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Audit Committee Agenda

9.30 am Wednesday, 27 January 2021
Via Microsoft Teams

DARLINGTON
BOROUGH COUNCIL

In accordance with Local Authorities and Police and Crime Panels (Coronavirus) (Flexibility of Local Authority and Police and Crime Panel Meetings) (England and Wales) Regulations 2020, this meeting will be held on a virtual basis. Members of the Public can view a live stream of the meeting at:
https://www.darlington.gov.uk/livemeetings
Members of the public wanting to raise issues/make representations at the meeting can do so by emailing Allison.hill@darlington.go.uk 24 hours before the meeting begins.

1. Introductions/Attendance at Meeting

2. Declarations of Interest

3. To approve the Minutes of the meeting of this Committee held on :

   (a) 28 October 2020; and (Pages 1 - 4)

   (b) Special meeting held on 18 November 2020 (Pages 5 - 6)

4. Annual Audit Letter 2019/20 –
   Report of the Managing Director
   (Pages 7 - 34)

5. Accounting Policies to be applied to the 2020/21 Financial Statements –
   Report of the Managing Director
   (Pages 35 - 56)

6. Final Accounts Timetable for the year ended 31 March 2021 –
   Report of the Managing Director
   (Pages 57 - 60)

7. Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting –
   Report of the Managing Director
   (Pages 61 - 156)

8. Mid Year Risk Management Update 2020/21 –

Report of the Managing Director
(Pages 157 - 180)

9. Prudential Indicators and Treasury Management Strategy Report 2021/22 –
Report of the Managing Director
(Pages 181 - 220)

10. Audit Services Activity Report –
Report of the Audit and Risk Manager
(Pages 221 - 244)

11. 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

12. Questions

Luke Swinhoe
Assistant Director Law and Governance

Tuesday, 19 January 2021

Town Hall
Darlington.

Membership
Councillors Durham, Baldwin, Crudass, Lee, McEwan and Paley

If you need this information in a different language or format or you have any other queries on this agenda please contact Allison Hill, Democratic Officer, 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 : Allison.hill@darlington.gov.uk or telephone 01325 405997

AUDIT COMMITTEE
Wednesday, 28 October 2020

PRESENT – Councillors Lee (Chair), Durham, Baldwin, Crudass and McEwan

APOLOGIES – Councillor Paley

ALSO IN ATTENDANCE – Helen Henshaw (Ernst and Young LLP) and Michael Mason (Ernst and Young LLP)

OFFICERS IN ATTENDANCE – Peter Carrick (Finance Manager Central/Treasury Management), Luke Swinhoe (Assistant Director Law and Governance), Lee Downey (Complaints and Information Governance Manager), Andrew Barber (Audit and Risk Manager, Stockton Borough Council), Ian Miles (Assistant Director Xentrall Shared Services) and Allison Hill (Democratic Officer)

A15 DECLARATIONS OF INTEREST

There were no declarations of interested reported at this meeting.

A16 MINUTES

Submitted – The Minutes (previously circulated) of the meeting of this Audit Committee held on 16 September 2020.

RESOLVED – That the Minutes of the Audit Committee held on 16 September 2020 be approved as a correct record.

A17 AUDIT OF ACCOUNTS 2019/20 AND ANNUAL GOVERNANCE STATEMENT

The Finance Manager gave a verbal update to Members to inform them that the Audit of Accounts 2019/20 and Annual Governance Statement were not able to be signed off by the external auditors.

He advised Members that the Accounts and Audit Regulations 2015 require local authorities to prepare, approve and publish, each year, an Annual Governance Statement (AGS). These regulations also determine the timetable for approval and publication. As a result of the Coronavirus pandemic the Regulations were amended requiring local authorities to sign off their draft accounts and publish their draft AGS by 31 August, instead of 31 May. The date for final publication of the accounts and AGS was also extended to 30 November, from 31 July.

RESOLVED – That a Special Audit Committee meeting be held on 18 November 2020 to approve the Audit of Accounts for 2019/20 and the Annual Governance Statement.

A18 ICT STRATEGY - IMPLEMENTATION PROGRESS

The Assistant Director Xentrall Shared Services submitted a report (previously circulated) to provide a six monthly report to the Audit Committee on progress in relation to the implementation of the ICT Strategy.

It was reported that the current ICT Strategy focused on three strategic priorities namely ICT Governance and Service Development; ICT Strategic Architecture; and Council Service Development and Transformation. The submitted report summarised progress on the main activities within each of the priorities.

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

A19 ANNUAL GRANT CERTIFICATION REPORT 2018/19

The Managing Director submitted a report (previously circulated) together with a report (also previously circulated) produced by Ernst and Young (EY), which summarised the high level results of its grants certification testing.

Helen Henshaw and Michael Mason, EY, attended the meeting and reported that the external audit work undertaken had identified that the claim certified, worth a net total of £33,395,659, required a qualification letter, although no amendment was made to the claim.

In addition, it was reported that Ernst and Young had also audited three claims that fell outside of the Public Sector Audit Appointments arrangements, in relation to Teachers' Pension, the Housing Pooling return and the 2018-19 Homes England Compliance Audit Checklist, and that no significant issues from those claims had been identified.

RESOLVED – That the report be noted.

A20 ANTI-FRAUD AND CORRUPTION STRATEGY 2020/21

The Audit and Risk Manager submitted a report (previously circulated) advising Members of the Council's anti-fraud and corruption arrangements for the period 2020/21.

It was reported that the Anti-Fraud and Corruption Strategy which had been developed in line with CIPFA's Code of Practice on Managing the Risk of Fraud and Corruption and addressed the five key themes within that Code, had been endorsed by senior management with a foreword provided by the Assistant Director Resources as the responsible finance officer and the Chair of this Committee.

It was reported that a number of actions were identified in the 2018/19 strategy and a position statement was provided in the 2019/20 update.

Members discussed how the risk of fraud is assessed and questioned if there was any evidence of emerging patterns of fraud across the neighbouring authorities as a result of Covid-19 and were advised that a report from CIPFA was expected to outline the national picture, however currently the authority were not see any specific areas of concern. Members also referred to the risk of fraud in relation to grants to businesses and other causes and Members requested sight of the monthly returns for fraudulent attempts.

RESOLVED – That the Anti-Fraud and Corruption Strategy, as appended to the submitted report, be approved

A21 INFORMATION GOVERNANCE PROGRAMME PROGRESS REPORT

The Managing Director submitted a six monthly report (previously circulated) on the progress and planned developments of the information governance programme.

It was reported that information governance programme has provided the assurance required to 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 made to the preparing for data protection after the EU Exit transition period ends.

Members made particular reference to the Social Media Training Module, as a result of the Social Media policy which was launched in April 2020 and where targets were not being met.

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

A22 MID YEAR PRUDENTIAL INDICATORS AND TREASURY MANAGEMENT MONITORING REPORT 2020/21

The Managing Director submitted a report (previously circulated) to seek Members approval of the revised Treasury Management Strategy, Prudential Indicators and provide Members with a half-yearly review of the Council's borrowing and investment activities.

It was reported that the mandatory Prudential Code, which governs Council's borrowing, required Council approval of controls, called Prudential Indicators, which related to capital spending and borrowing. The indicators were set out in three statutory annual reports and the key objectives of those reports were set out in the submitted report, together with the key proposed revisions to the prudential indicators which related to a reduction in the Operational Boundary to £188.018m and the Authorised Limit reduction to £229.233m to allow for any additional cashflow requirement.

With regard to Capital Expenditure, the submitted report highlighted the original elements of the capital programme and the expected financing arrangements of this capital expenditure; and the reduction in Borrowing Need due to the Housing programme being delayed due to Covid 19 and it was proposed to set an actual borrowing figure of £177.660m to accommodate the additional borrowing need and any debt requirements for cash flow purposes.

Reference was also made to investments were to include £30m in property funds which were expected to increase the net return on investments by approximately £0.500m in future years; and the Treasury Management Budget which was forecast to underspend by £0.110m in 2020/21.

The submitted report also highlighted that the authority had received a request from Darlington College to utilise the 'Loans to External Bodies or Organisations; facility within the Council's Capital Strategy.

RESOLVED – That the submitted report be referred to Cabinet and that it be advised that this Audit Committee approves the revised prudential indicators and limits and notes the potential of Darlington College accessing the Council's loan facility in accordance with the Capital Strategy; and notes the underspend in the revised Treasury Management Budget (Financing Costs).

A23 AUDIT SERVICES ACTIVITY REPORT

The Audit and Risk Manager submitted a report (previously circulated) to provide Members with a progress report of activity and proposed activity for the next period.

The submitted report outlined progress to date on audit assignment work, consultancy/contingency activity and provided a detailed feedback on the performance of the service and the position in relation to the completion of audit work.

It was also reported that COVID-19 had brought challenges to the Authority and it continues to be the focus for a number of service areas; audit advice had been provided as required and time had been spent transitioning to new ways of working; and testing had been undertaken and good progress had been made to date.

RESOLVED – That the activity be noted.

AUDIT COMMITTEE
Wednesday, 18 November 2020

PRESENT – Councillors Lee (Chair), Durham, Crudass and Paley

APOLOGIES – Councillors Baldwin and McEwan

ALSO IN ATTENDANCE – Helen Henshaw (Ernst and Young LLP) and Michael Mason (Ernst and Young LLP)

OFFICERS IN ATTENDANCE – Peter Carrick (Finance Manager Central/Treasury Management), Luke Swinhoe (Assistant Director Law and Governance), Lee Downey (Complaints and Information Governance Manager), Andrew Barber (Audit and Risk Manager, Stockton Borough Council) and Allison Hill (Democratic Officer)

A24 DECLARATIONS OF INTEREST

There were no declarations of interest reported at the meeting.

A25 AUDIT OF ACCOUNTS 2019/20

The Managing Director submitted a report (previously circulated) providing Members with information on the outcomes of the external audit by Ernst and Young LLP (EY), of the Council's accounts for the year ended 31 March 2020.

It was reported that, in accordance with statutory requirements, which had been updated for (Coronavirus)(Amendment) regulations 2020, EY had audited the accounts and a copy of the report which outlined the results of their findings from the audit were outlined in the audit plan presented to this Committee in September 2020.

Helen Henshaw and Michael Mason from EY advised Members that the audit work on the accounts had been completed and that an unqualified opinion on the Council's 2019/20 accounts would be issued; concluded that the Council had put in place proper arrangements to secure economy, efficiency and effectiveness of its use of resources; and confirmed that the Council's Annual Governance Statement was not misleading or inconsistent with other information known to them.

Members gave specific consideration to items that were classified as unadjusted audit differences in relation to Assets Held for Sale and the Private Finance Initiative.

It was also noted that EY had not raised any significant matters in relation to any significant deficiencies in internal control.

RESOLVED - (a) That the Auditors Audit Results Report on the Council's 2019/20 financial statements be noted.

(b) That Members note the Letter of Representation in Appendix B of the Audit Results Report.

(c) That the Audit Committee agree not to amend the unadjusted audit differences as

DARLINGTON BOROUGH COUNCIL

they were not material.

(d) That the Audit Committee approve the IFRS complaint Statement of Accounts for the 2019/20 financial year.

A26 ANNUAL GOVERNANCE STATEMENT

The Managing Director submitted a report (previously circulated) seeking approval of the Council's draft Annual Governance Statement (AGS)(also previously circulated), a key corporate document which involved a variety of people charged with delivering governance within the Authority and which was required to be published each year, to accompany the Statement of Accounts, in accordance with the Accounts and Audit Regulations 2015.

It was reported that as a result of the Coronavirus pandemic the Regulations had been amended requiring local authorities to sign off their draft accounts and publish their draft AGS by 31 August, instead of 31 May.

The Annual Governance Statement for 2019/20 outlined the Council's responsibilities; explained the purpose of the governance framework; set out key elements; detailed the review of its effectiveness; and highlighted any significant governance issues; and included a commitment by the Leader of the Council and the Managing Director to ensure the continuous improvement of the system in place.

Following discussion on the Action Plan for 2020/21, Members proposed that climate change be included in the actions for 2020/21.

RESOLVED – That the draft Annual Governance Statement, as appended to the submitted report, be approved.

AUDIT COMMITTEE
27 JANUARY 2021

ANNUAL AUDIT LETTER 2019/20

Purpose of the Report

1. To present the Annual Audit Letter for 2019/20

Summary

2. The Annual Audit Letter **(Appendix 1)** provides a high level summary of the results from the 2019/20 audit work undertaken by Ernst and Young LLP (EY), the Council's external auditors, for the benefit of Members and other interested stakeholders.

3. The Letter will be presented at the meeting by a representative from EY.

4. The letter confirms the Council's accounts give a true and fair view for the year ending 31 March 2020 and that the Council have put in place proper arrangements to secure value for money in its use of resources.

Recommendation

5. It is recommended that the Annual Audit Letter be noted.

Reasons

6. The recommendation is supported to enable the Audit Committee to receive the results of external audit work carried out.

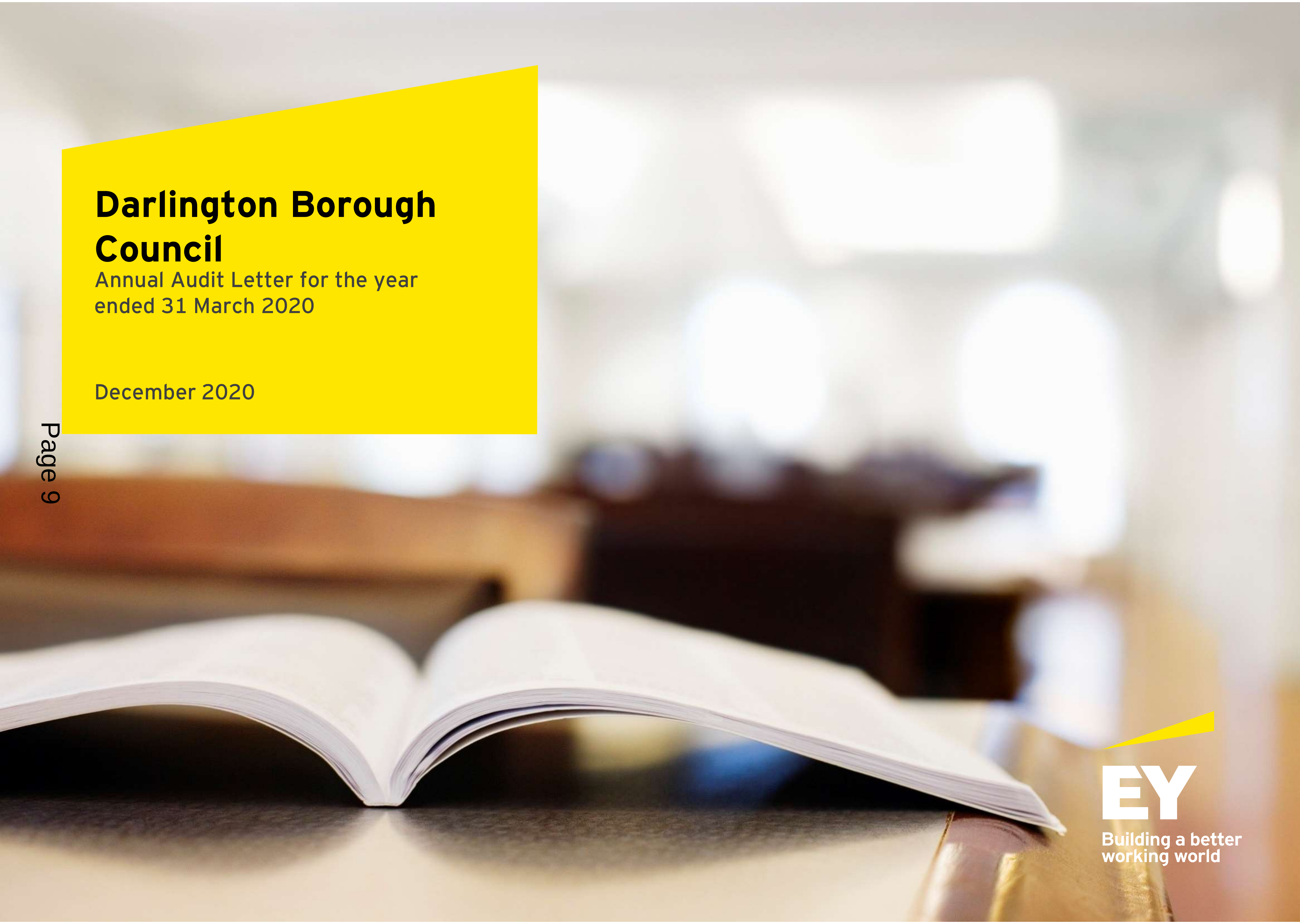
Paul Wildsmith
Managing Director

Background Papers

Annual Audit Letter 2019/20

Peter Carrick: Extension 5401

S17 Crime and Disorder	There are no specific issues which relate to crime and disorder.
Health and Well Being	There is no specific health and well being impact.
Carbon Impact and Climate Change	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	The External Auditors concluded that the Council had put in place proper arrangements to secure value for money in its use of resources.
Impact on Looked After Children and Care Leavers	This report has no impact on Looked After Children or Care Leavers



Darlington Borough Council

Annual Audit Letter for the year ended 31 March 2020

December 2020

Building a better working world

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Public Sector Audit Appointments Ltd (PSAA) have issued a 'Statement of responsibilities of auditors and audited bodies'. It is available from the Chief Executive of each audited body and via the PSAA website (www.psaa.co.uk).

This Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The 'Terms of Appointment (updated April 2018)' issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

This Audit Results Report is prepared in the context of the Statement of responsibilities. It is addressed to the Members of the audited body, and is prepared for their sole use. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure – If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Hywel Ball, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

Section 1

Executive Summary

Executive Summary

We are required to issue an annual audit letter to Darlington Borough Council (the Council) following completion of our audit procedures for the year ended 31 March 2020.

Covid-19 had an impact on a number of aspects of our 2019/20 audit. We set out these key impacts below.

Area of impact	Commentary
Impact on the delivery of the audit	
► Changes to reporting timescales	As a result of Covid-19, new regulations, the Accounts and Audit (Coronavirus) (Amendment) Regulations 2020 No. 404, have been published and came into force on 30 April 2020. This announced a change to publication date for final, audited accounts from 31 July to 30 November 2020 for all relevant authorities. We worked with the Council to deliver our audit in line with the revised reporting timescale.
Impact on our risk assessment	
► Valuation of Property Plant and Equipment	The Royal Institute of Chartered Surveyors (RICS), the body setting the standards for property valuations, issued guidance to valuers highlighting that the uncertain impact of Covid-19 on markets might cause a valuer to conclude that there is a material uncertainty. Caveats around this material uncertainty have been included in the year-end valuation reports produced by the Council's external valuer.
► Disclosures on Going Concern	Financial plans for 2020/21 and medium term financial plans will need revision for Covid-19. We considered the unpredictability of the current environment gave rise to a risk that the council would not appropriately disclose the key factors relating to going concern, underpinned by managements assessment with particular reference to Covid-19.
Impact on the scope of our audit	
► Information Produced by the Entity (IPE)	We identified an increased risk around the completeness, accuracy, and appropriateness of information produced by the entity due to the inability of the audit team to verify original documents or re-run reports on-site from the Council's systems. We undertook the following to address this risk: ► Used the screen sharing function of Microsoft Teams to evidence re-running of reports used to generate the IPE we audited; and ► Agree IPE to scanned documents or other system screenshots.
► Consultation requirements	Additional EY consultation requirements concerning the impact on auditor reports.

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Executive Summary (cont'd)

The tables below set out the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on the Council's:	
► Financial statements	Unqualified – the financial statements give a true and fair view of the financial position of the Council as at 31 March 2020 and of its expenditure and income for the year then ended.
► Consistency of other information published with the financial statements	Other information published with the financial statements was consistent with the financial statements.
► Concluding on the Council's arrangements for securing economy, efficiency and effectiveness	We concluded that you have put in place proper arrangements to secure value for money in your use of resources.

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Area of Work	Conclusion
Reports by exception:	
► Consistency of Governance Statement	The Governance Statement was consistent with our understanding of the Council.
► Public interest report	We had no matters to report in the public interest.
► Written recommendations to the Council, which should be copied to the Secretary of State	We had no matters to report.
► Other actions taken in relation to our responsibilities under the Local Audit and Accountability Act 2014	We had no matters to report.

Area of Work	Conclusion
Reporting to the National Audit Office (NAO) on our review of the Council's Whole of Government Accounts return (WGA).	We had no matters to report. The Council is below the specified audit threshold of £500mn. Therefore, we did not perform any audit procedures on the consolidation pack.

Executive Summary (cont'd)

As a result of the above we have also:

Area of Work	Conclusion
Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit.	Our Audit Results Report was issued on 15 October 2020.
Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.	Our certificate was issued on 23 November 2020.

We would like to take this opportunity to thank the Council staff for their assistance during the course of our work.

Helen Henshaw
Associate Partner
For and on behalf of Ernst & Young LLP

Section 2

Purpose and Responsibilities

Purpose

The Purpose of this Letter
The purpose of this annual audit letter is to communicate to Members and external stakeholders, including members of the public, the key issues arising from our work, which we consider should be brought to the attention of the Council. We have already reported the detailed findings from our audit work in our 2019/20 Audit Results Report to the 18 November 2020 Audit Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council.

Responsibilities

Responsibilities of the Appointed Auditor

Our 2019/20 audit work has been undertaken in accordance with the Audit Plan that we issued on 30 April 2020 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- Expressing an opinion:
  - On the 2019/20 financial statements; and
  - On the consistency of other information published with the financial statements.
- Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.
- Reporting by exception:
  - If the annual governance statement is misleading or not consistent with our understanding of the Council;
  - Any significant matters that are in the public interest;
  - Any written recommendations to the Council, which should be copied to the Secretary of State; and
  - If we have discharged our duties and responsibilities as established by the Local Audit and Accountability Act 2014 and Code of Audit Practice.

Alongside our work on the financial statements, we also review and report to the National Audit Office (NAO) on your Whole of Government Accounts return. The Council is below the specified audit threshold of £500mn. Therefore, we did not perform any audit procedures on the return.

Responsibilities of the Council

The Council is responsible for preparing and publishing its statement of accounts accompanied by an Annual Governance Statement (AGS). In the AGS, the Council reports publicly each year on how far it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in year, and any changes planned in the coming period.

The Council is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Section 3

Financial Statement Audit

Financial Statement Audit

Key Issues

The Council's Statement of Accounts is an important tool for the Council to show how it has used public money and how it can demonstrate its financial management and financial health.

We audited the Council's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK), and other guidance issued by the National Audit Office and issued an unqualified audit report on 23 November 2020.

Our detailed findings were reported to the 18 November 2020 Audit Committee.

The key issues identified as part of our audit were as follows:

Significant Risk	Conclusion
Misstatements due to fraud or error The financial statements as a whole are not free of material misstatements whether caused by fraud or error. As identified in ISA (UK) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.	We did not identify any material weaknesses in controls or evidence of material management override. We did not identify any instances of inappropriate judgements being applied. We did not identify any other transactions during our audit which appeared unusual or outside the Council's normal course of business. We did not identify any issues regarding the appropriateness of journal entries recorded in the general ledger and other adjustments made to the financial statements from our testing performed.

Financial Statement Audit (cont'd)

Significant Risk	Conclusion
Risk of fraud in revenue and expenditure recognition Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition. In the public sector, this requirement is modified by Practice Note 10 issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition. Local authorities have a statutory duty to balance their annual budget and are operating in a financially challenged environment with reducing levels of government funding and increasing demand for services. Achievement of budget is critical to minimising the impact and usage of the Council's usable reserves and provides a basis for the following year's budget. Any deficit outturn against the budget is therefore not a desirable outcome for the Council and management, and therefore this desire to achieve budget increases the risk that the financial statements may be materially misstated.	Our testing has not identified any material misstatements from revenue and expenditure recognition. Overall our audit work did not identify any material issues or unusual transactions to indicate any misreporting of the Council's financial position. However, our work performed on the HRA statement identified a number of errors which cumulatively were above our SAD limit. This resulted in expenditure being overstated by £413k and income being overstated by £406k. These errors have been corrected by management in the final set of accounts.

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The key issues identified as part of our audit were as follows:

Other Key Findings	Conclusion
Valuation of Land, Buildings and Investment Property The fair value of Property, Plant and Equipment (PPE) and Investment Properties (IP) represent a significant balance in the Council's accounts, and are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet. Covid-19 related constraints on property valuation: The Royal Institute of Chartered Surveyors (RICS), the body setting the standards for property valuations, has issued guidance to valuers highlighting that the uncertain impact of Covid-19 on the markets might cause a valuer to conclude that there is material uncertainty. The valuation reports received by the Council from their valuers included a statement on material uncertainties in relation to their valuation.	We identified differences in our valuations work relating to two assets (Drinkfield Civic Amenity Site, and Central House Annexe). The valuation of the building element of the Drinkfield Amenity was not included within the fixed asset register or the financial statements resulting in an understatement of £492k. The valuation of Central House Annexe had arithmetic errors, which amounted to an overstatement of £142k. Although this was below our reporting threshold, management chose to correct this and we have therefore included it in our report. We also noted a disclosure issue in the note of the accounts whereby PFI assets had been understated by £252k. We noted an overstatement of £1.4m relating to the valuation of the Railway Museum within Note 18, Heritage Assets. The overstatement was due to an out of date valuation report being used. We have no other matters to bring to your attention regarding the valuation of land and buildings and investment properties.

Financial Statement Audit (cont'd)

The key issues identified as part of our audit were as follows: (cont'd)

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Other Key Findings	Conclusion
Pension Liability Valuation The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by Durham County Council. The Council's pension fund deficit is a material estimated balance and the Code requires that this liability be disclosed on the Council's balance sheet. At 31 March 2020, this totalled £186.74m. The information disclosed is based on the IAS19 report issued to the Council by the actuary. Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs 500 and 540 requires us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.	We were satisfied that the required IAS 19 disclosures have been reflected in the financial statements and were based on accurate supporting information.
Group Accounting To assess if group accounting is required, the CIPFA Code requires an assessment of arrangements on a qualitative basis first, and then on a quantitative basis. Management should revisit the Group assessment annually, based on the most up-to-date information, to determine if the Group financial statements require additional entities to be incorporated within the consolidation.	We have: • Reviewed the Council's Group boundary assessment to ensure that it is complete and all Group entities have been identified; • Reviewed the Council's assessment of qualitative factors such as whether the Council is exposed to any commercial risk through its involvement with the potential Group entities, in order to ensure the assessment is appropriate; and • Tested the Council's quantitative assessment by agreeing all values included in the assessment to audited financial statements for each of the potential Group entities. We have no other matters to bring to your attention relating to group accounts.

Financial Statement Audit (cont'd)

The key issues identified as part of our audit were as follows: (cont'd)

Other Key Findings	Conclusion
Going Concern Disclosure Covid-19 has created a number of financial pressures throughout Local Government. It is creating financial stress through a combination of increasing service demand leading to increased expenditure in specific services, and reductions in income sources. CIPFA's Code of Practice on Local Authority Accounting in the United Kingdom 2019/20 states that organisations that can only be discontinued under statutory prescription shall prepare their accounts on a going concern basis. However, International Auditing Standard 570 Going Concern, as applied by Practice Note 10: Audit of financial statements of public sector bodies in the United Kingdom, still requires auditors to undertake sufficient and appropriate audit procedures to consider whether there is a material uncertainty on going concern that requires reporting by management within the financial statements, and within the auditor's report. We are obliged to report on such matters within the section of our audit report 'Conclusions relating to Going Concern'. To do this, the auditor must review management's assessment of the going concern basis applying IAS1 Presentation of Financial Statements.	We did not identify a material uncertainty in relation to Going Concern. We agree with management's assessment that the financial statements should be prepared on a going concern basis.

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Financial Statement Audit (cont'd)

Our application of materiality

When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole.

Item	Thresholds applied
Planning materiality	We determined planning materiality to be £4.6m, which is 2% of gross operating expenditure. We consider gross operating expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.
Reporting threshold	We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £0.232m.

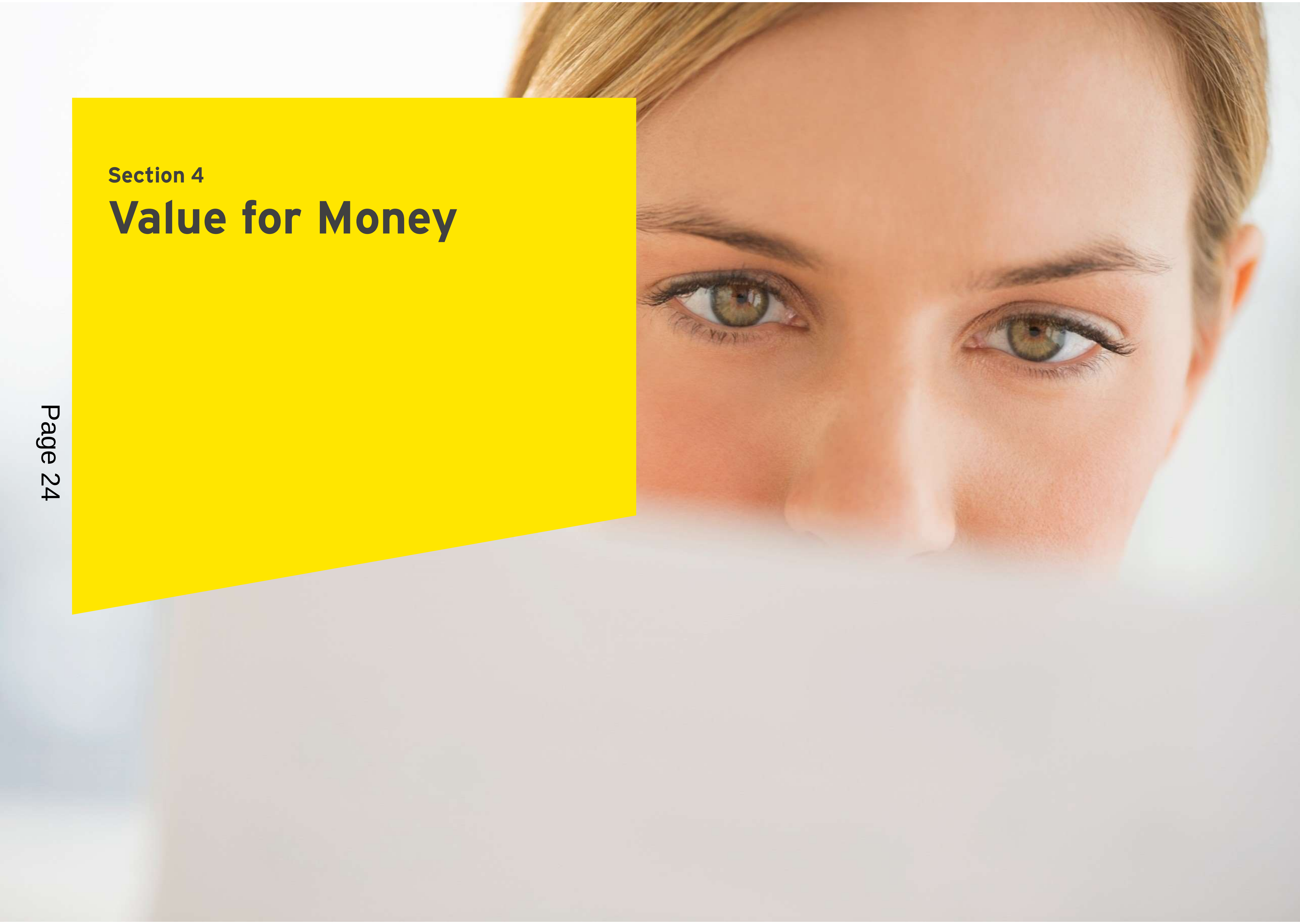
We also identified the following areas where misstatement at a level lower than our overall materiality level might influence the reader. For these areas we developed an audit strategy specific to these areas. The areas identified and audit strategy applied include:

- Remuneration disclosures including any severance payments, exit packages and termination benefits: We agreed all disclosures back to source data and approved amounts.
- Related party transactions. We tested the completeness of related party disclosures and the accuracy of all disclosures by checking back to supporting evidence.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations.

Section 4

Value for Money



Value for Money

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

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

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

On 16 April 2020 the National Audit Office published an update to auditor guidance in relation to the 2019/20 Value for Money assessment in the light of Covid-19. This clarified that in undertaking the 2019/20 Value for Money assessment auditors should consider Local Authorities' response to Covid-19 only as far as it relates to the 2019-20 financial year; only where clear evidence comes to the auditor's attention of a significant failure in arrangements as a result of Covid-19 during the financial year, would it be appropriate to recognise a significant risk in relation to the 2019-20 VFM arrangements conclusion.

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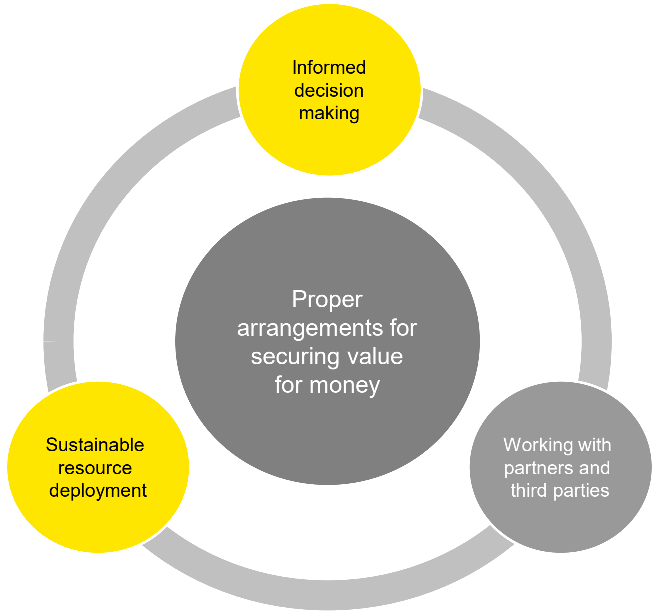
We identified one significant Value for Money risk which is covered on page 18.

We have performed the procedures outlined in our audit plan. We did not identify any significant weaknesses in the Council's arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.



Value for Money (cont'd)

We therefore issued an unqualified value for money conclusion on 23 November 2020.

Significant Risk	Conclusion
Financial Sustainability The Council continues to operate in a challenging financial environment. The main risks to the Council's finances are reductions in central government funding, increased reliance on locally raised taxes, increased budget pressures and increasing demands for services. In February 2020, the Council published its Medium Term Financial Plan (MTFP) for 2020/21 to 2023/24. The plan includes £10.3m of net pressures, which includes delivery of savings totalling £12.9m, over the duration of the plan. There is therefore significant pressure on the Council's finances over the coming years. We note that the above plan does not incorporate the potential financial impact of Covid-19, due to the timing of its production.	The Council has successfully managed its financial resources during 2019/20, such that they achieved a surplus on provision of services of £17.691 million at the year end. Also, a small contribution (after accounting adjustments) was made to the general fund balance giving a closing balance of £18.368 million. This is considerably above the current risk assessed minimum working balance of £4.350 million. The Council has maintained a positive cash balance throughout the year and has a significant closing year end balance of £16.263 million. The affect of covid-19 on the Council's 2019/20 accounts was limited with the lockdown being imposed in the last week of the year (23rd March 2020). However, it is clear that the pandemic will have an adverse impact on the council's finances post 2020/21. We understand that work to establish the overall impact on the council is continuing and a revised Medium-Term Financial Plan (MTFP) is due to be presented to Cabinet in December 20. In the current MTFP the Council's strategy has been to balance the budget going forward with the use of reserves and we understand that this will continue. We have reviewed information, such as Central Government guidance on cost pressures, to assess the completeness of the assessment for the remaining period. No areas have been identified that management have not taken into account. We have also reviewed and tested management's detailed cash flow forecast up to 30 November 2021. These forecasts demonstrate the Council will maintain a positive cash balance throughout 2020/21 and we are satisfied the Council have arrangements in place to monitor this going forwards. As a result of the procedures performed we are content that the Council has appropriate arrangements in place to manage its financial resources.

Section 5

Other Reporting Issues

Other Reporting Issues

Whole of Government Accounts

We are required to perform the procedures specified by the National Audit Office on the accuracy of the consolidation pack prepared by the Council for Whole of Government Accounts purposes.

The Council is below the specified audit threshold of £500mn. Therefore, we were not required to perform any audit procedures on the consolidation pack.

Annual Governance Statement

We are required to consider the completeness of disclosures in the Council's annual governance statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it is misleading.

We completed this work and did not identify any areas of concern.

Report in the Public Interest

We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by the Council or brought to the attention of the public.

We did not identify any issues which required us to issue a report in the public interest.

Written Recommendations

We have a duty under the Local Audit and Accountability Act 2014 to designate any audit recommendation as one that requires the Council to consider it at a public meeting and to decide what action to take in response.

We did not identify any issues which required us to issue a written recommendation.

Other Reporting Issues (cont'd)

Objections Received

We did not receive any objections to the 2019/20 financial statements from members of the public.

Other Powers and Duties

We identified no issues during our audit that required us to use our additional powers under the Local Audit and Accountability Act 2014.

Independence

We communicated our assessment of independence in our Audit Results Report to the Audit Committee on 18 November 2020. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning regulatory and professional requirements.

Control Themes and Observations

As part of our work, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Although our audit was not designed to express an opinion on the effectiveness of internal control, we are required to communicate to you significant deficiencies in internal control identified during our audit.

We have adopted a fully substantive audit approach and have therefore not tested the operation of controls.

Our audit did not identify any controls issues to bring to the attention of the Audit Committee.

Section 6

Focused on your future

Focused on your future

The Code of Practice on Local Authority Accounting in the United Kingdom introduces the application of new accounting standards in future years. The impact on the Council is summarised in the table below.

Standard	Issue	Impact
IFRS 16 Leases	It is currently proposed that IFRS 16 will be applicable for local authority accounts from the 2021/22 financial year. Whilst the definition of a lease remains similar to the current leasing standard; IAS 17, for local authorities who lease a large number of assets the new standard will have a significant impact, with nearly all current leases being included on the balance sheet. There are transitional arrangements within the standard and although the 2020/21 Accounting Code of Practice for Local Authorities has yet to be updated, CIPFA have issued some limited provisional information which begins to clarify what the impact on local authority accounting will be. Whether any accounting statutory overrides will be introduced to mitigate any impact remains an outstanding issue.	Until the revised 2020/21 Accounting Code is issued and any statutory overrides are confirmed there remains some uncertainty in this area. However, what is clear is that the Council will need to undertake a detailed exercise to identify all of its leases and capture the relevant information for them. The Council must therefore ensure that all lease arrangements are fully documented.

Section 8

Audit Fees

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Audit Fees

Our fee for 2019/20 is in line with the scale fee set by the PSAA / as agreed with your in our Engagement Letter and reported in our 15 October 2020 Audit Results Report.

Description	Final Fee 2019/20 £	Planned Fee 2019/20 £	Scale Fee 2019/20 £
Audit Fee – Code work	71,813	71,813	71,813
Changes in work required to address professional and regulatory requirements and scope associated with risk (see Note 1)	25,087		
Additional specific one-off work required for Covid-19 considerations and current year errors (see Note 2)	13,317		
Total Audit Fee	**110,217**		
Non-audit work – Housing Benefits Subsidy Claim	10,500	10,500	
Non-audit work – Teachers' Pension Certification Work	5,500	5,500	
Non-audit work – Homes England Grant	4,000	4,000	
Non-audit work – Pooling of Capital Receipts	TBC	TBC	
Total Fees	**TBC**	**TBC**	

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Note 1
For 2019/20 the scale fee has been re-assessed to take into account a number of risk factors as outlined below:
- Procedures performed to address the risk profile of Darlington Borough Council - £12,207
- Additional work to address increase in Regulatory standards - £12,880

This additional fee has been discussed with Management and is subject to review and approval by the PSAA Ltd.

Note 2
We have performed additional work as a result of Covid-19, particularly in respect of risk assessments, going concern consultations and the impact on asset valuations. Additionally, we have performed additional procedures which were required in respect of errors in heritage assets valuation in the draft accounts

This additional fee has been discussed with Management and is subject to review and approval by the PSAA Ltd.

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ED None

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AUDIT COMMITTEE
27 JANUARY 2021

ACCOUNTING POLICIES TO BE APPLIED TO THE 2020/21 FINANCIAL STATEMENTS

SUMMARY REPORT

Purpose of the Report

1. To update Members on the accounting policies to be applied in the preparation of the 2020/21 Statement of Accounts (SoA).

Summary

2. This report confirms that the majority of the Accounting Policies used in the preparation of the 2019/20 Statement of Accounts remain appropriate.

Recommendation

3. The Committee reviews the accounting policies and approves their use in the preparation of the 2020/21 financial statements.

Reasons

4. The recommendations are supported to provide the Audit Committee with evidence to reflect on progress in delivery of the 2020/21 Statement of Accounts.

Paul Wildsmith
Managing Director

Background Papers

Code of Practice on Local Authority Accounting In the UK 2020/21

Peter Carrick: Extension 5401

S17 Crime and Disorder	There is no specific crime and disorder impact.
Health and Well Being	There is no specific heath and well being impact.
Carbon Impact	Some of the initiatives contained within ICT Strategy will help contribute towards the carbon reduction commitments.
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 the report comprising part of the Council's governance arrangements.
Efficiency	There is no specific efficiency impact.
Impact on Looked After Children and Care Leavers	The report does not impact upon Looked After Children or Care Leavers.

MAIN REPORT

5. The Accounts and Audit Regulations 2015 and the Local Government Act 2003 require that the Statement of Accounts is produced in accordance with proper accounting practices.

6. One of the responsibilities of the Audit Committee is:

7. *'To review the annual statement of accounts prior to approval. Specifically, to consider whether appropriate accounting policies have been followed and whether there are concerns arising from the financial statements or from the audit that need to be brought to the attention of the Council'.*

8. Accounting policies are defined in the CIPFA Code of Practice for Local Authority Accounting in the UK 2020/21 as the 'specific principles, bases, conventions, rules and practices applied by an authority in preparing and presenting financial statements'.

9. The proposed accounting policies are in line with those used in the preparation of the 2019/20 accounts.

10. The full list of accounting policies the Council proposes to disclose in its Statement of Accounts notes are detailed in **Appendix 1**.

Appendix 1

Statement of Accounting Policies

a) General principles

The Statement of Accounts summarises the Council’s transactions for the 2020/21 financial year and its position at the year-end of 31 March 2021. The Council is required to prepare an annual Statement of Accounts by the Accounts and Audit Regulations 2015, which those Regulations require to be prepared in accordance with proper accounting practices. The principal accounting policies have been applied consistently throughout the year.

