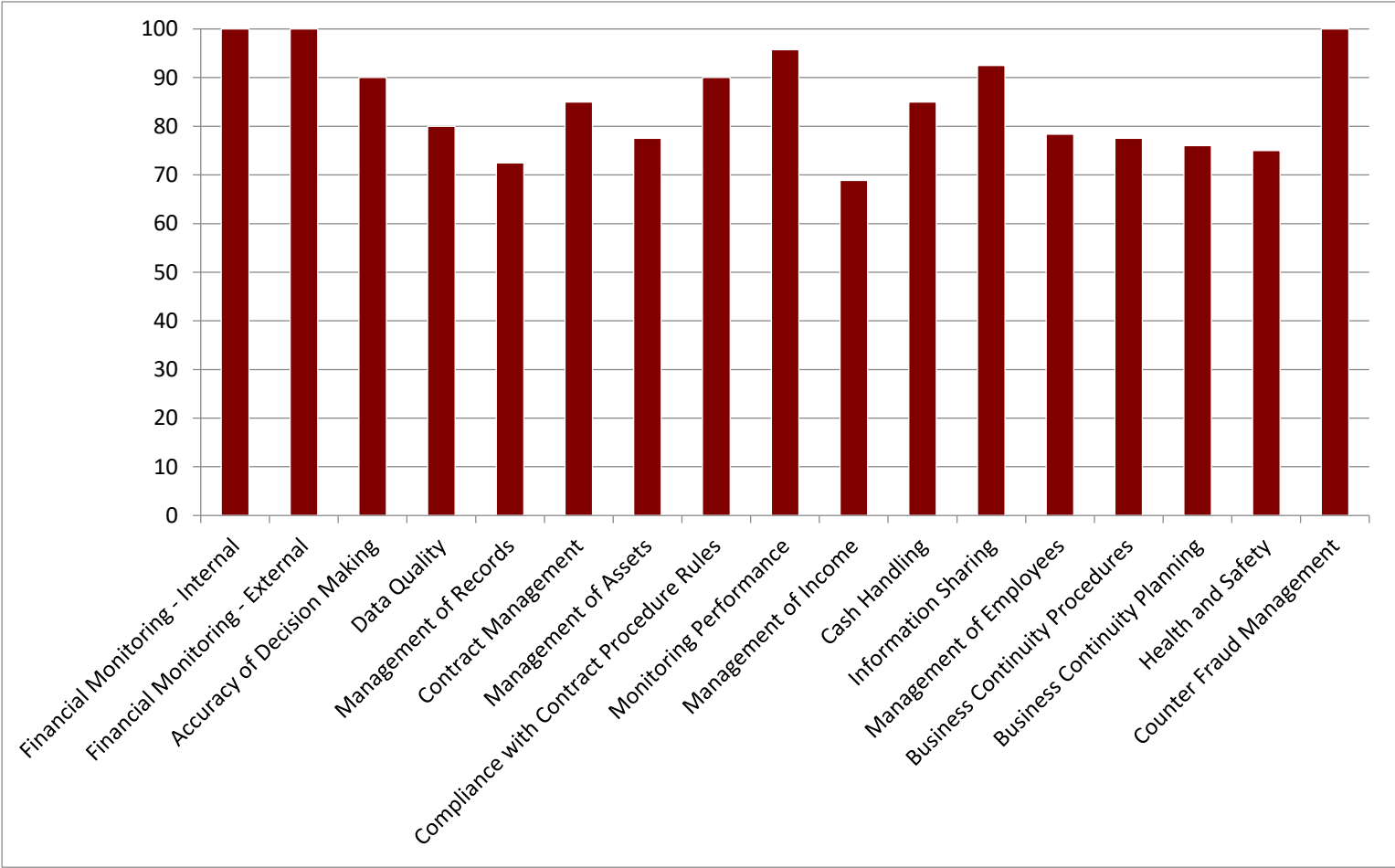
Department	No. of Audits Issued	Opinions						No. of Recs Made	Previous Recommendations			
		Full	Sub	Mod	Lim	None	N/A		Tested	Passed	Failed	N/A
Children's and Adult Services	1	0	1	0	0	0	0	3	0	0	0	0
Economic Growth & Neighbourhood Services	6	1	5	0	0	0	0	16	26	15	11	0
Resources	1	0	1	0	0	0	0	4	0	0	0	0
Law & Governance	3	1	2	0	0	0	0	3	4	2	1	1
Schools	1	1	0	0	0	0	0	0	0	0	0	0
Xentrall	5	5	0	0	0	0	0	0	0	0	0	0
Corporate	2	1	1	0	0	0	0	9	0	0	0	0
Contingency	0	0	0	0	0	0	0	0	0	0	0	0
BC Only	0	0	0	0	0	0	0	0	0	0	0	0
SYCA Only	0	0	0	0	0	0	0	0	0	0	0	0
Total	19	3	3	0	0	0	0	35	30	0	0	0