These practices under Section 21 of the 2003 Act primarily comprise the Code of Practice on Local Authority Accounting in the United Kingdom 2020/21, supported by International Financial Reporting Standards (IFRS) and statutory guidance issued under section 12 of the 2003 Act.

The accounting convention adopted in the Statement of Accounts is principally historical cost, modified by the revaluation of certain categories of non-current assets and financial instruments.

b) Accruals of income and expenditure

Activity is accounted for in the year that it takes place, not simply when cash payments are made or received. In particular:

- Revenue from contracts with service recipients, whether for services or the provision of goods, is recognised when (or as) the goods or services are transferred to the service recipient in accordance with the performance obligations in the contract.

- Supplies are recorded as expenditure when they are consumed – where there is a gap between the date supplies are received and their consumption, they are carried as inventories on the balance sheet.

- Expenses in relation to services received (including services provided by employees) are recorded as expenditure when the services are received rather than when payments are made.

- Interest receivable on investments and payable on borrowings is accounted for respectively as income and expenditure on the basis of the effective interest rate for the relevant financial instrument rather than the cash flows fixed or determined by the contract.

- Where revenue and expenditure have been recognised but cash has not been received or paid, a debtor or creditor for the relevant amount is recorded in the Balance Sheet. Where debts may not be settled, the balance is written down and a charge made to revenue for the income that might not be collected. The Council has adopted a de minimis level of £500 for year-end accruals which means that they are not included in the accounting statements.

- Income and expenditure are credited and debited to the relevant service revenue account, unless they properly represent capital receipts or capital expenditure.

The only exceptions to these principles where costs are not apportioned between years are:

- housing rents are shown in whole weeks

- quarterly accounts e.g. electricity are reflected on the basis of four payments per year.

This policy is consistently applied each year and does not materially affect the accounts.

c) Cash and cash equivalents

Cash is represented by cash in hand and deposits with financial institutions, including on-call accounts and deposits with Money Market Funds, repayable without penalty on notice of not more than 24 hours held to meet short-term cash commitments. Cash equivalents are highly liquid investments that mature in no more than three months or less from the date of acquisition and that are readily convertible to known amounts of cash with insignificant risk of change in value. In the Cash Flow Statement, cash and cash equivalents are shown net of bank overdrafts that are repayable on demand and form an integral part of the Council's cash management.

d) Prior period adjustments, changes in accounting policies and estimates and errors

Prior period adjustments may arise as a result of a change in accounting policies or to correct a material error. Changes in accounting estimates are accounted for prospectively, i.e. in the current and future years affected by the change and do not give rise to a prior period adjustment.

Changes in accounting policies are only made when required by proper accounting practices or the change provides more reliable or relevant information about the effect of transactions, other events and conditions on the Council's financial position or financial performance. Where a change is made, it is applied retrospectively (unless stated otherwise) by adjusting opening balances and comparative amounts for the prior period as if the new policy had always been applied.

Material errors discovered in prior period figures are corrected retrospectively by amending opening balances and comparative amounts for the prior period.

e) Charges to revenue for non-current assets

Services, support services and trading accounts are debited with the following amounts to record the cost of holding non-current assets during the year:

- depreciation attributable to the assets used by the relevant service;
- revaluation and impairment losses on assets used by the service where there are no accumulated gains in the revaluation reserve against which the losses can be written off, and
- amortisation of intangible fixed assets attributable to the service.

The Council is not required to raise council tax to fund depreciation, revaluation and impairment losses or amortisation. However, it is required to make an annual contribution from revenue towards the reduction in its overall borrowing requirement equal to an amount calculated on a prudent basis determined by the Council in accordance with statutory guidance.

Depreciation, revaluation and impairment losses and amortisation are therefore replaced by the contribution in the general fund balance (Minimum Revenue Provision), by way of an adjusting transaction with the capital adjustment account in the movement in reserves statement for the difference between the two.

f) Council tax and non-domestic rates

Billing authorities act as agents, collecting council tax and non-domestic rates (NDR) on behalf of major preceptors (including government for NDR) and, as principals, collecting council tax and NDR for themselves. Billing authorities are required by statute to maintain a separate fund (i.e. the Collection Fund) for the collection and distribution of amounts due in respect of council tax and NDR. Under the legislative framework for the collection fund, billing authorities, major preceptors and central government share proportionately the risks and rewards that the amount of council tax and NDR collected could be less or more than predicted.

Accounting for council tax and NDR

The council tax and NDR income included in the comprehensive income and expenditure statement (CIES) is the Council's share of accrued income for the year. However, regulations determine the amount of council tax and NDR that must be included in the Council's general fund. Therefore, the difference between the income included in the CIES and the amount required by regulation to be credited to the general fund is taken to the collection fund adjustment account and included as a reconciling item in the movement in reserves statement.

The balance sheet includes the Council's share of the end of year balances in respect of council tax and NDR relating to arrears, impairment allowances for doubtful debts, overpayments and prepayments and appeals.

Where debtor balances for the above are identified as impaired because of a likelihood arising from a past event that payments due under the statutory arrangements will not be made (fixed or determinable payments), the asset is written down and a charge made to the financing and investment income and expenditure line in the CIES. The impairment loss is measured as the difference between the carrying amount and the revised future cash flows.

g) Employee benefits

Benefits payable during employment

Short-term employee benefits are those due to be settled wholly within 12 months of the year-end. They include such benefits as wages and salaries, paid annual leave and paid sick leave, bonuses and non-monetary benefits (e.g. cars) for current employees and are recognised as an expense for services in the year in which employees render service to the Council.

An accrual is made for the cost of holiday entitlements (or any form of leave, e.g. flexi time or time off in lieu) earned by employees but not taken before the year-end which employees can carry forward into the next financial year. The accrual is made at the wage and salary rates applicable in the following accounting year, being the period in which the employee takes the benefit. The accrual is charged to surplus or deficit on the provision of services, but then reversed out through the movement in reserves statement so that holiday entitlements are charged to revenue in the financial year in which the holiday absence occurs.

Termination Benefits

Termination benefits are amounts payable as a result of a decision by the Council to terminate an officer’s employment before the normal retirement date or an officer’s decision to accept voluntary redundancy in exchange for those benefits and are charged on an accruals basis to the relevant service line or, where applicable, to a corporate service line at the earlier of when the Council can no longer withdraw the offer of those benefits or when the Council recognises costs for a restructuring.

Where termination benefits involve the enhancement of pensions, statutory provisions require the General Fund to be charged with the amount payable by the Council to the pension fund or pensioner in the year, not the amount calculated according to the relevant accounting standards although it is the Council's policy not to award any such enhancements.

Post-employment benefits

Employees of the Council are members of three separate pension schemes:

- The Teachers' Pension Scheme, administered by Capita Teachers' Pensions on behalf of the Department for Education (DfE).

- The NHS Pension Scheme, administered by NHS Pensions

- The Local Government Pensions Scheme, administered by Durham County Council.

The schemes provide defined benefits to members (retirement lump sums and pensions) earned as employees of the Council.

However, the arrangements for the teachers' and the NHS schemes mean that liabilities for these benefits cannot ordinarily be identified specifically to the Council. The schemes are therefore accounted for as if they were a defined contribution scheme and no liability for future payments of benefits is recognised in the balance sheet. The Childrens' and Adults Services line in the comprehensive income and expenditure statement is charged with the employer's contributions payable to Teachers' Pensions in the year as is the employer's contributions payable to the NHS Pension scheme in the year.

The Local Government Pension Scheme

The Local Government Pension Scheme is accounted for as a defined benefits scheme:

- The liabilities of the Durham County Council pension fund attributable to the Council are included in the balance sheet on an actuarial basis using the projected unit method - i.e. an assessment of the future payments that will be made in relation to retirement benefits earned to date by employees, based on assumptions about mortality rates, employee turnover rates, etc, and projected earnings for current employees.

- Liabilities are discounted to their value at current prices, using a discount rate of 2.4% (based on the indicative rate of return on high quality corporate bonds).

- The assets of Durham County Council pension fund attributable to the Council are included in the balance sheet at their fair value:

    - quoted securities – current bid price
    - unquoted securities – professional estimate
    - unitised securities – current bid price
    - property – market value.

The change in the net pensions liability is analysed into the following components:

- Service cost comprising:

    - current service cost - the increase in liabilities as a result of years of service earned this year - allocated in the comprehensive income and expenditure statement to the services for which the employees worked;

    - past service cost - the increase in liabilities as a result of a scheme amendment or curtailment whose effect relates to years of service earned in earlier years, debited to the surplus or deficit on the provision of services in the comprehensive income and expenditure statement.

    - net interest on the net defined benefit liability (asset), i.e. net interest expense for the Council – the change during the period in the net defined benefit liability (asset) that arises from the passage of time charged to the financing and investment income and expenditure line of the comprehensive income and expenditure statement - this is calculated by applying the discount rate used to measure the defined benefit obligation at the beginning of the period to the net defined benefit liability (asset) at the beginning of the period - taking into account any changes in the net defined benefit liability (asset) during the period as a result of contribution and benefit payments.

- Remeasurements comprising

    - the return on plan assets - excluding amounts included in net interest on the net defined liability (asset) charged to the pensions reserve as other comprehensive income and expenditure.

    - actuarial gains and losses - changes in the net pensions liability that arise because events have not coincided with assumptions made at the last actuarial valuation or because the actuaries have updated their assumptions - charged to the pensions reserve as other comprehensive income and expenditure.

- Contributions paid to the Durham County Council pension fund - cash paid as employer's contributions to the pension fund in settlement of liabilities; not accounted for as an expense.

In relation to retirement benefits, statutory provisions require the general fund balance to be charged with the amount payable by the Council to the pension fund or directly to pensioners in the year, not the amount calculated according to the relevant accounting standards. In the movement in reserves statement, this means that there are transfers to and from the pensions reserve to remove the notional debits and credits for retirement benefits and replace them with debits for the cash paid to the pension fund and pensioners and any such amounts payable but unpaid at the year-end. The negative balance that arises on the pensions reserve thereby measures the beneficial impact to the general fund of being required to account for retirement benefits on the basis of cash flows rather than as benefits are earned by employees.

Discretionary benefits

The Council also has restricted powers to make discretionary awards of retirement benefits in the event of early retirements. Any liabilities estimated to arise as a result of an award to any member of staff (including teachers) are accrued in the year of the decision to make the award and accounted for using the same policies as are applied to the Local Government Pension Scheme.

h) Events after the reporting period

Events after the balance sheet date are those events, both favourable and unfavourable, that occur between the end of the reporting period and the date when the statement of accounts is authorised for issue. Two types of events can be identified:

- those that provide evidence of conditions that existed at the end of the reporting period - the statement of accounts is adjusted to reflect such events; and
- those that are indicative of conditions that arose after the reporting period - the statement of accounts is not adjusted to reflect such events, but where a category of events would have a material effect, disclosure is made in the notes of the nature of the events and their estimated financial effect.

Events taking place after the date of authorisation for issue are not reflected in the statement of accounts.

i) Financial instruments

Financial liabilities

Financial liabilities are recognised on the balance sheet when the Council becomes a party to the contractual provisions of a financial instrument and are initially measured at fair value and are carried at their amortised cost. Annual charges to the financing and investment income and expenditure line in the comprehensive income and expenditure statement for interest payable are based on the carrying amount of the liability, multiplied by the effective rate of interest for the instrument. The effective interest rate is the rate that exactly discounts estimated future cash payments over the life of the instrument to the amount at which it was originally recognised.

For most of the borrowings that the Council has, this means that the amount presented in the balance sheet is the outstanding principal repayable (plus accrued interest); and interest charged to the comprehensive income and expenditure statement is the amount payable for the year according to the loan agreement.

Gains and losses on the repurchase or early settlement of borrowing are credited and debited to the financing and investment income and expenditure line in the comprehensive income and expenditure statement in the year of repurchase/settlement. However, where repurchase has taken place as part of a restructuring of the loan portfolio that involves the modification or exchange of existing instruments, the premium or discount is respectively deducted from or added to the amortised cost of the new or modified loan and the write-down to the comprehensive income and expenditure statement is spread over the life of the loan by an adjustment to the effective interest rate.

Where premiums and discounts have been charged to the comprehensive income and expenditure statement, regulations allow the impact on the general fund balance to be spread over future years. The Council has a policy of spreading the gain or loss over the term that was remaining on the loan against which the premium was payable or discount receivable when it was repaid. The reconciliation of amounts charged to the comprehensive income and expenditure statement to the net charge required against the general fund balance is managed by a transfer to or from the financial instruments adjustment account in the movement in reserves statement.

Financial assets

Financial assets are classified based on a classification and measurement approach that reflects the business model for holding the financial assets and their cash flow characteristics.

There are three main classes of financial assets measured at:

- amortised cost,
- fair value through profit or loss (FVPL), and
- fair value through other comprehensive income (FVOCI)

The Council's business model is to hold investments to collect contractual cash flows. Financial assets are therefore classified as amortised cost, except for those whose contractual payments are not solely payment of principal and interest (i.e. where the cash flows do not take the form of a basic debt instrument).

Financial assets measured at amortised cost

Financial assets measured at amortised cost are recognised on the balance sheet when the Council becomes a party to the contractual provisions of a financial instrument and are initially measured at fair value. They are subsequently measured at their amortised cost. Annual credits to the financing and investment income and expenditure line in the comprehensive income and expenditure statement for interest receivable are based on the carrying amount of the asset multiplied by the effective rate of interest for the instrument. For most of the financial assets held by the Council, this means that the amount presented in the balance sheet is the outstanding principal receivable (plus accrued interest) and interest credited to the comprehensive income and expenditure statement is the amount receivable for the year in the loan agreement.

The Council has the facility to make loans at less than market rates (soft loans). When soft loans are made, a loss is recorded in the comprehensive income and expenditure statement (debited to the appropriate service) for the present value of the interest that will be foregone over the life of the instrument, resulting in a lower amortised cost than the outstanding principal.

Interest is credited to the financing and investment income and expenditure line in the comprehensive income and expenditure statement at a marginally higher effective rate of interest than the rate receivable from the recipients of the loans, with the difference serving to increase the amortised cost of the loan in the balance sheet. Statutory provisions require that the impact of soft loans on the general fund balance is the interest receivable for the financial year - the reconciliation of amounts debited and credited to the comprehensive income and expenditure statement to the net gain required against the general fund balance is managed by a transfer to or from the financial instruments adjustment account in the movement in reserves statement.

Any gains or losses that arise on the derecognition of an asset are credited or debited to the financing and investment income and expenditure line of the comprehensive income and expenditure statement.

Expected credit loss model

The Council recognises expected credit losses on all of its financial assets held at amortised cost (or where relevant FVOCI), either on a 12-month or lifetime basis. The expected credit loss model also applies to lease receivables and contract assets. Only lifetime losses are recognised for trade receivables (debtors) held by the Council.

Impairment losses are calculated to reflect the expectation that the future cash flows might not take place because the borrower could default on their obligations. Credit risk plays a crucial part in assessing losses. Where risk has increased significantly since an instrument was initially recognised, losses are assessed on a lifetime basis. Where risk has not increased significantly or remains low, losses are assessed on the basis of 12-month expected losses.

The Council has a porfolio of a number of loans to local businesses. It does not have reasonable and supportable information that is available without undue cost or effort to support the measurement of lifetime losses on an individual instrument basis. It has therefore assessed losses for the portfolio on a collective basis.

Financial assets measured at fair value through other comprehensive income (FVOCI)

Financial assets that are measured at FVOCI are recognised on the balance sheet when the Council becomes a party to the contractual provisions of a financial instrument and are initially measured and carried at fair value. Fair value gains and losses are recognised as they arise in other comprehensive income.

Financial assets measured at fair value through profit and loss (FVPL)

Financial assets that are measured at FVPL are recognised on the Balance Sheet when the Council becomes a party to the contractual provisions of a financial instrument and are initially measured and carried at fair value. Fair Value gains and losses are recognised as they arise in the surplus or deficit on the provision of services.

Fair value measurements of financial assets

Fair value of an asset is the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date. The fair value measurements of the Council's financial assets are based on the following techniques:

- instruments with quoted market prices - the market price
- other instruments with fixed and determinable payments - discounted cash flow analysis.

The inputs to the measurement techniques are categorised in accordance with the following three levels:

- Level 1 inputs - quoted prices (unadjusted) in active markets for identical assets that the Council can access at the measurement date.
- Level 2 inputs - inputs other than quoted prices included within level 1 that are observable for the asset, either directly or indirectly.
- Level 3 inputs - unobservable inputs for the asset.

Any gains or losses that arise on the derecognition of the asset are credited or debited to the financing and investment income and expenditure line in the comprehensive income and expenditure statement.

An equity instrument can be elected into a FVOCI treatment rather than a FVPL treatment if it is not held for trading. The Council has reviewed its assets that would be measured at FVPL on the basis of the business model and has elected to classify instruments as either FVPL or FVOCI on an instrument by instrument basis based on the assessed benefit to the Council from the chosen classification.

As far as Durham Tees Valley Airport shares are concerned the Council has elected to treat them as an equity instrument which is not held for trading and therefore will be utilising the FVOCI treatment.

Instruments entered into before 1st April 2006

The Council has a financial guarantee that is not required to be accounted for as a financial instrument. This guarantee is reflected in the statement of accounts to the extent that it shown in contingent liabilities (note 27).

j) Government grants and contributions

Whether paid on account, by instalments or in arrears, government grants and third party contributions and donations are recognised as due to the Council when there is reasonable assurance that:

- the Council will comply with the conditions attached to the payments; and
- the grants or contributions will be received.

Amounts recognised as due to the Council are not credited to the comprehensive income and expenditure statement until conditions attached to the grant or contribution have been satisfied. Conditions are stipulations that specify that the future economic benefits or service potential embodied in the asset received in the form of the grant or contribution are required to be consumed by the recipient as specified, or future economic benefits or service potential must be returned to the transferor.

Monies advanced as grants and contributions for which conditions have not been satisfied are carried in the balance sheet as creditors. When conditions are satisfied, the grant or contribution is credited to the relevant service line (attributable revenue grants and contributions) or taxation and non-specific grant Income and expenditure (non-ringfenced revenue grants and all capital grants) in the comprehensive income and expenditure statement.

Where capital grants are credited to the comprehensive income and expenditure statement, they are reversed out of the general fund balance in the movement in reserves statement.

Where the grant has yet to be used to finance capital expenditure, it is posted to the Capital Grants Unapplied Reserve. Where it has been applied, it is posted to the capital adjustment account. Amounts in the capital grants unapplied reserve are transferred to the capital adjustment account once they have been applied to fund capital expenditure.

k) Heritage Assets

A heritage asset is defined as an asset with 'historical, artistic, scientific, technological, geophysical or environmental qualities that is held and maintained principally for its contribution to knowledge and culture'.

Heritage assets are accounted for in accordance with the Council's accounting policies on property, plant and equipment except 'where it is not practical to obtain a valuation at a cost which is commensurate with the benefits to users of the financial statements, heritage assets shall be measured at historic cost.' Valuations may also be made by any method that is appropriate and relevant.

The carrying amounts of heritage assets are reviewed where there is evidence of impairment for heritage assets e.g. where an item has suffered physical deterioration or breakage or where doubts arise as to its authenticity. Any impairment is recognised and measured in accordance with the Council's general policies on impairment. If any heritage assets are disposed of then the proceeds are accounted for in accordance with the Council's general provisions relating to the disposal of property, plant and equipment. Disposal proceeds are disclosed separately in the notes to the financial statements and are accounted for in accordance with statutory accounting requirements relating to capital expenditure and capital receipts.

l) Interests in companies and other entities

The Code of Practice on Local Authority Accounting 2019/20 requires local authorities to produce group accounts to reflect significant activities provided to council taxpayers by other organisations in which an authority has an interest. The Council has interests in companies and other entities that have the nature of subsidiaries, associates and joint ventures and require it to prepare group accounts. In the Council's own single-entity accounts, the interest in companies and other entities are recorded as financial assets at cost, less any provision for losses.

m) Inventories and long-term contracts

Inventories are included in the balance sheet at the lower of cost and net realisable value, with the exception of stores held at Allington Way Depot, which are valued at last price paid. This is a departure from the Code of Practice but the effect of the different treatment is not material. Work in progress is subject to an interim valuation at the year-end and recorded in the balance sheet at cost plus any profit reasonably attributable to the works.

Long-term contracts are accounted for on the basis of charging the surplus or deficit on the provision of services with the consideration allocated to the performance obligations satisfied based on the goods or services transferred to the service recipient during the financial year.

n) Investment properties

Investment properties are those that are used solely to earn rentals and/or for capital appreciation. The definition is not met if the property is used in any way to facilitate the delivery of services or production of goods or is held for sale.

Investment properties are measured initially at cost and subsequently at fair value, being the price that would be received to sell such an asset in an orderly transaction between market participants at the measurement date. As a non-financial asset, investment properties are measured at highest and best use. Properties are not depreciated but are revalued annually according to market conditions at year-end. Gains and losses on revaluation are posted to the financing and investment income and expenditure line in the comprehensive income and expenditure statement. The same treatment is applied to gains and losses on disposal.

Rentals received in relation to investment properties are credited to the financing and investment income line and result in a gain for the general fund balance. However, revaluation and disposal gains and losses are not permitted by statutory arrangements to have an impact on the general fund balance. The gains and losses are therefore reversed out of the general fund balance in the movement in reserves statement and posted to the capital adjustment account and (for any sale proceeds greater than £10,000) the capital receipts reserve.

o) Leases

Leases are classified as finance leases where the terms of the lease transfer substantially all the risks and rewards incidental to ownership of the property, plant or equipment from the lessor to the lessee. All other leases are classified as operating leases.

Where a lease covers both land and buildings, the land and buildings elements are considered separately for classification.

Arrangements that do not have the legal status of a lease but convey a right to use an asset in return for payment are accounted for under this policy where fulfilment of the arrangement is dependent upon the use of specific assets.

The Council as lessee

Finance leases

Property, plant and equipment held under finance leases is recognised on the balance sheet at the commencement of the lease at its fair value measured at the lease's inception (or the present value of the minimum lease payments, if lower). The asset recognised is matched by a liability for the obligation to pay the lessor. Initial direct costs of the Council are added to the carrying amount of the asset. Premiums paid on entry into a lease are applied to writing down the lease liability. Contingent rents are charged as expenses in the periods in which they are incurred.

Lease payments are apportioned between:

- a charge for the acquisition of the interest in the property, plant or equipment - applied to write down the lease liability; and

- a finance charge (debited to the financing and investment income and expenditure line in the comprehensive income and expenditure statement).

Property, plant and equipment recognised under finance leases is accounted for using the policies applied generally to such assets, subject to depreciation being charged over the lease term if this is shorter than the asset's estimated useful life (where ownership of the asset does not transfer to the Council at the end of the lease period).

The Council is not required to raise council tax to cover depreciation or revaluation and impairment losses arising on leased assets. Instead, a prudent annual contribution is made from revenue funds towards the deemed capital investment in accordance with statutory requirements. Depreciation and revaluation and impairment losses are therefore substituted by a revenue contribution in the general fund balance, by way of an adjusting transaction with the capital adjustment account in the movement in reserves statement for the difference between the two.

Operating Leases

Rentals paid under operating leases are charged to the comprehensive income and expenditure statement as an expense of the services benefitting from use of the leased property, plant or equipment. Charges are made on a straight-line basis over the life of the lease, even if this does not match the pattern of payments (e.g. there is a rent free period at the commencement of the lease).

The Council as lessor

Finance leases

Where the Council grants a finance lease over a property or an item of plant or equipment, the relevant asset is written out of the balance sheet as a disposal. At the commencement of the lease, the carrying amount of the asset in the balance sheet (whether property, plant and equipment or assets held for sale) is written off to the other operating expenditure line in the comprehensive income and expenditure statement as part of the gain or loss on disposal. A gain, representing the Council's net investment in the lease, is credited to the same line in the comprehensive income and expenditure statement also as part of the gain or loss on disposal (i.e. netted off against the carrying value of the asset at the time of disposal), matched by a lease (long term debtor) asset in the Balance Sheet.

Lease rentals receivable are apportioned between:

- a charge for the acquisition of the interest in the property - applied to write down the lease debtor (together with any premiums received); and

- finance income (credited to the financing and investment income and expenditure line in the comprehensive income and expenditure statement).

The gain credited to the comprehensive income and expenditure statement on disposal is not permitted by statute to increase the general fund balance and is required to be treated as a capital receipt. Where a premium has been received, this is posted out of the general fund balance to the capital receipts reserve in the movement in reserves statement. Where the amount due in relation to the lease asset is to be settled by the payment of rentals in future financial years, this is posted out of the general fund balance to the deferred capital receipts reserve in the movement in reserves statement. When the future rentals are received, the element for the capital receipt for the disposal of the asset is used to write down the lease debtor. At this point, the deferred capital receipts are transferred to the capital receipts reserve.

The written-off value of disposals is not a charge against council tax, as the cost of non-current assets is fully provided for under separate arrangements for capital financing. Amounts are therefore appropriated to the capital adjustment account from the general fund balance in the movement in reserves statement.

Operating Leases

Where the Council grants an operating lease over a property or an item of plant or equipment, the asset is retained in the balance sheet. Rental income is credited to the other operating expenditure line in the comprehensive income and expenditure statement. Credits are made on a straight-line basis over the life of the lease, even if this does not match the pattern of payments (e.g. there is a premium paid at the commencement of the lease). Initial direct costs incurred in negotiating and arranging the lease are added to the carrying amount of the relevant asset and charged as an expense over the lease term on the same basis as rental income.

p) Overheads and support services

The costs of overheads and support services are charged to service segments in accordance with the Council's arrangements for accountability and financial performance.

q) Property, plant and equipment

Assets that have physical substance and are held for use in the production or supply of goods or services, for rentals to others, or for administrative purposes and that are expected to be used during more than one financial year are classified as property, plant and equipment.

Capital expenditure under £5,000 is classified as de-minimis and is charged to the comprehensive income and expenditure statement. The de-minimis expenditure is financed using existing capital resources or by borrowing, this is posted out of the general fund balance to the capital adjustment account in the movement in reserves statement so there is no impact on the levels of council tax.

Recognition

Expenditure on the acquisition, creation or enhancement of property, plant and equipment is capitalised on an accruals basis, provided that it is probable that the future economic benefits or service potential associated with the item will flow to the Council and the cost of the item can be measured reliably. Expenditure that maintains but that does not add to an asset's potential to deliver future economic benefits or service potential (i.e. repairs and maintenance) is charged as an expense when it is incurred.

Measurement

Assets are initially measured at cost, comprising:

- the purchase price
- any costs attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management
- the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located.

The Council does not capitalise borrowing costs incurred whilst assets are under construction.

The cost of assets acquired other than by purchase is deemed to be its fair value, unless the acquisition does not have commercial substance (i.e. it will not lead to a variation in the cash flows of the Council). In the latter case, where an asset is acquired via an exchange, the cost of the acquisition is the carrying amount of the asset given up by the Council.

Donated assets are measured initially at fair value. The difference between fair value and any consideration paid is credited to the taxation and non-specific grant income line of the comprehensive income and expenditure statement, unless the donation has been made conditionally. Until conditions are satisfied, the gain is held in the donated assets account. Where gains are credited to the comprehensive income and expenditure statement, they are reversed out of the general fund balance to the capital adjustment account in the movement in reserves statement.

Assets are then carried in the Balance Sheet using the following measurement bases:

- infrastructure, community assets and assets under construction - depreciated historical cost;

- dwellings - current value, determined using the basis of existing use value for social housing (EUV - SH);

- school buildings - current value, but because of their specialised nature, are measured at depreciated replacement cost which is used as an estimate of current value;

- surplus assets - the current value measurement basis is fair value, estimated at highest and best use from a market participant's perspective;

- all other assets - current value, determined as the amount that would be paid for the asset in its existing use (existing use value - EUV).

Where there is no market-based evidence of current value because of the specialised nature of an asset, depreciated replacement cost (DRC) is used as an estimate of current value.

Where non-property assets have short useful lives or low values (or both), depreciated historical cost basis is used as a proxy for current value.

Assets included in the balance sheet at current value are revalued sufficiently regularly to ensure that their carrying amount is not materially different from their current value at the year-end, but as a minimum every five years. Increases in valuations are matched by credits to the revaluation reserve to recognise unrealised gains. Exceptionally, gains might be credited to the surplus or deficit on the provision of services in the comprehensive income and expenditure statement where they arise from the reversal of a loss previously charged to a service.

Where decreases in value are identified, they are accounted for by:

- where there is a balance of revaluation gains for the asset in the Revaluation Reserve, the carrying amount of the asset is written down against that balance (up to the amount of the accumulated gains);

- where there is no balance in the revaluation reserve or an insufficient balance, the carrying amount of the asset is written down against the relevant service line(s) in the comprehensive income and expenditure statement.

The revaluation reserve contains revaluation gains recognised since 1 April 2007 only, the date of its formal implementation. Gains arising before that date have been consolidated into the capital adjustment account.

Impairment

Assets are assessed at each year-end as to whether there is any indication that an asset may be impaired. Where indications exist and any possible differences are estimated to be material, the recoverable amount of the asset is estimated and, where this is less than the carrying amount of the asset, an impairment loss is recognised for the shortfall.

Where impairment losses are identified, they are accounted for by:

- where there is a balance of revaluation gains for the asset in the revaluation reserve, the carrying amount of the asset is written down against that balance (up to the amount of the accumulated gains);
- where there is no balance in the revaluation reserve or an insufficient balance, the carrying amount of the asset is written down against the relevant service line(s) in the comprehensive income and expenditure statement.

Where an impairment loss is reversed subsequently, the reversal is credited to the relevant service line(s) in the comprehensive income and expenditure statement, up to the amount of the original loss, adjusted for depreciation that would have been charged if the loss had not been recognised.

Depreciation

Depreciation is provided for on all property, plant and equipment assets by the systematic allocation of their depreciable amounts over their useful lives. An exception is made for assets without a determinable finite useful life (i.e. freehold land and certain Community Assets) and assets that are not yet available for use (i.e. assets under construction).

Depreciation is calculated on the following bases:

- dwellings and other buildings - straight-line allocation over the useful life of the property as estimated by the valuer;
- vehicles, plant, furniture and equipment - a percentage of the value of each class of assets in the balance sheet, as advised by a suitably qualified officer;
- infrastructure - straight-line allocation over 30 years.

Where an item of property, plant and equipment has major components whose cost is significant in relation to the total cost of the item, the components are depreciated separately. Assets valued higher than £1m that are made up from different components and whose cost is significant in relation to the total cost of the item are depreciated on a component by component basis. The components used are host (structure), externals, services and roof. Once separated, depreciation is charged across each components useful life as appropriate.

Revaluations gains are also depreciated, with an amount equal to the difference between current value depreciation charged on assets and the depreciation that would have been chargeable based on their historical cost being transferred each year from the revaluation reserve to the general fund.

Disposals and non-current assets held for sale

When it becomes probable that the carrying amount of an asset will be recovered principally through a sale transaction rather than through its continuing use, it is reclassified as an asset held for sale. The asset is revalued immediately before reclassification and then carried at the lower of this amount and fair value less costs to sell. Where there is a subsequent decrease to fair value less costs to sell, the loss is posted to the other operating expenditure line in the comprehensive income & expenditure statement. Gains in fair value are recognised only up to the amount of any previously recognised losses in the surplus or deficit on the provision of services. Depreciation is not charged on assets held for sale.

If assets no longer meet the criteria to be classified as assets held for sale, they are reclassified back to non-current assets and valued at the lower of their carrying amount before they were classified as held for sale; adjusted for depreciation, amortisation or revaluations that would have been recognised had they not been classified as held for sale, and their recoverable amount at the date of the decision not to sell.

Assets that are to be abandoned or scrapped are not reclassified as assets held for sale.

When an asset is disposed of or decommissioned, the carrying amount of the asset in the balance sheet (whether property, plant and equipment or assets held for sale) is written off to the other operating expenditure line in the comprehensive income and expenditure statement as part of the gain or loss on disposal. Receipts from disposals (if any) are credited to the same line in the comprehensive income and expenditure statement as part of the gain or loss on disposal (i.e. netted off against the carrying value of the asset at the time of disposal). Any revaluation gains accumulated for the asset in the revaluation reserve are transferred to the capital adjustment account.

Amounts received for a disposal in excess of £10,000 are categorised as capital receipts. A proportion of capital receipts relating to housing disposals is payable to the Government. The balance of receipts remains within the capital receipts reserve, and can then only be used for new capital investment or set aside to reduce the Council's underlying need to borrow (the capital financing requirement). Receipts are appropriated to the reserve from the general fund balance in the movement in reserves statement.

The written-off value of disposals is not a charge against council tax, as the cost of non-current assets is fully provided for under separate arrangements for capital financing. Amounts are appropriated to the capital adjustment account from the general fund balance in the movement in reserves statement.

r) Private finance initiative (PFI) and similar contracts

PFI and similar contracts are agreements to receive services, where the responsibility for making available the property, plant and equipment needed to provide the services passes to the PFI contractor. As the Council is deemed to control the services that are provided under its PFI schemes, and as ownership of the property, plant and equipment will pass to the Council at the end of the contract for no additional charge, the Council carries the assets used under the contract on its balance sheet as part of property, plant and equipment (unless the PFI scheme is a school that has subsequently transferred to Academy status and then it will be removed from the Council's balance sheet).

The original recognition of these assets at fair value (based on the cost to purchase the property, plant and equipment) was balanced by the recognition of a liability for amounts due to the scheme operator to pay for the capital investment.

Non-current assets recognised on the balance sheet are revalued and depreciated in the same way as property, plant and equipment owned by the Council.

The amounts payable to the PFI operators each year are analysed into three elements:

- fair value of the services received during the year - debited to the relevant service in the comprehensive income and expenditure statement,
- finance cost - an interest charge of 4.77% on the outstanding balance sheet liability, debited to the financing and investment income and expenditure line in the comprehensive income and expenditure statement,
- payment towards liability - applied to write down the balance sheet liability towards the PFI operator (the profile of write-downs is calculated using the same principles as for a finance lease).

s) Provisions, contingent liabilities and contingent assets

Provisions

Provisions are made where an event has taken place that gives the Council a legal or constructive obligation that probably requires settlement by a transfer of economic benefits or service potential, and a reliable estimate can be made of the amount of the obligation. For instance, the Council may be involved in a court case that could eventually result in the making of a settlement or the payment of compensation.

Provisions are charged as an expense to the appropriate service line in the comprehensive income and expenditure statement when the Council has an obligation, and are measured at the best estimate at the balance sheet date of the expenditure required to settle the obligation, taking into account relevant risks and uncertainties.

When payments are eventually made, they are charged to the provision carried in the balance sheet. Estimated settlements are reviewed at the end of each financial year - where it becomes less than probable that a transfer of economic benefits will now be required (or a lower settlement than anticipated is made), the provision is reversed and credited back to the relevant service.

Where some or all of the payment required to settle a provision is expected to be recovered from another party (e.g. from an insurance claim), this is only recognised as income for the relevant service if it is virtually certain that reimbursement will be received if the Council settles the obligation.

Contingent Liabilities

A contingent liability arises where an event has taken place that gives the Council a possible obligation whose existence will only be confirmed by the occurrence or otherwise of uncertain future events not wholly within the control of the Council. Contingent liabilities also arise in circumstances where a provision would otherwise be made but either it is not probable that an outflow of resources will be required or the amount of the obligation cannot be measured reliably.

Contingent liabilities are not recognised in the balance sheet but disclosed in note 27 to the accounts.

Contingent assets

A contingent asset arises where an event has taken place that gives the Council a possible asset whose existence will only be confirmed by the occurrence or otherwise of uncertain future events not wholly within the control of the Council.

Contingent assets are not recognised in the balance sheet but disclosed in a note to the accounts where it is probable that there will be an inflow of economic benefits or service potential although at present the Council doesn't have any contingent assets.

t) Reserves

The Council sets aside specific amounts as reserves for future policy purposes or to cover contingencies. Reserves are created by transferring amounts out of the general fund balance. When expenditure to be financed from a reserve is incurred, it is charged to the appropriate service in that year to score against the surplus or deficit on provision of services in the comprehensive income and expenditure statement. The reserve is then transferred back into the general fund balance so that there is no net charge against council tax for the expenditure.

Certain reserves are kept to manage the accounting processes for non-current assets, financial instruments, local taxation, retirement and employee benefits and do not represent usable resources for the Council - these reserves are explained in the relevant policies.

u) Revenue expenditure funded from capital under statute

Expenditure incurred during the year that may be capitalised under statutory provisions but that does not result in the creation of a non-current asset has been charged as expenditure to the relevant service in the comprehensive income and expenditure statement in the year. Where the Council has determined to meet the cost of this expenditure from existing capital resources or by borrowing, a transfer in the movement in reserves statement from the general fund balance to the capital adjustment account then reverses out the amounts charged so that there is no impact on the level of council tax.

v) Value Added Tax (VAT)

VAT payable is included as an expense only to the extent that it is not recoverable from Her Majesty's Revenue & Customs (HMRC). VAT receivable is excluded from income.

If the Council was unable to recover exempt input tax it would be included as an expense in the comprehensive income and expenditure statement.

w) Schools

The Code of Practice on Local Authority Accounting in the United Kingdom confirms that the balance of control for local authority maintained schools (i.e. those categories of school identified in the School Standards and Framework Act 1998, as amended) lies with the local authority.

The Code also stipulates that those schools' assets, liabilities, reserves and cash flows are recognised in the local authority financial statements. Therefore schools' transactions, cash flows and balances are recognised in each of the financial statements of the Council as if they were the transactions, cash flows and balances of the Council.

x) Fair Value Measurement

The Council measures some of its non-financial assets such as surplus assets and investment properties and some of its financial instruments such as equity shareholdings at fair value at each reporting date. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place either:

- in the principal market for the asset or liability, or
- in the absence of a principal market, in the most advantageous market for the asset or liability.

The Council measures the fair value of an asset or liability using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

When measuring the fair value of a non-financial asset, the Council takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in highest or best use.

The Council uses valuation techniques that are appropriate in the circumstances and for which sufficient data is available, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

Inputs to the valuation techniques in respect of assets and liabilities for which fair value is measured or disclosed in the Council's financial statements are categorised within the fair value hierarchy, as follows:

- Level 1 - quoted prices (unadjusted) in active markets for identical assets that the Council can access at the measurement date
- Level 2 - inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly
- Level 3 - unobservable inputs for the asset or liability.

y) Exceptional Items

When items of income and expense are material, their nature and amount is disclosed separately, either on the face of the comprehensive income and expenditure statement or in the notes to the financial statements, depending on how significant the items are to an understanding of the Council's financial performance.

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This document was classified as: OFFICIAL

AUDIT COMMITTEE
27 JANUARY 2021

FINAL ACCOUNTS TIMETABLE FOR THE YEAR ENDED 31 MARCH 2021

SUMMARY REPORT

Purpose of the Report

1. To provide Members with the Final Accounts Closedown Timetable for 2020/21. This timetable details the target dates for key actions in order to complete the Statement of Accounts (SoA) in line with statutory deadlines.

Summary

2. It is the responsibility of the Assistant Director Resources to sign and certify the unaudited SoA 2020/21 by no later than 31 May 2021 and it is also the responsibility of the Audit Committee to approve the audited set of accounts on or before 31 July 2021.

3. Due to a potential change in the regulations brought about by recommendations in the 'Redmond Review' (which is included on the Agenda) it is likely that the statutory deadlines will change to the 31 July 2021 for the unaudited SoA and 30 September 2021 for the full approval.

4. The final accounts timetable serves as a tool for monitoring progress against the target dates to ensure compliance with the statutory deadlines. The enclosed timetable will still aim to comply with the original date of 31 May for the unaudited SoA so that there is less disruption to the normal work schedule of the Council.

Recommendation

5. Members are asked to note the key dates in the Final Accounts Timetable for 2020/21 detailed in Appendix 1.

Reasons

6. The recommendations are supported to provide the Audit Committee with evidence to reflect on progress in delivery of the 2020/21 Statement of Accounts.

Paul Wildsmith
Managing Director

Background Papers

Code of Practice on Local Authority Accounting in the UK 2020/21

Peter Carrick: Extension 5401

S17 Crime and Disorder	There is no specific crime and disorder impact.
Health and Well Being	There is no specific heath and well being impact.
Carbon Impact	Some of the initiatives contained within ICT Strategy will help contribute towards the carbon reduction commitments.
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 the report comprising part of the Council's governance arrangements.
Efficiency	There is no specific efficiency impact.
Impact on Looked After Children and Care Leavers	The report does not impact upon Looked After Children or Care Leavers.

MAIN REPORT

7. The Accounts and Audit Regulations 2015 require that the responsible financial officer, by no later than the 31 May, signs and certifies that the SoA presents a true and fair view of the financial position of the Council for the year to 31 March previous, subject to the views of the External Auditor, Ernst & Young (EY).

8. The Regulations then require that on or before 31 July, approval needs to be given to the SoA by resolution of a committee, which for Darlington is the Audit Committee. This approval will take into account the views of the External Auditor.

9. Due to the recommendations of the Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting which the MHCLG is minded to agree with, the deadline for approval is likely to change to 30 September although no legislation has been yet enacted.

10. The Final Accounts timetable **(Appendix 1)** is a tool for the effective management and monitoring of the process of closing the Council's accounts.

11. The timetable is compiled annually by Finance with input from services to ensure that deadlines are achievable and will lead to completion of a SoA for signing by the Section 151 Officer (the responsible financial officer) by the statutory deadline. New and amended processes are considered for the impact on the achievement of dates, as well as reference to the previous year's problems and meeting of deadlines.

12. The enclosed timetable will enable Finance to produce an unaudited SoA by the 31 May 2021, which will be ahead of the potential revised statutory dates but will then not distract from the other 'business as usual' such as reviewing the Medium Term Financial Plan.

13. The Finance Manager closely monitors the achievement of the dates in the timetable throughout the final accounts period, following up delays and missed deadlines. This helps to ensure that the overall timetable will be achieved and to identify improvements that can be made to the process.

Appendix 1

2020/2021 Accounts - General Closure Timetable

Date for Completion		Item
March		
	31	On-line goods receipting of orders relating to 2020/2021 to be completed (including order authorisation).
	31	End of facility for on-line processing of purchase invoices in Business World On! relating to 2020/2021 to be posted to period 12 of that year.
	31	Capital Charges to revenue accounts
April		
	6	All interface files posted to Council's General Ledger
	6	Petty cash and stock valuation certificates, certified by authorised signatories, sent to Financial Services.
	6	Details of purchase invoices and sundry debtor accounts relating to 2020/2021 not paid by 31/03/2021 to be given to Departmental Finance Teams for provision in 2020/2021 accounts (invoice values above £500 only).
	9	Bank reconciliation to be completed
	16	Work in progress, Retentions & Income in Advance from Building Services included in accounts for both trading and client accounts. Expenditure provisions and provision for future losses for Trading Accounts in Place based Services.
	16	All expenditure and income relating to 2020/2021 identified and included in accounts to enable progress of next stages of process.
	16	Control accounts balanced and all holding accounts cleared.
	16	Internal recharges completed including inter-departmental recharges.
	16	Intra-departmental apportionments and reallocations completed
	26	Comparison of out-turn income and expenditure with approved budgets - including analysis of significant variances and any resulting corrective action including coding corrections.
	26	Departmental Financing of capital expenditure.
	30	**Accounts Closed**
May		
	4	Commence process of consolidation of individual cost-centre and subjective level accounts into statutory format for Statement of Accounts (SoA).
	31	Produce signed unaudited Statement of Accounts.
Sept	30	Audit Committee Meeting – approval of Statement of Accounts
	30	Publication of audited Statement of Accounts

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AUDIT COMMITTEE
27 JANUARY 2021

INDEPENDENT REVIEW INTO THE OVERSIGHT OF LOCAL AUDIT AND THE TRANSPARENCY OF LOCAL AUTHORITY FINANCIAL REPORTING

Responsible Cabinet Member –
Councillor Charles Johnson, Resources Portfolio

Responsible Director –
Paul Wildsmith, Managing Director

SUMMARY REPORT

Purpose of the Report

1. To update Members on the outcome of the Independent Review into the Oversight of Local audit and the Transparency of Local Authority Financial Reporting.

Summary

2. In June 2019, the Secretary of State for the Ministry of Housing, Communities and Local Government (MHCLG) asked Sir Tony Redmond to conduct a review of the arrangements in place to support the transparency and quality of local authority financial reporting and external audit including those introduced by the Local Audit and Accountability Act 2014.

3. This report summarises the findings and recommendations of the review and the subsequent Government response.

Recommendation

4. It is recommended that members note the contents of the report.

Reasons

5. To inform Members of the potential changes to the regulations.

Paul Wildsmith
Managing Director

Background Papers:
Independent Review into the Oversight of Local audit and the Transparency of Local Authority Financial Reporting.
MHCLG response

Peter Carrick: Extension 5401

S17 Crime and Disorder	This report has no implications for crime and disorder
Health and Wellbeing	No direct impacts
Carbon Impact and Climate Change	No direct Impacts
Diversity	No direct impacts
Wards Affected	No direct impacts
Groups Affected	No direct impacts
Budget and Policy Framework	This decision does not represent a change to the budget and policy framework.
Key Decision	This is not an executive decision
Urgent Decision	This is not an executive decision
One Darlington: Perfectly Placed	The proposals in the report support delivery of the Community Strategy through appropriate and effective deployment of the Council's resources.
Efficiency	There is no specific efficiency impact.
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

Terms of Reference for the Review

6. In June 2019, The Secretary of State for the Ministry of Housing, Communities and Local Government (MHCLG) invited Sir Tony Redmond to conduct a Review of the arrangements in place to support the transparency and quality of local authority financial reporting and external audit including those introduced by the Local Audit and Accountability Act 2014 (the Act.

Review Objectives

7. The Review was to examine the existing purpose, scope and quality of statutory audits of local authorities in England and the supporting regulatory framework in order to determine:

    (a) Whether the audit and related regulatory framework for local authorities in England is operating in line with the policy intent set out in the Act and the related impact assessment,

    (b) Whether the reforms have improved the effectiveness of the control and governance framework along with the transparency of financial information presented by councils;

    (c) Whether the current statutory framework for local authority financial reporting supports the transparent disclosure of financial performance and enables users of the accounts to hold local authorities to account; and

(d) To make recommendations on how far the process, products and framework may need to improve and evolve to meet the needs of local residents and local taxpayers, and the wider public interest

Scope of the Review

8. The review's scope was taken to include the objectives and context included in the terms of reference.

9. In practice, this meant that the review was likely to focus on the following questions:

   (a) Have the financial savings from local audit reforms been realised?
   (b) Is there a more accessible audit market and has there been an increase in audit providers?
   (c) Have audit standards been maintained or improved, and not been compromised?
   (d) Is there an 'expectation gap' in what external audit provides? What is the nature of the gap and how can it be filled?
   (e) Are auditors properly responding to questions or objections by local taxpayers?
   (f) Are auditors using their reporting powers in an appropriate way?
   (g) Are audit recommendations effective in helping local authorities to improve their financial management?
   (h) Are councils responding to auditor recommendations in an appropriate manner?
   (i) Whether local authority accounts report financial performance including use of resources against budget in a manner that is transparent and comprehensible to council tax payers and the general public?
   (j) Does the financial information provided in local authority accounts facilitate scrutiny by local taxpayers and by the local press?

Results of the Review

10. The Review examined the effectiveness of local audit and its ability to demonstrate accountability for audit performance to the public. It also considered whether the current means of reporting the Council's annual accounts enabled the public to understand the financial information and receive the appropriate assurance that the finances of the authority are sound.

11. There are 23 recommendations coming from the report and the full review and recommendations are shown in **Appendix 1,** with the MHCLG response to these in **Appendix 2.**

12. MHCLG have already agreed to some of the recommendations and they are considering the rest and will make a full response by Spring 2021.

13. Although all of the recommendations in the report are important the ones most pertinent to this Committee are reviewed below:

   (a) **Recommendation No.4** - The governance arrangements within local authorities be reviewed by local councils with the purpose of:
      (i) an annual report being submitted to Full Council by the external auditor;
      (ii) consideration being given to the appointment of at least one independent member, suitably qualified, to the Audit Committee; and

(iii) formalising the facility for the CEO, Monitoring Officer and Chief Financial Officer (CFO) to meet with the Key Audit Partner at least annually.

(b) **Recommendation No.6 -** The current fee structure for local audit be revised to ensure that adequate resources are deployed to meet the full extent of local audit requirements.

(c) **Recommendation No. 9 -** External Audit recognises that Internal Audit work can be a key support in appropriate circumstances where consistent with the Code of Audit Practice

(d) **Recommendation No.10 -** The deadline for publishing audited local authority accounts be revisited with a view to extending it to 30 September from 31 July each year.

(e) **Recommendation No. 19 -** A standardised statement of service information and costs be prepared by each authority and be compared with the budget agreed to support the council tax/precept/levy and presented alongside the statutory accounts.

(f) **Recommendation No.20 -** The standardised statement should be subject to external audit.

(g) **Recommendation No.22 -** CIPFA/LASAAC be required to review the statutory accounts, in the light of the new requirement to prepare the standardised statement, to determine whether there is scope to simplify the presentation of local authority accounts by removing disclosures that may no longer be considered to be necessary.

14. With respect to Recommendation No.4, The MHCLG have agreed to work with the Local Government Association (LGA), National Audit Office (NAO) and the Chartered Institute of Public Finance and Accountancy (CIPFA) to deliver the recommendation. It is not yet known in what format the annual report to Full Council will take as the external auditor already submits the Annual Audit Letter via Audit Committee to Cabinet but Members will be briefed as soon as the report is formalised.

15. Members will need to be updated as to how the recommendation of the appointment of a suitably qualified independent member affects this Committee and be involved in the process as soon as possible. As far as formalising the facility for the Managing Director, Chief Finance Officer and Monitoring Office to meet with the Audit Partner is concerned, this is already happening to a certain extent as the Managing Director and Chief Financial Officer already meet with the external auditor on a quarterly basis.

16. Recommendation No.6 requests that the current fee structure is revised as it has acknowledged that external audit is underfunded which will mean increased fees for Local Government, although MHCLG have made a commitment in the December 20 Settlement to put an additional £15m into the system. At present the Council doesn't know what its allocation from this money will be but Members will be updated as and when the information is available.

17. Recommendation No. 9 is welcomed as this Committee receives regular updates on Internal Audit work and recognises the benefit it could add to the process and MHCLG have agreed to work with the NAO and CIPFA to deliver this recommendation.

18. Recommendation No. 10 is important as it is extending the deadline for the approval of the Statement of Accounts from 31 July to 30 September each year (initially for 2 years and then to be reviewed by MHCLG) which will mean that the Audit Committee dates will need to be reviewed accordingly and to cause as least disruption as possible it is recommended that the October meeting is rescheduled to end of September to enable the approval of the Statement of Accounts by the statutory deadline. In practice this won't have much effect on the Final Accounts timetable as the Council now has procedures in place to ensure that the accounts are closed and finalised by the end of May and it is proposed to adhere to this timescale to ensure that there is no knock-on effect on other Council processes, although this is reliant on External Audit being able to complete the audit in the timeframe.

19. With Recommendations No.19 & No.20, no further information is known as MHCLG have agreed that CIPFA will develop a product that will need to go alongside the Statement of Accounts and be audited by external audit and will therefore have to be approved by this Committee and Members will be updated on progress as soon as possible.

20. Recommendation No.22 is about reviewing the statutory Accounts with a view to removing any disclosure notes that don't add any value to the understanding of the accounts and MHCLG have agreed that CIPFA can deliver this and is to be welcomed to cut down on unnecessary notes.

Conclusion

21. The Review has highlighted a potential weakness in the way in which audit outcomes are considered and presented to both the local authority and the public. In addition, the Review also states that transparency and accountability of audit reports, from a public perspective is lacking and there is considerable scope for the Key Audit Partner to present a report on the principal issues arising from the audit to Full Council at least annually.

Outcome of Consultation

22. No formal consultation has been undertaken regarding this report

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Independent Review into the Oversight of Local Audit and the Transparency of Local Authority Financial Reporting

Sir Tony Redmond
September 2020

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September 2020

The Rt Hon Robert Jenrick MP

Secretary of State for Housing, Communities and Local Government
Ministry of Housing, Communities & Local Government
2 Marsham Street
London, SW1P 4DF

Dear Secretary of State,

In June 2019, I was asked to undertake an independent review of the effectiveness of local audit and the transparency of local authority financial reporting. I am grateful for the opportunity given to me by ministers to conduct this Review. Whilst conducting the Review my guiding principles have been accountability and transparency. How are local authorities accountable to service users and taxpayers and how are auditors accountable for the quality of their work; and how easy is it for those same individuals to understand how their local authority has performed and what assurance they can take from external audit work.

This report sets out my conclusions. It makes detailed proposals for a new organisation with the clarity of mission and purpose to act as the system leader for the local audit framework; and for a standardised statement of service information and costs, compared to the annual budget, that is aimed at taxpayers and service users.

As I conducted my work, it became clear that the local audit market is very fragile. The current fee structure does not enable auditors to fulfil the role in an entirely satisfactory way. With 40% of audits failing to meet the required deadline for report in 2018/19, this signals a serious weakness in the ability of auditors to comply with their contractual obligations. In addition, the ambition of attracting new audit firms to the local authority market has not been realised. Without prompt action to implement my recommendations, there is a significant risk that the firms currently holding local audit contracts will withdraw from the market.

It will be possible to achieve part, but only part, of what needs to be done without legislation. However, it is important to emphasise that to fully achieve the vision set out in the Review, primary legislation will be essential. Only this can give the new organisation the tools it needs to do its job and to rebuild the sustainability of the local audit market.

I should like to thank:

- First, all those stakeholders who have engaged with the Review and responded to the Review’s Call for Views;
- Second, the excellent team which has supported the Review’s work: Ollie Hulme, Joe Pilgrim, Beth Addison and Gareth Caller; and
- Third, all the members of the Review’s advisory group: Lynn Pamment, Maggie McGhee, Professor Laurence Ferry, Catherine Frances, Vicky Rock, Richard Hornby and Mark Holmes. This formidable group provided much wise guidance and counsel, as well as lively challenge and debate, for which I am hugely grateful.

Responsibility for the Review’s conclusions and recommendations, is however, mine and mine alone.

Sir Tony Redmond

Sir Tony Redmond

Contents

Executive Summary

- This Review has examined the effectiveness of local audit and its ability to demonstrate accountability for audit performance to the public. It has also considered whether the current means of reporting the Authority's annual accounts enables the public to understand this financial information and receive the appropriate assurance that the finances of the authority are sound. It is important to note that this Review encompasses not only principal local authorities but also PCCs, Fire and Rescue Authorities, Parish Councils and Meetings and Drainage Boards.

- The Review has received 156 responses to the Calls for Views and carried out more than 100 interviews. Serious concerns have been expressed regarding the state of the local audit market and the ultimate effectiveness of the work undertaken by audit firms. This is not to say that the audits are carried out unprofessionally but there remains a question of whether such audit reports deliver full assurance on the financial sustainability and value for money of every authority subject to audit. A particular feature of the evidence submitted relates to concern about the balance of price and quality in the structure of audit contracts.

- A regular occurrence in the responses to the calls for views suggests that the current fee structure does not enable auditors to fulfil the role in an entirely satisfactory way. To address this concern an increase in fees must be a consideration. With 40% of audits failing to meet the required deadline for report in 2018/19, this signals a serious weakness in the ability of auditors to comply with their contractual obligations. The current deadline should be reviewed. A revised date of 30 September gathered considerable support amongst respondents who expressed concern about this current problem. This only in part addresses the quality problem. The underlying feature of the existing framework is the absence of a body to coordinate all stages of the audit process. Although there is some scope to effect alterations to the individual roles, appropriately fulfilled with the existing framework, this would not achieve the overriding objective of providing a coherent local audit function which offers assurance to stakeholders and the public in terms of performance and accountability of the local authority and the auditor.

- Consequently, a key recommendation is to create a new regulatory body responsible for procurement, contract management, regulation, and oversight of local audit. It is recognised that the new body will liaise with the Financial Reporting Council (FRC) with regard to its role in setting auditing standards. The engagement of audit firms to perform the local audit role would be accompanied by a new price/quality regime to ensure that audits were performed by auditors who possessed the skills, expertise and experience necessary to fulfil the audit of local authorities. These auditors would be held accountable for performance by the new regulator, underpinned by the updated code of local audit practice. A further recommendation is to formalise the engagement between local audit and Inspectorates to share findings which might have relevance to the bodies concerned.

- The Regulator would be supported by a Liaison Committee comprising key stakeholders and chaired by the Ministry of Housing, Communities and Local Government (MHCLG). The new regulatory body would be small and focused and would not represent a body which has the same or similar features as the Audit Commission.

- The report recognises that local audit is subject to less critical findings in respect of audit procurement and quality relating to smaller authorities. However, the recommendations include a review by Smaller Authorities' Audit Appointments (SAAA) of current arrangements relating to the proportionality of small authority audits together with the process for managing vexatious complaints where issues have been raised by those bodies which have experienced such challenges.

- Governance in respect of the consideration and management of audit reports by authorities has also been examined in considerable detail. Based on evidence presented, there is merit in authorities examining the composition of Audit Committees in order to ensure that the required knowledge and expertise are always present when considering reports, together with the requirement that at least an annual audit report to be submitted to Full Council. This demonstrates transparency and accountability from a public perspective which is currently lacking in many authorities.

- The issue of transparency is of equal relevance to the current presentation and publication of the annual accounts. Given that the feedback from practitioners and other key stakeholders revealed that current statutory accounts prepared by local authorities are considered to be impenetrable to the public, it is recommended that a simplified statement of service information and costs is prepared by each local authority in such a way as to enable comparison with the annual budget and council tax set for the year. This would enable Council taxpayers and service users to judge the performance of the local authority for each year of account. The new statement would be prepared in addition to the statutory accounts, which could be simplified. All means of communicating such information should be explored to achieve access to all communities.

- The outcome of this Review is designed to deliver a new framework for effective local audit and an annual financial statement which enables all stakeholders to hold local authorities to account for their performance together with a robust and effective audit reporting regime.

- Aside from the additional costs arising from a fee increase, the resource implications of the new regulatory body would amount to approximately £5m per annum after taking into account the amount related to staff subject to transfer under the TUPE arrangements.

- Implementation of recommendations contained in this Review would, in part, require regulatory or legislative change but it is important to note that many of the issues identified in this report require urgent attention, given the current concerns about local audit demonstrated in this Review.

Recommendations

The recommendations of this Review are as follows:

External Audit Regulation

1. A new body, the Office of Local Audit and Regulation (OLAR), be created to manage, oversee and regulate local audit with the following key responsibilities:
   - procurement of local audit contracts;
   - producing annual reports summarising the state of local audit;
   - management of local audit contracts;
   - monitoring and review of local audit performance;
   - determining the code of local audit practice; and
   - regulating the local audit sector.

2. The current roles and responsibilities relating to local audit discharged by the:
   - Public Sector Audit Appointments (PSAA);
   - Institute of Chartered Accountants in England and Wales (ICAEW);
   - FRC/ARGA; and
   - The Comptroller and Auditor General (C&AG)

   to be transferred to the OLAR.

3. A Liaison Committee be established comprising key stakeholders and chaired by MHCLG, to receive reports from the new regulator on the development of local audit.

4. The governance arrangements within local authorities be reviewed by local councils with the purpose of:
   - an annual report being submitted to Full Council by the external auditor;
   - consideration being given to the appointment of at least one independent member, suitably qualified, to the Audit Committee; and
   - formalising the facility for the CEO, Monitoring Officer and Chief Financial Officer (CFO) to meet with the Key Audit Partner at least annually.

5. All auditors engaged in local audit be provided with the requisite skills and training to audit a local authority irrespective of seniority.

6. The current fee structure for local audit be revised to ensure that adequate resources are deployed to meet the full extent of local audit requirements.

7. That quality be consistent with the highest standards of audit within the revised fee structure. In cases where there are serious or persistent breaches of expected quality standards, OLAR has the scope to apply proportionate sanctions.

8. Statute be revised so that audit firms with the requisite capacity, skills and experience are not excluded from bidding for local audit work.

9. External Audit recognises that Internal Audit work can be a key support in appropriate circumstances where consistent with the Code of Audit Practice.

10. The deadline for publishing audited local authority accounts be revisited with a view to extending it to 30 September from 31 July each year.

11. The revised deadline for publication of audited local authority accounts be considered in consultation with NHSI(E) and DHSC, given that audit firms use the same auditors on both Local Government and Health final accounts work.

12. The external auditor be required to present an Annual Audit Report to the first Full Council meeting after 30 September each year, irrespective of whether the accounts have been certified; OLAR to decide the framework for this report.

13. The changes implemented in the 2020 Audit Code of Practice are endorsed; OLAR to undertake a post implementation review to assess whether these changes have led to more effective external audit consideration of financial resilience and value for money matters.

Smaller Authorities Audit Regulation

14. SAAA considers whether the current level of external audit work commissioned for Parish Councils, Parish Meetings and Internal Drainage Boards (IDBs) and Other Smaller Authorities is proportionate to the nature and size of such organisations.

15. SAAA and OLAR examine the current arrangements for increasing audit activities and fees if a body's turnover exceeds £6.5m.

16. SAAA reviews the current arrangements, with auditors, for managing the resource implications for persistent and vexatious complaints against Parish Councils.

Financial Resilience of local authorities

17. MHCLG reviews its current framework for seeking assurance that financial sustainability in each local authority in England is maintained.

18. Key concerns relating to service and financial viability be shared between Local Auditors and Inspectorates including Ofsted, Care Quality Commission and HMICFRS prior to completion of the external auditor's Annual Report.

Transparency of Financial Reporting

19. A standardised statement of service information and costs be prepared by each authority and be compared with the budget agreed to support the council tax/precept/levy and presented alongside the statutory accounts.

20. The standardised statement should be subject to external audit.

21. The optimum means of communicating such information to council taxpayers/service users be considered by each local authority to ensure access for all sections of the communities.

22. CIPFA/LASAAC be required to review the statutory accounts, in the light of the new requirement to prepare the standardised statement, to determine whether there is scope

to simplify the presentation of local authority accounts by removing disclosures that may no longer be considered to be necessary.

23. JPAG be required to review the Annual Governance and Accountability Return (AGAR) prepared by smaller authorities to see if it can be made more transparent to readers. In doing so the following principles should be considered:
    - Whether "Section 2 – the Accounting Statements" should be moved to the first page of the AGAR so that it is more prominent to readers;
    - Whether budgetary information along with the variance between outturn and budget should be included in the Accounting Statements; and
    - Whether the explanation of variances provided by the authority to the auditor should be disclosed in the AGAR as part of the Accounting Statements.

1. Introduction

1.1 The Local Audit and Accountability Act 2014 (the 2014 Act) introduced a new Audit regime for local government to replace the previous arrangements, under which the Audit Commission performed that role. This Review examines the effectiveness of local audit as now practised.

1.2 The purpose of the Review is to test not only the impact of external audit activity in local government but also to look, critically, at how this helps to demonstrate public accountability, particularly to service users and council taxpayers. In a similar context the brief of the Review extends to the issues of transparency in financial reporting of local authorities, with attention being directed towards whether the annual accounts and associated published financial information can be readily understood by the public.

1.3 The framework for local audit encompasses procurement, contract management and delivery, the code of audit practice and regulation and accountability for performance. All of these aspects of local audit have been examined in depth. Whilst the focus of this Review is on local audit and public accountability there are a number of related factors which have contributed to the shape and nature of the findings. Such matters include: the breadth and complexity of International Financial Reporting Standards (IFRS); the role of the sponsoring department (MHCLG); and the current state of the local audit market. Local authorities include Councils, Police and Crime Commissioners (PCCs), Fire and Rescue Authorities (FRAs), and National Parks Authorities. NHS bodies are not local authorities and are outside the scope of this Review.

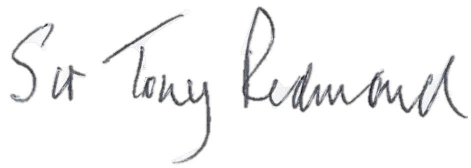
1.4 It is also important to emphasise that the Review includes the functions of Police and Fire Services as well as Parish Councils and Drainage Boards and due regard has been paid to the specific requirements of these bodies, as appropriate.

1.5 Substantial evidence has been collated from the 'Call for Views' and individual stakeholder meetings and this has formed the basis of the Report's findings. The co-operation received from all interested parties including local government practitioners, audit firms, professional accounting bodies, academia and the media and the general public has been much appreciated. All parties who have participated in the Review share a desire to ensure local audit is effective and that public accountability is seen to be achieved. The approach to the Review has sought to harness those valuable contributions.

1.6 Attention has been paid to the findings of the Brydon and Kingman Reviews as well as the study carried out by the Competition and Markets Authority (CMA). Each of these reviews offers an insight into the principles and practices of auditors in the corporate sector, which have relevance to the public sector, including local government.

1.7 While testing the quality of outcomes has been a key feature of this approach, attention has been directed towards the governance arrangements in the way in which audit reports are managed and reported. The focus here has been on the level of public awareness of audit findings. Current practices relating to the annual publication of financial information have also been reviewed with an emphasis on the transparency, access and intelligibility of such reports.

1.8 In examining options for change to the current local audit arrangements, account has also been taken of the potential resource implications of any new initiative or development contained in the recommendations.



Sir Tony Redmond

2. The direction and regulation of local audit

2.1 Introduction

2.1.1 The direction and regulation of local audit must be structured as to enable public accountability to be served. Each stage of the local audit process must adhere to this and remain consistent throughout. Ultimately, the direction and regulation of audit must be coherent, consistent in quality monitoring and fulfil the public accountability principle. The test, therefore, is whether the current arrangements deliver that, or can be altered to achieve that, or whether a new structure for the local audit regulatory framework needs to be put in place.

2.1.2 Public Interest Reports may be seen as relating to the local community's serious concern, but these are rarely used. In any event, council taxpayers are entitled to know the outcome of the annual statutory audit whether it be positive or negative.

2.2 Overview of the Regulatory Framework

2.2.1 The 2014 Act split the responsibilities formerly carried out by the Audit Commission between a range of bodies. **Figure 2.1** summarises the entities that have a significant role or influence on the accounting, audit and governance framework within which local authorities operate.

2.2.2 Currently there are six different entities with a statutory role in overseeing and/or regulating elements of the local authority accounting and audit framework. This framework is further complicated by the fact that different elements apply to different sectors. The elements of the audit framework undertaken by the C&AG, FRC and the ICAEW apply jointly to the local authorities and NHS bodies in England. However, whereas PSAA is the appointing body for 98% of local authority audits, NHS bodies do not have an appointing body and as such appoint their own auditors. By comparison the accounting framework applies to local authorities in England, Scotland, Wales and Northern Ireland, but not to the NHS.

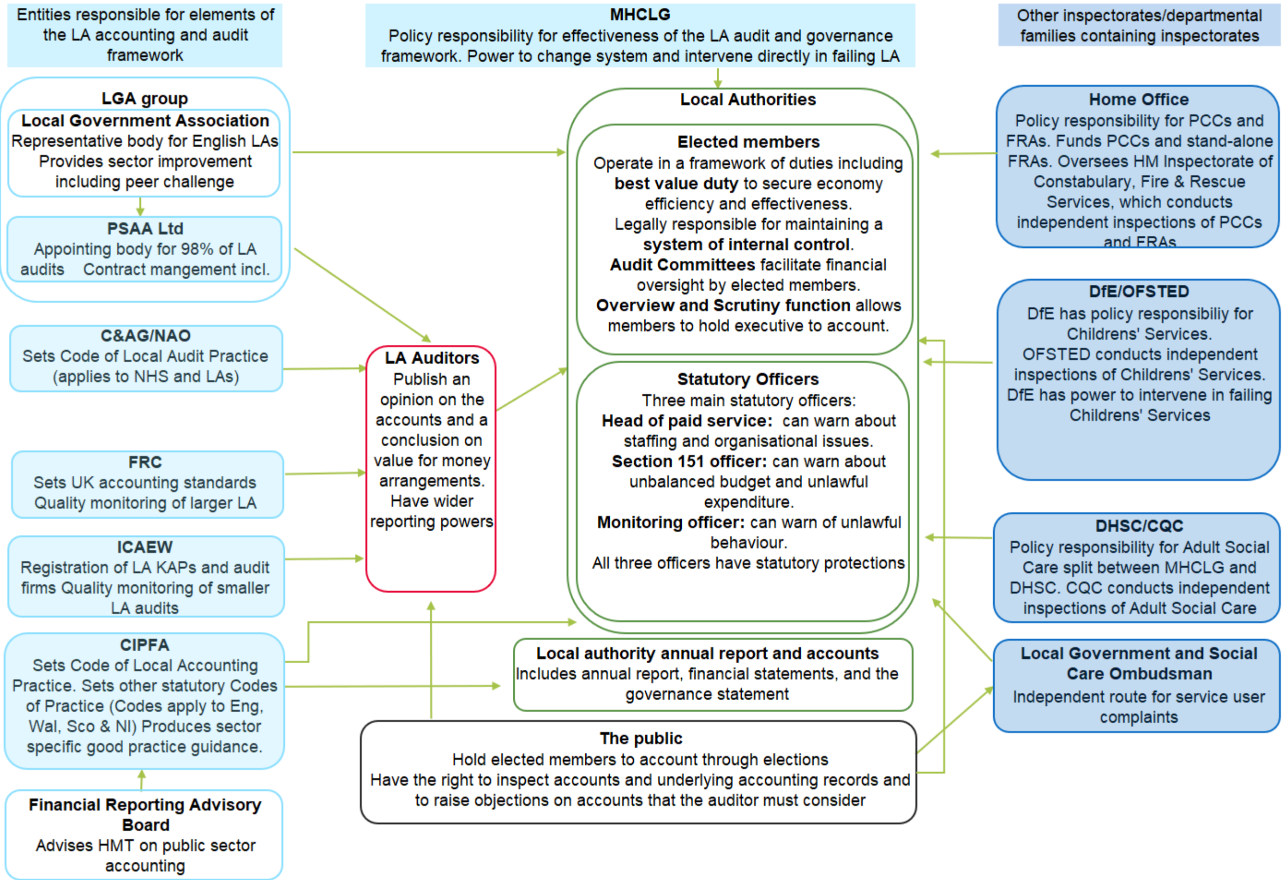
2.2.3 Another challenge is that the local authority sector is not the main focus for some of the regulatory bodies; specifically:

- The C&AG and National Audit Office's (NAO's) responsibilities relate mainly to holding central government departments to account on behalf of Parliament.
- The vast majority of the FRC's and the ICAEW's work relates to the private sector, and in the FRC's case, to regulating the audit and corporate governance arrangements within listed companies known as Public Interest Entities ("PIEs").

2.2.4 Finally, none of the six entities with responsibility for the different elements of the framework has a statutory responsibility, either to act as a system leader or to make sure that the framework operates in a joined-up and coherent manner. Although various ad hoc forums have been set up to share information, it is not clear how the membership and remit of these has been agreed. As a result, the lack of co-ordination and the lack of a system leader is widely recognised as a weakness in the framework by most of the stakeholder groups.

Figure 2.1

The Local Authority Governance, Audit and Accounting Framework 2018-19



Notes

1. Adapted from Figure 1 in NAO report *Local Authority Governance* (Jan 2019)
2. There are other statutory officers in local authorities, but between them, the three listed have overall responsibility for effective goverance
3. Arrows show the influences on local authority governance arrangements
4. In a Police and Crime Commissioner or Fire and Rescue Authority, the Commissioner is the sole elected member; in a Mayoral Combined Authority, the mayor is the sole
5. Audit Committees are mandatory in PCCs, stand-alone FRAs and mayoral combined authorities. They are not mandatory for other LAs.
6. ICAS also has the power to act as a registering body for KAPs and audit firms. However, following mergers, no firms active in England are currently registered with ICAS.
7. MHCLG part funds the LGA's sector improvement work

2.3 Functions of the bodies responsible for the framework

PSAA Ltd

2.3.1 One of the original objectives behind the 2014 Act was to widen participation in the local audit market by allowing local authorities to appoint their own auditors. Once the Act had passed, it became clear that the auditor appointment provisions in the 2014 Act were onerous and there was little appetite amongst local authorities to appoint their own auditors. As a result, MHCLG ran a tender exercise to identify an entity which would act as an appointing person for local authority audits.

2.3.2 PSAA, a new company set up by the Local Government Association (LGA), was the only bidder and accordingly was designated as an appointing person under legislation. Under the transitional arrangements, PSAA was given the responsibility of managing the framework contracts let by the Audit Commission in 2012 and 2014, and during the period to 2017-18 producing a report summarising the results of local authority and NHS audits.

2.3.3 Category 1 Authorities[1] were given the choice of opting in or out of the PSAA arrangements. Most (currently 98%) chose to opt in.

2.3.4 In 2017 PSAA let the new local audit framework contracts, active from the 2018-19 financial year. PSAA's current responsibilities[2] are:

- To perform the functions of an appointing person for local authority audits;
- To take steps to ensure that public money is properly accounted for and protected;
- To oversee the delivery of consistent high quality and effective audit services; and
- To ensure effective management of audit contracts.

More detail on the contracting process and on audit quality is contained in **Chapters 3 and 4** respectively.

The C&AG and the NAO

2.3.5 The C&AG is responsible for laying the Code of Local Audit Practice in Parliament. The C&AG is supported in this work by a small Local Audit Code and Guidance (LACG) team, which is part of the NAO. The LACG team is responsible for the preparation, maintenance and publication of the C&AG's Code of Audit Practice and supporting guidance to auditors. LACG undertakes the full range of activities associated with these responsibilities including:

- providing a point of contact to address significant issues raised by auditors and other stakeholders that may require the update of the Code of Audit Practice or issuing guidance to auditors; and
- facilitating timely engagement with, and advice to, auditors and other stakeholders to facilitate consistency of approach on significant issues – for example, through convening and providing secretariat support to a Local Auditors Advisory Group.

2.3.6 The 2014 Act provides the C&AG with the power to issue guidance to auditors which may explain or supplement the provisions of the Code of Audit Practice. The Act requires auditors to have regard to such guidance. The NAO maintains a series of Auditor Guidance Notes (AGNs) to support auditors in their work and facilitate consistency of approach between auditors of the same types of entity. The 2015 Code is supplemented by seven AGNs. These apply equally across local government and the NHS. The AGN on value for money arrangements is supplemented by sector specific supporting information.

2.3.7 The 2014 Act gives the C&AG the responsibility for undertaking value for money investigations on local government. However, the C&AG does not have the power to make recommendations directly to local authorities. This means that when a value for money study finds that one or more local authorities have breached either the letter or the spirit of the statutory framework, the accompanying recommendations must be addressed to MHCLG or Treasury, if they relate to the Public Works Loan Board, as the responsible central government departments.

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[1] "Category 1 authority" means a relevant authority that either— (a) is not a smaller authority; or (b) is a smaller authority that has chosen to prepare its accounts for the purpose of a full audit in accordance with regulation 8 of the Smaller Authorities Regulations
https://www.legislation.gov.uk/uksi/2015/234/pdfs/uksi_20150234_en.pdf

2.3.8 The main roles of the C&AG and the NAO are to support Parliament in holding government to account, through auditing the accounts of government departments and arms-length bodies and undertaking value for money investigations. When the NAO undertook the 2019 study on Local Authority Governance, which included work on local authority audit, the team did not include the Audit Code within the scope of the review. This was to avoid the risk of self-review. As a result, the findings of that report could not take account of an element of the governance framework.

The Financial Reporting Council

2.3.9 The FRC is responsible for issuing standards and guidance to auditors for use in the UK. The suite of standards is known as *International Standards on Auditing (UK)*, and apply equally to audits of local authorities and entities in other sectors.

2.3.10 During the transitional arrangements operating from 2015-16 to 2017-18, the FRC had no formal responsibility for assessing the quality of local authority audit. PSAA took the decision to contract the FRC to undertake six quality assurance reviews of local authority audits, with coverage of at least one from each firm. In practice, the FRC conducted quality assurance reviews of seven audits in both 2016-17 and in 2017-18. This is because the FRC's methodology requires them to re-review all audits that received an unsatisfactory quality assurance review score in the prior year. The results of these quality reviews are discussed in **Chapter 4**.

2.3.11 From 2018-19, the FRC has taken on statutory responsibility for quality assurance reviews of the 230 larger local authority audits. It treats the NHS and local government bodies as a single population and, to maintain equivalence with their coverage of the audit of PIEs, look to cover at least 5% of that population in each year. For 2018-19, the sample included 3 NHS bodies and 12 local authorities. Because some of the audits originally selected for quality review were not complete when the FRCs Audit Quality Review team conducted its fieldwork, these had to be replaced with other audits. The results of the 2018-19 quality assurance reviews are expected to be available in the Autumn of 2020.

2.3.12 The methodology adopted for quality assuring audits in local authority sector is broadly equivalent to that of the Public Interest Entities sector. The review team focuses on what is on the audit file and assesses the extent to which that complies with the applicable quality framework. The document review is supplemented by meetings with the audit team and the Chair of the Audit Committee.

2.3.13 Formal client communications are included within the scope of the quality review. However, ongoing liaison between auditors and local authorities would be assessed only if included on the audit file.

2.3.14 Unlike for PIE audits, the FRC does not have the power to fine audit firms if the quality of their local authority audits proves to be deficient. However, all of the firms active in the market indicated that they are very conscious of the reputational damage of a poor rating from the FRC for one of their local authority audits.

2.3.15 FRC is of the view that the perception that it focuses mainly on asset valuations understates the scope of their quality reviews. It also believes that if a focus on asset and pension valuations is inappropriate, this is the responsibility of the partnership between CIPFA (England, Northern Ireland and Wales) and the Local Authority (Scotland) Accounts Advisory Committee (LASAAC) known as CIPFA/LASAAC to resolve, through modifications to the Accounting Code.

2.3.16 The FRC is in the process of being reconstituted as the Audit Reporting and Governance Authority (ARGA) in line with the recommendations made in the Kingman Review. Sir Donald Brydon also recently published a report that made a number of recommendations to develop corporate auditing as a profession. As the FRC and the Department for Business, Energy & Industrial Strategy (BEIS) consider these recommendations, there is a risk of divergence between the focus and methodologies used to quality assure external audit engagements. Managing this interaction will require ongoing engagement.

ICAEW

2.3.17 The ICAEW has two statutory functions. Since 2015 it has been responsible for maintaining the register of audit firms and Key Audit Partners (KAP) authorised to sign off local authority audits; and since 2018-19 it has been responsible for quality assurance reviews of the 313 smaller local authority audits. The framework for approving firms and partners is tightly controlled by legislation.

2.3.18 Like the FRC, the ICAEW treats local authorities and NHS bodies as a single population for quality assurance review purposes. The 2018-19 quality assurance process is ongoing. ICAEW has selected 15 audits for quality assurance review, split roughly two thirds local government and one third health. The results of this quality assurance review process are not yet available.

2.3.19 Similarly to the FRC, the ICAEW quality assurance reviews focus on what is on the audit file and assesses the extent to which that complies with the applicable quality framework. The methodology used to assess the audits of English local authorities is the same as is used to assess audits undertaken by the Auditor General for Wales. This methodology does not require review teams to meet with Audit Committee chairs. As with the FRC, the ICAEW does not have any powers to fine or otherwise sanction auditors whose audits do not meet appropriate quality standards.

2.3.20 ICAEW and the FRC liaise to make sure that all audits fall within one or other of their sample populations and use, broadly, the same quality ratings. Both use well established methodologies to arrive at those ratings.

CIPFA

2.3.21 CIPFA has a dual role. It has been given the statutory responsibility for producing many of the finance related codes of practice that local authorities are required to observe. At the same time, it is a professional institute that represents the majority of accountants working in the local government sector, including most CFOs.

2.3.22 The Accounting Code is prepared by a small secretariat employed by CIPFA who report to the CIPFA/LASAAC Accounting Code Board ("CIPFA/LASAAC"). CIPFA/LASAAC is responsible for preparing, maintaining, developing and issuing the Code of Practice on Local Authority Accounting for the United Kingdom. Its membership primarily comprises accounts preparers representing the different types of authorities in England, Scotland, Wales and Northern Ireland, the Supreme Audit Institutions, and a representative of one of the external audit firms active in the sector in England. The FRC along with representatives of MHCLG and the Scottish, Welsh and Northern Irish governments have observer status on CIPFA/LASAAC.

2.3.23 In England CIPFA/LASAAC is supported by a CIPFA facilitated Local Authority Accounting Panel, which focuses on local government accounting and financial reporting issues and produces guidance for practitioners.

2.3.24 The Accounting Code could be characterised as long and complex. Part of the reason for this is the challenge of writing a Code that covers four countries, each of which has its individual statutory framework with a different set of statutory adjustments and disclosures. In addition to this, CIPFA has taken the decision to draft a highly prescriptive Code that provides detailed guidance on the correct accounting for each class of transactions. An alternative approach would be to draft a principles-based Code, which requires local authorities to comply with generally accepted accounting practice ("GAAP") and only provides detailed guidance where GAAP is adapted or interpreted, specifically for the local authority context. **Chapter 7** covers the accounting framework in more detail.

Assessment of whether an existing body could act as the system leader

2.3.25 The detailed analysis of the bodies responsible for the framework supports the conclusion reached in Sir John Kingman's Independent Review of the Financial Reporting Council:

"*The structure is fragmented and piecemeal. Public sector specialist expertise is now dispersed around different bodies. The structure means also that no one body is looking for systemic problems, and there is no apparent co-ordination between parties to determine and act on emerging risks*"[2]

2.3.26 The Kingman Review recommended that the fragmented structure be resolved by designating a single body as the system leader. When asked whether an existing body or a new body would be best placed to take on the role of a system leader, 82% of respondents expressed a preference for a single regulatory body. Many stakeholders who were interviewed also agreed. The other suggestions made were either that the C&AG or the FRC should take the role of system leader.

2.3.27 The C&AG clearly has the relevant experience and expertise to take on such a role. However, taking on responsibility for an element of a framework that is the policy responsibility of a government department could significantly increase the risk of a conflict of interest with the C&AG's main responsibility, which, as already stated, is to hold government departments to account on behalf of Parliament.

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[2] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/767387/frc-independent-review-final-report.pdf

2.3.28 As the regulator for the audit profession in the UK, the FRC will continue to have an important role in setting standards for all external auditors, including those working in local public audit. However, the FRC's main focus is corporate sector external audit, and to be fully effective the system leader for local public audit will need to demonstrate detailed expertise and a clear focus on that sector.

2.4 Interactions with other inspectorates

2.4.1 There are a number of other inspectorates who cover the local authority sector. Ofsted and the CQC assess the effectiveness of children's services and adult social care respectively in authorities with those statutory responsibilities; HM Inspectorate of the Constabulary and Fire and Rescue Services (HMICFRS) undertakes independent inspections of PCCs and FRAs covering both service delivery and financial planning; the Local Government and Social Care Ombudsman (LGSCO) looks at individual complaints against councils, all adult social care providers in both public and private sector, FRAs, and some other organisations providing local public services; and the Independent Office for Police Conduct performs the same function for PCCs.

2.4.2 Evidence suggests that where a local authority receives an "Inadequate" rating for its children's services, the auditor as a general rule qualifies the value for money conclusion. For example; when PSAA published its summary report on the results of 2017-18 audit work, it listed 32 qualified Value for Money (VfM) opinions; half of these were due to an "inadequate" Ofsted rating[3]. The auditor's value for money conclusion remains qualified until a future Ofsted inspection finds that children's services are no longer "Inadequate". Local authorities questioned the benefits of including Ofsted judgements in the audit report. The circumstances supporting an "inadequate" Ofsted rating are fully explained in a detailed and publicly available report. In the light of this there is a question as to how qualifying the VfM opinion solely for this reason fully reflects the governance arrangements within the authority that could be brought to the attention of elected representatives and other key stakeholders. When asked whether a value for money opinion should be qualified solely because a local authority has received an inadequate Ofsted opinion or a similar opinion from another inspectorate, 97% of respondents thought that it should not. There is no evidence of reports by other inspectorates leading to modifications to the auditor's opinion.

2.4.3 We have been told by external audit firms and local authorities that external auditors utilise inspectorate reports on a case by case basis. There is little evidence of any additional dialogue between external audit and other inspectorates to discuss inspectorate reports or take into consideration any improvements that a local authority may have made since an inspectorate rating had been issued. This is a change from practice since prior to 2015, where external auditors and inspectorates liaised much more frequently. Whilst external audit firms were broadly in agreement that there should be engagement with inspectorates, many felt that the current arrangements were sufficient.

[3] Report on the results of auditor's work (Oct 2018) – list of qualified opinions will not include LAs where the 2017-18 audit was concluded after the PSAA report was published.

2.4.4 Whilst recognising that each inspectorate focuses on a different area, there is a question as to whether more liaison may add value. Many examples of service delivery and financial failures are underpinned by weaknesses in governance and senior leadership. Given this, it may be valuable for the auditor or an inspector that has concerns, to find out if those concerns are reflected in other areas of a local authority's business or indicative of wider financial resilience issues.