2017/18

Department	No. of Audits Issued	Opinions						No. of Recs Made	Previous Recommendations			
		Full	Sub	Mod	Lim	None	N/A		Tested	Passed	Failed	N/A
Children's and Adult Services	15	2	6	0	0	0	6	9	9	3	0	2
Chief Executive	1	0	1	0	0	0	0	0	0	0	0	0
Neighbourhood Services & Resources	23	7	11	0	0	0	3	27	32	22	3	7
Xentrall	13	13	0	0	0	0	0	2	0	0	0	0
Economic Growth	9	2	4	0	0	0	3	8	12	8	2	2
Corporate	3	2	1	0	0	0	0	3	4	3	0	1
Schools	0	0	0	0	0	0	0	0	0	0	0	0
IT Systems	0	0	0	0	0	0	0	0	0	0	0	0
Total	64	26	23	0	0	0	12	49	57	36	5	12

Trend Analysis

2.4 Below is a graph demonstrating the level of compliance across a number of themed tests. The majority of areas are shown as Substantial Assurance (70%) with 2 areas just below this level (Management of Income and Management of Employees). As these are only marginally below the substantial assurance level they require monitoring but no action at this time.



2.5 Shown below is a list of all the audit engagements undertaken during the year together with their assurance opinion.

2018/19 Audit Plan Current Position as at 31st December 2018

Department	Audit ID	Name	Status	Assurance	Recommendations				Bud	Rem	Final Var
					L	H	M	C			
Corporate	2602	Financial Management	In Progress						5.0	5.0	-47.1
Corporate	2603	Council Plans	In Progress						5.0	5.0	
Corporate	2604	Risk Management	In Progress						35.0	23.7	
TYCA Only	2605	Concessionary Travel Scheme	Ready to Start						15.0	13.8	
Corporate	2606	Absence Management	In Progress						10.0	9.1	
Xentrall	2607	Active Directory	In Progress						5.6	1.0	
Children's and Adult Services	2608	Adult Safeguarding	Ready to Start						20.0	8.9	
Resources	2609	Communications Unit	In Progress						15.0	10.1	
Economic Growth & Neighbourhood Services	2610	Building Control	In Progress						7.0	3.9	
Xentrall	2611	Cloud Computing	Not Started						5.0	4.9	

Economic Growth & Neighbourhood Services	2612	Asset Register/Asset Management	In Progress						7.0	4.5	
Corporate	2613	Business Continuity & Emergency Planning	In Progress						10.0	10.0	
Economic Growth & Neighbourhood Services	2614	Business Support & Development	Not Started						25.0	25.0	
Children's and Adult Services	2615	Child Placement - Adoption	In Progress						7.0	6.3	
Children's and Adult Services	2616	Independent Living - Remote Monitoring	Under Review						20.0	0.0	
Xentrall	2617	Creditors	In Progress						20.0	7.4	
Corporate	2618	Cash Offices & Cash Holdings	Complete	Substantial Assurance	2	2	5	0	25.0		-29.1
Children's and Adult Services	2619	Better Care Fund	Not Started						20.0	20.0	
Resources	2620	Client Financial Services	Draft						12.0	2.4	
Law & Governance	2621	Complaints Review	Complete	Full Assurance	0	0	0	0	9.0		-5.7
Children's and Adult Services	2622	Community Transport	In Progress						7.0	7.0	
Xentrall	2623	Change Control	Complete	Full Assurance	0	0	0	0	6.0		-1.0
Law & Governance	2624	Democratic & Development Services	Not Started						10.0	10.0	
Economic Growth & Neighbourhood Services	2625	Security & Surveillance	Complete	Substantial Assurance	1	4	1	0	20.0		-8.2

Economic Growth & Neighbourhood Services	2626	Car Parking	Complete	Substantial Assurance	0	1	0	0	10.0		-9.1
Law & Governance	2627	Elections	Not Started						20.0	20.0	
Xentrall	2628	ICT Project Management	Not Started						10.0	5.3	
SBC Only	2629	Members Payments and Allowances/Travel and Subsistence	Draft						15.0	9.2	
Economic Growth & Neighbourhood Services	2630	Dolphin Leisure Centre	Complete	Substantial Assurance	3	6	1	0	15.0		-4.5
SBC Only	2631	Heating, Ventilation, Electrical & Building Services	In Progress						20.0	8.6	
Economic Growth & Neighbourhood Services	2632	Housing Benefits	In Progress						18.0	2.6	
Xentrall	2633	Remote Access	Complete	Full Assurance	0	0	0	0	10.0		0.3
Xentrall	2634	Debtors	In Progress						16.0	4.8	
Economic Growth & Neighbourhood Services	2635	Highways Maintenance Operational	Not Started						13.0	13.0	
Resources	2636	Customer Services	Complete	Substantial Assurance	0	4	0	0	25.0		9.4
Corporate	2637	Information Management	In Progress						10.0	10.0	
Corporate	2638	Inventories	Draft						10.0	0.0	