2.5 The role of MHCLG

2.5.1 The Ministry of Housing, Communities and Local Government (MCHLG) has a statutory role in regulating and monitoring the financing and service delivery of local government. The Accounting Officer within the Department has responsibility for overall expenditure control within local authorities given the funding regime under which the sector operates. In addition, he has policy responsibility for the effective operation of the local authority audit and accounting framework.

2.5.2 Support to the Accounting Officer in fulfilling these responsibilities is split between two directorates:

- Local Government Finance; and
- Local Government and Communities (formerly Local Government Policy)

Local Government Finance

2.5.3 This Directorate covers payments to local authorities through the grant system, has responsibility for business rates and council tax policy, oversees borrowing, capital and fiscal arrangements and is responsible for assessing the financial sustainability of local government. When a local authority experiences financial difficulty, it is the Local Government Finance Directorate that usually leads the government response. It also provides the MHCLG representation on CIPFA's accounting panels.

Local Government and Communities

2.5.4 This Directorate has overall responsibility for MHCLG's local government assurance framework as set out in the Accounting Officer's system statement. Regular advice is given to the Accounting Officer on whether the framework for which he is responsible is operating effectively.

2.5.5 The directorate includes a team that maintains a view of local authorities where concerns exist about financial resilience, service delivery or officer/member conduct issues. In appropriate circumstances this may lead to statutory interventions into local authorities or, alternatively, statutory support. Qualified audit opinions are considered a part of this view.

2.5.6 Another team has responsibility for the local audit policy framework, the 2014 Act and the Accounts and Regulations 2015, managing relationships with PSAA, SAAA, NAO, ICAEW, Institute of Chartered Accountants of Scotland (ICAS) and FRC insofar as their activities relate to the local audit framework and logging Public Interest Reports.

2.5.7 In 2014 the team responsible for local audit set up a Local Audit Delivery Board to support implementation of the 2014 Act. In 2018, it became the Local Audit Monitoring

Board, with revised terms of reference and expanded membership. The Board comprises representatives of relevant departments and framework bodies to facilitate sharing of information about the operation of the framework. This Board is a consultative body, that holds meetings in private and has no formal powers or remit.

2.5.8 In viewing these roles from a local authority perspective, it is clear that MHCLG provides a national oversight of the financing of local government, capital and revenue spending, accounting arrangements and financial resilience. This work is substantial and seeks to offer assurance regarding the financial stability of individual local authorities and it includes, within its brief, responsibility for testing adherence to legislation and regulations governing local audit.

2.5.9 The responsibility for regulating local audit sits elsewhere yet MHCLG has a key role in offering assurance about the financial health of local authorities. The intelligence network and information flow relating to accounting and audit reporting on financial sustainability should reach MHCLG in a structured, timely and coordinated fashion. Given the strategic roles that the Department and The Accounting Officer carry it is crucial that systems and procedures are in place to enable this to happen. Clarity, coherence and consistency in fulfilling the Department's role are key to helping to ensure effective local audit.

3. Procurement of local audit

3.1 Statutory framework and eligibility criteria

3.1.1 In order to bid for a local authority audit, both audit firms and every individual responsible for signing off an audit opinion, typically but not always a KAP, needs to be pre-approved either by ICAEW or ICAS. Eligibility criteria are set out in Schedule 5 to the 2014 Act. These criteria stipulate that it is impossible to bid for local authority audits unless both the firm and each nominated KAP has recent experience of undertaking local authority audits. It is difficult for new entrants to enter the local authority market as a consequence of these criteria as audit firms not currently in the market are unable to gain the relative knowledge and expertise that would be required to become a KAP.

3.1.2 Despite the high barriers to entry, since 2016 there has been a 7% increase in the number of KAPs eligible to sign off local authority Audits. Firms active in the market continue to register new KAPs. 39% of KAPs currently registered were not KAPs in 2016, with the firms with a smaller market share being responsible for much of this increase. However, the headline KAP figure is slightly misleading. The number of KAPs has declined by 13% once those who are working for firms who do not currently hold contracts with PSAA are excluded.

Figure 3.1

Number of Key Audit Partners registered with ICAEW

Firm	2016	2020
BDO	5	7
EY	13	16
GT	32	26
Mazars	4	10
KPMG	22	23
Deloitte	6	8
Total KAPs (Firms holding contracts with PSAA)	76*	67*
Cardens	0	1
Moore Stephens	2	0
PWC	12	9
Scott-Moncrieff	0	3
Total KAPs	96	103

** Deloitte did not hold any PSAA contracts in 2016. KMPG does not currently hold any PSAA contracts.*

3.1.3 There is a risk that the Competition and Markets Authority: Statutory Audit Services Market Study[4] recommendation to implement an operational split between the Big Four's audit and non-audit businesses, to ensure maximum focus on audit quality will further reduce the number of KAPs qualified to sign off local authority audits. KAPs may be responsible for a mixture of external audit, internal audit and consultancy engagements. If required to choose between specialisms, there is, of course, no guarantee that they will opt for external audit.

[4] See Annex 5 for a more detailed analysis of the potential impacts of the CMA, Kingman and Brydon recommendations for local audit.

3.2 The 2017 procurement process

3.2.1 As detailed in **Chapter 2**, PSAA took over the administration of the bulk audit contracts let by the Audit Commission in 2014. These ran from 2015-16 to 2017-18. They comprised five lots let on a regional basis. In 2017 PSAA ran a new procurement to contract for local authority audits for the period 2018-19 to 2022-23.

3.2.2 PSAA chose to split lots by market share rather than on a regional basis. The reason for this was a concern that some regions could prove less popular with bidders than others. They also checked for potential conflicts of interest. Five lots comprising between 40% and 5% of the total market were let, each for a period of five years. No firm could win more than one lot. A sixth lot with no guaranteed work was let, with the aim of providing some resilience in the market.

3.2.3 Local authorities were notified of the lot to which they had been allocated and were given the opportunity to request transfer to a different lot; for example, if they were in a shared service arrangement with an authority in a different lot. Seven local authorities asked for their audit to be transferred to a different lot. Five of these requests were accepted.

3.2.4 Of the nine firms registered to undertake local authority audits seven bid for one or more lots. One firm decided not to bid and a second was excluded from the bidding process by PSAA because it felt the firm was too small to have a realistic chance of submitting a competitive bid.

3.2.5 Assessment of audit firms was split 50:50 between price and quality, compared to the final Audit Commission procurement which was done on a price quality ratio of 60:40. The team assessing quality scores was not given sight of the price each firm had bid. In addition, PSAA asked an ex-District Auditor working for the LGA to quality assure the assessors' quality scores. The assessment of quality was based solely on the tender documents submitted. Past performance was not considered.

3.2.6 One of the firms bid at a much higher price point than the other firms. This generated such a low "price" score that it was effectively impossible for its quality score to make up sufficient difference to win a lot.

3.2.7 Although the headline quality price ratio was 50:50, as highlighted in **Figure 3.2**, many of the questions included in the quality score do not directly relate to factors impacting audit quality.

3.2.8 Four firms bid for the largest two lots (including the firm who priced themselves out of the market); and six for the remaining four lots. Each successful firm was eliminated from consideration for each smaller lot, leaving only two firms from which to choose when awarding Lot 5.

3.2.9 After excluding the firm that priced itself out of the market, the firms awarded the five contracts were those with the highest quality scores. The firm with the highest quality score won the largest lot; the second highest quality score the second highest lot; and there was a marginal difference between the quality scores for the other successful firms.

Figure 3.2: Audit Quality Questions – PSAA tender document

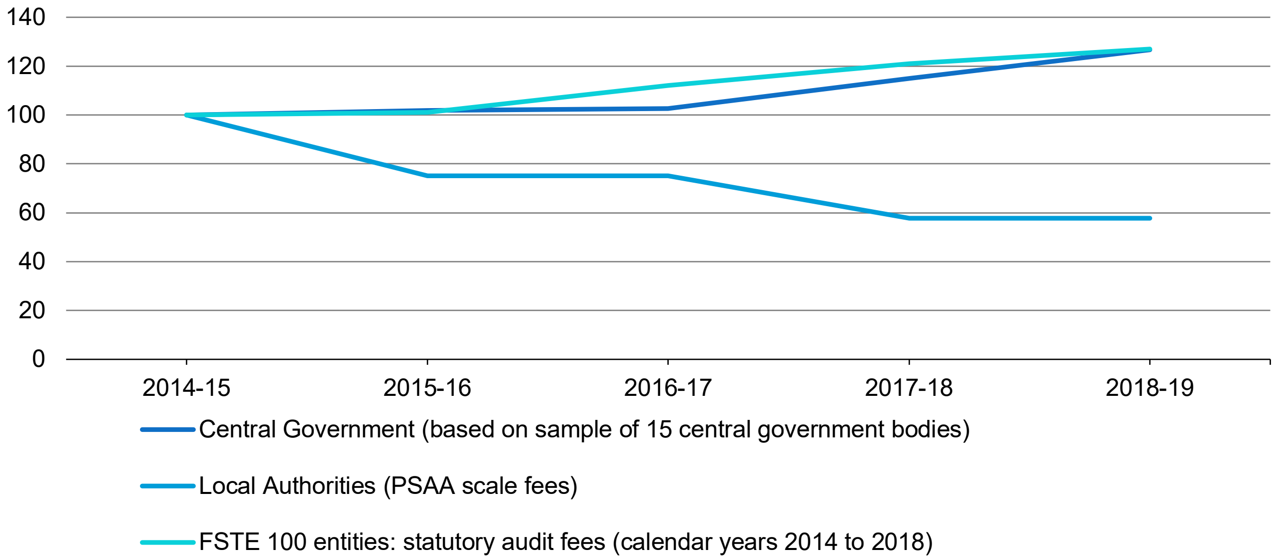
Question number	Question	Weighting	Maximum weighted score
1.1 and 1.2	Confirmation of information in SQ Response; and other declarations; Guarantee (if applicable) and completed, unqualified Form of Tender	N/A	N/A
2.1	Identifying and addressing risks and issues and engaging with different stakeholders	0.5	5
2.2	Continuing professional development	0.2	2
3.1	Providing a clearly articulated audit plan to address the risks identified, and arrangements for carrying out the planned work effectively	1	10
3.2	Information assurance	N/A	N/A
4.1	Quality assurance arrangements to ensure that local audits are undertaken to a consistently high standard	0.6	6
5.1	Schedule of staff	N/A	N/A
5.2	Details of resourcing	0.5	5
5.3	Details and role of Contact Partner	0.3	3
6.1	Selection of a team to work on an individual audit	0.5	5
6.2	Arrangements for discharging statutory reporting responsibilities under the Local Audit and Accountability Act 2014, managing authority and public expectations	0.4	4
7.1	Arrangements to ensure a smooth transition for audits of local government bodies transferring between audit firms	0.5	5
8.1	Opportunities to be commenced and completed	0.3	3
8.2	Other economic, social and environmental initiatives to be undertaken	0.2	2
Overall quality score			50
Price	Ranking of Bid Rate %	1	50%
Overall score (quality and price combined)			

Questions 2.1, 3.1 and 4.1 are direct indicators of quality.

3.2.10 Lot six was designed to provide spare capacity in the market. However, this has not worked as intended, in part because mergers mean that the firm that won Lot 6 no longer exists.

3.2.11 As demonstrated by **Figure 3.3**, audit fees in the local authority sector have dropped significantly at the same time that audit fees in other sectors have significantly risen. As well as the overall external audit fee paid by the sector declining in cash terms it has also dropped as a percentage of net current expenditure of local authorities, from 0.05% in 2014-15 to 0.04% in 2018-19. Within the sector there are further variations with PCCs and Local Authority Pension Funds typically paying much lower audit fees as a percentage of net expenditure than other types of local authorities.

Figure 3.3
Sector by sector comparison of change in audit fees over time



Notes

1 2014/15 base 100

3.3 Translating bids into audit fees paid by LAs

3.3.1 PSAA told the Review that the scale fee paid by individual LAs under the current contracts has been calculated by taking the total annual fee paid to external auditors under the contract and adding PSAA's margin; comparing the total amount paid to the total amount paid under the 2014 contracting process; and applying the percentage reduction in total amount paid equally across all local authority audits.

3.3.2 The Audit Commission adopted the same approach for allocating fees to individual local authorities when it let the 2012 and 2014 contracts. This means that no assessment of the amount it would cost to audit each local authority based on their level of audit risk has been made in the past ten years.

3.3.3 Since 2010, there have been changes to the major powers and duties of local authorities and to the business environment within which they operate. Individual local authorities will have been impacted by these changes to differing extents. As a result, there is no guarantee that the fee paid by each local authority accurately reflects the risk profile or amount of audit work required for their external audit.

3.3.4 88% of local authorities who responded to the Call for Views think that the current procurement process does not drive the right balance between cost reduction, quality of work, volume of external auditors and mix of staff undertaking the work.

3.3.5 Audit fees for those local authorities who have opted out of the PSAA arrangements have changed in a way similar to fees for those who have opted in.

3.4 Fee variations and contract management

3.4.1 When an auditor requests a fee variation, this must be agreed by PSAA[5]. In practice, PSAA may challenge fee variations by asking for more information from the firm but expects the auditor and the local authority to come to an agreement as to the additional fee to be paid. PSAA records and monitors this activity. It may also facilitate a conversation between the auditor and local authority in the case of disagreement.

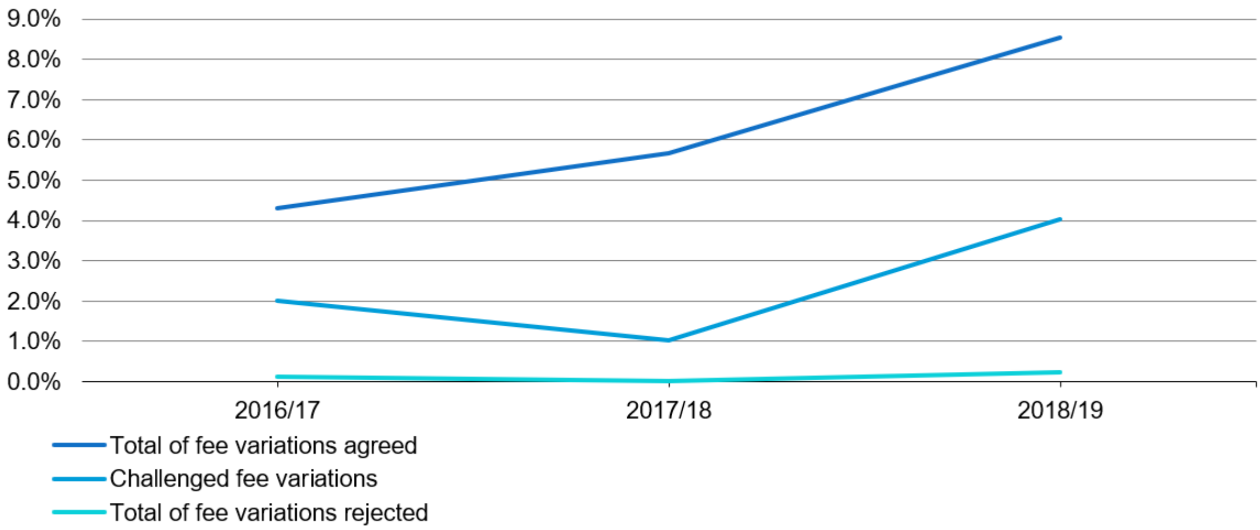
3.4.2 As demonstrated by **Figure 3.4** the number and size of fee variation requests have increased over time. Fee variation requests are often received some months after audits are completed, which means it is difficult to assess the true level of fees paid by the sector. As delayed audits are more likely to generate issues that require more work and thereby attract fee variations, and some firms are not always prompt in submitting fee variations, there are likely to be some requests outstanding relating to 2017-18 and 2018-19 audits.

3.4.3 Audit firms consider the fee variation process to be unsatisfactory. They have raised concerns that the scope to claim fee variations is not sufficient to meet their costs. Increasing the scale fee, to reflect changes in regulatory requirements is for practical purposes not possible under the current arrangements.

3.4.4 The majority of local authorities' representatives who offered a view on fee variations also considered them to be unsatisfactory. A concern, which has been raised by a not insignificant number of authorities, is the fact that fee variation requests are not always supported by any evidence of additional work done. Some local authorities passed examples to the Review of auditors, representing more than one audit firm, refusing to provide evidence to support a requested fee variation.

Figure 3.4

Fee variations as a percentage of total scale fees



Notes

1 Transitional arrangements in 2016-17 & 2017-18, PSAA contract in 2018-19.

2 Some fee variation requests for 2018-19 audits still to be received and agreed.

[5] https://www.psaa.co.uk/wp-content/uploads/2019/12/PSAA-fee-variation-process.pdf

3.4.5 Some local authorities questioned why they have been asked to join a call with a significant number of a firm's technical experts, most of whom do not contribute to the discussion, when they need to resolve technical accounting issues. They have questioned whether the costs of these calls are factored into later fee variation requests.

3.4.6 Fee variations can be submitted at any time which increases uncertainty for local authorities. In addition, some local authorities have claimed that they were led to believe by their auditors that they would refuse to sign off their accounts until they agreed a fee variation.

3.4.7 Finally, some authorities have also claimed that they are being asked to fund the costs of additional audit fieldwork because auditors have not resourced the planned audit visit properly and as a result, need to conduct additional audit testing. It has not been possible to assess whether this is happening or how widespread is the practice.

3.4.8 For the 2019-20 audit cycle, PSAA has taken steps to manage fee variations more proactively. Rather than wait for fee variations to be submitted, PSAA has asked all of the firms active in the market to estimate the additional fee required to ensure that their audit work and audit files meet current quality standards. Four of the firms have suggested that an increase of between 15% to 25% on the scale fee is required with the fifth firm requesting an increase of 100% on the scale fee. PSAA informed local authorities that it expects audit firms to provide fee variation information at the earliest possible opportunity, and that PSAA has emphasised this to the firms in its recent auditor communications. PSAA is currently in the process of reviewing how each firm's standard audit testing programmes have changed over the past three audit cycles to identify whether the increases requested are justified. PSAA will use this work to enable it to provide reassurance to audited bodies that extra work has been validated.

3.4.9 Some local authorities have suggested that PSAA has an incentive to approve fee variations as they are funded through making a margin on audit fees. This is not correct. Because PSAA calculates its margin on a total system cost, it is not possible for local authorities to calculate how much of each audit fee or fee variation is due to PSAA. However, as a not for profit company, PSAA has no incentive to claim more funding than it is entitled to. The company's Articles of Association requires PSAA to return surpluses to the sector. In late 2019, under the transitional arrangement, a distribution of the surplus funds of £3,500,000 (9.3% of the 17-18 scale fee £37.6m) was approved by the Board to be returned to the sector, apportioned between local authorities on a scale fee basis. This might be interpreted as an effective transfer of funds from LAs charged fee variations to those who have not been charged variations.

3.4.10 Some LAs have stated through interviews, that PSAA's role is opaque and that they feel that they have no route to challenge audit fees that they feel are unfair or to raise concerns relating to poor quality or delayed audits. The contract provides no mechanism for individual LAs to complain about the service they receive from their auditors.

3.4.11 PSAA states that its role as defined under statute does not include active contract management and it does not currently have the expertise to do so. However, in the *Local Audit (Appointing Person) Regulations 2015* the additional functions of appointing person include requirements to:

"monitor compliance by a local auditor against the contractual obligations in an audit contract… [and] resolve disputes or complaints from— (aa)local auditors, opted in authorities and local government electors relating to audit contracts and the carrying out of audit work by auditors it has appointed."[6]

3.4.12 During the transitional period implementing the new arrangements (2015-16 to 2017-18), there was a Memorandum of Understanding (MoU) between MHCLG and PSAA, which required PSAA to fulfil its statutory functions. When the MoU expired MHCLG did not renew it.

[6] https://www.legislation.gov.uk/ukdsi/2015/9780111126134

4. Audit performance

4.1 Introduction to local authority audit

4.1.1 Auditors of local authorities provide two audit opinions. These are:

- A financial audit opinion; and
- An opinion on the effectiveness of the systems in place to meet the best value duty (known as the 'value for money' opinion).

Scope of financial audit opinion

4.1.2 The purpose of a financial audit is to form an opinion on a set of financial statements. Financial audits are required to be conducted in accordance with International Standards on Auditing – UK (ISAs). The auditor is required to certify whether the financial statements are free from *material* misstatement and are properly prepared in accordance with the relevant accounting and legislative framework. For local authorities, the relevant accounting framework is the Code of Accounting Practice prepared by CIPFA.

4.1.3 In a local authority context, the audit opinion covers the financial statements, the Collection Fund Account and the Housing Revenue Account. It does not cover the narrative statement or annual governance statement. These are covered by what is known as a 'negative assurance' or 'consistent with' opinion. The auditor is required to read these statements to confirm that there is nothing inconsistent or misleading based on what is reported in the accounts and their understanding of the business. If these statements contain information which is misleading or inconsistent, auditors should insist that the relevant sections are appropriately reworded or removed. If not, no further work is required.

4.1.4 Materiality is a key concept in financial audits. Errors or misstatements are material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions that users take on the basis of the financial statements. Auditors are not required to take account of individual users, but do need to assess them as a group.

4.1.5 Auditors do not test every transaction supporting a set of financial statements. Instead they split the financial statements into groups of transactions with similar characteristics and assess the risks of material misstatement for each. The amount and types of audit testing for each of these areas is informed by this risk assessment.

4.1.6 It therefore follows that the key factors in delivering a quality audit are understanding the needs of the users of the accounts; and undertaking an effective risk assessment informed by a proper awareness of the business.

Scope of value for money opinion

4.1.7 The framework for the value for money opinion is set out in the NAO's Statutory Code of Audit Practice, published in April 2015.[7] ISAs do not apply to VfM audits.

[7] https://www.nao.org.uk/code-audit-practice/wp-content/uploads/sites/29/2015/03/Final-Code-of-Audit-Practice.pdf

4.1.8 The 2015 Audit Code requires auditors to:
"undertake sufficient work to be able to satisfy themselves as to whether, in the auditor's view, the audited body has put arrangements in place that support the achievement of value for money. In carrying out this work, the auditor is not required to satisfy themselves that the audited body has achieved value for money during the reporting period."

4.1.9 The Audit Code goes on to say:
"Ultimately, it is a matter for the auditor's judgement on the extent of work necessary to support their conclusion on value-for-money arrangements".

4.1.10 The Audit Code requires documentation of the overall conclusion, consideration of risk and of the planned response and work done to address significant risks. If there are no significant risks, the Code does not explicitly require documentation of work done.

Changes introduced by the 2020 Code of Audit Practice

4.1.11 In 2020, the C&AG published a new Code of Local Audit Practice. This is effective from the 2020-21 financial year. The main changes made are in respect of the value for money opinion and supporting work and have been broadly welcomed by auditors and those local authorities who have so far expressed a view.

4.1.12 The binary audit opinion on whether appropriate arrangements are in place has been replaced by a commentary on:

- *Financial sustainability: how the body plans and manages its resources to ensure it can continue to deliver its services;*
- *Governance: how the body ensures that it makes informed decisions and properly manages its risks; and*
- *Improving economy, efficiency and effectiveness: how the body uses information about its costs and performance to improve the way it manages and delivers its services.*

In addition, the updated Code will explicitly require auditors to document clearly the work that they have done to support their findings.

4.1.13 The consultation on the supplementary statutory guidance issued by the NAO to support the new Code closed on 2 September 2020. Once this guidance is finalised auditors will need to consider the factors including the following:

- whether a revised risk assessment is required;
- how to design an approach that moves away from obtaining evidence to support a binary audit opinion, to one that generates information to support a commentary on the arrangements in place.
- whether additional or different types of audit testing will be required, and how to structure and produce the new narrative reports.

Other statutory duties and powers

4.1.14 In addition, auditors of local authorities have other statutory powers and duties. These are:

- The power to issue a Public Interest Report at any time;
- The power to issue statutory recommendations to management, copied to the Secretary of State;
- The power to issue an advisory notice setting out potential illegal expenditure;
- The power to apply to the Courts to have unlawful expenditure disallowed;
- The duty to consider qualifying whistleblowing disclosures; and
- The duty to respond to objections raised by electors or other relevant persons.

The Audit Code includes guidance on the scenarios that might give rise to use of these powers and duties. Use of the powers along with the work required to support reports, recommendations and responses to objections is a matter of judgement.

4.2 Defining audit quality

4.2.1 Audit quality is a key determinant of audit performance and this must be seen, not only as a measure against agreed standards and principles, but also whether the output of an audit is seen to meet the legitimate expectations of council taxpayers and other users of accounts.

4.2.2 Financial audit is fundamental to these requirements to give assurance to the reader that the accounts are properly prepared and fairly reflect the council's financial position and use of resources.

4.2.3 Value for money audit should be designed to provide the reader with assurance that the systems in place for use of resources in an effective and efficient way are adequate and appropriate, and that the local authority plans will deliver financial resilience in the immediate and medium term.

4.2.4 The effectiveness of audit also depends on the usefulness, impact and timeliness of auditor reporting. Consideration of Public Interest Reports and Statutory Recommendations is relevant here. Finally, the effectiveness of audit also depends on the Authority's response to audit recommendations. This is a wider definition than that currently used by regulators. Ultimately, regulators consider a local authority financial audit to be of acceptable quality if the audit opinion is supported by sufficient and appropriate evidence and if the work complies with auditing standards, relevant legislation and the Code of Audit Practice. As VfM audit is not covered by auditing standards, the regulators focus principally on whether the audit complies with the Code of Audit Practice.

4.2.5 Nevertheless, the effectiveness and usefulness of local audit has to be measured alongside the assessment of quality. The Review has considered the extent to which the auditors of local authorities:

- Meet the contract specification;
- Demonstrate sufficient understanding of the local authority environment through identification and testing of key financial audit and value for money risks;

- Deliver audits in a cost-effective way;
- Make balanced and considered recommendations; and
- Issue reports and make recommendations in timely fashion.

4.3 Assessing Audit Quality

Meeting the Contract Specification

4.3.1 The contract between PSAA and audit firms largely follows standard terms and conditions. It requires providers of audit services to deliver audits in accordance with statutory obligations and appropriate professional standards. These are discussed below.

4.3.2 The contract is supplemented with a Statement of Responsibilities published, on the PSAA website, which is intended to set out the engagement between PSAA and the appointed auditors. The contract requires audit firms to familiarise themselves with this statement. In accompanying text on their website, PSAA makes clear that the responsibilities of auditors are derived from statute, principally, the 2014 Act and from the NAO Code of Audit Practice and nothing in the Statement is meant to vary those responsibilities.

Demonstrating an understanding of the local authority environment

4.3.3 Feedback received from interviews with local authorities is that KAPs tend to be knowledgeable, skilled and experienced. However, the amount of time devoted to the audit has become more limited in recent years. Anecdotal evidence on the accessibility of KAPs varies. Local authorities largely stated that the senior partners were brought in to resolve significant issues, so were not often visible during the course of the audit. This matched many audit firms' comments that senior partners were brought in for the specific and more complex issues. Most local authorities commented that this was reasonable, and as expected, but some felt that it was difficult to secure input from their KAP on specific issues. Some local authorities commented that during 2018-19 audits, the visibility of both the audit team and KAP had declined somewhat compared to prior years.

4.3.4 As demonstrated by the responses in **Figure 4.1,** despite valuing KAPs, many local authorities had a negative opinion of the overall knowledge and expertise of their audit teams. The two areas of particular concern were:

- the knowledge and continuity of working level audit staff; and
- whether audit work always covered the most important areas of the accounts from a financial resilience and service user perspective.

4.3.5 There is a question as to whether external audit could make more use of the knowledge and expertise of internal audit in developing sufficient understanding of the local authority. It is usual for the external audit team to meet the Head of Internal Audit as part of the audit planning process, but it is unclear if liaison extends much beyond that. Internal auditors are likely to be much closer to the business than external audit and, in many authorities, a proportion of their work focuses on governance and service delivery matters. This could make internal audit a rich source of knowledge, should the external audit team wish to use it.

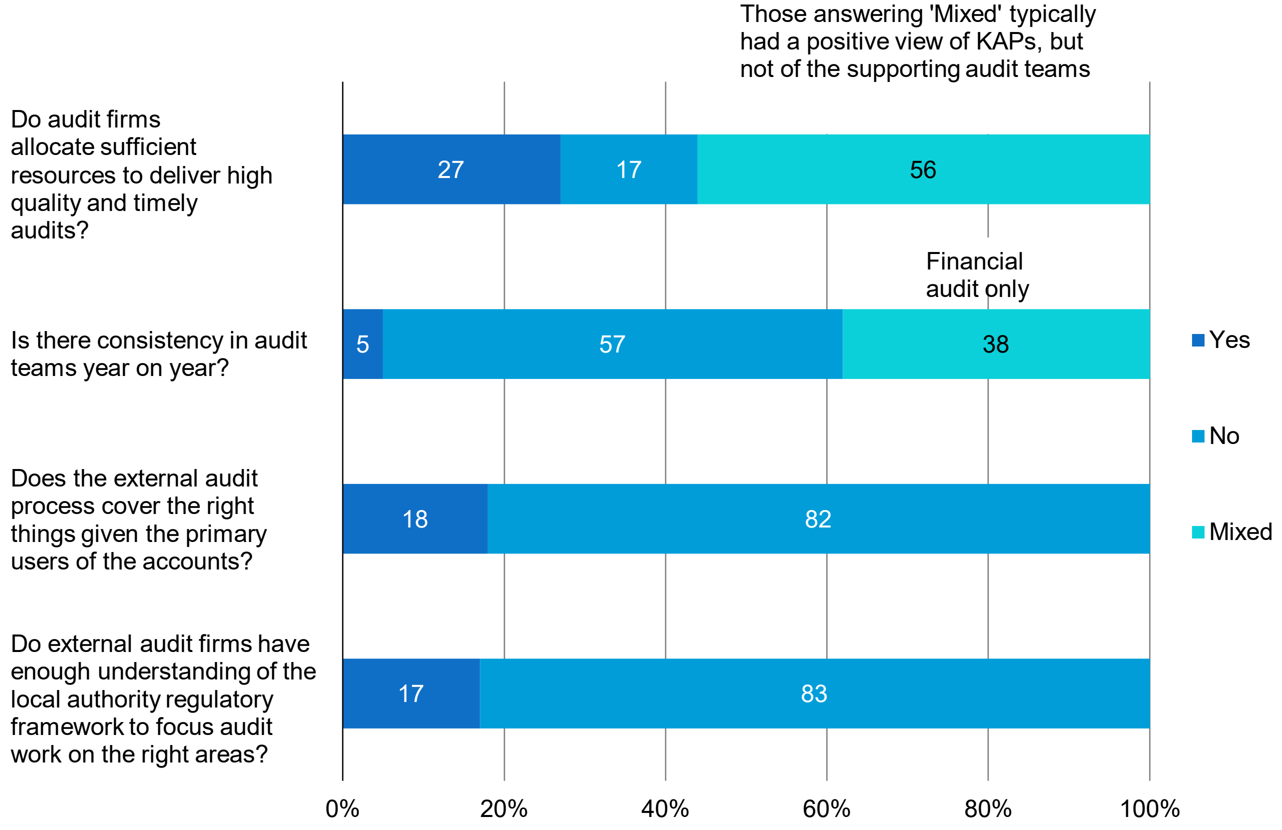
Knowledge, experience and continuity of audit staff

4.3.6 All audit firms active in the local audit market told the Review that they had expert technical teams who provided sector specific training to staff working on local authority audits. Nonetheless, many local authorities reported significant concerns about the knowledge and expertise of staff working on their audit. Issues identified included:

- audit examiners not having a full understanding of how local authorities were funded and how this impacted the accounts;
- a lack of continuity from year to year, or in some cases from week to week, leading to a lack of client knowledge; and
- a lack of understanding of local authority specific financial statements such as the Collection Fund and Housing Revenue Account.

4.3.7 Local authorities also reported the use of audit examiners from other countries to help manage the local audit peak. This is not unique to audits in the local authority sector and can be advantageous as different countries will encounter different audit peaks. However, may local authorities whose audits are staffed in this way reported that such examiners processed very little training in respect of English local government.

Figure 4.1
Opinions on External Audit Quality



Local Authority Call for Views responses

4.3.8 Firms agreed that consistency in audit teams could sometimes be compromised by either the difficulty in attracting and retaining quality junior staff or the challenge to retain more experienced staff.

4.3.9 Underpinning the concerns about the quality and continuity of working level audit staff is a concern that there are not enough audit examiners with local authority expertise, and that this is an area in which accountancy trainees no longer wish to specialise.

4.3.10 This is a concern that has developed since 2015. Prior to 2012, the Audit Commission's in-house audit practice, District Audit (DA), was responsible for 70% of the local authority audit market. In its 2012 procurement the Audit Commission outsourced its audit practice. DA staff were TUPE'd[8] to the private sector firms who largely took over responsibility for auditing local authorities. This meant that there was then a plentiful supply of audit examiners with local authority experience. Since 2015, many of those audit examiners have left the external audit profession and have not always been replaced.

4.3.11 A reason for the decline in the number of audit examiners with sector specific expertise is the route taken by auditors to qualify as accountants. Currently, there are five chartered British and Irish professional accountancy bodies that include external audit as a significant element in their qualification. Only one of these bodies (CIPFA) has a mainly public sector focus. All District Audit service trainees would have followed the CIPFA qualification route. Only one of the firms currently active in the market (Grant Thornton) uses the CIPFA qualification route for its public sector audit staff. In addition, audit firms highlight that between 2010 and 2015 the Audit Commission cut back on its recruitment of audit examiners. This means that an increasing number of local authority auditors will not have had the public sector as their main focus whist studying for their accountancy qualification.

4.3.12 In March 2020, PSAA published research it had commissioned on the future of the local audit market.[9] In this research firms raised two main issues that made it difficult for them to attract and retain high quality staff that wanted to specialise in local authority audit:

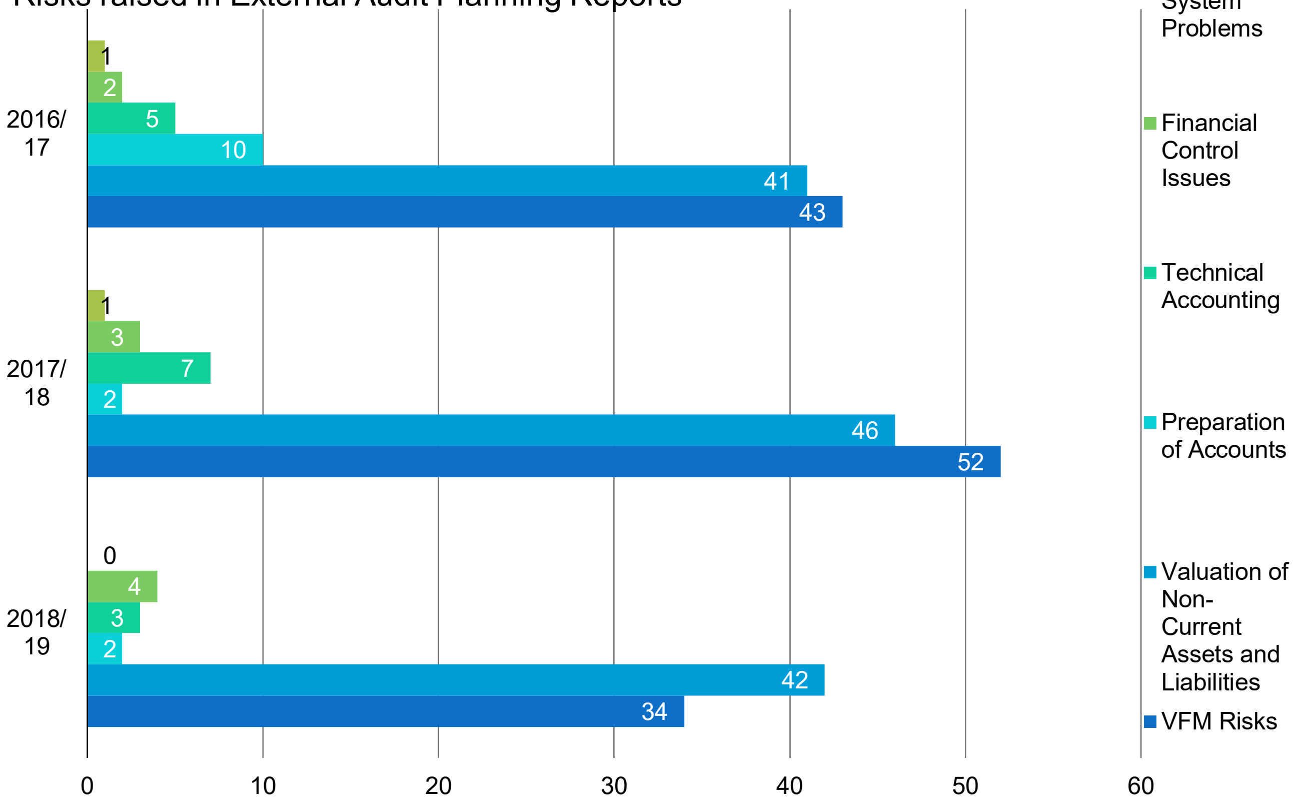
- **Timetable** - In 2017-18 the target date for completing local authority audits was brought forward from 30 September to 31 July. This reform was requested by many local authorities, who wanted to complete their accounts and audit process as quickly as possible, so as to free up their finance teams to work on other areas. The compression of the audit timetable was mentioned as an issue by every audit firm. Firms raised concerns about the resulting peaks in workload, pressures on staff during the summer months, and knock-on effects when target dates are not met. These pressures contribute to making work unpopular with local audit staff.
- **Fees** – Firms stated generally that the lack of profitability changes the way that local audit work is perceived within the firm. As the contribution that local audit makes to the overall profit of the Partnership is low, specialising in this area is seen by many auditors as having a detrimental impact on career prospects.

[8] TUPE stands for the Transfer of Undertakings (Protection of Employment) Regulations and its purpose is to protect employees if the business in which they are employed changes hands.
[9] https://www.psaa.co.uk/wp-content/uploads/2020/03/PSAA-Future-Procurement-and-Market-Supply-Options-Review.pdf

Focus of audit work

4.3.13 Many local authorities have raised concerns that auditors spend a significant amount of time focusing on fixed asset and pension valuations, whereas a fuller understanding of the business would lead to more of a focus on major areas of expenditure, together with the level of usable non-ringfenced revenue reserves. The reason for this argument is that most changes to fixed asset and pension values are 'reversed out' of the accounts by a range of statutory adjustments. As a result, in those circumstances, these valuations have no immediate impact on the cost of delivering services or on the financial resilience of a local authority.

Figure 4.2
Risks raised in External Audit Planning Reports



Notes

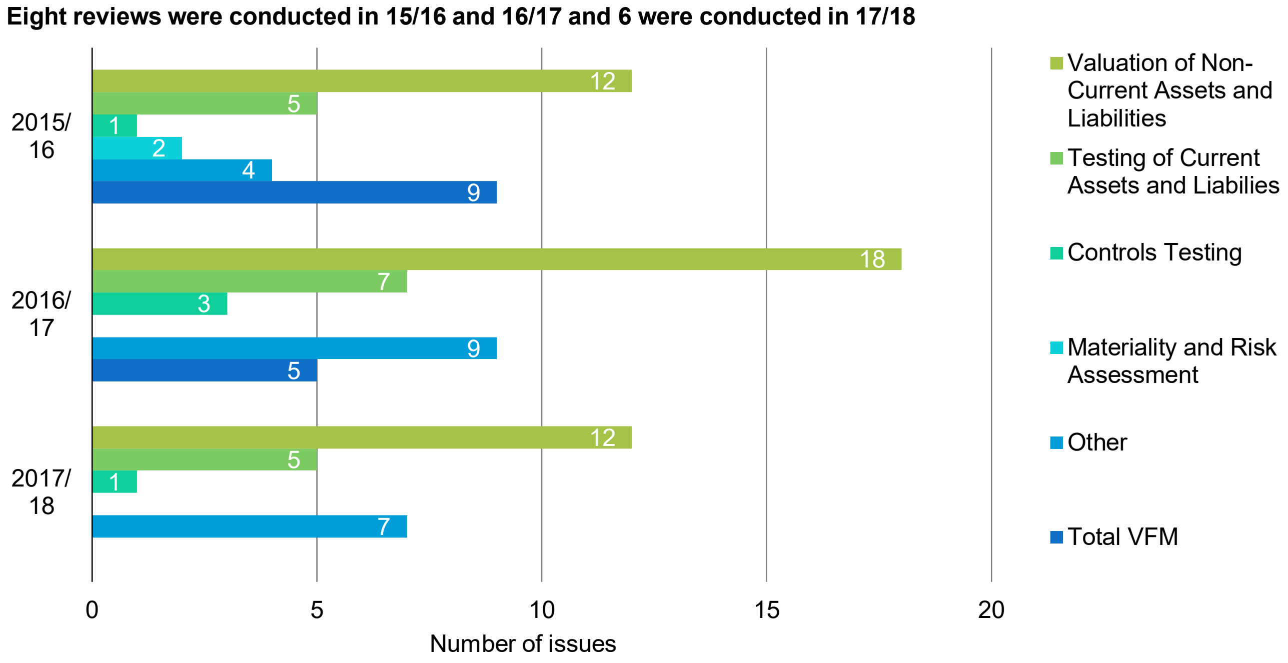
1 Representative sample of 30 local authorities. Presumed risks excluded

4.3.14 As demonstrated in **Figure 4.2**, valuation of non-current assets and liabilities have been the most common significant financial audit risk category identified in Audit Planning Reports. In addition, irrespective of the risk profile, the amount of detailed testing undertaken on these balances has increased significantly over the past three audit cycles. To manage the risk of regulatory criticism, that more scepticism is needed when assessing non-current assets and liabilities, audit firms are increasingly using their own expert valuers to assess valuations provided by a local authority employed expert. Some audit firms agreed that they would prefer to do less work on asset and pension valuations but explained that these areas of the accounts were given more attention as it was important in the context of securing a positive assessment from the FRC quality assurance processes.

4.3.15 The results of the quality assurance reviews of local authority audit files undertaken between 2015-16 and 2017-18 in **Figure 4.3** demonstrate clear and continuing concerns about the quality of audit work to support fixed asset and pension valuations. The FRC commented that, overall, the local authority audit files it reviewed tended to be of slightly lower quality than the files of corporate sector audits.

Figure 4.3

Issues identified by FRC file reviews conducted on behalf of PSAA



4.3.16 The FRC quality reviews identified far fewer significant issues in VfM audit work. This may be because the current Audit Code gives auditors quite a lot of discretion as to how much work they need to undertake before forming their VfM opinion.

Deliver audits in a cost-effective way

4.3.17 Since 2015, audit fees paid by local authorities have dropped by 42.25% (in cash terms). The decrease in fees has been welcomed by the LGA and by many local authorities. This reduction in fees has been attributed to the following reasons:

- PSAA costs being lower than those of the Audit Commission;
- Improved audit efficiency;
- Reduction in firms' profit expectations; and
- Reduced financial risks for the firms from staff previously TUPEd.

4.3.18 It is difficult to identify the extent to which local authority audits are more efficient than previously. All of the audit firms active in the market have looked to generate efficiencies through making significant investments in digital technology and innovation to equip audit teams with the appropriate tools to deliver a digital audit. However, audit firms note that many local authorities have IT systems that do not lend themselves to the delivery of a digital audit, so some of the anticipated efficiencies have not been realised.

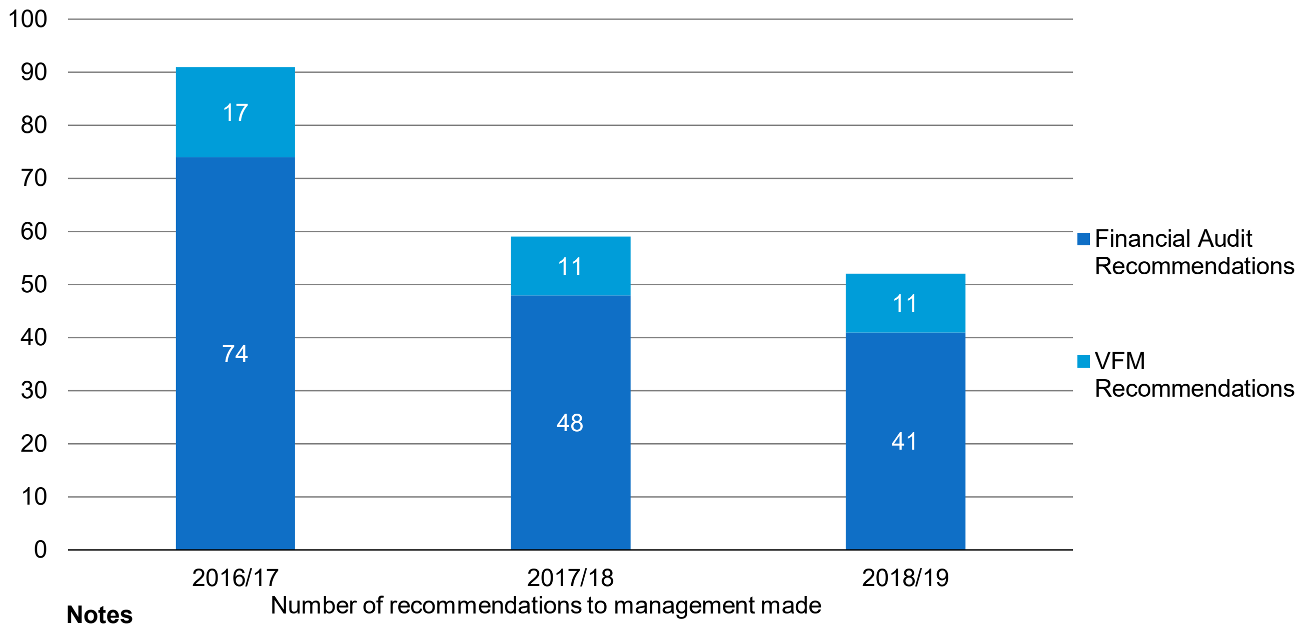
4.3.19 The decrease in fees must be set against the potential impact on quality if audit is considered to be cost effective. Audit firms have raised concerns about whether audit fees are at a sustainable level. One of the registered firms not active in the local authority market said that they had decided not to bid because it was impossible to deliver cost effective and high-quality audits at current fee levels.

4.3.20 Firms have the power to request fee variations where the cost of the work is greater than allowed for by the contract fee. As discussed in **Chapter 3** the fee variation process is an ongoing and increasing source of tension, with auditors concerned that they are not always able to recover legitimate costs. Local authorities are concerned about late notifications and that requested variations are not always supported by evidence of additional work done.

Make sensible recommendations

4.3.21 Auditors can issue recommendations to management through their end of audit communications. These can either be statutory recommendations, which must be copied to the Secretary of State, introduced through the "management letter" recommendations. Eleven statutory recommendations have been issued since 2015.

Figure 4.4
Number of External Audit recommendations given to local authorities



Notes

1 Representative sample of 30 local authorities.

2 Not all audits in 17/18 18/19 have been signed off in this sample.

4.3.22 As demonstrated in **Figure 4.4,** a review of Audit Completion Reports indicates that the number of management letter recommendations issued seems to be declining year on year. The practice on following up management letter recommendations was mixed and Audit Committees were more likely to check progress on implementation of internal audit recommendations rather than external audit recommendations. A majority of the recommendations made relate to technical accounting issues rather than financial control or value for money matters. This is not surprising given the focus of external audit, but it contributes to a perception that the process is not adding as much value as formerly.

Provide useful and timely reports

4.3.23 As demonstrated by **Figure 4.5,** the number of delayed audit opinions has significantly increased over the past three years. For 2018-19, all the audit firms in the market had some outstanding audit opinions as at 30 September 2019, though the extent varied from firm to firm; one firm completed just less than 40% of audits by the deadline while another completed 80%. All firms have made progress in completing these delayed audits although at December 2019, there were still 85 outstanding audit opinions (17.5%); and by July 2020, 42 (8.6%) of 2018-19 audits remained incomplete. These delays are likely to have had a knock-on impact for the 2019-20 timetable.

Figure 4.5

Audit opinions signed off by the statutory deadline for publishing audited accounts

	2018/19	2017/18	2016/17
Opinions issued by the statutory publication deadline	57% *31 July 2019	87% *31 July 2018	95% *30 September 2017
Opinions issued by 30 September	70%	95%	N/A

*statutory deadline for publishing local authority accounts 30 September in 2016-17; and 31 July thereafter.

4.3.24 PSAA asks audit firms to explain the reason for delayed audits. The four most common reasons provided were:

- poor quality accounts/working papers submitted by the local authority;
- potential qualification issues;
- outstanding objections on the accounts; and
- for the first time in 2019-20, having insufficient qualified individuals to deliver all audits at the appropriate time was included as a reason for some of the delays.

4.3.25 Audits are by their nature backwards looking and the increasing delays in signing off local authority audits have an impact on the timeliness of reports. The more material issues that an auditor finds, the greater the risk that the sign off of the audit opinion is delayed. When a judgement needs to be made about modifying an audit opinion, audit firms are required to undertake enhanced quality assurance procedures, and these take time. In addition, some audits will be delayed if a local authority presents poor quality accounts or if there is an outstanding objection. As a result, a number of local authority audits will inevitably be signed off after the reporting deadline.

4.3.26 In recognition of the increased challenges posed by Covid-19, MHCLG has extended the deadline for signing off 2019-20 audits to 30 November 2020. If a majority of audits are not signed off by this date, there could be a significant impact on MHCLG's ability to run the non-domestic rates system effectively. It is too early to say how many local authority audits will make this target date or whether the extension of the deadline will enable audit firms to complete more of the outstanding 2018-19 audits.

4.3.27 Examples of useful and timely auditor reporting through client communications are relatively few. Some local authority Chief Financial Officers commented that they no longer got the useful and informative advice, challenge and support that they had received from KAPs prior to 2015. Audit Planning Reports tend to be presented in February, March or April, which is rather late in the financial year. This means that local authorities get late notification of audit risks. In addition, it is not possible to undertake interim audit work on management controls if the plan is presented in the last month of the financial year and this increases the pressure on the year end peak.

4.3.28 If an Auditor is assessing a significant issue, which they believe needs to be brought to the attention of elected representatives and the public as soon as possible, the have the power to issue a Public Interest Report (PIR). PIRs can be issued at any time. However, only four PIRs have been issued since 2015. Three of these related to matters identified prior to 31 March 2015 and the fourth, issued on 11 August 2020, related to a wholly-owned local authority company.[10] This means that the opportunity to enhance transparency and accountability by sighting key stakeholders on significant issues in a timely fashion is not often used.

4.3.29 Audit firms have not commented on why there is not a greater use of the statutory powers available to them. The position in which auditors find themselves can relate to a situation where intervention in a local authority may be warranted by the use of statutory powers. It is possible that the legal and reputational risks of using these powers may play a part in their thinking as may the difficulty of recovering the costs of the extra work required to support use of these powers.

4.4 Interactions between external audit and relevant stakeholders

4.4.1 The areas of concern that particularly stood out from interviews with local authorities and through the Call for Views were:

- Senior audit staff not being contactable by clients when issues arose;
- Late notification of audit risks;
- Changes to the audit timetable – without justification given;
- Late notification of fee variations with no justification or breakdown of cost given; and
- The auditor's valuation expert overriding asset valuations provided by client experts with equivalent qualifications sometimes with no justification given.

4.4.2 It is important to note that these concerns are not unreciprocated. Auditors raised concerns about LAs not preparing properly prepared draft accounts supported by high quality working papers or not being available to answer audit questions.

4.5 VfM expectation gap

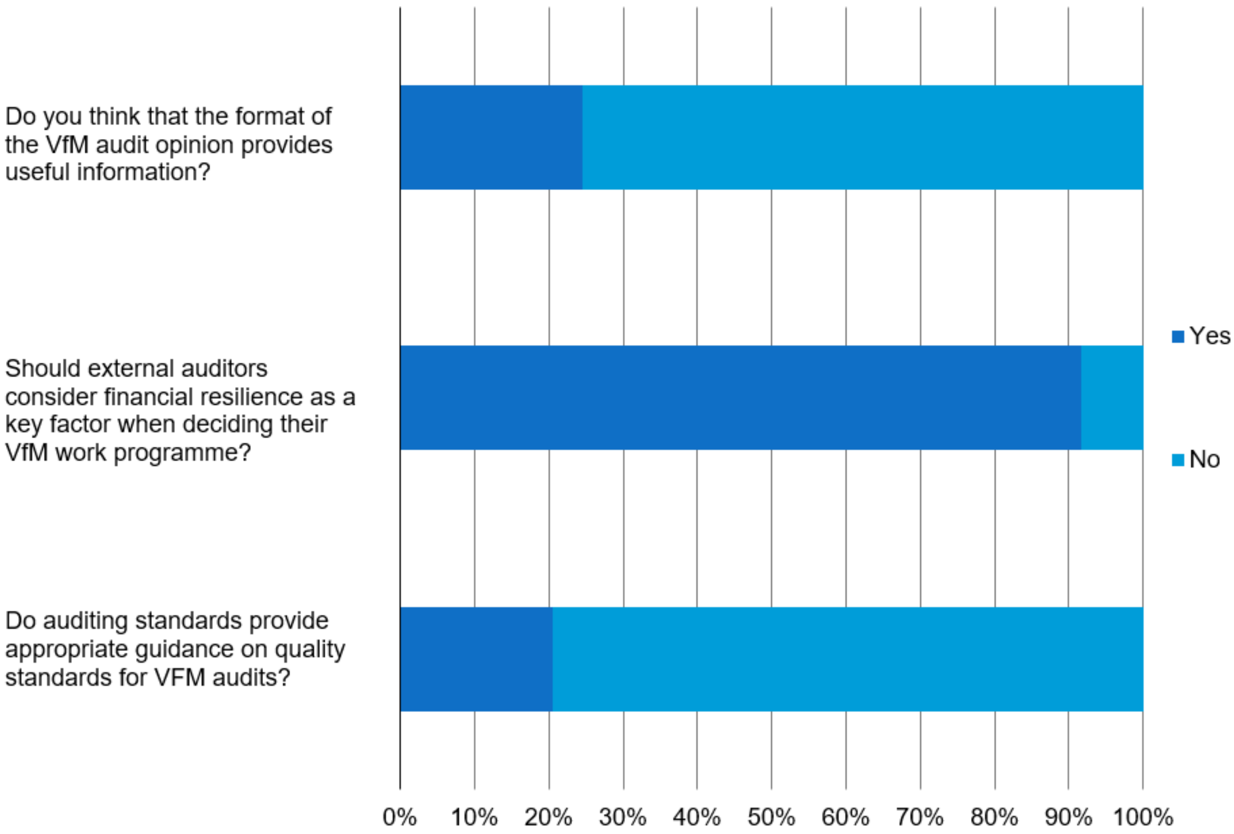
4.5.1 Whilst audit firms feel that the NAO's new code of practice resolves many of the VfM conclusion shortcomings, some local authorities believe that more significant changes need to be made. There is a large expectation gap between what local authorities

[10] https://www.nottinghamcity.gov.uk/publicinterestreport

expect a VfM opinion should provide and what it actually provides. The VfM conclusion is viewed by many local authorities to be an exercise with limited use to them as it is too retrospective and often states what the local authority often already knows. **Chapter 6** includes a more detailed consideration of the extent to which the VfM opinion covers financial resilience risks.

Figure 4.6

Opinions on the VfM opinion and auditing standards



Notes

1 Data from Local Authority Call for Views responses.

4.5.2 As demonstrated in **Figure 4.6**, 74% of the local authority respondents to the Call for Views think the format of the VfM opinion does not provide useful information. Some of these respondents recognised that the opinion is limited to giving assurance only that processes are in place to secure value for money and therefore that the opinion needs to be expanded to provide useful information. 79% of these respondents do not think the standards provide appropriate guidance on quality standards for VfM audits.

4.5.3 91% of respondents think external audit should be required to assess financial resilience. Although 3% of these respondents felt that financial resilience is already covered to an appropriate amount, most of the other respondents thought that financial resilience should be considered in the medium and long term as part of the value for money audit opinion. This included most audit firm respondents to this question, all of whom stated that the updated NAO Code of Audit Practice, effective from 2020-21, would provide a suitable level of coverage. No local authorities specifically mentioned the NAO Code of Audit Practice in their responses, although this may be due to the fact that the updated Audit Code had not been finalised at the time the Call for Views closed. However, 16% of local authority respondents thought the non-statutory CIPFA Financial Management Code (published Oct 2019) could provide a suitable framework for assessing financial resilience and financial management.

4.6 Summary of audit performance

4.6.1 There is an expectation gap that extends across both the financial and the VfM audit. The coverage of the financial and VfM audits is far narrower than many stakeholders expect.

4.6.2 There are questions about the level of audit performance. In addition, although external auditors may be meeting the contract specification by delivering audits that, for the most part, meet the quality standards set out in ISAs and the Audit Code, an increasing number of audits are not being completed by the statutory deadline for publishing audited accounts.

4.6.3 Audit fees paid by local authorities have reduced, whereas, over the same period, they have increased in other sectors. There is some evidence that the reduction in fees has led to a decline in the number of examiners with appropriate skills, knowledge and expertise. This has had an impact on the timeliness of audits, the usefulness of auditor reporting to management and the quality of interactions between external auditors and local authorities.

4.6.4 Underpinning concerns about audit performance is a question of focus. There is a perception amongst many local authorities that an increasing amount of time is spent auditing fixed asset and pension valuations. It is clear that external audit increasingly has a greater focus on these areas, and that this has been driven by the requirement to meet quality standards and comply with relevant statutory guidance. What is less clear is the extent to which this has led to a reduction of audit work in other areas, but given the reduction in audit fees, it is likely to have had some impact.

4.6.5 It is more difficult to summarise audit performance in relation to the VfM engagement. This is partly because the 2015 Audit Code requires minimal documentation unless significant VfM risks are identified. This makes it impossible to assess whether the external audit assessment of VfM risks is complete in all cases. However, given the squeeze on audit fees and the reduction in the number of audit examiners with appropriate skills, knowledge and expertise, this remains a matter of significant concern.

5. Governance arrangements in place for responding to audit recommendations

5.1 Outline of the different frameworks in operation

5.1.1 The effectiveness of audit must, in part, be determined by the arrangements in place within each body subject to audit for considering and acting upon external audit reports. All local authorities are required to set up Audit Committees or the equivalent with responsibility for considering the annual accounts and receiving internal and external audit plans and reports. The specific arrangements vary between different types of local authorities. However, the purpose of an Audit Committee is to provide independent challenge on behalf of the authority in respect of accountability and risk management arrangements.

Arrangements within PCCs

5.1.2 A PCC is an elected official charged with securing efficient and effective policing of a police area. The policing function is delivered by the constabulary, led in large part by Chief Constables. PCCs are required to set up Joint Audit Committees covering the activities of both the PCC and the constabulary. These arrangements appear to work effectively and the findings and conclusions in the rest of this Chapter do not apply to PCCs.

5.1.3 Some PCCs also have responsibility for overseeing the delivery of Fire and Rescue Authorities, which deliver the fire service, in their local area. In other areas, primarily Shire Counties, the fire service is the responsibility of the County Council.

Arrangements within other types of local authorities

5.1.4 Mayoral Combined Authorities[11] are required by statute to have an Audit Committee, although there is no statutory guidance on the membership or remit. Whilst not a requirement for other types of local authorities, in practice most have set up an Audit Committee or equivalent.

5.1.5 Constitutionally, Audit Committees in local authorities are sub-committees of Full Council. This means that a majority of its members will be elected as a councillor or its equivalent. As highlighted in **Figure 5.1,** membership tends to be based on the political balance of the council and the chair is often, but not always, a member of the ruling group.

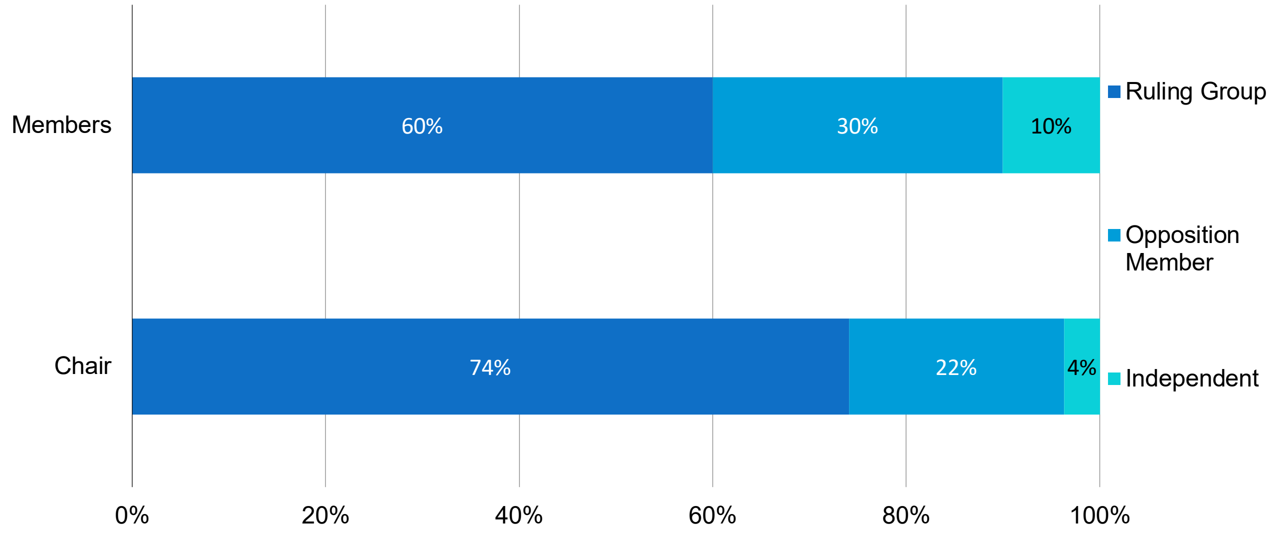
5.1.6 The number of members of Audit Committees varies from four to seventeen, with seven being the most common. This compares to common practice in central government and the private sector, which is to have no more than three or four Audit Committee members. The size of the committee might vary according to the number of councillors an authority has; however, Birmingham City Council, which by expenditure is the largest local authority and has more councillors (99) than any other local authority in England, has eight members on its Audit Committee, whereas the

[11] Combined Authorities are statutory bodies made up of neighbouring local authorities that broadly cover a city-region that have agreed to work together. A Mayoral Combined Authority is where a mayor is the directly elected leader of the combined authority.

Audit Committees of some Shire District Councils have memberships that far exceed this.

Figure 5.1
Composition of audit committees in councils

56% of committees had no independent members



Notes

1 Representative sample of 27 Local Authority Committees (not including FRAs or PCCs).

5.1.7 Local authority accounts are very complex and there appears to be a significant difference between the assurance that external auditors provide and public expectations. Elected members may or may not have relevant skills, expertise or background to fulfil the role of a member of an Audit Committee. Many local authorities provide training for Audit Committee members, but it has not been possible to assess how comprehensive or effective this training is. As a result, it is not possible to conclude whether members are always equipped to provide effective challenge to Auditors or Statutory Officers.

5.1.8 As part of its Audit Quality Reviews of 2018-19 audits, the FRC review teams have met with Audit Committee chairs of 12 selected local authorities. Although the reviews of the related audits are not yet publicly available, a mixed picture was reported, with some chairs being very engaged and informed, but others being less so. As the FRC is responsible only for the quality assurance reviews of the 230 larger local authorities and NHS bodies, the experience provided by their quality reviews may not be fully representative of the sector.

5.1.9 Whilst the vast majority of local authorities interviewed were supportive of the principle of appointing independent members, only about 40% of Audit Committees currently have done so. The reported experience of having independent members on Audit Committees was mixed. In some cases, they provided useful challenge, but some authorities reported that the effectiveness of independent members was hampered by their lack of sector specific knowledge.

5.1.10 A particular challenge for authorities is attracting independent members with the relevant technical experience. This challenge can sometimes be greater depending on an authority's geographical location. Some PCCs have found that the introduction of Joint Audit Committees, which are seen as more prestigious, has made Audit Committee membership more attractive to appropriately qualified independent members, but there is still not an abundance of suitable applicants for vacant positions.

5.1.11 The independent member is often a voluntary position across the local authority sector. This compares to NHS trusts who are more likely to pay independent Audit Committee members, which may make it slightly easier for them to attract applicants with relevant expertise.

5.1.12 Local authorities have a number of statutory officers, three of whom have responsibilities that may be covered by audit work. They are:

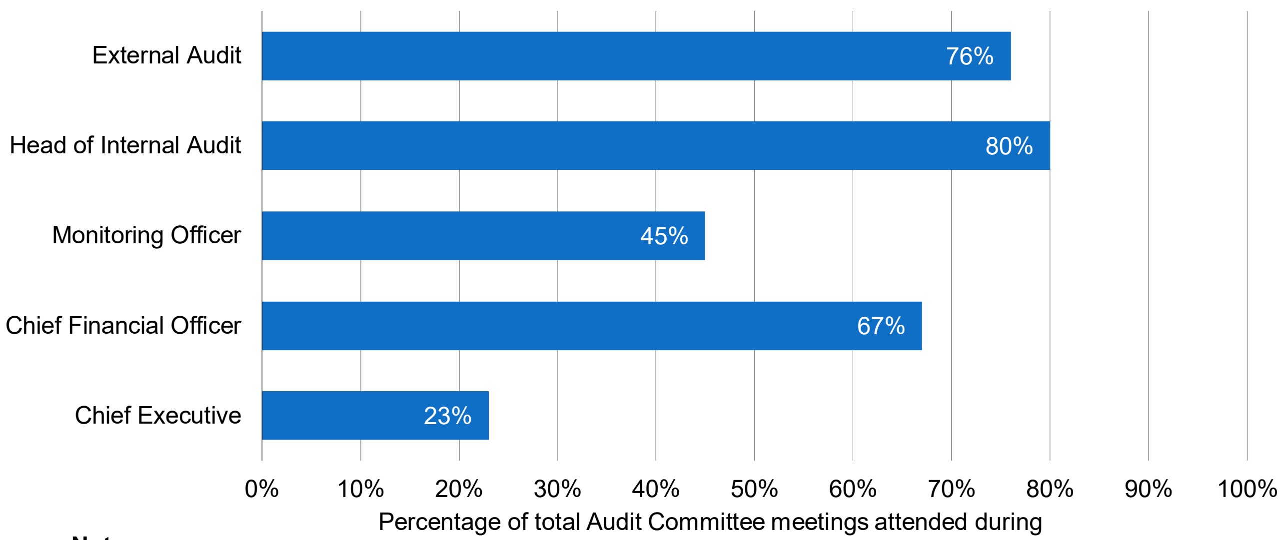
- The **Head of Paid Service** – typically the Chief Executive or Managing Director
- The **Section 151 Officer** – typically the Chief Financial Officer or Finance Director
- The **Monitoring Officer** – typically the Head of Legal Services

5.1.13 As demonstrated by **Figure 5.2** the frequency of attendance of statutory officers at Audit Committee meetings is mixed. Whilst the Chief Financial Officer and Head of Internal Audit attend a majority of meetings, Monitoring Officers attend just under half of the meetings and the Chief Executive attends such meetings less often. Other statutory officers and service heads usually attend Audit Committee meetings if a matter relevant to their service area is discussed.

5.1.14 The Chief Financial Officer is more likely to attend meetings where external audit completion reports are presented. Attendance of the Chief Executive increased by 2% and the Monitoring Officer attendance decreased. This may be reflective of the fact that in local government, the Chief Financial Officer signs the accounts on behalf of the local authority, or it may be indicative of the profile of external audit.

Figure 5.2

Audit Committee attendance: Local Authority Officers and External Audit Representative



Notes

1 Representative sample of 30 local authorities

5.1.15 In local government, representatives of external audit are not expected to attend every Audit Committee meeting. Based on a representative sample, the KAP attended 56% of meetings, rising to 87% of meetings where either external audit papers were tabled or where the final accounts were presented. For the 13% of these meetings where the KAP was not in attendance, external audit was represented by a less senior member of the audit team.

5.2 Scope of audit committees within local government

5.2.1 The scope of Audit Committees also varied between authorities. CIPFA's *Position Statement and supporting guidance on Audit Committees (2013)* says that the Audit Committee should cover:

- The annual governance statement
- The work of internal audit
- Risk management
- Assurance framework and assurance planning
- Value for money and best value
- Countering fraud and corruption
- External audit
- Partnership governance

and may also cover:

- Specific matters at the request of statutory officers or other committees
- Ethical values
- Treasury management

5.2.2 Most of the committees reviewed covered most of the items in the CIPFA position statement. There were two areas which had either minimal or no specific coverage: *partnership governance,* which was considered by only two of the 30 authorities reviewed; and *value for money and best value* which was not considered by any of those 30 authorities. The *CIPFA Survey on Local Authority Audit Committees* (November 2016) also found that Audit Committees were much less likely to consider these two areas. However, the scope of Audit Committees in local authorities is not limited to the areas suggested in the CIPFA guidance.

5.2.3 The scope of committees whose responsibilities included audit varied. The second most common name, after the 'Audit Committee' itself was a name which indicated the combining of audit with the functions of an overview and scrutiny committee. Overview and scrutiny committees are required by statute[12] and are responsible for overseeing and scrutinising the whole range of the Council's functions and responsibilities, as well as other public service providers' work and its impact on the local community. Whilst the functions of these two committees have some synergy, there is a question as to whether it enables the audit responsibilities to be fully addressed.

5.2.4 In one example a local authority had set up an Audit, Resources and Performance Committee. This is a significant concern because the prime purpose of an Audit

[12] Schedule 2, Localism Act 2011

Committee is to review the comprehensiveness and reliability of assurances on governance, risk management, the control environment and the integrity of financial statements and the annual report. The Resources Committee will use financial projections and risk management information to take decisions about use of resources. If the same committee is responsible for using information to take management decisions and providing independent assurance over the reliability of that information, there is no effective segregation of duties. There is also a potential for conflicts of interest.

5.3 Relationship between Audit Committees and Full Council or equivalent

5.3.1 Full Council has a role, ultimately, in responding to audit matters that is beyond receiving Public Interest Reports or qualified audit opinions. Full Council is generally more visible to the public than committees/subcommittees. The Council's public accountability to local taxpayers and service users is best served by having significant matters relating to audit discussed in a transparent and accessible way.

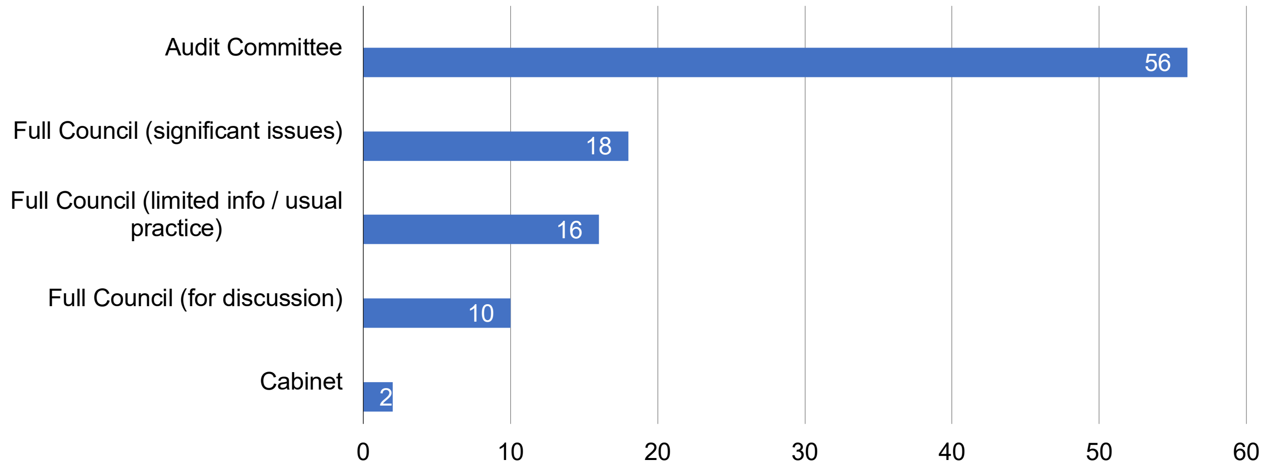
5.3.2 Matters raised at Audit Committee can be referred to Full Council. In addition, the auditor has the power to present some statements, for example an advisory notice that planned expenditure may be unlawful, directly to Full Council.

5.3.3 In practice the auditor tends to present matters to the Audit Committee, which decides if a matter is serious enough to be referred to Full Council. Most local authorities feel that this arrangement is appropriate. It is rare for an Audit Committee to put a substantive item onto the Full Council's agenda. The exception is the Treasury Management Strategy, where some local authorities have a practice of ensuring that it is considered by the Audit Committee before being forwarded to Full Council for approval.

5.3.4 Many local authorities stated that the existing relationship between Audit Committee and Full Council involved either forwarding for information a yearly summary report or meeting minutes and that this was considered to be sufficient. Many also commented that if there were significant recommendations made by the external auditor, such as a Public Interest Report, that then should be a matter for Full Council.

5.3.5 In some cases, some quite serious matters seem not to have been passed onto Full Council. For example, the 'best value' report into Northamptonshire County Council found that when the external auditor reported that appropriate arrangements to deliver best value outcomes were not in place, for the second year in succession, there is no evidence that the Audit Committee forwarded the qualified audit opinion to Full Council.

Figure 5.3
To whom should external auditors present audit reports and findings?



Notes

1 92% of local authorities respondents answered this Call for Views question

5.3.6 If this practice is widespread, there is a significant risk that in many councils, a majority of elected members may not be sighted on serious governance or financial resilience issues. This risk does not fully pertain to PCCs, where the PCC and Chief Constable are expected to attend the Joint Audit Committee and generally do so. There is a question as to whether Audit Committees, including Joint Audit Committees, are sufficiently transparent to local taxpayers and service users. Whilst by default, proceedings of these committees are public, it is not clear that taxpayers and service users are aware that they have a right to attend or to read the papers and the minutes.

5.3.7 As demonstrated in **Figure 5.3** most local authorities felt that external audit reports should be presented to the Audit Committee rather than to Full Council. Reasons given included:

- Full Council only taking items for decision;
- elected members not having the skills, knowledge or experience to understand the report unless they had received Audit Committee training.

5.3.8 Many commented that external audit reports should be reported to Full Council only in exceptional circumstances where there is significant cause for concern. One respondent commented that given the target dates and tight deadlines, there is insufficient time to report to Full Council prior to sign off of the accounts by the external auditors.

Raising the profile of external audit work

5.3.9 The content of the standard suite of external audit reports is mandated by auditing standards. Whilst audit firms have made significant strides in making reports more accessible to clients, much of the required disclosure is highly technical. Given this, it is perhaps understandable that many local authorities do not present such documents to Full Council.

5.3.10 Nevertheless, external auditors may have insights from their work, that could provide assurance to Elected Representatives that their local authority is being run with the best interests of service users and taxpayers in mind. The auditor also has the facility to sight elected representatives on matters that audit work has highlighted as a potential issue.

5.3.11 This suggests that the external auditor should report to Full Council on risks identified and conclusions reached, in a transparent and understandable format. To be of most use, such a report would need to be timely. Given the increase in the number of delayed audits, this report should not necessarily be linked to the certification of the financial accounts as it should be made at the most useful point in the year. Comparatively few local authorities commented on what was the right point in the year to receive audit reports. Two thirds of those who did, expressed a preference for end-September, coming as it does near the start of the following year's annual budget setting planning cycle.

Collating the results of external audit work

5.3.12 Prior to 2015, the Audit Commission published an annual report summarising the results of the audits of local authorities and the NHS. Up to the end of 2017-18 responsibility for preparing this report passed to PSAA. The report summarised the number of audits completed by the statutory deadline and the number of qualified financial audit and value for money opinions, with the latter categorised by theme. It also listed all Public Interest Reports, Statutory Recommendations and Advisory Notices issued in the preceding year. It did not include any details on risks raised by auditors in their Audit Planning Reports or non-statutory recommendations made to local authorities. Just over two thirds of Call for Views respondents think a publication summarising the results of local authority audits adds value.

5.3.13 The responsibility for preparing this report was included in the Memorandum of Understanding between PSAA and MHCLG. When MHCLG decided not to renew the Memorandum of Understanding, PSAA's responsibility for reporting on the results of audit work lapsed. This reinforces the point that no entity currently has the responsibility to collate and report on the results of the work of the external auditors of local authorities and individual NHS bodies.

6 Audit work on the financial resilience of local authorities

6.1 Stakeholders' expectations regarding financial resilience

6.1.1 Reference has been made to the role of external audit in assessing financial resilience and sustainability in local authorities. In England, neither the financial nor the value for money audit includes a specific responsibility to provide an opinion on whether a local authority is financially sustainable.

6.1.2 However, it is legitimate to expect the auditor to examine the ability of the local authority to provide resources sufficient to deliver the statutory services for which it is responsible. It would not be appropriate for this Review to provide a commentary on local government funding, but there are a number of key questions that it would be reasonable to expect the auditor to assess. These could include:

- Has the auditor scrutinised the balance sheet to understand the debt profile of the authority and the level and depletion rate of usable reserves?
- What metrics does the authority use to determine the level of financial risk it faces?
- When the annual budget is approved by Full Council or equivalent, the CFO is required to present a "Section 25" report, providing a view on the reasonableness of financial estimates and the adequacy of reserves. Should the auditor be required to confirm that this report is sound?
- It is good practice for local authorities to prepare a mid-term financial strategy, normally covering a three to five-year period that is presented alongside the budget. Is it reasonable to expect the auditor to consider the assumptions underpinning this strategy or to form a view on its whether it is robust and realistic?
- Local authorities are also required to prepare statutory reports that have implications for financial sustainability and available resources in future years. These include setting a Prudential Borrowing limit, calculating an appropriate provision for repayment of debt (known as "Minimum Revenue Provision"), preparing an Investment Strategy, and potentially preparing a Flexible Use of Capital Receipts Strategy. Is it reasonable to expect the auditor to consider some of these strategies and estimates?

6.1.3 CFOs may have specific expectations of auditors. As previously indicated, many of the CFOs who contacted the Review made it clear that they valued the informal contact and challenge from the KAP. Dialogue between the KAP and the CFO does take place, if not on as wide a scale as it did pre-2015, and there is no doubt this can be beneficial. However, the independence of the auditor must be preserved in the way that advice and guidance may be tendered.

6.2 What does financial resilience mean in a local authority context?

The statutory framework

6.2.1 Financial resilience in a local authority is different to a private sector context. The powers and responsibilities of local authorities along with the financial control framework within which they operate are set by statute.

6.2.2 The services that local authorities are required to provide are set out in legislation along with the accompanying powers and duties. The statutory responsibilities to deliver these services exist even if the local authority's resources may be considered to be insufficient at any given time.

6.2.3 The key financial controls set out in statute are:

- The requirement to calculate an **annual balanced revenue budget** for the upcoming financial year, that must be approved by Full Council or the equivalent. Local authorities are not allowed to run a deficit budget. Instead they are required to calculate a level of Council Tax that equates to the difference between income and expenditure. The increase in the level of Council Tax that can be charged is restricted by a 'referendum principle'. If a local authority wishes to raise Council Tax by more than a percentage specified by Ministers, they are required to put the planned increase to a referendum of local electors. Local authorities can borrow to fund capital investment but are not normally allowed to do so to finance in-year expenditure.
- The CFO's **"Section 25" report** on the robustness of the council's budget estimates and the adequacy of its reserves, which must be presented to Full Council alongside the annual balanced budget.
- The CFO has the power to issue a **"Section 114 notice"** if the CFO believes that the local authority is unable to set or maintain a balanced budget. After a section 114 notice is issued, the local authority may not incur new expenditure commitments, and the Full Council must meet within 21 days to discuss the report. There is no legal provision regarding what action they then must take. There is no procedure in law for a UK local authority to go bankrupt, and none has ever done so.

6.2.4 If a local authority mismanages its budgets over a number of years so that it is unable to recover its financial position, then central government has the choice of intervening under its "best value" powers, providing exceptional financial support, facilitating an offer of leadership and governance support from elsewhere in the sector, or using a mixture of these options.

6.2.5 Intervention on the grounds of lack of financial resilience is very rare. The most recent statutory intervention using best value powers was in Northamptonshire in 2018. Although there have been three other statutory interventions in the intervening years (Doncaster due to pervasive corporate governance failures, Rotherham due to institutional failure in responding to child sexual abuse and Tower Hamlets due to pervasive governance and financial impropriety issues), Northamptonshire was the first statutory intervention primarily due to financial resilience issues since Hackney in 2000.

6.2.6 In both Northamptonshire and Hackney, central government supported the council during the intervention by providing exceptional financial support, primarily by allowing receipts from sale of assets to be used to support revenue expenditure. Northamptonshire was also permitted to raise council tax by 2% more than other authorities for 2019-20 without triggering a referendum.

6.2.7 Whilst this might suggest that financial resilience is not an issue for local authorities, that may not always be the case. Firstly, central government support cannot always be guaranteed and secondly, a local authority experiencing severe financial resilience issues may also be facing governance and service delivery issues, with a consequential impact on those who depend on those services. Furthermore, the impact of financial resilience issues on service delivery is iterative. It must be emphasised here that the system must identify and highlight financial resilience issues at the earliest opportunity in order to avoid negative impact on service. When a service fails, it is likely that that cost of recovery will be greater with a possible consequential impact on financial resilience.

6.2.8 This suggests that in a local authority context, financial resilience means the ability to manage budgets over the medium term whilst continuing to deliver high quality and effective services, that can be accessed by service users. The level of service provided is very important. Local authorities in financial difficulties can seek to cut costs by reducing the level of service. This may be the case for demand led services such as social care where it is more difficult to forecast accurately local demand pressure.

Commercialisation and local authority resilience

6.2.9 One of the most significant sectoral trends since 2015 is the increased commercialisation of local authorities. To simplify, there are two main categories of local authority commercialisation:

- Investment in commercial property, usually through the general fund; and
- Investment in wholly owned companies set up using the "general power of competence". The most common type of wholly owned local authority company is the housing company. Other examples identified include energy companies, recruitment agencies, back office service delivery companies and leisure trusts. PCCs and FRAs do not have a "general power of competence".

6.2.10 The risks commercialisation poses to local authority financial resilience were highlighted in a recent NAO study on *"Local Authority Investment in Commercial Property"*[13] which concluded:

"Buying commercial property can deliver benefits for Local Authorities including both the generation of income and local regeneration. However, as with all investments, there are risks. Income from commercial property is uncertain over the long term and authorities may be taking on high levels of long-term debt with associated debt costs or may become significantly dependent on commercial property income to support services. At the national or regional level, Local Authority activity could have an inflationary effect on the market or crowd out private sector investment."

6.2.11 Although the NAO study focused solely on commercial property, this conclusion is as relevant to investments in wholly owned companies. If a company that is set up using the "general power of competence" gets into difficulty, the parent local authority may ultimately be responsible or may have to write off loans or equity funding, and this can impact financial resilience.

6.2.12 An additional risk with wholly owned companies is a potential lack of transparency. It can be very difficult for a reader to identify a local authority's exposure as a result of

[13] https://www.nao.org.uk/wp-content/uploads/2020/02/Local-authority-investment-in-commercial-property.pdf

investments in or loans to wholly owned companies by looking at the accounts. Unless an investment in, or transactions with, a wholly owned company is material by value, there is no requirement to consolidate the company's income, expenditure, assets or liabilities in the local authority's accounts. Instead, what is required is a disclosure of transactions between the authority and each of its wholly owned companies in what is known as the "Related Parties note". This note is presented less prominently in the annual report and accounts document. In addition, decisions a local authority makes pertaining to its wholly owned companies, including those relating to providing additional finance and awarding contracts, are often held in private on grounds of commercial confidentiality.

Defining local authority financial resilience

6.2.13 CIPFA has attempted to define financial resilience in a local authority context. In *Building Financial Resilience (Jun 2017)*[14]. This publication highlights four pillars of sound financial management and five indicators of financial stress.

Figure 6.1

CIPFA Pillars of Financial Resilience

<table>
<tr><th>Pillars of financial resilience</th><th>Indicators of financial stress</th></tr>
<tr><td>Getting routine financial management right</td><td>Running down reserves</td></tr>
<tr><td rowspan="2">Benchmarking against nearest neighbours – e.g. unit costs, under/overspends by service area, under-recovery of income.</td><td>Failure to deliver planned savings</td></tr>
<tr><td>Shortening medium term financial planning horizons</td></tr>
<tr><td>Clear plans for delivering savings</td><td>Increase gaps in saving plans (i.e. where proposals are still to be identified)</td></tr>
<tr><td>Managing reserves over the medium-term financial planning horizon.</td><td>Increase unplanned overspends in service delivery departments.</td></tr>
</table>

6.2.14 The pillars of financial resilience identified by CIPFA related to process and governance points, so could be covered by the auditor's VfM opinion. Likewise, the indicators of financial stress could be covered by a sector-wide VfM audit framework.