Children's and Adult Services	2639	Harewood Hill Lodge	Complete	Substantial Assurance	0	3	0	0	5.0		-6.7
Economic Growth & Neighbourhood Services	2640	Housing Rents	Not Started						15.0	15.0	
Economic Growth & Neighbourhood Services	2641	Dolphin Centre Catering	Complete	Substantial Assurance	1	5	0	0	10.0		-6.8
Law & Governance	2642	Land Charges	Complete	Substantial Assurance	0	3	0	0	6.0		-6.6
Economic Growth & Neighbourhood Services	2643	Highways Maintenance Management	In Progress						10.0	9.7	
Economic Growth & Neighbourhood Services	2644	Highways Inspection	Not Started						7.0	7.0	
Central	2645	Hardware Controls	In Progress						10.0	6.5	
Children's and Adult Services	2646	Leaving Care	Draft						7.0	0.0	
Economic Growth & Neighbourhood Services	2647	Flooding Risk Management	Not Started						5.0	5.0	
Children's and Adult Services	2648	First Contact	In Progress						3.0	2.9	
Economic Growth & Neighbourhood Services	2649	Sale of Council Houses	Complete	Substantial Assurance	0	4	0	0	10.0		-0.9
Children's and Adult Services	2650	Independent Sector Assessment & Payments	Ready to Start						15.0	12.5	
Corporate	2651	Anti-Fraud Management	In Progress						35.0	14.4	

Xentrall	2652	Bank Reconciliation	Not Started						12.0	12.0	
Corporate	2653	DBS Procedures	In Progress						6.0	5.4	
Economic Growth & Neighbourhood Services	2654	Development Services	In Progress						9.4	0.0	
Children's and Adult Services	2655	Referral & Assessment - Children's	In Progress						15.0	10.6	
Children's and Adult Services	2656	Early Years & Complex Needs	Not Started						8.0	7.7	
Xentrall	2657	Virtualisation	In Progress						6.0	4.2	
Children's and Adult Services	2658	Emergency Duty Team	In Progress						3.0	1.9	
Children's and Adult Services	2659	Looked After Children	Not Started						12.0	11.7	
Corporate	2660	Officer Payments - Mileage	Complete	Full Assurance	0	0	0	0	8.0		-1.0
Xentrall	2661	Network Management	Not Started						10.0	9.3	
Xentrall	2662	PCI Compliance	Complete		0	0	0	0	10.0		9.5
Xentrall	2663	Pension Payments/Early Retirement	Complete	Full Assurance	0	0	0	0	10.0		-0.7
Resources	2664	Treasury Management	Draft						7.0	3.5	
Resources	2665	VAT	In Progress						6.0	1.4	

Economic Growth & Neighbourhood Services	2666	Taxation	In Progress						12.0	0.0	
Corporate	2667	Recruitment Services	In Progress						6.0	4.1	
Xentrall	2668	Server Operating Systems	Not Started						5.0	5.0	
Corporate	2669	Performance Management Framework	In Progress						15.0	15.0	
Resources	2670	Personal Budgets & Direct Payments	Not Started						11.0	8.7	
Children's and Adult Services	2671	Troubled Families Initiative	In Progress						16.0	0.0	
Xentrall	2672	Firewalls	Complete	Full Assurance	0	0	0	0	6.0		-0.6
Children's and Adult Services	2673	Referral & Assessment - Adults	Not Started						12.0	11.2	
Xentrall	2674	Payroll & Absence Recording	In Progress						26.0	2.4	
Corporate	2675	Workforce Development	Ready to Start						12.0	6.1	
Economic Growth & Neighbourhood Services	2676	Environmental Health	Complete	Full Assurance	0	0	0	0	6.0		-1.6
Economic Growth & Neighbourhood Services	2677	Enforcement	Ready to Start						7.0	0.0	
Law & Governance	2678	Mayor's Charity Fund	Complete	< None >	0	0	0	0	2.0		0.0

Children's and Adult Services	2679	Youth Offending and Prevention	Not Started						8.0	8.0	
Children's and Adult Services	2680	Early Years, Children's Centres & Childcare	Not Started						8.0	7.8	
Schools	2681	Schools	Complete	Full Assurance	0	0	0	0	25.0		16.5
Contingency	2682	Grants Contingency	In Progress						25.0	0.0	
TVCA Only	2683	Investment Plan	In Progress						13.0	13.0	
TVCA Only	2684	Core Systems	In Progress						7.0	7.0	
Contingency	2685	Procurement/Contract Management	In Progress						62.0	24.1	
Contingency	2686	ICT Individual Systems	In Progress						66.0	49.0	
Contingency	2687	Continuous Contingency	In Progress						65.0	31.2	
Contingency	2689	Audit Liaison & Planning	In Progress						20.0	0.0	
Contingency	2690	Advice & Guidance	In Progress						50.0	32.5	

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