6.2.15 An alternative and more detailed model, mentioned by some local authorities, is the seventeen principles set out in CIPFA's recently published Financial Management Code. Although only three of the seventeen principles are categorised under the heading of sustainability, in practice, all of the principles relate to matters that directly or indirectly contribute to an authority's capacity and capability to deliver sustainable services over the medium term.

6.2.16 A challenge common to both the *Pillars of Financial Resilience* and the *Financial Management Code* is that neither has any statutory basis. Whilst CIPFA requires its members to follow the *Financial Management Code*, compliance cannot be enforced. As a result, auditors may be reluctant to treat non-compliance with either as a matter serious enough on which to report.

[14] https://www.cipfa.org/policy-and-guidance/reports/building-financial-resilience-managing-financial-stress-in-local-authorities

6.2.17 A further challenge with the *Financial Management Code* is that the key principles are fairly detailed. Whilst an auditor could assess compliance with these principles, the costs of doing so in terms of both the auditor and of local authority time could be quite high.

6.2.18 Finally, neither the *Pillars* nor the *Financial Management Code* explicitly cover the impact of commercial activity on a local authority's financial resilience. General fund investments should be considered as part of the audit of financial accounts but wholly owned companies would only be considered if material enough to be consolidated into the accounts.

6.3 Current audit requirements to assess the sustainability and resilience of LAs in England

The Going Concern opinion

6.3.1 An underpinning principle of a financial audit is a 'going concern assumption'. The going concern principle means that readers of a set of accounts are entitled to assume a business will continue in the future, unless there is evidence to the contrary. When an auditor conducts the examination of the accounts, there is an obligation to review its ability to continue as a going concern for the next twelve months.

6.3.2 If the auditor concludes that there is significant doubt that the reporting entity is a going concern, the audit opinion is qualified, and a report explaining the auditor's financial resilience concerns is included with the audit opinion. In addition, if an entity is not a going concern, assets and liabilities must be valued at the amount they can be sold for rather than by assessing their ongoing value to the entity.

6.3.3 This particular way of validating a local authority's financial health has attracted much criticism from respondents. The view of practitioners is that that a local authority cannot face the prospect of bankruptcy/liquidity in the way that a company might.

6.3.4 In addition, local authorities are presumed to be a going concern for the purpose of forming an audit opinion, as the financial reporting frameworks for these bodies dictate a continued service approach, unless there is a clearly expressed Parliamentary intention to discontinue the provision of the services which the entity provides. The NAO has consulted on Supplementary Auditor Guidance, that reinforces this point.

6.3.5 87% of respondents to the Call for Views think the going concern assumption is meaningless in a local authority context. Respondents noted that local authorities would be likely to receive support from Central Government in the wake of a serious event. Many highlighted the example of Northamptonshire remaining a going concern for audit opinion purposes, even when the auditors had issued an advisory notice on what was considered to be an undeliverable budget. as an apparent example of the opinion's flaws. Those who responded that the opinion was meaningful included a majority of audit firms who acknowledged the going concern opinion's flaws and suggested changes but, on the whole, felt that it was still important that this assessment was carried out.

The value for money opinion

6.3.6 The other dimension of audit which could look at financial resilience is through the work required to support what is known as the 'value for money opinion'. The work required to support this opinion is governed by the NAO's Code of Audit Practice ("the Audit Code"). What the auditor is required to do is to form an opinion on the adequacy of the systems in place to support the economy, effectiveness and efficiency of service delivery. Under current practice in England, the auditor may test the adequacy of systems and procedures used to construct the mid-term financial plan but is only required to do so if a significant risk is identified during the audit. The auditor is not required to examine the mid-term financial plan from a sustainability perspective or form a conclusion on the financial resilience of the authority.

6.3.7 The update to the Audit Code, effective from 2020-21, will require auditors to provide a narrative statement on the arrangements in place. The aim of this statement is to provide more useful information to stakeholders, to report in a timelier manner and, through the move away from a binary opinion, encourage auditors to be bolder in highlighting concerns. The updated Audit Code has been broadly welcomed by stakeholders and has the potential to enhance value for money reporting in England.

6.3.8 What the updated Audit Code does not do is specify that auditors consider specific matters or judge local authority systems and performance against specific standards or good practice examples, such as CIPFA's *Pillars of Financial Sustainability* or their *Financial Management Code*. Nor does the updated Audit Code provide any guidance on how to assess whether a value for money risk is material.

Timeliness of the value for money opinion

6.3.9 Less than half of respondents to the Call for Views expressed an opinion on the timing of the VfM opinion. Two thirds of those who expressed an opinion agreed that the statutory reporting deadline of end-September was the right point in the annual cycle to present the VfM opinion, coming as it does near the start of the following year's annual budget setting planning cycle. Many commented that the external audit firms still had the capability to raise any significant VfM concerns outside this process, a process where they were happy with the content.

6.3.10 Those that disagreed included all but one of the audit firms who responded to this question. In addition, many of the local authorities who responded to the Call for Views didn't have strong opinions either way. Some thought that the opinion might be better presented in May, right at the start of the following financial year, but others expressed concern as to whether audit firms would have the capacity to handle a split reporting timetable.

6.3.11 A subsidiary, but still important, factor when considering the timing of the opinion is auditor resourcing. If the full benefits from the revised VfM opinion in the new Audit Code are to be realised, auditors will need to do more work.

6.3.12 Therefore, thinking about how to time the publication of the opinion so that it is of the most use, has the most impact, and can be supported by timely audit work must be a matter for serious consideration.

6.4 Practice in other jurisdictions

6.4.1 Audit requirements in other jurisdictions, for example Scotland, Wales and New Zealand provide alternative models, all of which provide practices that could help bridge the expectation gap between what auditors are required to do and what stakeholders expect them to do to assess financial resilience. The Review has explored New Zealand as it has a different model that is worthy of consideration.

6.4.2 Scotland and Wales have different models of value for money reporting, with Scotland's model requiring the auditor to assess future plans and Wales' model including the option for the auditor to undertake more focussed work on financial resilience as a separate engagement.

6.4.3 In New Zealand, there is no VfM opinion, but instead the financial audit opinion has been extended to cover a large number of pass/fail service delivery and financial resilience metrics. The financial resilience metrics are common to all authorities, allowing comparisons to be made.

6.4.4 Care needs to be taken when assessing the appropriateness of these models. There are currently 32 unitary authorities in Scotland, 22 unitary authorities in Wales and 78 local, regional and unitary councils in New Zealand compared to 343 local authorities in England. It may not be possible to scale-up practices that are appropriate in these jurisdictions to England in a coherent way or to do so at a reasonable cost.

Practice in Scotland

6.4.5 When scoping, planning, performing, and reporting on their 'best value' work, auditors in Scotland are required to consider four audit dimensions. The first of these, financial sustainability, interprets the short term going concern opinion and requires auditors to look *"forward to the medium (two to five years) and longer term (longer than five years) to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered."*

6.4.6 The results of VfM audits of Scottish local authorities tend to produce quite rich reports, which the Accounts Commission, the public spending watchdog for local government in Scotland, uses to identify and highlight key trends and risks across the sector. For example, the *Local Government in Scotland, Financial Overview Report 2018-19 (Dec 2019)*[15] found that Scottish councils were increasingly drawing down on their revenue reserves; and whilst all councils had medium term financial planning covering the next three to five years, long term financial planning had not improved since the last report.

[15] https://www.audit-scotland.gov.uk/uploads/docs/report/2019/nr_191217_local_government_finance.pdf

Practice in Wales

6.4.7 The value for money audit opinion an auditor of a Welsh local authority is required to provide is the same as that in England; that is an opinion on the "arrangements for securing economy, efficiency and effectiveness in its use of resources". However, the Welsh Code of Audit Practice requires auditors to review significant arrangements in place irrespective of whether material risks have been identified.

6.4.8 Where an auditor identifies notable financial resilience or other value for money concerns, the Auditor General for Wales has the statutory power[16] to publish a separate substantive report. These reports are publicly available on the Wales Audit Office's website and provide an in-depth assessment of the issues identified and the appropriateness of the plans that the local authority has to address these.

Practice in New Zealand

6.4.9 Local authorities in New Zealand are required to report performance in the Annual Report and Accounts against a range of financial prudence benchmarks specified in legislation. The auditor is required to report on the completeness and accuracy of the local authority's disclosures against these benchmarks. As all of the benchmarks have pass/fail thresholds, they lend themselves to a binary audit opinion.

6.4.10 The purpose of this statement is to disclose the Council's financial performance in relation to required benchmarks in order to assess whether the Council is prudently managing its revenues, expenses, assets, liabilities and general financial dealings. Although the benchmarks are backwards looking, five-year trend information is presented which helps the user of the accounts to understand how effective the local authority is in managing its financial resilience.

6.5 The audit of financial resilience – a new model for England?

Introduction

6.5.1 There is a significant gap between the reasonable expectations of many stakeholders and what the auditor is required to do when assessing the financial stability and resilience of local authorities.

6.5.2 To help bridge the expectation gap, the scope of audit should include a substantive test of a local authority's financial resilience and sustainability. Care and attention will need to be taken to define how the auditor should address historical, current and future financial sustainability issues, so that the engagement does not become overly burdensome or provide false comfort to stakeholders. In addition, expanding the scope of the audit will increase costs, and there needs to be a balance between those costs and the potential benefits of additional audit coverage and reporting.

6.5.3 However, cost should not be a deterrent in and of itself. The expansion of the opinion to encompass financial resilience and sustainability would, potentially, provide comfort to the authority and to council taxpayers that the finances are in good order. This

[16] under Section 17 of the Public Audit (Wales) Act 2004 and section 18 of the Local Government Wales Measure 2009

would represent a genuine demonstration of public accountability both from a local authority and from an audit perspective.

Form of the opinion

6.5.4 The revised narrative opinion proposed in the new NAO code should lead to a significant enhancement in the usefulness of auditor reporting. The 2020 Audit Code sets out three reporting criteria (para 3.10)[17]:

- Financial sustainability: *how the body plans and manages its resources to ensure it can continue to deliver its services;*
- Governance: *how the body ensures that it makes informed decisions and properly manages its risks; and*
- Improving economy, efficiency and effectiveness: *how the body uses information about its costs and performance to improve the way it manages and delivers its services.*

6.5.5 These criteria are not dissimilar to the four reporting pillars in the Scottish model. The pillar that auditors of English local authorities are not explicitly required to report on is financial management. It is unclear why this has been omitted but a possible reason is that an auditor would normally be expected to review material financial management controls as part of financial audit work.

6.5.6 The reporting requirements contained within the 2020 Audit Code will take time to settle down and embed and there will be a role for the regulator in identifying and promoting good practice. However, if practice develops as the NAO intends, the new reports should provide more useful information to stakeholders.

Work required to support an assessment of financial resilience

6.5.7 The 2020 Audit Code requires auditors to do less work to assess financial resilience than is required in either Scotland or Wales.

6.5.8 Specifically, auditors in England will not be required to test whether the body is planning effectively to continue to deliver its services or the way in which they would be delivered over the medium or longer time horizon as in Scotland. Nor will auditors be requested to review the design of significant arrangements to secure value for money, and, where appropriate given the assessment of risk, test the operating effectiveness of those arrangements as in Wales.

6.5.9 In addition to the factors mentioned in the Code, auditors could use the indicators of financial stress in the CIPFA publication, *Pillars of Financial Resilience*, as a key element of the risk assessment.

6.5.10 To support such an assessment the auditor could be required to critically assess and, in cases where significant risks are identified, test the CFO's Section 25 report along with any other statutory reports or management estimates that have an impact on medium or long term financial resilience. This testing could include an assessment

[17] https://www.nao.org.uk/code-audit-practice/wp-content/uploads/sites/29/2020/01/Code_of_audit_practice_2020.pdf

of whether there are clear plans for delivering savings, the usage rate for non-ringfenced revenue reserves and whether the local authority benchmarks its costs against nearest neighbours and takes appropriate action in response to variances, as set out in accordance with CIPFA's *Pillars of Financial Resilience*.

6.5.11 In addition, the auditor could explicitly be required to assess whether the local authority has complied in practice, and in spirit, with statutory guidance that it is required to "have regard to".

6.5.12 CIPFA's *Financial Management Code* is another model that provides a set of standards against which auditors could assess value for money and financial resilience. However, it is too detailed to assess without a considerable amount of additional audit work. Nevertheless, the principles in the *Financial Management Code* would enhance the consistency of local authority financial management. MHCLG could take the opportunity to give it statutory status when the opportunity arises and require local authorities to report on their compliance with it in their Annual Governance Statement. Since auditors are required to read the Annual Governance Statement to ensure it is consistent with their knowledge of the business this, combined with the enhanced resilience testing recommended, would require auditors to report material breaches.

6.5.13 Consideration has also been given to whether it would be appropriate to require a specific investigation. A more detailed report would enable specific VfM or financial resilience issues to be identified, as in the Welsh model. This is not recommended, as this element of the Welsh model is not applicable due to scale.

7. Financial reporting in local government

7.1 The purpose of financial reporting in the local authority sector

7.1.1 Financial reports provide information to people who seek to understand the performance of an entity. As most of the money that local authorities receive is provided from general or local taxation, it is reasonable to expect people outside the body who are interested in a local authority's financial performance to want to know how the money being managed is being spent. This includes knowing whether the local authority is performing effectively to achieve what was intended with this money.

7.1.2 Local taxpayers and service users do not have the power to require a local authority to produce bespoke financial information for them. Instead, they have to rely on the financial statements. They can inspect the financial statements and the underlying accounting records for a 30-day period that must comprise the first ten days in June. This means that to be relevant the information produced in local authority financial statements must meet the accountability and/or decision-making needs of users and be sufficiently transparent and understandable to allow them to ask appropriate questions.

7.2 Introduction to the framework

7.2.1 When producing financial reports, local authorities are required to have regard to the Statutory Code of Local Authority Accounting Practice ("the Accounting Code"), issued by the CIPFA. The Accounting Code is based on private sector accounting standards other than where they have been adapted for the specific circumstances of local authorities or where these are overridden by specific statutory requirements. As set out in **Figure 7.1**, Government retains the power to use secondary legislation either to override normal accounting practices or to require local authorities to include additional disclosures in their accounts.

Figure 7.1
Hierarchy of the Local Authority Accounting Framework

Primary Legislation	**Local Government Act 2003** Allows SoS to make provision about accounting practices that local authorities must follow.
Secondary Legislation	**Capital Finance and Accounting Regulations 2003** Gives CIPFA the power to produce a statutory accounting code. Introduces statutory overrides to private sector accounting practices; which must be reflected in the accounting code.
Statutory Code of Practice	**CIPFA Accounting Code of Practice** Statutory code setting out proper practices for local authority accounting in England.

7.2.2 When implementing, adapting or interpreting accounting standards, the Code seeks to maintain consistency with other parts of the UK public sector. Preparation of the Code is overseen by the CIPFA/LASAAC Accounting Code Board, which comprises representatives of all the key stakeholder groups. MHCLG has observer status on this Board.

7.2.3 This Accounting Code board does not act in isolation. Its decisions are reported to the Financial Reporting Advisory Board (FRAB), which advises HM Treasury on public sector accounting. In practice, both the annual update to the Accounting Code and any amendments or adaptations to accounting standards for the local authority sector need to be considered at FRAB as well as at the CIPFA/LASAAC Board.

7.2.4 The Accounting Code applies to Principal Councils, PCCs, Chief Constables, FRAs, the GLA, Mayoral Combined Authorities, Passenger Transport Executives and National Park authorities in England. It also applies to similar authorities in Wales, Scotland and Northern Ireland, although the legislative framework for these authorities is different and they are outside the scope of this Review. The Code does not normally apply to subsidiary companies consolidated into local authority accounts. Such companies use the applicable private sector accounting framework.

7.2.5 The Accounting Code is updated annually, and a new edition is published each financial year. Purchasing the 2019-20 Code from CIPFA costs £340 (hard copy) or £710 (online copy). CIPFA's sales numbers demonstrate that at least one third of local authorities do not purchase an Accounting Code in any given year.

7.2.6 The Accounting Code does not apply to smaller authorities, for example Parish Councils, Ports Authorities or Independent Drainage Boards with gross income or expenditure of less than £6.5m per annum (which is currently all but one of them). The accounting and governance framework for these authorities is set by an organisation called the Joint Panel on Accountability and Governance (JPAG), which comprises representatives of all of the key stakeholder groups. Smaller Parish Councils fill in a simplified financial return on a receipts and payments basis. Further discussion of smaller authorities is included in **Chapter 8**.

7.3 Format of local authority accounts

7.3.1 Local authority accounts are very lengthy compared to accounts in other sectors, typically numbering in excess of 50 pages for shire districts and more than 80 for upper and single tier local authorities. They have more primary statements than central government and private sector accounts. **Figure 7.2** shows the primary statements and supplementary accounts that the user can expect to find in a set of local authority accounts.

7.3.2 Local authority accounts are arguably more complex and more challenging for a service user to understand than accounts produced by other parts of the public sector. This is primarily because there is a difference between the budget analysis of information for council tax purposes and the statutory basis of year end accounts.

Figure 7.2

Local Authority Accounts – Primary Statements and Supplementary Accounts

Statement	Purpose
Comprehensive Income and Expenditure Statement (CIES)	Summary of the resources generated and consumed by the council on an accruals basis. Shows gross and net expenditure by service area and other income and expenditure incurred by the council.
Movement in Reserves Statement (MIRS)*	Shows how the movement in reserves in the Balance Sheet is reconciled to the CIES deficit and what adjustments are required to be charged to the general fund balance for Council Tax setting purposes.
Balance Sheet	Sets out the Council's financial position at the year end.
Expenditure and Funding Analysis (EFA)*	Summarises the annual expenditure used and funded by the Council together with the adjustments between the funding and accounting basis to reconcile with the CIES.
Cashflow Statement	Summarises the inflows and outflows of cash for revenue and capital transactions during the year.
Collection Fund Account* • Billing authorities	Agent's statement that reflects the statutory obligation for billing authorities to maintain an account showing collection of Council Tax and National Non-Domestic Rates (NNDR) and the distribution of these taxes to precepting authorities.
Housing Revenue Account (HRA)* • LAs with social housing stock	Local authorities are not allowed to cross subsidise provision of social housing from general taxation or vice versa. The HRA shows the major elements of expenditure on social housing and how these costs are met.

** Statements unique to local authority accounts*

7.3.3 Local authorities calculate their annual council tax requirement through setting a "balanced budget". The balanced budget calculation that local authorities are required to make is specified in primary legislation and is undertaken on a receipts and payments basis. Following the adoption of accruals accounting[18] by the local authority sector and as IFRS have continued to develop, successive governments have sought to protect council taxpayers from accruals movements that do not have an immediate impact on the costs of service delivery. They have done this through introducing statutory overrides.

7.3.4 The most significant of these statutory overrides relates to depreciation. Local authorities are required to charge depreciation on assets in the same way as any other entity. They then reverse out the depreciation charge in the Movement in Reserves statement (MIRS) and replace it with a prudent provision for the debt taken out to acquire assets (Minimum Revenue Provision).

[18] Accruals accounting is a form of accounting where you recognise the economic cost of assets and liabilities over the period when benefits accrue. For example, if you are using accruals accounting and buy a car that you expect will last five years you would split the purchase cost of that car over five years. By comparison if you are accounting on a receipts and payments basis you would recognise the full cost of the car in the year you pay for it.

7.3.5 The adjustments process has two consequences. Firstly it substantially increases the length of local authority accounts as the financial statements report some transactions on both an accruals basis (through the CIES) and a funding basis (through the EFA and MIRS) and include notes reconciling the two; and secondly, unlike for financial statements produced by other sectors, neither the CIES nor the Balance Sheet shows the true financial position of a local authority. To understand that position it is necessary to understand how the outturn reported in these statements reconciles to the basis on which the balanced budget calculation is made.

7.3.6 In addition to the statements in **Figure 7.2**, those local authorities who are also "administering authorities" for local authority pension funds are required to publish full Pension Fund accounts in the same document as their local authority accounts. The Pension Fund accounts are audited as a separate audit engagement. This further lengthens the document and means that the audited accounts cannot be published as final until both the local authority audit and the pension fund audit have been completed. The sector has asked MHCLG to look at decoupling the local authority and pension fund accounts. However, it is not possible to do this without primary legislation.

7.4 Usefulness, understandability and transparency of local authority accounts

7.4.1 The Annual Accounts that each local authority must prepare are prescribed in detail and relevant standards must be observed in the preparation of the statutory accounts and financial report. IFRS cover both the public and private sectors so auditors seek to adhere to those principles when auditing local authority accounts. There is widespread agreement that the resultant accounts are not transparent or easily understandable.

7.4.2 Local government practitioners argue that the extent and nature of asset valuations, very relevant in a commercial setting, undertaken by auditors, have limited significance in local government where assets are more often than not critical to service delivery and "market value" is not a consideration. Time allocated to the asset valuation process for property and pensions, it is agreed, is considerable and increases the cost of audit as well as, in some cases, leading to delays in the audit being finalised. Underlying this point is the question of whether IFRS should continue to be a key element of local authority statutory accounts.

7.4.3 An issue related to the concern in local government about the complex local authority accounting arrangements is the capacity of the external auditor to test and validate technically intricate accounting treatment without a familiarity with local authority finance and accounting. Such an assertion by local government is not universal but it is a concern of many. However, the audit community, whilst recognising that there has been depletion in the number of auditors who served in the District Audit Service, is confident it has necessary skills and resources to fulfil the role.

7.4.4 As highlighted in **Chapter 4**, there is evidence of market stress in the supply of appropriately experienced and qualified local authority auditors. Some auditors have also argued that local government itself does not always have accounting staff with the technical expertise to complete the final accounts without guidance and support from external audit.

7.4.5 That the local authority accounts are very complex is not in dispute. There is wide acknowledgment from all stakeholder groups that the annual financial statement of accounts is understandable only to those with the necessary technical and professional knowledge of local authority accounts. When asked whether local authority accounts allow the user to understand an authority's financial performance and its financial resilience, 93% of respondents said no.

7.4.6 Whilst some local authority respondents argued that the understandability of the accounts is not an issue, because service users and taxpayers can take assurance from the fact that they are prepared and audited to internationally recognised standards, it is questionable whether this is a defensible position.

7.4.7 The lack of transparency and understandability of local authority accounts raises a fundamental and serious challenge in terms of transparency and public accountability. Potential users extend beyond councils, government and auditors. Key stakeholders include council taxpayers/service users, the general public, academia, the media and local authority partners and contractors. Without an appropriate level of transparency these users may not have the information to challenge their local authority effectively. The rigour underpinning local authority accounting and auditing may not be at issue but the accounts, as currently structured and presented, do not enable the public to understand how local authorities are stewarding public funds.

7.5 Options for reform

7.5.1 There are three broad options for enhancing the transparency and usefulness of local authority financial statements, so that they better serve the needs of a wider group of stakeholders. These are:

- Review of IFRS as a basis for the preparation of local authority accounts.
- Expansion and standardisation of the current narrative statement.
- Introduction of a new summary statement presented alongside the IFRS accounts.

7.5.2 The underlying purpose of all three options is to strengthen financial transparency and accountability by providing a simplified presentation that is more relevant to stakeholders. All options have costs associated with them but these need to be set against the benefits of that increased transparency.

Review basis on which accounts are prepared

7.5.3 CIPFA could be asked to review the basis of accounts, with the aim of updating the Accounting Code so that the transactions presented in the annual financial statements are prepared on the same basis as the annual budget approved by Full Council.

7.5.4 If followed to its logical conclusion, this would allow local authorities to prepare simplified accounts that could be easily reconciled to the annual budget. If accounts are presented on a funding basis, the reconciliations between the funding and accounting basis would no longer be required. In addition, many of the lengthier notes to a set of financial statements, such as the financial instruments disclosures, are mainly required to support IFRS disclosures and could be removed or simplified. This would lead to much shorter documents.

7.5.5 There are some issues that would have to be addressed with this recommendation. Firstly, designing and implementing a new accounting framework would be challenging. CIPFA could go back to the pre-2010 near cash accounting framework, but it is questionable whether this would be appropriate. Many local authorities are far more commercial in their operations and have far more leveraged balance sheets than in 2010, so removing much of the accounting for long term assets and liabilities could present a misleading picture of financial resilience to service users. It could lead to local authorities to leveraging their balance sheet yet further, storing up potential financial problems for future years.

7.5.6 Secondly, there is the perception risk of such a step. There could be a perceived disconnect if local authorities reverted to cash accounting at the same point that some are becoming more commercial, taking on more debt to invest in assets acquired solely or partially to generate a return.

7.5.7 Thirdly, moving away from IFRS accounting would create consistency problems between various parts of the public sector. The Accounting Code applies to Scotland, Wales and Northern Ireland as well as to England. If English local government moved to a near cash accounting framework, the other UK jurisdictions would face the decision of mirroring that move or else the Accounting Codes would need to diverge. In addition, the results of UK local government bodies are consolidated into the Whole of Government Accounts, which are prepared on an IFRS basis. If English local authority accounts moved to a near-cash accounting basis, those authorities would in practice be required to maintain financial records and prepare accounts on two bases: on a near-cash basis for their own accounts and an IFRS basis for consolidation into WGA. This would impose considerable additional cost.

7.5.8 Finally, the UK public sector is held up as applying a gold standard of accounting, primarily because it is one of the few to apply IFRS fully. If part of the sector moved away from this it could generate considerable reputational risk. As a result, HM Treasury and FRAB may well oppose any significant modification of the English local authority accounting framework.

Expansion and standardisation of the narrative statement

7.5.9 The framework for local authority annual reports and accounts is unusual in that, although local authorities are required to prepare an annual report, it does not include any mandatory disclosures. In 2015 CIPFA launched the “Telling the Story” initiative, which encouraged local authorities to use the annual report to accurately reflect financial and service performance. Some local authorities have produced innovative and informative annual reports following the launch of this initiative, but performance varies, with other authorities making minimal disclosures. In addition, because “Telling the Story” does not include mandated standards or disclosures it is not consistent across authorities.

7.5.10 By comparison, the UK Central Government Financial Reporting Manual (the "FReM") requires all central government reporting entities to prepare a Performance Report and an Accountability Report, both of which are based on Companies Act requirements as adapted for the public sector and contain mandated disclosures.

7.5.11 A similar approach could be adopted for local authority accounts. In this model, local authorities could be required to include a Performance Report in their annual report and accounts containing a reconciliation between the approved budget and year-end service expenditure, along with explanations for significant variances and the impact of the variances on revenue reserves, prepared on a budget setting basis whilst being reconcilable to the statutory accounts. Potentially this could be supplemented with standardised service delivery metrics and an explanation of longer-term risks and mitigations linked to key financial management strategies such as the Mid-Term Financial Plan, as appropriate.

7.5.12 The proposed Performance Report could be a transparent element of a local authority's Annual Report and Accounts, which discloses what the local authority planned to spend on each major service area, what it actually spent, where there were significant variances between the two what the reasons were, and what impact that has had on the reserves available to support the following year's expenditure. With the addition of service delivery metrics, the Report could also start to give an indication of what service users and taxpayers have got for their money. If the financial information and performance metrics are prepared to common standards, this could start to bring a degree of comparability between authorities, which could promote improvements in the effectiveness and efficiency of service delivery.

7.5.13 Finally, if the reconciliation between budget and outturn is presented in the Annual Report, it may be possible to remove or reduce the MIRS, the EFA and supporting disclosures. This could offset the increased work required to produce the new Performance Report.

7.5.14 There are some challenges with this approach:

- it would mean extending the scope of the audit engagement, particularly if the auditors are required to form an opinion on non-financial information.
- if non-financial service delivery metrics are subject to audit they will need to be prepared and disclosed on a consistent basis. It will be necessary to identify appropriate metrics across a range of service areas, a process that could take time. In addition, including metrics for all of the services that a local authority provides would require very lengthy disclosures.
- if included in a long Annual Report and Accounts document, there is no guarantee that this statement would be any more visible to the general public than the current financial statements are.
- there is a risk that some local authorities use the narrative element of such a statement to present an overly positive view of their achievements and finances.

Introduction of a new summary statement

7.5.15 A variation in part, and a replacement of the enhanced narrative statement, is to leave the current local authority accounts largely unaltered and instead require the production of Summarised Accounts, prepared on the budget setting basis. As with the enhanced narrative statement, the Summarised Accounts would need to be reconcilable to the Statutory Accounts and be subject to audit to have credibility.

7.5.16 Statutory Guidance would need to be developed to set out the form and content of the Summarised Accounts. Potentially they could contain:

- A statement of service information and costs prepared in a standard format and to a standardised framework. The most appropriate framework would probably be the statutory Service Reporting Code of Practice (SERCoP).
- Comparison between budget setting information and outturn performance.
- A degree of detail to encompass all key service expenditure heads; where appropriate this could be extended to present unit cost information. A simplified balance sheet, including some form of assurance relating to non-ringfenced revenue reserves and debt levels and borrowing plans, with the latter linked to the Prudential Framework disclosures, could also be produced.
- A brief narrative. This could be limited to a financial commentary comprising explanations of significant variances between budget and outturn along with an assessment of the impact on medium term financial sustainability. It may also be possible to include a brief description of outcomes though this would need to be linked back to the objectives set when the annual budget was approved.

7.5.17 The aim of this document would be to present a statement aimed at the local community rather than as a basis for compiling national statistics. Because of differences between local authorities, comparability would be difficult and potentially misleading. Local authorities could be asked to think about a range of communication methods to reach their local communities more effectively.

7.5.18 The summary accounts would be a vehicle to increase transparency. As this would be a short stand-alone document, it would be much more accessible to taxpayers and service users.

7.5.19 Local authorities would have to reconcile outturn between the funding basis and IFRS accounting basis. However, the value of disclosing these reconciliations could be reassessed, potentially allowing the MIRS, the EFA and supporting disclosures to be discontinued. This could allow the statutory financial statements to be prepared on an IFRS basis without statutory adjustments.

7.5.20 Finally, consideration would need to be given as to the level of audit required for the Simplified Statements, and the agreed procedures that auditors would be required to undertake to provide assurance over reconciliations between the IFRS Financial Statements and the Simplified Financial Statements, that are not disclosed in either.

8. Smaller authorities

8.1 Introduction

8.1.1 Smaller authorities are defined in the 2014 Act as an authority where the higher of gross annual income or expenditure does not exceed £6.5 million for three years (or one or two if the authority has not existed for three years). Currently there are just under 10,000 smaller bodies, only one of which has to prepare a full set of IFRS compliant accounts and undergo a full audit.

8.1.2 There are different types of smaller authority with a varied range of responsibilities and powers:

- Local councils including Parish, Town, Village and Community Councils and parish meetings. Some common responsibilities can include, but are not limited to, commons and open spaces, car parks, lighting, footpaths, leisure and sports facilities, litter bins, and tourism activities. Some of these services are delivered on behalf of the unitary and district councils.
- IDBs which are responsible for managing water levels including managing flood risks and land drainage.
- Other smaller authorities such as charter trustees, port health authorities, conservation bodies and crematorium boards.

Smaller authorities are financed primarily through a precept which is collected as part of council tax by the unitary or district council. They can also apply for grants and awards.

8.1.3 Governance arrangements depend on the type and size of the authority. All local authorities are required to have a clerk; however, for small authorities, this could be their only employee or may be a volunteer or part-time worker. Roughly two-thirds of smaller authorities have a single employee, and some don't have any employees. The clerk is analogous, in part, to a CFO in a principal authority, as there is a requirement to give guidance to councillors, in many cases carrying out the role of the Finance Officer. Smaller authorities must publish the statement of accounts together with any certificate or opinion provided by the local auditor[19].

8.2 Scale of audit

8.2.1 Smaller authorities are not required to produce IFRS based accounts but instead produce a simplified statement of account on a receipts and payments basis. Some larger Parish Councils present accruals-based accounts alongside this, although these are unaudited. As set out in **Figure 8.1**, smaller authorities are either exempt from audit or undergo a 'limited assurance engagement'. As the name suggests, this provides less assurance than a full-scale audit.

8.2.2 While most authorities with an income or expenditure of up to £25,000 are exempt from audit, a request can be made for a 'limited assurance engagement' from SAAA who will then appoint an auditor to undertake this work. More than 100 bodies have chosen to do this.

[19] The Accounts and Audit Regulations 2015
https://www.legislation.gov.uk/uksi/2015/234/pdfs/uksi_20150234_en.pdf

Figure 8.1

Table of audit thresholds and associated requirements for smaller authorities [20]

Level of income or spending	Form of external assurance to be provided from 2017-18 onwards	% of smaller authorities in each band
More than £6.5 million.	'Full audit' under international auditing standards.	0.01%
Up to £6.5 million but more than £200,000 (accounts on income and expenditure basis)	Limited assurance engagement but may opt for 'full audit'.	11%
Up to £200,000 but more than £25,000 (accounts can be on either receipts and payments or income and expenditure basis)	Limited assurance engagement but may opt for 'full audit'.	31%
Gross income or gross expenditure up to £25,000	Exempt from audit and limited assurance engagement in most cases, subject to the authority certifying that it is exempt. Work by an auditor may still be needed in certain circumstances – notably if there are objections to the accounts.	58%
No financial transactions and no accounts	Exempt from audit and limited assurance engagement in most cases, subject to the authority certifying that it is exempt.	

8.2.3 Smaller authorities are also required to undertake an internal audit to evaluate the effectiveness of its risk management, control and governance processes[21]. Quality of internal audit staff is said by some respondents to be variable, which has the potential to cause issues for the external audit.

8.2.4 One of the trends in recent years has been the transfer of assets and associated running costs to Parish Councils. If smaller authorities are given more responsibility, or if the spending of smaller authorities were to change to where many such authorities approach the £6.5 million threshold, the current accountability arrangements may no longer be appropriate. The assurance levels may need to be reviewed by MHCLG. This is especially pertinent as smaller authorities are not bound

[20] NAO AGN02 Specified Procedures for Assurance Engagements at Smaller Authorities https://www.nao.org.uk/code-audit-practice/wp-content/uploads/sites/29/2015/03/Auditor-Guidance-Note-02-Specified-Procedures-for-Assurance-Engagements-at-Smaller-Authorities.pdf

[21] The Accounts and Audit Regulations 5(1) 2015https://www.legislation.gov.uk/uksi/2015/234/made#:~:text=5.,internal%20auditing%20standards%20or%20guidance.

by council tax referendum rules[22] and can raise their precept by the amount they consider necessary.

8.2.5 In 2020, one IDB met the threshold for preparing full statutory accounts. Available evidence suggests that this is the first occasion of this happening. The cause of the IDB's increase in income and expenditure was the capital grants it received and, as such, the requirements for a full code audit may be temporary. PSAA and the Association of Drainage Authorities (ADA) have worked with the authority to find a new auditor as the previously appointed auditor does not qualify under the statutory framework to undertake full audits. This also resulted in an increased audit fee, from less than £5,000 to £40,000. Producing full IFRS accounts will considerably increase the amount of internal work required by the IDB and this is likely to represent a challenge to its available skills and infrastructure.

8.3 Procurement of audit

8.3.1 Prior to 2017, smaller authorities were included in the audit contracts let by the Audit Commission in 2014 that were taken over by PSAA through the transitional arrangements. SAAA was designated as an appointing person under legislation[23] by the Secretary of State to take over this role from 2017-18. SAAA is an independent, not for profit company. SAAA was set up by the National Association of Local Councils (NALC), Society of Local Council Clerks (SLCC) and the Association of Drainage Authorities (ADA). Although smaller authorities have the same power to appoint their own auditors as principal authorities, in practice, all smaller authorities opted in to SAAA's procurement. SAAA has appointed external auditors for a 5-year period from 1 April 2017.

8.3.2 SAAA's procurement comprised 17 equally sized lots. Other than for IDBs, which were grouped together, lots were geographically based. The SAAA procurement was based on price once a supplier had met a minimum quality threshold. There were five firms that met this threshold. The result of this exercise was that 15 were awarded to a single audit firm and two other firms won one lot each. This met SAAA's declared objective of having a minimum of three firms in the market. Of the three firms, two had previously held contracts with PSAA and one re-joined the market. With regard to the quality and price ration for appointing auditors, SAAA believes that once a certain threshold is reached, it is very difficult to differentiate between firms on the basis of quality.

Fee scale

8.3.3 SAAA's fee scale is based on 15 bands of income or expenditure (whichever is higher). Audit Commission and then PSAA, through the transitional arrangements, also used this fee scale. Exempt authorities do not pay an audit fee. Authorities with income or expenditure of between £25,000 and £50,000 pay an audit fee of £200. Fees rise in stages up to a maximum of £3,600 in cases where income or expenditure is more than £5 million but less than £6.5 million.

[22] The Local Authorities (Conduct of Referendums) (Council Tax Increases) (England) Regulations 2012 https://www.legislation.gov.uk/ukdsi/2012/9780111519035/regulation/3
[23] The Local Audit (Smaller Authorities) Regulations 2015 https://www.legislation.gov.uk/ukdsi/2015/9780111126103

8.3.4 The scale fees paid by smaller authorities for their audit have remained unchanged for the past 12 years. There have been savings for those smaller authorities that, from 2017, could declare themselves as exempt and, therefore, did not have to pay for an audit.

8.3.5 This audit fee model relies on larger authorities supplementing the cost of audit work for smaller authorities. As there are 15 bands of fees, there may be councils receiving the same level of audit work whilst paying different amounts. Although this may offer the most efficient method of payment to ensure audit is affordable for all smaller authorities, the banding system may warrant review.

8.3.6 Overall, smaller authorities seem content with the level of audit fees they pay. The only area of concern raised related to capital grant funding. Two Parish Councils raised concerns that the impact of the rising scale fee could be a deterrent for local authorities investing in future capital schemes in the local community.

Fee variations

8.3.7 Smaller authorities may be subject to variations to the scale fees set out above if additional work is needed. Some of this work is costed as a fixed supplement of the fee scale and some is charged at fixed hourly rates. SAAA agreed a maximum hourly rate for additional work and this is published on their website. Examples of where fee variations may be charged include the auditor considering objections to the accounts from local electors, and where special investigations are undertaken.

Quality

8.3.8 There is no indication that the smaller authority audit market is encountering delayed audit opinions, as is the case for larger authorities. SAAA use trackers completed by the firms to collate and analyse key management information to track and report on the management, delivery and the outcomes of limited assurance reviews. SAAA also reviews the underlying data quality and system interfaces on a light touch risk basis.

8.3.9 In carrying out its quality assurance role, as set out in the Appointing Person Legislation, SAAA review and test the firms' internal quality assurance processes and contract compliance systems (quality aspects) to ensure the delivery of good quality reviews. An overall rating for both quality of limited assurance review work and contract management, compliance and data quality is provided. The findings of this process are reported to each firm and to SAAA's Board. They do not publish these findings, though they maintain the right to do so.

8.3.10 A very small number of smaller authorities responded to the Call for Views; therefore, it must be stressed that the following comments are not necessarily reflective of the sector. One Parish Council commented that the arrangement with SAAA made it feel that the auditor didn't consider the council to be its customer. Similar feedback has been received concerning PSAA's role. It also commented that it felt the quality of their audit was very poor and that it added no value. This may be in part due to the framework of limited assurance audit for smaller authorities and a resulting 'expectation gap'. The Review is unable to corroborate whether this is a commonly held view.

8.3.11 Two other Parish Councils questioned whether auditors provided the right level of assurance. One commented that larger Parish Councils should be held to the same standards for financial reporting, transparency and accountability as those applied to principal authorities of equivalent size. The council linked this to the fact that some councils are playing an increasingly significant role in their communities. It is true that there are currently three smaller authorities that have an annual income or expenditure of over £5 million which is similar to the smallest Category 1 authority which is subject to a full audit. However, there are not many Category 1 authorities that are this small. The other respondent was specifically concerned about governance and financial transparency within the council and the lack of clarity on spending.

8.4 Accountability

8.4.1 In addition to producing a financial return, most smaller authorities are subject to transparency requirements. There are two Transparency Codes; authorities with an income or expenditure of £200,000 or more are included in the same mandatory Transparency Code[24] as principal authorities. Exempt authorities are subject to a specific smaller authority Transparency Code[25], made mandatory in April 2015, that:

"will enable local electors and ratepayers to access relevant information about the authorities' accounts and governance".

8.4.2 Authorities with income and expenditure under £200,000 but above £25,000 are expected to follow the same requirements but it is not mandatory. As these authorities are subject to audit, the transparency code was not considered to be applicable. Such difference in approach may warrant further attention. However, Commitment 8 in the governments UK National Action Plan for Open Government[26], sets out the government's plan for local transparency which includes MHCLG developing proposals to:

"help and encourage councils to publish all the information they can".

Objections

8.4.3 Local objections can be made to an item of expenditure in a smaller authority's finance return. It is very difficult to ascertain how many objections to the accounts smaller authorities receive, as the auditor is required to respond, by statute, only to the objector. As a result, most objections are never made public, the exceptions being if an objector choses to publish a response or the investigation leads to a Public Interest Report. However, one authority reported over 100 objections in a single year. NALC commented that several authorities at the smaller end of the income and expenditure level are consistently subject to objections, sometimes by the same individual or group of objectors.

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[24] Local Government Transparency Code 2015
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/408386/150227_PUBLICATION_Final_LGTC_2015.pdf

[25] Transparency Code for Smaller Authorities
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/388541/Transparency_Code_for_Smaller_Authorities.pdf

[26] 2019-2021 UK National Action Plan for Open Government
https://www.opengovernment.org.uk/resource/uk-national-action-plan-for-open-government-2019-2021/

8.4.4 The auditor is responsible for reviewing all objections that meet the statutory requirement. In deciding whether to investigate, the auditor has to review the objection, which will result in a cost to the authority (not exceeding the maximum hourly rates as specified by SAAA) even if they do not subsequently pursue an investigation.

8.4.5 The auditor can refuse to investigate an objection[27] if:

- the cost of dealing with the complaint would be disproportionate to the underlying sum;
- the objection is frivolous or vexatious; or
- it is a repeat of a complaint made in a prior year of account.

8.4.6 A number of smaller authorities receive repeat or vexatious complaints. Where an authority receives such a complaint, it can choose to terminate communication with the complainant. However, if that individual raises an objection, an auditor must consider it to see if it is something to be pursued. This work incurs a supplement to the scale fee as set out by the SAAA. Given the size of many smaller authorities, objections can be proportionately very costly, both in terms of additional fees paid to auditor firms and in terms of resources that the authority requires to support, appropriately, the objection process. As with larger authorities, outstanding objections can cause a delay in issuing the audit opinion

8.4.7 The objections regime does provide a solid basis of accountability and ensures the auditor investigates potential issues further, to supplement the 'limited assurance' audit. There may be cases where the system is misused. Consideration should be given to provide more support to auditors to enable them to identify repeat or vexatious objectors in a more efficient manner.

Public Interest Reports

8.4.8 External auditors have a duty under the 2014 Act to consider whether to issue a report where there has been a significant matter identified that needs to be addressed in the interests of the public. There are more PIRs issued for smaller authorities than there are for larger authorities. SAAA publishes reports from the 17/18 financial year on their website, and previous financial years are available on the archived PSAA website.

Figure 8.2

Smaller Authorities - Reasons why a PIR was issued

	16/17	17/18	19/20
Failure to produce an annual return (for 16/17) or an AGAR (from 17/8 onwards)	16	22	23
Criteria submitted for exemption not all satisfied	N/A	0	8
Other	6	1	0
Total	22	23	31

The "other" category includes issues relating to governance, fraud, employment law, and non-compliance with VAT regulations.

[27] NAO Local Authority accounts: A guide to your rights https://www.nao.org.uk/code-audit-practice/wp-content/uploads/sites/29/2015/03/Council-accounts-a-guide-to-your-rights.pdf

8.4.9 One authority had a PIR issued for all three years for failure to produce an annual return or annual governance and accountability returns (AGAR), and a further seven authorities had a PIR issued in two of the three years for the same reason. Failure to produce an AGAR from 2017/18 triggers a statutory recommendation to the authority from the external auditor that it should submit an approved AGAR within 42 days. A public interest report is then issued if the authority fails to do so.

8.4.10 Out of the six PIRs issued in 16/17 that were *not* due to a failure to produce an annual return, four of them related to work carried out by auditors in response to objections raised by a local elector. In one authority's case, it received objections on a multitude of issues with one issue (ineffective internal audit and other governance failings) receiving a number of objections.

8.4.11 If a smaller authority chooses not to engage with external audit recommendations or PIRs, there is no mechanism, other than through local elections, to hold smaller authorities to account. The LGSCO investigates complaints against larger local authorities, but this does not extend to Parish Councils. If MHCLG wishes to devolve more powers to smaller authorities or smaller authorities increase their spending considerably, MHCLG should consider further accountability arrangements for smaller authorities.

8.5 Financial Reporting in Smaller Authorities

8.5.1 Smaller authorities that are able to declare that they have had had no financial transactions in the year of account do not need to prepare accounts. Instead they can send a declaration that they are exempt to their auditor.

8.5.2 Smaller authorities that cannot declare themselves exempt have to prepare an Annual Governance and Accountability Return (AGAR). The AGAR which is freely available, is updated and produced by SAAA and approved by the SAAA board. The cost of its production is met by SAAA.

8.5.3 JPAG is responsible for issuing proper practices about the governance and accounts of smaller authorities. Its membership consists of sector representatives from the National Association of Local Councils, the Society of Local Council Clerks and the Association of Drainage Authorities, together with stakeholder partners representing MHCLG, the Department of Environment, Food and Rural Affairs, CIPFA, the NAO and a representative of the external audit firms appointed to smaller authorities.

8.5.4 The AGAR has a number of sections. In order these are:

a. Guidance notes on how to complete the template and what information needs to be published on the authority's website.
b. The Annual Internal Audit Report.
c. Section 1: The Governance Statement.
d. Section 2: The Accounting Statement, which is prepared on a receipts and payments basis.
e. The External Auditor Report and Certificate.

8.5.5 Each non-exempt smaller authority is required to complete parts b, c, and d of the AGAR and send it together with a bank reconciliation and an explanation of any variances between the budget and the outturn to the auditor. The template itself is quite short, but fairly busy, with detailed guidance included in each section.

8.5.6 Under the Accounts and Audit Regulations 2015, authorities must publish the following information on a publicly accessible website. Before 1 July, smaller authorities must publish:

- Notice of the period for the exercise of public rights and a declaration that the accounting statements are as yet unaudited;
- Section 1 - Annual Governance Statement, approved and signed; and
- Section 2 - Accounting Statements, approved and signed.

8.5.7 Not later than 30 September, smaller authorities must publish:

- Notice of conclusion of the audit;
- The External Auditor Report and Certificate: and
- Sections 1 and 2 of AGAR including any amendments as a result of the limited assurance review.

9. Conclusions

9.1 During the course of this Review it has become increasingly apparent that the current local audit arrangements fail to deliver, in full, policy objectives underpinning the 2014 Act. As a result, the overriding concern must be a lack of coherence and public accountability within the existing system. For local audit to be wholly effective it must provide a service which is robust, relevant, and timely; it must demonstrate the right balance between price and quality; and be transparent to public scrutiny. The evidence is compelling to suggest that the current audit service does not meet those standards.

Key Factors Determining the Outcomes of The Review

9.2 In reaching the outcome and recommendations for this Review the following key factors have been taken into account:

- providing clarity of purpose in local audit;
- giving emphasis to performance and accountability in local audit framework;
- maintaining and improving the stability of the local audit market;
- reaffirming the importance of the auditing and accounting staff having the requisite skills, training and experience to fulfil their roles;
- improving and strengthening the governance arrangements underpinning effective local audit;
- developing coherence and coordination in the procurement and effective delivery of audit performance within a clear and consistent accountability framework;
- engaging key stakeholders in regular dialogue as an aid to maintaining an effective local audit service; and
- providing transparency in financial and external audit reporting to reinforce public accountability.

Local Audit

9.3 As currently configured the local audit market is vulnerable, due in no small part to the under-resourcing of audit work required to be undertaken within the contract sum. In addressing this weakness, a fundamental review of the fee structure is necessary. Evidence suggests that audit fees are at least 25% lower than is required to fulfil current local audit requirements effectively. Concerns reported about variable levels of knowledge and experience of local government finance and accounting demonstrated by auditors must also be addressed. The skills and competencies of auditors must also be paramount if the full extent of audit requirements are to be delivered satisfactorily. The current audit deadline of 31 July is viewed as unrealistic and in the light of the evidence presented by the Call for Views, there is a compelling argument to change this date to 30 September. The procurement arrangements must acknowledge these factors and it is essential that the audit performance regime offers assurance to the public that true accountability has been served.

9.4 Attention has been given to whether the existing local audit framework might be improved to achieve these objectives. The roles and responsibilities of all relevant bodies should be reviewed to respond to the concerns expressed in this report. However, the key challenge is the underlying weakness of the current arrangements where there is no coordination and regulation of local audit activity. This is a role best discharged by a single overarching body.

9.5 A single body would embrace all aspects of local audit incorporating procurement, contract management, the code of local audit practice, accountability for performance, oversight and regulation. Clarity of purpose, consistency and public accountability would be essential features of this approach and the expertise and skills of those currently providing these services would be harnessed and maintained in the new body.

9.6 The Review has highlighted a potential weakness in the way in which audit outcomes are considered and presented to both the local authority and the public. The ability of Audit Committees, which mostly lack independent, technically qualified members, to consider, effectively, audit reports has been challenged in responses to the call for views. In addition, transparency and accountability of audit reports, from a public perspective is lacking and there is considerable scope for the Key Audit Partner to present a report on the principal issues arising from the audit to Full Council at least annually.

9.7 The situation facing PCCs and FRAs is many ways similar to those for principal councils in that audit quality and price are in need of review. Governance here, however, is somewhat different in terms of reporting lines and public accountability as these are currently more transparent than those applying in Principal Authorities.

9.8 Parish Councils, Meetings, IDBs and other smaller authorities operate on a much smaller scale and procurement/contractor arrangements are overseen by SAAA where no serious concerns have been identified. However, there is scope here to improve public reporting of local audit outcomes and attention should be given to ‘turnover’ thresholds in order to ensure a proportionate level of resource is utilised in fulfilling audit requirements.

9.9 An area that has generated considerable comment is the perceived gap between the reasonable expectations of many stakeholders and what auditors are required to do relating to the financial stability and resilience of local authorities. There is a compelling argument to extend the scope of audit to include a substantive test of financial resilience and sustainability. The scope of this audit needs to be clearly defined and focused to ensure there is a balance between cost and the potential benefits of such additional audit coverage and reporting. This would represent a genuine demonstration of public accountability.

9.10 The new NAO code includes a revised narrative audit opinion and sets out three reporting criteria relating to financial sustainability, governance and improving economy, efficiency, and effectiveness. This approach, once fully established, will provide a very important statement to stakeholders regarding a local authority’s financial health. In effecting this scrutiny of financial sustainability, the auditor would also undertake an assessment of the risks identified in the CFO’s annual Section 25 report of the budget. This could be further assisted by a review of the local authority’s observance of CIPFA’s Financial Management Code which provides a set of statements including value for money and financial resilience. To ensure that the Auditor’s work is genuinely transparent and accessible to local taxpayers an Auditor’s Report should be presented to the first Full Council meeting after 30 September every year, irrespective of whether the financial accounts have been certified.

Transparency of Financial Reporting

9.11 This report has highlighted the inability of the general public to understand the annual statutory accounts presented by local authorities. The technical complexity of the accounts means that service users/council taxpayers have little or no opportunity to comprehend what is being said or to challenge expenditure and income relating to a specific service and how the local authority has performed.

9.12 Three options have been explained in this report as a possible response to this problem. A review of the existing IFRS based accounts could be undertaken, but, given the requirement to observe international reporting standards, it may not yield the simplicity in presentation and terminology that is sought here. An alternative detailed in this report would entail adapting the existing narrative report produced by local authorities as an addendum to the statutory accounts where discretion would be afforded to each local authority regarding style, content and presentation. The third and final option relates to a new simplified statement of service information and costs as a means of enabling each local authority to communicate, in a standardised format, the key information relating to the budget and council tax setting compared to actual financial performance. If transparency and consistency of financial reporting are to be achieved this last option best meets these objectives although the experience developed in the production of narrative reports may be beneficial in its design.

9.13 A draft of a simplified statement is included as an annex to this report which incorporates the key features of simplicity and transparency. Observance of IFRS based accounts remains an important ingredient in ensuring proper accountability for financial performance, so the current statutory accounts should still be produced. This requirement is underpinned by a Code of Accounting Practice produced by CIPFA. Many local authorities have not purchased the most recent copy of the Accounting Code. Consideration should be given to this being freely available, given its importance in the construction of statutory accounts.

10. List of Annexes

1. What are auditors required to do?
2. Roles and duties of Statutory Officers
3. Functions of the Office of Local Audit and Regulation
4. Illustrative Simplified Financial Statements
    a. District Council
    b. Fire and Rescue Authority
    c. Police and Crime Commissioner
    d. Unitary Authority
5. Potential impact of recommendations made by other reviews of audit
6. Approach of other state auditors to performance audit
7. Terms of Reference
8. Call for Views respondents

Appendix – Glossary of Key Terms, Acronyms and Abbreviations

ACCA – Association of Chartered Certified Accountants
Professional accounting body offering the Chartered Certified Accountant qualification

Accounting Officer
Normally the Permanent Secretary of a government department who is personally responsible for the regularity and propriety of expenditure, robust evaluation of different mechanisms for delivering policy objectives, value for money, the management of risk, and accurate accounting for the use of resources

Accounts and Audit Regulations 2015
Statutory Instrument that sets the deadlines for publishing unaudited local authority accounts for inspection and for publishing audited local authority accounts; requires local authorities to have an internal audit; and details the information that must be included in local authority annual report and accounts.

Adverse Opinion
An audit opinion - a conclusion that an authority's accounts are not true and fair/proper arrangements to secure the economy, effectiveness and efficiency of service delivery are not in place.

AGN – Auditor Guidance Notes
Guidance produced by the National Audit Office to support external auditors in their work and to facilitate consistency of approach between auditors of the same types of entity. These have the same status as the NAO Audit Code of Practice

ALB – Arm's Length Body
A body which has a role in the processes of national government but is not a government department or part of one, and which accordingly operates to a greater or lesser extent at arm's length from ministers.

Annual Audit Letter – also known as Audit Completion Report or ISA260 Report
The annual audit letter summarises key findings from the auditor's yearly audit; often includes management recommendations.

AQR – Audit Quality Review team
The part of the Financial Reporting Council that monitors the quality of the audit work of statutory auditors and audit firms in the UK that audit Public Interest Entities (PIEs). Since 2018-19 AQR has been responsible for the quality assurance of larger local authority audits.

ARGA – Audit, Reporting and Governance Authority
A planned independent regulatory body to replace the Financial Reporting Council. This was recommended by Sir John Kingman in his review of the Financial Reporting Council and supported by Sir Donald Brydon in his review into the quality and effectiveness of audit

Audit Commission
A now disbanded independent public corporation that had the responsibility for appointing auditors to a range of local public bodies in England. They set the standards for auditors and had oversight their work

Audit Scotland
The body responsible for supporting the Auditor General for Scotland in providing independent assurance to the people of Scotland that public money is spent properly, efficiently and effectively.

BEIS – Department for Business, Energy & Industrial Strategy
Has policy responsibility for statutory audit, including taking forward the recommendations made by the Kingman and Brydon reviews.

Best Value
A local authority should make arrangements to secure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness. Under the Duty of best value, therefore, authorities should consider overall value, including economic, environmental and social value, when reviewing service provision. Central government may use its best value powers to intervene in a local authority in exceptional cases where that best value duty has not been met.

Brydon Review
Independent Review into the Quality and Effectiveness of PIE Audits led by Sir Donald Brydon (published December 2019).

C&AG – Comptroller and Auditor General
An independent officer of the House of Commons who leads and is supported by the National Audit Office. Has the statutory authority to examine and report to Parliament on whether departments and the bodies they fund have used their resources efficiently, effectively and with economy. Responsible for preparing, maintaining, and developing the Code of Audit Practice for local authority auditors (the Audit Code).

Capital Finance and Accounting Regulations 2003 (as amended)
Regulations governing local authority capital finance and investment. Include the statutory overrides to GAAP that local authorities in England are required to apply.

Category 1 Authority
A relevant authority that either: (a) is not a smaller authority; or (b) is a smaller authority that has chosen to prepare its accounts for the purpose of a full audit in accordance with regulation 8 of the Smaller Authorities Regulations. All local authorities with income or expenditure of more than £6.5m are Category 1 authorities. The Council of the Isles of Scilly and Shire Districts with income and expenditure of less than £6.5m are also Category 1 authorities.

Category 2 Authority
A relevant authority that is a smaller authority (that is a parish council, parish meeting or internal drainage board) and has annual income and expenditure of less than £6.5m

CFO – Local Authority Chief Financial Officer / Head of Finance (also referred to as the S151 Officer)
A local authority officer, who has statutory responsibility for the proper conduct of that local authority's financial affairs.

CIAA – Chartered Institute of Internal Auditors
A representative body of internal auditors

CIPFA – Chartered Institute of Public Finance and Accountancy
A professional public finance accountancy body. Maintains four statutory codes that local authorities are required to 'have regard to'.

Clean opinion – also known as an "unqualified opinion"
An audit opinion – that the accounts are true and fair, free from material misstatement and have been properly prepared in accordance with the applicable accounting framework.

Code of Audit Practice
The "Audit Code" sets out what local auditors are required to do to fulfil their statutory responsibilities under the Local Audit and Accountability Act 2014. The Comptroller and Auditor General is responsible for the preparation, publication and maintenance of the Code of Audit Practice.

Code of Practice on Local Authority Accounting
Public sector organisations responsible for locally delivered services are required by legislation to prepare their accounts in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom (the Accounting Code)

CIPFA/LASAAC
A partnership between CIPFA (England, Northern Ireland and Wales) and the Local Authority (Scotland) Accounts Advisory Committee (LASAAC). Responsible for preparing, maintaining, developing and issuing the Accounting Code.

CMA – Competition and Markets Authority
A non-ministerial government department responsible for strengthening business competition and preventing and reducing anti-competitive activities

CMA Markets Study - Audit
The CMA carried out a study into the statutory audit market, to see if the market is working as well as it should. (published October 2018)

County councils – also known as Shire Counties
Upper tier authority responsible for services across the whole of a county such as: education; transport; planning; social care.

CQC – Care Quality Commission
An executive non-departmental public body responsible for monitoring, inspecting and regulating health and social care services.

DHSC – Department for Health and Social Care

District Audit Service
Set up in 1844, and originally part of HMT, was the Audit Commission's in-house audit practice until all local authority audits were outsourced for the 2012-13 financial year. Most staff working in the DAS at that time transferred to the private sector accountancy firms who took on responsibility for local authority audits.

District Council – also known as Shire District
Lower tier authority, responsible for services over a smaller area than county councils such as: rubbish collection; recycling; Council Tax collections; housing; planning applications

EFA - Expenditure and Funding Analysis
Summarises the annual expenditure used and funded by the Council together with the adjustments between the funding and accounting basis to reconcile with the CIES

Except for opinion
An audit opinion - a conclusion that in all material respects the accounts are true and fair/proper arrangements are in place except for the matters detailed in the audit certificate and report OR a conclusion that the supporting evidence provided by the authority is so deficient that the auditor is unable to conclude whether one or more material items in the accounts are true and fair/a material element of proper arrangements are in place

Financial Reporting
Financial reporting uses financial statements to disclose financial data that indicates the financial health of an entity over during a specific period of time. These reports provide information to people who wish to understand the performance of an entity

FRA – Fire and Rescue Authority
A supervisory body which ensures that a local fire service performs efficiently and in the best interest of the public and community it serves. FRAs can be part of a another type of local authority or can be stand-alone entities.

FRAB – Financial Reporting Advisory Board
The role of the board is to ensure that government financial reporting meets the best possible standards of financial reporting by following Generally Accepted Accounting Practice as far as possible.

FRC - Financial Reporting Council
An independent regulatory body which regulates auditors, accountants and actuaries and sets the UK's Corporate Governance and Stewardship Codes. Currently transforming into a new body the Audit, Reporting and Governance Authority.

FReM - UK Central Government Financial Reporting Manual
The technical accounting guide to the preparation of financial statements, prepared after consultation with the Financial Reporting Advisory Board. It complements guidance on the handling of public funds published separately by the relevant authorities in England and Wales, Scotland and Northern Ireland

General Fund
The main revenue account that local authorities are required to maintain. The majority of income goes into the general fund account and most service expenditure is funded from it.

General Power of Competence
Introduced by the Localism Act 2011 and took effect in February 2012. In simple terms, it gives councils the ***power*** *to do anything an individual can do provided it is not prohibited by other legislation. Most wholly-owned local authority companies are set up under the General Power of Competence.*

Generally Accepted Accounting Practice/Principles (GAAP)
A collection of commonly-followed accounting rules and standards for financial reporting. The acronym is pronounced "gap." GAAP specifications include definitions of concepts and principles, as well as industry-specific rules.

Going Concern Test
An element of the audit report certifying that readers of a set of accounts are entitled to assume a business will continue in the future, unless there is evidence to the contrary. Going concern reporting is very specifically about ensuring that the correct accounting basis is being used, not about confirming whether an authority is running out of resources.

Greater London Authority (GLA)
A type of local authority. The GLA regional authority, with powers over transport, policing, economic development, and fire and emergency planning in Greater London. The GLA is unique in the British devolved and local government system, in terms of structure elections and selection of powers.

Head of Paid Service
The Head of Paid Service has statutory responsibility for the management and coordination of the employees appointed by the Council. Although the roles are separate, frequently the Chief Executive or Managing Director of a local authority.

HMICFRS - Her Majesty's Inspectorate of Constabulary and Fire & Rescue Services
Inspectorate responsible for independently assessing the effectiveness and efficiency of police forces and fire & rescue services.

HMT – Her Majesty's Treasury

HOFMCP - Home Office Financial Management Code of Practice
The financial management code of practice provides clarity around the financial governance arrangements within policing

Housing Revenue Account
Legislation prohibits social housing expenditure from being subsidised by general fund expenditure and vice versa. Therefore, local authorities with social housing stock are required to maintain a separate "housing revenue account", which must be self-financing.

ICAEW - Institute of Chartered Accountants of England and Wales
A professional membership organisation that promotes, develops and supports chartered accountants and students in the UK, Wales and globally. Responsible for maintaining the register of firms and KAPs qualified to sign off audits of local authority accounts.

ICAS - Institute of Chartered Accountants of Scotland
A professional membership organisation that promotes, develops and supports chartered accountants and students in Scotland.

IFRS – International Financial Reporting Standard (set by the International Accounting Standards Board)
A public interest organisation which has developed and maintains a single set of globally accepted accounting standards.

Internal Drainage Board
A type of local authority which is established in areas of special drainage need in England and Wales with permissive powers to undertake work to secure clean water drainage and water level management within drainage districts. The area of an IDB is not determined by county or metropolitan council boundaries, but by water catchment areas within a given region.

ISA - International Standards on Auditing
Standards for audits of financial statements, which include objectives for the auditor, together with requirements and related application and other explanatory material. ISAs(UK) are issued by the FRC.

KAP – Key Audit Partner
A senior member of staff within an audit firm who is registered to sign off a set of local authority accounts. Does not need to be a partner in the firm.

Kingman Review
Independent Review of the Financial Reporting Council led by Sir John Kingman (published December 2018). Included commentary and recommendations for local audit.

KPI – Key Performance Indicator
A performance measurement which helps evaluate the success of an organisation or of a particular activity in which it engages.

LGA – Local Government Association
The national membership body for local authorities.

LGSCO – Local Government and Social Care Ombudsman
A service that investigates complaints from the public about councils, registered adult social care providers and other select bodies providing public services in England

Limitation in Scope
An audit opinion - a conclusion that the supporting evidence provided by the authority is so deficient that the auditor is unable to conclude whether the accounts are true and fair and/or proper arrangements are in place to deliver economy, efficiency and effective services.

Local Audit and Accountability Act 2014
Abolished the Audit Commission and established the current arrangements for the audit and accountability of the local public audit system

Local Audit Delivery Board
Consultative board chaired by MHCLG, which compromises of representatives of relevant departments and framework bodies to facilitate sharing of information about the operation of the local authority accounting framework. Meetings are held in private and it has no formal powers or remit.

Local Government Act 2000
An Act to make provision with respect to the functions and procedures of local authorities

London Borough
A single tier of local authority that provides all the services that a county and district/borough/city council would usually provide. Some services, like fire, police and public transport, are provided through the Greater London Authority.

Mayoral Combined Authority
A type of local authority created in areas where they are considered likely to improve transport, economic development and regeneration. MCAs are led by metro mayors who make decisions about policy and spending in conjunction with council leaders from each constituent council. Both the metro mayor and each of the council leaders have a single vote and must approve or oppose decisions.

Metropolitan borough – also known as Metropolitan District
A single tier of local authority that provides all the services that a county and district/borough/city council would usually provide. Some services, like fire, police and public transport, are provided through 'joint authorities

MHCLG – Ministry of Housing, Communities and Local Government
The government department with policy responsibility for the local audit framework.

MIRS - Movement in Reserves Statement
Shows how the movement in reserves in the Balance Sheet is reconciled to the CIES deficit and what adjustments are required to be charged to the general fund balance for Council Tax setting purposes

Monitoring Officer
A local government officer with three main roles: to report on matters he or she believes are, or are likely to be, illegal or amount to maladministration; to be responsible for matters relating to the conduct of councillors and officers; and. to be responsible for the operation of the council's constitution.

NAO – National Audit Office
The UK's independent public spending watchdog. The NAO support Parliament in holding government to account and they work to improve public services through their audits. They are led by the Comptroller and Auditor General

NHSI(E) – NHS England and NHS Improvement
The umbrella body for the NHS in England. From 1 April 2019, NHS England and NHS Improvement have worked together as a new single organisation to better support the NHS to deliver improved care for patients.

Ofsted - Office for Standards in Education
Office for Standards in Education, Children's Services and Skills. Inspect services providing education and skills for learners of all ages. Also inspects and regulate services that care for children and young people including those delivered by local authorities.

Parish Council – can also be known as community councils
A civil local authority found in England and is the lowest tier of local government. They are elected corporate bodies, have variable tax raising powers. Responsibilities of parish council's vary considerably but can include allotments, bus shelters, burials and maintenance of common land and rights of way.

Parish Meeting
A meeting to which all the electors in a civil parish are entitled to attend. In some cases, where a parish or group of parishes has fewer than 200 electors, the parish meeting can take on the role of a parish council, with statutory powers, and electing a chairman and clerk to act on the meeting's behalf.

PCC – Police and Crime Commissioner
An elected official in England and Wales charged with securing efficient and effective policing of a police area. Commissioners replaced the now-abolished police authorities.

PIE – Public Interest Entity
A listed company or an entity with listed debt. Under EU Law, entities are designated by Member States and are usually defined as having undertakings that are of significant public relevance because of the nature of their business, their size or the number of their employees.

PIR – Public Interest Report
When an Auditor considers there to be a matter that is sufficiently important enough to be publicly brought to the notice of the council or the public they can make a report in the public interest.

PSAA - Public Sector Audit Appointments Ltd
Public Sector Audit Appointments is a company limited by guarantee wholly owned by the Local Government Association. PSAA are specified as an appointing person for local authority under provisions of the Local Audit and Accountability Act 2014. The functions of PSAA are specified in statute.

Qualified Audit Opinion
When an external auditor concludes that financial records have not been maintained in accordance with the Generally Accepted Accounting Principles. There are three types of qualified opinion; an except for; adverse; and limitation in scope opinion

SAAA - Smaller Authorities' Audit Appointments Ltd
The sector-led limited company appointed as the specified person to procure and appoint external auditors to smaller authorities and to manage the ongoing smaller authority audit contracts.

SERCoP - Service Reporting Code of Practice
A statutory code that sets out the proper practices with regard to consistent financial reporting for services; all local authorities in the UK are expected to adopt its mandatory requirements and recommendations and use them when reporting statistical data to central government.

Smaller Authorities - parish, community and town councils and internal drainage boards
These operate at a level below district and borough councils and in some cases, unitary authorities. They sometimes deliver additional services on behalf of the district council.

SOLACE – Society of Local Authority Chief Executives
Members' network for local government and public sector professionals throughout the UK

TUPE - Transfer of Undertakings (Protection of Employment)
Regulations to protect employees if the business in which they are employed changes hands. The two types of transfer protected by TUPE regulations are business transfer and service provision changes

Unitary Authorities
A single tier of local authority that provides all the services that a county and district/borough/city council would usually provide.

Unqualified Audit Opinion
When an external auditor concludes that the financial statements of an entity present fairly its affairs in all material aspects

VfM Conclusion – Value for Money Conclusion
A requirement that external auditors undertake sufficient work to be able to satisfy themselves as to whether the audited body has put arrangements in place that support the achievement of value for money. In carrying out this work, the auditor is not required to satisfy themselves that the audited body has achieved value for money during the reporting period

Welsh Audit Office
The Wales Audit Office provides staff and other resources for the Auditor General's work, and monitors and advises the Auditor General for Wales.

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Appendix 2: Summary of MHCLG's response to the recommendations made by the Redmond Review

Action to support immediate market stability (recommendations 5, 6, 8, 10, 11)

Recommendation	MHCLG Response
5. All auditors engaged in local audit be provided with the requisite skills and training to audit a local authority irrespective of seniority.	**Agree**; we will work with key stakeholders to deliver this recommendation
6. The current fee structure for local audit be revised to ensure that adequate resources are deployed to meet the full extent of local audit requirements.	**Agree**; we will look to revise regulations to enable PSAA to set fees that better reflect the cost to audit firms of undertaking additional work
8. Statute be revised so that audit firms with the requisite capacity, skills and experience are not excluded from bidding for local audit work.	**Part agree**; we will work with the FRC and ICAEW to deliver this recommendation, including whether changes to statute are required
10. The deadline for publishing audited local authority accounts be revisited with a view to extending it to 30 September from 31 July each year.	**Part agree**; we will look to extend the deadline to 30 September for publishing audited local authority accounts for two years, and then review
11. The revised deadline for publication of audited local authority accounts be considered in consultation with NHSI(E) and DHSC, given that audit firms use the same auditors on both Local Government and Health final accounts work.	**Agree**

Consideration of system leadership options (recommendations 1, 2, 3, 7, 13, 17)

Recommendation	MHCLG response
1. A new body, the Office of Local Audit and Regulation (OLAR), be created to manage, oversee and regulate local audit with the following key responsibilities: - procurement of local audit contracts - producing annual reports summarising the state of local audit - management of local audit contracts - monitoring and review of local audit performance - determining the code of local audit practice - regulating the local audit sector	**We are considering these recommendations further** and will make a full response by spring 2021.
2. The current roles and responsibilities relating to local audit discharged by the: - Public Sector Audit Appointments (PSAA)	**We are considering these recommendations further** and

Recommendation	MHCLG response
- Institute of Chartered Accountants in England and Wales (ICAEW) - FRC/ARGA - The Comptroller and Auditor General (C&AG) to be transferred to the OLAR	will make a full response by spring 2021.
3. A Liaison Committee be established comprising key stakeholders and chaired by MHCLG, to receive reports from the new regulator on the development of local audit.	**We are considering these recommendations further** and will make a full response by spring 2021.
7. That quality be consistent with the highest standards of audit within the revised fee structure. In cases where there are serious or persistent breaches of expected quality standards, OLAR has the scope to apply proportionate sanctions.	**We are considering these recommendations further** and will make a full response by spring 2021.
13. The changes implemented in the 2020 Audit Code of Practice are endorsed; OLAR to undertake a post implementation review to assess whether these changes have led to more effective external audit consideration of financial resilience and value for money matters.	**We are considering these recommendations further** and will make a full response by spring 2021.
17. MHCLG reviews its current framework for seeking assurance that financial sustainability in each local authority in England is maintained.	**We are considering these recommendations further** and will make a full response by spring 2021.

Enhancing the functioning of local audit, and the governance for responding to its findings (recommendations 4, 9, 12, 18)

Recommendation	MHCLG response
4. The governance arrangements within local authorities be reviewed by local councils with the purpose of: - an annual report being submitted to Full Council by the external auditor - consideration being given to the appointment of at least one independent member, suitably qualified, to the Audit Committee - formalising the facility for the CEO, Monitoring Officer - Chief Financial Officer (CFO) to meet with the Key Audit Partner at least annually.	**Agree**; we will work with the LGA, NAO and CIPFA to deliver this recommendation
9. External Audit recognises that Internal Audit work can be a key support in appropriate circumstances where consistent with the Code of Audit Practice.	**Agree**; we will work with the NAO and CIPFA to deliver this recommendation

Recommendation	MHCLG response
12. The external auditor be required to present an Annual Audit Report to the first Full Council meeting after 30 September each year, irrespective of whether the accounts have been certified; OLAR to decide the framework for this report.	**Agree**; we will work with the LGA, NAO and CIPFA and other key stakeholders to deliver this recommendation, including whether changes to statute are required
18. Key concerns relating to service and financial viability be shared between local auditors and inspectorates including Ofsted, Care Quality Commission and HMICFRS prior to completion of the external auditor's annual report.	**Agree**; we will work with other departments and the NAO to deliver this recommendation

Improving transparency of local authorities' accounts to the public (recommendations 19, 20, 21, 22)

Recommendation	MHCLG response
19. A standardised statement of service information and costs be prepared by each authority and be compared with the budget agreed to support the council tax/precept/levy and presented alongside the statutory accounts.	**Agree**; we will look to CIPFA to develop a product through consultation with local government. We will work with CIPFA to deliver this recommendation
20. The standardised statement should be subject to external audit.	**Agree**; we will work with CIPFA, the LGA and the NAO to deliver this recommendation
21. The optimum means of communicating such information to council taxpayers/service users be considered by each local authority to ensure access for all sections of the communities.	**Agree**; we will work with the LGA and CIPFA to deliver this recommendation
22. CIPFA/LASAAC be required to review the statutory accounts, in the light of the new requirement to prepare the standardised statement, to determine whether there is scope to simplify the presentation of local authority accounts by removing disclosures that may no longer be considered to be necessary.	**Agree**; we will look to CIPFA to deliver this recommendation

Action to further consider the functioning of local audit for smaller bodies (recommendations 14, 15, 16, 23)

Recommendation	MHCLG response
14. SAAA considers whether the current level of external audit work commissioned for Parish Councils, Parish Meetings and Internal Drainage Boards (IDBs) and Other Smaller Authorities is proportionate to the nature and size of such organisations.	**Agree**; we will look to SAAA to deliver this recommendation

Recommendation	MHCLG response
15. SAAA and OLAR examine the current arrangements for increasing audit activities and fees if a body's turnover exceeds £6.5m.	**We are considering this recommendation further** and will make a full response by spring 2020
16. SAAA reviews the current arrangements, with auditors, for managing the resource implications for persistent and vexatious complaints against Parish Councils.	**Agree**; we will look to SAAA to deliver this recommendation
23. JPAG be required to review the Annual Governance and Accountability Return (AGAR) prepared by smaller authorities to see if it can be made more transparent to readers. In doing so the following principles should be considered: - whether "Section 2 – the Accounting Statements" should be moved to the first page of the AGAR so that it is more prominent to readers - whether budgetary information along with the variance between outturn and budget should be included in the Accounting Statements - whether the explanation of variances provided by the authority to the auditor should be disclosed in the AGAR as part of the Accounting Statements.	**Agree**; we will work to JPAG to deliver this recommendation

1. This recommendations (and the department's response) applies only to principal local authorities (i.e. not police and crime commissioners or fire and rescue authorities) ↩
2. This recommendations (and the department's response) applies only to principal local authorities (i.e. not police and crime commissioners or fire and rescue authorities) ↩

This document was classified as: OFFICIAL

Agenda Item 8

AUDIT COMMITTEE
27 JANUARY 2021

ITEM NO.

MID YEAR RISK MANAGEMENT UPDATE REPORT 2020/21

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) Annual Risk Management Report to Audit Committee 16 September 2020

Lee Downey 5451

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 and Climate Change	There are no specific recommendations contained within the attached reports concerning Carbon Reduction.
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 Departmental risks.

7. All risks are continually managed during the year by Corporate and Departmental Management Teams including any emerging risks identified. In addition, Assistant Directors are required to confirm in their Annual Managers' Assurance Statements (MAS) 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 departmental staff, details progress made on improvement actions for those risks identified as above the risk appetite line.

    (a) **Corporate Risks (Appendix A)** – one risk has been identified as above the risk appetite line.

    (C18) COVID-19:

    1. **Health and safety of the Council workforce**
    2. **Health and safety of the public of Darlington**
    3. **The impact on the Economy of the Borough and its population**
    4. **Financial impacts on the Council of increased costs and reduced income**

    (i) In terms of mitigating this risk the Council has introduced safe working practices; is working with partners to make the public aware of risks and working to ensure compliance within businesses and other sectors in the Borough; will work with Government departments and the Tees Valley Combined Authority to seek to limit the impacts by utilising interventions to kick start the economy; and will keep its Medium Term Financial Plan

(MTFP) under constant review and take appropriate decisions to safeguard the Council's finances.

(ii) The Council is also running community testing in a number of settings to help identify asymptomatic people and supporting the roll out of the vaccinations programme by the NHS, along with volunteers to reduce the health risks particularly of the most vulnerable in the early stages of the roll out.

(b) **Children and Adult Services (Appendix B)** – three risks have been identified as above the risk appetite line.

(C & A1) Inability to contain placement costs for children looked after.

(i) A full Transformation and Efficiency programme is being delivered with the key objective of developing sufficient provision within or close to Darlington that meets the needs of 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 & A8b) Increased demand for Children's services impacts negatively on budget.

(ii) Work is ongoing within the Transformation Programme to safely reduce the level of risk in children's services. Input to this work has been enhanced with colleagues from Leeds City Council under the DfE sponsored Strengthening Families Programme. The ethos of the work will continue despite the programme formally ceasing over the next six months.

(C & A 14b) Failure to respond appropriately to safeguard vulnerable children, in line with national legislation and safeguarding children, thresholds and procedures.

(iii) Services are in place to screen contacts and referrals, and to respond should concerns be identified. Pathways for intervention are both internal and multi-agency, and the Council ensure that its own staff understand and apply them robustly.

(iv) During the Covid-19 restrictions, each child open to children's services has a risk assessment in place to determine level of safeguarding need and appropriate visiting frequency. Children have received face to face contact from children's teams to ensure appropriate safe living environments and that services are put in place to meet their needs.

(c) **Economic Growth & Neighbourhood Services (Appendix C)** – two risks have been identified as above the risk appetite line.

(EG &NS 13) Significant impacts arising from the reduction in available cash/resources to the local economy, Council's General Fund and

Housing Revenue Account and businesses due to the impacts of increased levels of unemployment and Universal Credit payments.

(i) The Council has increased bad debt provision.

(EG & NS20) Inability to cope with significant increase in homelessness cases due to new requirements by Ministry of Housing Communities and Local Government (MHCLG) to accommodation everyone irrespective of status in order to limit spread of COVID-19 and also increased levels of homelessness due to increased relationship breakdowns and financial difficulties.

(ii) Work is ongoing with MHCLG and People's Commissioners to attract additional funding and commission new services.

(d) **Resources (Appendix D)** – no risks have been identified as above the risk 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. The key health and safety focus over the last nine months have been to ensure effective measures are in place to manage the risks associated with the COVID-19. Services have reviewed their risk assessments to ensure Government guidance is being followed in relation to COVID-19 and identify any new hazards and risks that may be present due to changes in work activities. Appropriate control measures identified to reduce risks included social distancing and good hand hygiene practices. The Council enabled staff to work from home wherever possible, in line with Government guidance.

11. The corporate risk assessment COVID-19 was completed detailing arrangements in line with the Government's working safely during COVID-19, and includes; hygiene, cleaning and hand sanitising and steps to maintain 2m social distancing in the workplace. The risk assessment was developed with the involvement of Public Health and in consultation with the trade unions, gaining from their knowledge and experience in health and safety and has been updated at least monthly, throughout the period, to ensure it remains up to date with the constantly changing Government guidance.

12. Managers with staff returning to work, were required to carry out a return to work/building induction, to ensure employees are aware of the measures in place and on-site arrangements such as one-way systems.

13. Under consultation with Public Health and the trade unions, service specific and corporate safe systems of work safe have been developed, reviewed and updated following changes to the corporate risk assessment COVID-19 in line with Government guidance, these are available on the intranet.

14. Regular communications have been issued to staff regarding the importance of following the Government guidance and an on-line training module produced 'Getting back to work safely during COVID-19' for all staff to complete, providing further information and guidance on the measures in place to help keep staff safe at work.

15. Before returning to work all employees in vulnerable groups, received a vulnerability assessment carried out by occupational health, and appropriate reasonable adjustments introduced where required.

16. Monitoring the implementation of the risk assessments and safe systems of work is carried out by mangers. Managers have recently been issued with a specific COVID-19 secure workplace monitoring checklist to assist in effective monitoring of the arrangements. Additional monitoring is being carried out by Corporate Landlord and the Health and Safety Team.

17. In March 2020 a new Street Works Permit Scheme was implemented in Darlington. The Council has worked with the other north east authorities over the last 18 months to develop the scheme. Studies by the Department for Transport have indicated that works durations are generally less in areas where a permit scheme operates compared with a noticing regime therefore reducing disruption to the public and road users.

18. The highway inspection & repair regime was able to operate throughout the first six months of the financial year in spite of the restrictions imposed due to COVID-19. 98.6% of highway safety inspections were carried out on schedule during the period with 98% of urgent defects repaired on time. Work is continuing with the supplier of our Highway Asset Management system to develop a new "Report It" webpage. This will allow customers to report highway defects online.

19. The work in recent years to convert the Street Lighting stock to LED lanterns continues to show benefits. As well as the reduction in carbon emissions and electricity costs there has been a decrease in the number of faults reported.

20. The Council has completed a programme of carriageway resurfacing works, including micro asphalt and carriageway recycling schemes. Although there were delays and different working measures had to be employed due to the restrictions around social distancing the program has been completed. Highways have been given and extra 1.2 million from the Government to be spent on maintenance schemes and these are now being designed ready to carry out in 2021/22.

21. During the COVID-19 restrictions our Highway Inspectors have continued to monitor the condition of our roads and footways. During the initial lockdown only urgent works were completed however we are now working as normal while being aware of the social distancing measures which are in place.

22. The proactive tree risk management processes continue to provide positive results enabling the Council to defend the majority of storm and subsidence compensation claims received.

23. Occupational health (OH) is a specialist branch of medicine that focuses on the physical and mental wellbeing of employees in the workplace and considers an employee's ability and fitness to perform a particular job. It has a key role in

assisting to manage risks in the workplace that may have the potential to give rise to work-related ill health. The Council's service operates as an in-house model with a directly employed OH Advisor and an OH Doctor provided via a contract with Durham County Council, both of which are suitably qualified and experienced. Together their aim is to prevent work-related illness and injury by:

- Encouraging safe working practices and proactive absence management;
- Health surveillance and vaccination programmes in line with HSE recommendations, relevant to the workplace and specific job roles;
- Supporting the management of sickness absence and facilitating early return to work;
- Working with Human Resources, Health and Safety and managers to assist with policies to ensure we are health and safety compliant, including ensuring that reasonable adjustments are considered;
- Providing specific advice to managers on hazards and risks to health with work functions;
- Conducting pre-employment health assessments;
- Supporting health promotion and awareness programmes;
- Providing advice and signposting around non health related problems; and
- Challenging fit note advice from a GP to ensure a swift return to work that is suitable and safe for the employee and team.

24. During the COVID-19 pandemic and lockdowns, OH has continued to provide a service to the Council, albeit primarily as a virtual/telephone/paper assessment service. The very few face to face assessments that have been carried out have been risk assessed and safe systems of working, appropriate cleaning and PPE used.

25. COVID-19 has also impacted upon workforce capacity, including that of key services. This has included cases where staff have been infected by COVID-19, required to self-isolate or are shielding. Vulnerability assessments have been undertaken by OH for those required to shield and those returning to work, this has included both vulnerable and extremely vulnerable individuals and appropriate adjustments have been made.

26. What is not yet known is the impact of long COVID sickness absence, reduced access to NHS appointments, the availability of surgery including the associated requirement to isolate to receive treatment and the cost of those medical cases which are now more prolonged as a result of longer waiting times.

27. We continue to monitor the health of the workforce and offer support at different levels for those impacted by COVID-19 and the changes to their working environment. We have worked with partners such as our counselling and physiotherapy providers to ensure that support is available to employees throughout the pandemic and have reinforced the importance of self-referring if these services are needed.

28. Mental health first aiders and mental health mentors have continued to be an asset to the workplace and during the pandemic. The Council has continued to promote their availability via 'Teams' and telephone for confidential chats where employees are offered a listening ear and signposted to further help where applicable.

29. Mental health awareness sessions for both managers and employees were initially suspended during the first lockdown, however, these have now resumed with sessions taking place virtually. Mental health continues and will continue to be a focus for wellbeing, especially during the pandemic.

30. The Council's annual winter flu vaccination programme continued this year in a COVID secure way. The Council was successful in obtaining a number of vaccines early in the season and prioritised its front line services to receive them. A larger number of employees received a vaccination than did the previous year. Again we had a successful year, however, due to supply restrictions and prioritising front line employees, there were a number of other employees who have not been able to obtain a vaccination. As we were unable to obtain any further vaccines from our supplier we were unable to administer the vaccine to as many employees as we would have liked to.

31. Wellbeing activities and events run throughout the year to engage with as many employees as possible. These have also been tailored to meet the COVID restrictions, with workshops on 'Stress Busting' and 'Improving Sleep' being delivered virtually. Information, advice and guidance has been targeted to managers to help them to deal with changing work practices, including dealing with employees who are working in differing roles and from home. This included producing and circulating ' A Managers Guide to staying Connected'.

32. Following national guidelines, the Children and Adults Services Workforce Development Team have worked both independently and in collaboration with multiagency partners to continue to offer a strong training and development offer to staff, partners and volunteers working with children, young people, adults and families in Darlington. The training offered throughout the pandemic has been 'blended', meaning that online training, webinars, interactive pod/vodcasts, etc have been developed and delivered alongside face to face training where safe to do so. Children and adults training and support materials are available on the Workforce Development pages of the intranet.

33. Like most services, Housing and Building Services has increased its agile working with IT and the digital platform to customers being improved with more improvements planned for 2021. 80% of the Housing Income Team now work primarily from home. Safe systems of work and risk assessments have been updated and new working practices introduced to maximise safety of residents and staff and reduce risks as much as possible. Gas servicing had been suspended for a short period but is now back on track and meeting compliance standards along with Fire Risk Assessments being carried out in communal areas. Some activities continue to be suspended and communal areas remain closed in sheltered and extra-care facilities in line with Government guidance. There has been increased customer contact and engagement throughout lockdown with staff making regular contact with the over 70s and vulnerable customers.

Conclusion

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

Outcome of Consultation

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

APPENDIX A

<u>RISK MATRIX</u>

CORPORATE RISK REGISTER

LIKELIHOOD	A Very High				
	B High				
	C Significant			**18**	
	D Low			**3, 4, 5, 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 D/II		

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
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	None at D/II		
C18	COVID-19: 1. Health and safety of the Council workforce 2. Health and safety of the public of Darlington 3. The impact on the Economy of the Borough and its population 4. Financial impacts on the Council of increased costs and reduced income	Paul Wildsmith	None at C/II		See main body of report at paragraph 8 (a) i and ii

APPENDIX B

RISK MATRIX

CHILDREN AND ADULT SERVICES

LIKELIHOOD	A Very High				
	B High			**8b**	
	C Significant		**9b, 16, 17,**	**1**	
	D Low		**18,19**	**3a, 3b, 5, 9a, 10, 14a, 15**	**14b**
	E Very Low			**8a**	
	F Almost Impossible				
		IV Negligible	III Marginal	II Critical	I Catastrophic
IMPACT					

CHILDREN AND ADULT SERVICES 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	None at D/II		
C&A 3b	**Risk Reworded** Inability to recruit and retain sufficient qualified suitably experienced social workers and reablement staff in Adult Services impacts on cost and quality of service	Linda Thirkeld	None at D/II		

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 D/II		
C&A 8a Adult	Increased demand for Adult Services impacts negatively on plans for budget efficiencies	Linda Thirkeld	None at E/II		
C&A 8b	Increased demand for Children's Services impacts negatively on budget	Jane Kochanowski	None at B/II		See main body of report at paragraph 8 (b) ii
C&A 9a	Market (Domiciliary Care Residential Care providers) failure following the Care Act/Living Wage	Christine Shields	None at D/II		
C&A 9b	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	Linda Thirkeld	None at D/II		
C&A 14a	Failure to respond appropriately to safeguard vulnerable adults, in line with national legislation and safeguarding adults procedures	Linda Thirkeld	None at D/II		
C&A 14b	Failure to respond appropriately to safeguard vulnerable children, in line with national legislation and safeguarding children, thresholds and procedures.	Jane Kochanowski	None at D/I		See main body of report at paragraph 8 (b) iii and iv
C&A 15	Working with other local commissioners to ensure their understanding of their responsibilities within the Childhood pathway.	Penny Spring	None at D/II		
C&A 16	Risk of unsuccessful mobilisation of new service - Support,	Penny Spring	None at C/III		

	Recovery and Treatment In Darlington through Empowerment (STRIDE).				
C&A 17	Impact of NECA not retaining the Drug & Alcohol Contract on the Stop Smoking Service - Will the provider be able to manage the Stop Smoking staff if the Gate is no longer used by the Service.	Penny Spring	None at C/III		
C&A 18	Impact of COVID-19 on team capacity.	Penny Spring	None at D/III		
C&A 19	New Director of Public Health transition.	Penny Spring	None at D/III		

APPENDIX C

RISK MATRIX

ECONOMIC GROWTH & NEIGHBOURHOOD SERVICES

LIKELIHOOD					
	A Very High				
	B High				
	C Significant		**9**	**13, 20**	
	D Low			**1, 7, 8, 14, 16, 17, 18, 19**	
	E Very Low			**12**	
	F Almost Impossible				
		IV Negligible	III Marginal	II Critical	I Catastrophic
IMPACT					

ECONOMIC GROWTH & NEIGHBOURHOOD SERVICES 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 12	Planning Performance at risk of Standards Authority intervention	David Coates	None at E/II		
EG &NS 13	Significant impacts arising from the reduction in available cash/resources to the local economy, Council's GF and HRA and businesses due to the impacts of increased levels of unemployment and Universal Credit payments	Pauline Mitchell	None at C/II		See main body of report at paragraph 8 (c) i

EG & NS14	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 & NS16	Delay in delivering replacement cremators resulting in failure of existing equipment and therefore closure of the service	Ian Thompson	None at D/II		
EG & NS17	Impact of COVID-19 on customers and audiences on confidence to return to leisure and cultural facilities	Ian Thompson	None at D/II		
EG & NS18	Impacts arising from the ability to progress and complete schemes/projects in the event of further COVID-19 lockdowns	Dave Winstanley	None at D/II		
EG & NS19	Potential impact on public transport networks if commercial services do not recover or continue to receive support from Government and routes are withdrawn	Dave Winstanley	None at D/II		

EG & NS20	Inability to cope with significant increase in homelessness cases due to new requirements by MHCLG to accommodation everyone irrespective of status in order to limit spread of COVID-19 and also increased levels of homelessness due to increased relationship breakdowns and financial difficulties	Pauline Mitchell	None at C/II		See main body of report at paragraph 8 (c) ii

APPENDIX D

RISK MATRIX

RESOURCES

LIKELIHOOD					
	A Very High				
	B High				
	C Significant		**1, 9, 26**		
	D Low		**2, 3, 5**		
	E Very Low				
	F Almost Impossible				
		IV Negligible	III Marginal	II Critical	I Catastrophic
IMPACT					

RESOURCES 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 partial exemption breech due to exempt VAT being close to the 5% limit	Elizabeth Davison	None at C/III		
RE2	Fraud in General	Andrew Barber	Reduce to D/III	Reduced from C/III due to low instances of fraud and sound systems in place.	
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		
RE26	Joint Venture Arrangements impacted by a slow down in house building	Elizabeth Davison	None at C/III		

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AUDIT COMMITTEE
27 JANUARY 2021

ITEM NO. ....

PRUDENTIAL INDICATORS AND TREASURY MANAGEMENT STRATEGY REPORT 2021/22

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 2021/22 to 2023/24 relating to capital expenditure and Treasury Management activity.

    (b) A policy statement relating to the Minimum Revenue Provision.

    (c) The Treasury Management Strategy 2021/22, which includes the Annual Investment Strategy for 2021/22

2. The report outlines the Council's prudential indicators for 2021/22 – 2023/24 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 Chartered Institute of Public Finance and Accountancy (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.

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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 Council via Cabinet in order that they approve them:

   (a) The Prudential Indicators and limits for 2021/22 to 2023/24 summarised in Tables 1 and 2.

   (b) The Minimum Revenue Provision (MRP) statement (paragraphs 33 - 37).

   (c) The Treasury Management Strategy 2021/22 to 2023/24 as summarised in paragraphs 41 to 69.

   (d) The Annual Investment Strategy 2021/22 contained in paragraphs 70 to 107.

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 Ministry of Housing, Communities & Local Government (MHCLG) 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 2019/20
(ii) Draft Capital Strategy (incl Capital MTFP 2021/22 to 2024/25)
(iii) Link Asset Services Economic Report Dec 2020

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 and Climate Change	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. CIPFA defines treasury management as:

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

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

8. 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.

9. The contribution the treasury management function makes to the Council 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.

10. 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.

Reporting requirements

Capital Strategy

11. The 2017 CIPFA Prudential and Treasury Management Codes require all local authorities to prepare a capital strategy report, which will provide the following:
    - a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
    - an overview of how the associated risk is managed
    - the implications for future financial sustainability

12. The aim of the 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. The Capital Strategy is reported separately to Cabinet and Council on an annual basis.

Treasury Management Reporting

13. 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.

Prudential and Treasury Indicators and Treasury Strategy (this report)

14. 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

15. This is primarily a progress report and will update members 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

16. 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.

17. These reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Audit Committee.

Treasury Management Strategy for 2021/22

18. The strategy for 2021/22 covers two main areas:

(a) Capital Issues:
- the capital expenditure plans and the prudential indicators;
- the minimum revenue provision (MRP) policy.

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

19. 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.

20. 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

	2020/21 Revised	2021/22 Estimated	2022/23 Estimated	2023/24 Estimated
Capital Expenditure Tables 3 and 4	£28.793m	£43.326m	£38.271m	£36.237m
Capital financing requirement - Table 5	£218.318m	£229.504m	£242.402m	£253.543m
Ratio of financing costs to net revenue stream – General Fund See paragraph 39 - Table 6	2.76%	2.58%	2.65%	4.56%
Ratio of financing costs to net revenue stream –	13.21%	14.86%	16.20%	17.30%

HRA See paragraph 39 - Table 6				
Operational boundary for external debt - Table 9	£187.957m	£201.831m	£215.716m	£229.610m
Authorised limit for external debt - Table 10	£229.233m	£240.979m	£254.522m	£266.220m

Table 2 – Treasury Management

	2021/22 Upper Limit	2022/23 Upper Limit	2023/24 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 2021/22			
		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

21. 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 a session held in December 2020 and further training will be arranged as required. The training needs of treasury management officers are periodically reviewed.

Treasury Management Consultants

22. The Council uses Link Group, 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 the services of our external service provider. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisors.

23. 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 2021/22– 2023/24

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

Capital Expenditure

25. 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

	2020/21 Revised £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
General Fund	22.520	22.395	14.149	14.149
HRA	7.590	20.449	21.704	20.971
Estimated Capital Expenditure	**30.110**	**42.844**	**35.853**	**35.120**
Loans to Joint Ventures	(1.317)	0.482	2.418	1.117
Total	**28.793**	**43.326**	**38.271**	**36.237**

26. The financing need above excludes other long-term liabilities, such as PFI and leasing arrangements which already include borrowing instruments.

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

Table 4 Financing of the Capital Programme

	2020/21 Revised £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
General Fund	22.520	22.395	14.149	14.149
HRA	7.590	20.449	21.704	20.971
Loans to Joint Ventures	(1.317)	0.482	2.418	1.117
Total Capital	**28.793**	**43.326**	**38.271**	**36.237**
Financed by:				
Capital receipts -General Fund	1.357	1.150	0.400	0.400
Capital receipts - Housing	0.303	0.303	0.303	0.303
Capital grants	16.876	12.171	3.749	3.749
Self financing - GF	0.250	0.250	10.000	10.000
Revenue Contributions (Housing)	7.288	6.761	5.986	5.586
HRA Investment Fund	0.000	4.982	4.982	4.982
Total excluding borrowing	**26.074**	**25.617**	**25.420**	**25.020**
Borrowing need	**2.719**	**17.709**	**12.851**	**11.217**

The Council's Borrowing Need (the Capital Financing Requirement)

28. 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.

29. The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each assets' life, and so charges the economic consumption of capital assets as they are used.

30. The CFR includes any other long-term liabilities (e.g. PFI schemes, finance leases) brought onto the balance sheet. Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme 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 £10.358m of such schemes within the CFR.

31. Under a new accounting standard (IFRS 16) the Council will be required to add any finance leases to its balance sheet and therefore increase its CFR accordingly, this standard was due to be introduced from 1 April 2021 but has been deferred to 1 April 2022 when the Council will include any identified elements on its balance sheet and hence increase its CFR.

32. The Committee is asked to approve the CFR projections below:

Table 5 – CFR Projections

	2020/21 Revised £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
CFR – General Fund	126.994	129.802	132.401	134.658
CFR – PFI and Finance leases	10.358	9.232	8.117	7.011
CFR - housing	68.168	77.189	86.185	95.058
CFR - Loans to JV's	12.798	13.281	15.699	16.816
Total CFR	**218.318**	**229.504**	**242.402**	**253.543**
Movement in CFR		**11.186**	**12.898**	**11.141**

MRP Policy Statement

33. 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).

34. 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.

35. It is proposed that Darlington Borough Council's MRP policy statement for 2021/22 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 2021/22 and in future years, which would otherwise have been made. The MRP adjustment for 2021/22 and in future years charge will be done in such a way as to ensure that:-

- the total MRP after applying the adjustment will not be less than zero in any financial year,
- the cumulative amount adjusted for will never exceed the amount over-charged,
- the extent of the adjustment will be reviewed on an annual basis.

36. 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.

37. Repayments included in annual PFI or finance leases are applied as MRP.

Affordability Prudential Indicators

38. 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.

39. 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

	2020/21 Revised	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
General Fund	2.76%	2.58%	2.65%	4.56%
HRA	13.21%	14.86%	16.20%	17.30%

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

Treasury Management Strategy

Borrowing

41. 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 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 approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

Under Borrowing position

42. 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 it was agreed that longer term investments would be pursued as these would give a return over and above the cost of any additional borrowing that would be taken. Following due diligence the Council has 3 Property Funds with £10 million in each fund and these are expected to bring a net return of around 1.5% over the life of the MTFP. Additional borrowing of £25m was undertaken which resulted in the underborrowed position being reduced.

Current Portfolio Position

43. The overall treasury management portfolio as at 31 March 2020 and for the position as at 5 January 2021 are shown below for both borrowings and investments.

Table 7 – Treasury Portfolio

TREASURY PORTFOLIO				
	Actual 31/03/2020 £m's	Actual 31/03/2020 %	Current 31/12/2020 £m's	Current 31/12/2020 %
Treasury Investments				
banks	6.500	11.4	8.000	14.0
local authorities	10.000	17.6	10.000	17.5
money market funds	10.300	18.2	9.300	16.2
Total managed in house	**26.800**	**47.2**	**27.300**	**47.7**
property funds	29.999	52.8	29.999	52.3
Total managed externally	**29.999**	**52.8**	**29.999**	**52.3**
Total treasury investments	**56.799**	**100.0**	**57.299**	**100.0**
Treasury external borrowing				
local authorities	40.000	22.0	25.000	15.0
PWLB	129.061	71.1	129.061	77.4
LOBO's	12.600	6.9	12.600	7.6
Total external borrowing	**181.661**	**100.0**	**166.661**	**100.0**
Net treasury borrowing	**124.862**		**109.362**	

44. The Council's expected treasury portfolio position at 31 March 2021, with forward projections is summarised below at Table 8. 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 8 - Gross Borrowing to CFR

	2020/21 Revised £m	**2021/22 Estimate £m**	**2022/23 Estimate £m**	**2023/24 Estimate £m**
Debt at 31 March	162.801	177.318	189.900	203.783
Loans to Joint Ventures	12.798	13.281	15.699	16.816
Other long-term liabilities (OLTL)	10.358	9.232	8.117	7.011
Gross Actual debt at 31 March	**185.957**	**199.831**	**213.716**	**227.610**
The Capital Financing Requirement from Table 5	**218.318**	**229.504**	**242.402**	**253.543**
Under / (over) borrowing	**32.361**	**29.673**	**28.686**	**25.933**

45. Within the range of 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 2021/22 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 or speculative purposes.

46. 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 within this budget report.

Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary

47. 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 9 - Operational Boundary

	2020/21 Revised £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
Debt from Table 8 (incl JV's)	175.599	190.599	205.599	220.599
Other long-term liabilities	10.358	9.232	8.117	7.011
Prudential Borrowing for leasable assets	1.000	1.000	1.000	1.000
Prudential Borrowing under Directors Delegated Powers	1.000	1.000	1.000	1.000
Operational Boundary	**187.957**	**201.831**	**215.716**	**229.610**

The Authorised Limit for external debt

48. 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:

49. 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.

50. The Council is asked to approve the following Authorised Limit:

Table 10 – Authorised Limit

	2020/21 Revised £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
CFR	218.318	229.504	242.402	253.543
Additional Headroom @ 5%	10.915	11.475	12.120	12.677
Authorised Limit	**229.233**	**240.979**	**254.522**	**266.220**

51. It is proposed that the additional headroom for years 2021/22 to 2023/24 is 5% above the CFR, this would allow for any additional cashflow needs throughout the years.

Prospects for Interest Rates

52. The Council has appointed Link Group 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 – Interest rates

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including *certainty rate adjustment)			
		5 year	10 year	25 year	50 year
Mar 2021	0.10	0.80	1.10	1.50	1.30
Jun 2021	0.10	0.80	1.10	1.60	1.40
Sep 2021	0.10	0.80	1.10	1.60	1.40
Dec 2021	0.10	0.80	1.10	1.60	1.40
Mar 2022	0.10	0.90	1.20	1.60	1.40
Jun 2022	0.10	0.90	1.20	1.70	1.50
Sep 2022	0.10	0.90	1.20	1.70	1.50
Dec 2022	0.10	0.90	1.20	1.70	1.50
Mar 2023	0.10	0.90	1.20	1.70	1.50
Jun 2023	0.10	1.00	1.30	1.80	1.60
Sep 2023	0.10	1.00	1.30	1.80	1.60
Dec 2023	0.10	1.00	1.30	1.80	1.60
Mar 2024	0.10	1.00	1.30	1.80	1.60

** 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*

53. The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its subsequent meetings to 5th November, although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently

thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected in the forecast table above as economic recovery is expected to be only gradual and, therefore, prolonged. These forecasts were based on an assumption that a Brexit trade deal would be agreed by 31.12.20; as this has now occurred, these forecasts do not need to be revised

54. As the interest forecast table for PWLB certainty rates above shows, there is expected to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment, (as shown on 9th November when the first results of a successful COVID-19 vaccine trial were announced). Such volatility could occur at any time during the forecast period.

Investment and borrowing rates

55. Investment returns are likely to remain exceptionally low during 2021/22 with little increase in the following 2 years.

56. Borrowing interest rates fell to historically very low rates as a result of the COVID crisis and the quantitative easing operations of the Bank of England: indeed, gilt yields up to 6 years were negative during most of the first half of 20/21. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years.

57. While the Council will not be able to avoid borrowing to finance new capital expenditure, to replace maturing debt and the rundown of reserves, there will be a cost of carry (the difference between higher borrowing costs and lower investment returns), so any new short or medium-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

Borrowing Strategy

58. 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.

59. Against this background and the risks within the economic forecast, caution will be adopted with the 2021/22 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 borowing 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 borrowing 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.

60. Any decisions would be reported to the appropriate Committee at the next available opportunity.

Treasury Management Limits on Activity

61. 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

	2021/22	2022/23	2023/24
	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 2021/22			
		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

62. The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance 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.

63. 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

64. Rescheduling of current borrowing in our debt portfolio is unlikely to occur as the 100bps reduction in PWLB rates only applied to new borrowing rates and not to premature debt repayment rates.

65. If there was a possibility 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).

66. 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.

67. If rescheduling was done it will be reported to Committee at the earliest meeting following its action.

New Financial Institutions as a source of borrowing

68. Currently the PWLB Certainty Rate is set at gilts + 80 basis points for both HRA and Non-HRA borrowing. However, consideration may still need to be given to sourcing funding from the following sources for the following:

    - Local authorities (primarily shorter dated maturities out to 3 years or so – still cheaper than the Certainty Rate)
    - Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates where the objective is

to avoid a 'cost of carry' or to achieve refinancing certainty over the next few years)
- Municipal Bond Agency (possibly still a viable alternative depending on market circumstances prevailing at the time).

69. Our advisors will keep us informed as to the relative merits of each of these alternative funding sources.

Annual Investment Strategy

Investment and Creditworthiness Policy

70. The MHCLG and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals soley with financial investments (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy.

71. 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 Code")
    (c) CIPFA Treasury Management Guidance Notes 2018

72. The Council's investment priorities will be security first, liquidity second and then yield (return). The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs. However, where appropriate (from an internal as well as external perspective), the Council will also consider the value available in periods up to 12 months with high credit rated financial institutions, as well as wider range fund options.

73. The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. This Council has adopted a prudent approach to managing risk and defines its risk appetite by the following means:

    a) Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentrtation risk. The key ratings used to monitorcounterparies are the short term and long-term ratings.

    b) Other information: ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration 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.

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

d) This Council has defined the list of types of investment instruments that the treasury management team are authorised to use. There are 2 lists in **Appendix 2** under the categories of ‘specified’ and ‘non-specified’ investments.

- Specified investments are those with a high level of credit quality and subject to a maturity limit of one year.

- 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.

e) Lending limits, (amounts and maturity), for each counterparty will be set through applying the matrix table in Table 13

f) Transaction limits are set for each type of investment in Table 13

g) This Council wil set a limit for the amount of its investments which are invested for longer than 365 days.

h) Investments will be placed with counterparties from countries with a specified minimum sovereign rating.

i) This Council has engaged external consultants, to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this Council in the context of the expected level of cash balances and need for liquidity throughout the year.

j) All investments will be denominated in sterling.

k) As a result of the change in accounting standards for 2020/21 under International Financial Reporting Standard (IFRS) 9, this Council will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018 the Ministry of Housing, Communities and Local Government [MHCLG], conlcuded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for 5 years ending31 March 2023).

74. However, this Council will also pursue value for money in treasury mangement and will monitor the yield from investment income against appropriate benchmarks for

investment performance. Regular monitoring of investment performance will be carried out during the year.

Investment Counterparty Selection Criteria

Creditworthiness policy

75. 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.

76. 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.

77. Credit rating information is supplied by the Link Group, 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.

78. 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.

79. 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/or

II. are non-UK and domiciled in a country which has a minimum sovereign Long Term rating of AA-

and have, as a minimum, the following Fitch, Moody’s and Standard & Poors credit ratings (where rated):

I. Short Term – F1
II. Long Term – A-

(b) Banks 2 – Part nationalised UK banks – Royal Bank of Scotland ring-fenced operations. These banks can be included provided they continue to be part nationalised or meet the ratings in Banks 1 above.

(c) Banks 3 – 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 invested.

(d) Building societies -The Council will use all societies which meet the ratings for the banks outlined above and have assets in excess of £1,000m.

(e) Money Market Funds (MMFs) CNAV - AAA
(f) Money Market Funds (MMF’s) LNVAV - AAA
(g) Money Market Funds (MMF’s) VNAV - AAA

(h) Ultra-Short Dated Bond Funds - AAA

(i) UK Government (including gilts, Treasury Bills and the DMADF)

(j) Local authorities, parish councils etc

(k) Supranational institutions

(l) Housing associations

(m) Property Funds, Corporate Bond Funds and Asset Backed Investment Products.

80. A limit of £50m will be applied to the use of non-specified investments.

Use of additional information other than credit ratings

81. 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.

82. 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 utlilising credit ratings from the three main credit rating agencies - Fitch, Moodys and Standard & 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.

83. 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

84. 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)

Table 13 – Time and monetary limits applying to investments

	Fitch Long term Rating (or equivalent)	Money Limit	Time Limit
Banks 1 high quality	AA-	£5m	Maximum of 2 years Suggested duration using Link Group colour coding (CDS adjusted with manual override)
Banks 1 medium quality	A	£4m	Maximum of 1 year Suggested duration using Link Group colour coding (CDS adjusted with manual override)
Banks 1 lower quality	A-	£3m	Maximum of 1 year Suggested duration using Link Group colour coding (CDS adjusted with manual override)
Banks 2 category – part nationalised	N/A	£5m	Maximum of 1 years
Banks 3 category – Council's banker (not meeting Banks 1)		£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

85. 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.

86. The proposed criteria for Specified and Non-Specified investments are shown in Appendix 2 for approval.

87. 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 Group 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.

88. 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

89. 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 cash 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.

- 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.
- 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

90. Bank Rate is unlikely to rise from 0.10% for a considerable period. It is very difficult to say when it may start rising so it may be best to assume that investment earnings from money market-related instruments will be sub 0.50% for the foreseeable future.

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

(a) 2020/21 0.10%
(b) 2021/22 0.10%
(c) 2022/23 0.10%
(d) 2023/24 0.25%
(e) 2024/25 0.75%
(f) Later years 2.00%

92. The overall balance of risks to economic growth in the UK is probably relatively even, but is subject to major uncertainty due to the virus. It may also be affected by what deal the UK agrees as part of Brexit.

93. There is relatively little UK domestic risk of increases or decreases in Bank Rate and shorter term PWLB rates until 2023/24 at the earliest.

Negative Investment Rates

94. While the Bank of England said in August / September 2020 that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months, some deposit accounts are already offering negative rates for shorter periods. As part of the response to the pandemic and lockdown, the Bank and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government has provided large sums of grants to local authorities to help deal with the COVID crisis; this has caused some local authorities to have sudden large increases in cash balances searching for an investment home, some of which was only very short term until those sums were able to be passed on.

95. As for money market funds (MMFs), yields have continued to drift lower. Some managers have already resorted to trimming fee levels to ensure that net yields for investors remain in positive territory where possible and practical. Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is a surfeit of money swilling around at the very short end of the market. This has seen a number of market operators, now including the DMADF, offer nil or negative rates for very short term maturities. This is not universal, and MMFs are still offering a marginally positive return, as are a number of financial institutions for investments at the very short end of the yield curve.

96. Inter-local authority lending and borrowing rates have also declined due to the surge in the levels of cash seeking a short-term home at a time when many local authorities are probably having difficulties over accurately forecasting when disbursements of funds received will occur or when further large receipts will be received from the Government.

Investment treasury indicator and limit

97. 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.

98. The Committee is asked to approve the treasury indicator and limit: -

Table 14 – Maximum Principal sums invested

	2021/22	2022/23	2023/24
Principal sums invested greater than 365 days	£50m	£50m	£50m

99. For its cash flow generated balances, the Council will seek to utilise its instant access accounts, 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

100. 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.

101. 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.

102. 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.

103. Yield - local measures of yield benchmarks are:

(a) Investments – internal returns above the 7-day LIBID rate

(b) Investments – Longer term – capital investment rates returned against comparative average rates

104. 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.

The Council is appreciative that the provision of LIBOR and associated LIBID rates is expected to cease at the end of 2021. It will work with its advisors in determining suitable replacement investment benchmark(s) ahead of this cessation and will report back to members accordingly.

105. 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.

106. 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 Group.

End of year investment report

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

Outcome of Consultation

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

APPENDIX 1

Economic Background provided by Link Group

- UK. The key quarterly meeting of the Bank of England's Monetary Policy Committee kept Bank Rate unchanged on 5th November. However, it revised its economic forecasts to take account of a second national lockdown from 5th November to 2nd December which is obviously going to put back economic recovery and do further damage to the economy. It therefore decided to do a further tranche of quantitative easing (QE) of £150bn, to start in January when the current programme of £300bn of QE announced in March to June, runs out. It did this so that "announcing further asset purchases now should support the economy and help to ensure the unavoidable near-term slowdown in activity was not amplified by a tightening in monetary conditions that could slow the return of inflation to the target".
- Its forecasts appeared, at the time, to be rather optimistic in terms of three areas:
  - The economy would recover to reach its pre-pandemic level in Q1 2022
  - The Bank also expected there to be excess demand in the economy by Q4 2022.
  - CPI inflation was therefore projected to be a bit above its 2% target by the start of 2023 and the "inflation risks were judged to be balanced".

- Significantly, there was no mention of negative interest rates in the minutes or Monetary Policy Report, suggesting that the MPC remains some way from being persuaded of the case for such a policy, at least for the next 6 -12 months. However, rather than saying that it "stands ready to adjust monetary policy", the MPC this time said that it will take "whatever additional action was necessary to achieve its remit". The latter seems stronger and wider and may indicate the Bank's willingness to embrace new tools.
- One key addition to the Bank's forward guidance in August was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate. Our Bank Rate forecast currently shows no increase, (or decrease), through to quarter 1 2024 but there could well be no increase during the next five years due as it will take some years to eliminate spare capacity in the economy, and therefore for inflationary pressures to rise to cause the MPC concern. Inflation is expected to briefly peak at just over 2% towards the end of 2021, but this is a temporary short lived factor and so not a concern.
- However, the minutes did contain several references to downside risks. The MPC reiterated that the "recovery would take time, and the risks around the GDP projection were judged to be skewed to the downside". It also said "the risk of a more persistent period of elevated unemployment remained material". Downside risks could well include severe restrictions remaining in place in some form during the rest of December and most of January too. Upside risks included the early roll out of effective vaccines.

- COVID-19 vaccines. we had been waiting expectantly for news that various COVID-19 vaccines would be cleared as being safe and effective for administering to the general public. The Pfizer announcement on 9th November was very encouraging as its 90% effectiveness was much higher than the 50-60% rate of effectiveness of flu vaccines which might otherwise have been expected. However, this vaccine has demanding cold storage requirements of minus 70C that impairs the speed of application to the general population. It has therefore been particularly welcome that the Oxford University/AstraZeneca vaccine has now also been approved which is much cheaper and only requires fridge temperatures for storage. The Government has 60m doses on order and is aiming to vaccinate at a rate of 2m people per week starting in January, though this rate is currently restricted by a bottleneck on vaccine production; (a new UK production facility is due to be completed in June).

- These announcements, plus expected further announcements that other vaccines will be approved soon, have enormously boosted confidence that life could largely return to normal during the second half of 2021, with activity in the still-depressed sectors like restaurants, travel and hotels returning to their pre-pandemic levels; this would help to bring the unemployment rate down. With the household saving rate having been exceptionally high since the first lockdown in March, there is plenty of pent-up demand and purchasing power stored up for these services. A comprehensive roll-out of vaccines might take into late 2021 to fully complete; but if these vaccines prove to be highly effective, then there is a possibility that restrictions could begin to be eased, beginning possibly in Q2 2021, once vulnerable people and front-line workers have been vaccinated. At that point, there would be less reason to fear that hospitals could become overwhelmed any more. Effective vaccines would radically improve the economic outlook once they have been widely administered; it may allow GDP to rise to its pre-virus level a year earlier than otherwise and mean that the unemployment rate peaks at 7% in 2021 instead of 9%. Public borrowing was forecast in November by the Office for Budget Responsibility (the OBR) to reach £394bn in the current financial year, the highest ever peace time deficit and equivalent to 19% of GDP. In normal times, such an increase in total gilt issuance would lead to a rise in gilt yields, and so PWLB rates. However, the QE done by the Bank of England has depressed gilt yields to historic low levels, (as has similarly occurred with QE and debt issued in the US, the EU and Japan). This means that new UK debt being issued, and this is being done across the whole yield curve in all maturities, is locking in those historic low levels through until maturity. In addition, the UK has one of the longest average maturities for its entire debt portfolio, of any country in the world. Overall, this means that the total interest bill paid by the Government is manageable despite the huge increase in the total amount of debt. The OBR was also forecasting that the government will still be running a budget deficit of £102bn (3.9% of GDP) by 2025/26. However, initial impressions are that they have taken a pessimistic view of the impact that vaccines could make in the speed of economic recovery.
- Public borrowing is now forecast by the Office for Budget Responsibility (the OBR) to reach £394bn in the current financial year, the highest ever peace time deficit and equivalent to 19% of GDP. In normal times, such an increase in total gilt issuance would lead to a rise in gilt yields, and so PWLB rates. However, the QE done by the Bank of England has depressed gilt yields to historic low levels, (as has similarly occurred with QE and debt issued in the US, the EU and Japan). This means that new UK debt being issued, and this is being done across the whole yield curve in all maturities, is locking in those historic low levels through until maturity. In addition, the UK has one of the longest average maturities for its entire debt portfolio, of any country in the world. Overall, this means that the total interest bill paid by the Government is manageable despite the huge increase in the total amount of debt. The OBR was also forecasting that the government will still be running a budget deficit of £102bn (3.9% of GDP) by 2025/26. However, initial impressions are that they have taken a pessimistic view of the impact that vaccines could make in the speed of economic recovery.
- Overall, the pace of recovery was not expected to be in the form of a rapid V shape, but a more elongated and prolonged one. The initial recovery was sharp after quarter 1 saw growth at -3.0% followed by -18.8% in quarter 2 and then an upswing of +16.0% in quarter 3; this still left the economy 8.6% smaller than in Q4 2019. It is likely that the one month national lockdown that started on 5th November, will have caused a further contraction of 8% m/m in November so the economy may have then been 14% below its pre-crisis level.

- December 2020 / January 2021. Since then, there has been a rapid back tracking on easing restrictions due to the spread of a new mutation of the virus by the imposition of severe restrictions across all four nations. These restrictions were changed on January 5th to national lockdowns of various initial lengths in each of the four nations as the NHS was under extreme pressure. It is now likely that wide swathes of the UK will remain under severe restrictions for some months; this means that the near-term outlook for the economy is grim. However, the distribution of vaccines and the expected consequent removal of COVID-19 restrictions, should allow GDP to rebound rapidly in the second half of 2021 so that the economy could climb back to its pre-pandemic peak as soon as late in 2022. Provided that both monetary and fiscal policy are kept loose for a few years yet, then it is still possible that in the second half of this decade, the economy may be no smaller than it would have been if COVID-19 never happened. The significant caveat is that another mutation of COVID-19 does not appear that defeats the current batch of vaccines. However, now that science and technology have caught up with understanding this virus, new vaccines ought to be able to be developed more quickly to counter such a development and vaccine production facilities are being ramped up around the world.

- This recovery of growth which eliminates the effects of the pandemic by about the middle of the decade would have major repercussions for public finances as it would be consistent with the government deficit falling to around 2.5% of GDP without any tax increases. This would be in line with the OBR's most optimistic forecast in the graph below, rather than their current central scenario which predicts a 4% deficit due to assuming much slower growth. However, Capital Economics forecasts assumed that there is a reasonable Brexit deal and also that politicians do not raise taxes or embark on major austerity measures and so, (perversely!), depress economic growth and recovery

- There will be some painful longer term adjustments as e.g. office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possibly ever, even if vaccines are fully successful in overcoming the current virus. There is also likely to be a reversal of globalisation as this crisis has exposed how vulnerable long-distance supply chains are. On the other hand, digital services are one area that has already seen huge growth.

- Brexit. While the UK has been gripped by the long running saga of whether or not a deal would be made by 31st December, the final agreement on December 24th, followed by ratification by Parliament and all 27 EU countries in the following week, has eliminated a significant downside risk for the UK economy. The initial agreement only covers trade so there is further work to be done on the services sector where temporary equivalence has been granted in both directions between the UK and EU; that now needs to be formalised on a permanent basis. As the forecasts in this report were based on an assumption of a Brexit agreement being reached, there is no need to amend these forecasts.

- Monetary Policy Committee meeting of 17 December. All nine Committee members voted to keep interest rates on hold at +0.10% and the Quantitative Easing (QE) target at £895bn. The MPC commented that the successful rollout of vaccines had reduced the downsides risks to the economy it had highlighted in November. But this was caveated by it saying "Although all members agreed that this would reduce downside risks, they placed different weights on the degree to which this was also expected to lead to stronger GDP growth in the central case." So, while the vaccine is a positive development, in the eyes of the MPC at least, the economy is far from out of the woods. As a result of these continued concerns, the MPC voted to extend the availability of the Term Funding Scheme with additional incentives for small and medium size enterprises for six months from 30th April until 31st October 2021. (The MPC had assumed that a Brexit deal would be agreed).

- **Fiscal policy.** In the same week as the MPC meeting, the Chancellor made a series of announcements to provide further support to the economy: -
  - An extension of the COVID-19 loan schemes from the end of January 2021 to the end of March.
  - The furlough scheme was lengthened from the end of March to the end of April.

- The Budget on 3rd March 2021 will lay out the "next phase of the plan to tackle the virus and protect jobs". This does not sound like tax rises are imminent, (which could hold back the speed of economic recovery).

- The **Financial Policy Committee** (FPC) report on 6th August revised down their expected credit losses for the banking sector to "somewhat less than £80bn". It stated that in its assessment "banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection". The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%.

US - The result of the November elections means that while the Democrats gained the presidency and a majority in the House of Representatives, it looks as if the Republicans could retain their slim majority in the Senate provided they keep hold of two key seats in Georgia in elections in early January. If those two seats do swing to the Democrats, they will then control both Houses and President Biden will consequently have a free hand to determine policy and to implement his election manifesto

The economy had been recovering quite strongly from its contraction in 2020 of 10.2% due to the pandemic with GDP only 3.5% below its pre-pandemic level and the unemployment rate dropping below 7%. However, the rise in new cases during quarter 4, to the highest level since mid-August, suggests that the US could be in the early stages of a fourth wave. While the first wave in March and April was concentrated in the Northeast, and the second wave in the South and West, the third wave in the Midwest looks as if it is now abating. However, it looks as if the virus is rising again in the rest of the country. The latest upturn poses a threat that the recovery in the economy could stall. This is the single biggest downside risk to the shorter term outlook – a more widespread and severe wave of infections over the winter months, which is compounded by the impact of the regular flu season and, as a consequence, threatens to overwhelm health care facilities. Under those circumstances, states might feel it necessary to return to more draconian lockdowns.

The restrictions imposed to control its spread are once again weighing on the economy with employment growth slowing sharply in November and retail sales dropping back. The economy is set for further weakness in December and into the spring. However, a $900bn fiscal stimulus deal passed by Congress in late December will limit the downside through measures which included a second round of direct payments to households worth $600 per person and a three-month extension of enhanced unemployment insurance (including a $300 weekly top-up payment for all claimants). GDP growth is expected to rebound markedly from the second quarter of 2021 onwards, as vaccines are rolled out on a widespread basis and restrictions are loosened.

After Chair Jerome Powell unveiled the **Fed's adoption of a flexible average inflation target** in his Jackson Hole speech in late August 2020, the mid-September meeting of the Fed agreed by a majority to a toned down version of the new inflation target in his speech - that *"it would likely be appropriate to maintain the current target range until labour market conditions were judged to be consistent with the Committee's assessments of maximum employment and inflation had risen to 2% and was on track to moderately exceed 2% for some time."* This change was aimed to provide more stimulus for economic growth and higher levels of employment and to avoid the danger of getting caught in a deflationary "trap" like Japan. It is to be noted that inflation has actually been under-shooting the 2% target significantly for most of the last decade, (and this year), so financial markets took note that higher levels of inflation are likely to be in the pipeline; long-term bond yields duly rose after the meeting. The FOMC's updated economic and rate projections in mid-September showed that officials expect to leave the fed funds rate at near-zero until at least end-2023 and probably for another year or two beyond that. There is now some expectation that where the Fed has led in changing its inflation target, other major central banks will follow. The increase in tension over the last year between the US and China is likely to lead to a lack of momentum in progressing the initial positive moves to agree a phase one trade deal.

The Fed's meeting on 5 November was unremarkable - but at a politically sensitive time around the elections. At its 16 December meeting the Fed tweaked the guidance for its asset purchases in the statement issued after the conclusion of today's FOMC meeting, with the new language implying those purchases could continue for longer than previously believed. Nevertheless, with officials still projecting that inflation will only get back to 2.0% in 2023, the vast majority expect the fed funds rate to be still at near-zero until 2024 or later. Furthermore, the new rate forecast tables reveal that officials think the balance of risks surrounding that median inflation forecast are firmly skewed to the downside. The key message is still that policy will remain unusually accommodative – with near-zero rates and asset purchases – continuing for several more years. This is likely to result in keeping Treasury yields low – which will also have an influence on gilt yields in this country

EU. In early December, the figures for Q3 GDP confirmed that the economy staged a rapid rebound from the first lockdowns. This provides grounds for optimism about growth prospects for next year. In Q2, GDP was 15% below its pre-pandemic level. But in Q3 the economy grew by 12.5% q/q leaving GDP down by "only" 4.4%. That was much better than had been expected earlier in the year. However, growth is likely to stagnate during Q4, and in Q1 of 2021, as a second wave of the virus has affected many countries:it is likely to hit hardest those countries more dependent on tourism. The €750bn fiscal support package eventually agreed by the EU after prolonged disagreement between various countries, is unlikely to provide significant support, and quickly enough, to make an appreciable difference in the worst affected countries.

With inflation expected to be unlikely to get much above 1% over the next two years, the ECB has been struggling to get inflation up to its 2% target. It is currently unlikely that it will cut its central rate even further into negative territory from -0.5%, although the ECB has stated that it retains this as a possible tool to use. The ECB's December meeting added a further €500bn to the PEPP scheme (purchase of government and other bonds), and extended the duration of the programme to March 2022 and re-investing maturities until December 2023. Three additional tranches of TLTRO (cheap loans to banks) were approved, indicating that support will last beyond the impact of the pandemic, implying indirect yield curve control for government bonds for some time ahead. The Bank's forecast for a return to pre-virus activity levels was pushed back to the end of 2021, but stronger growth is projected in 2022.

The total PEPP scheme of €1,850bn of QE which started in March 2020 is providing protection to the sovereign bond yields of weaker countries like Italy. There is therefore unlikely to be a euro crisis while the ECB is able to maintain this level of support.

However, as in the UK and the US, the advent of highly effective vaccines will be a game changer, although growth will struggle before quarter 2 of 2021.

China. After a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in Q2 and then into Q3 and Q4; this has enabled China to recover all of the contraction in Q1. Policy makers have both quashed the virus and implemented a programme of monetary and fiscal support that has been particularly effective at stimulating short-term growth. At the same time, China's economy has benefited from the shift towards online spending by consumers in developed markets. These factors help to explain its comparative outperformance compared to western economies.

However, this was achieved by major central government funding of yet more infrastructure spending. After years of growth having been focused on this same area, any further spending in this area is likely to lead to increasingly weaker economic returns in the longer term. This could, therefore, lead to a further misallocation of resources which will weigh on growth in future years.

Japan. A third round of stimulus in early December took total fresh fiscal spending this year in response to the virus close to 12% of pre-virus GDP. That's huge by past standards, and one of the largest national fiscal responses. The budget deficit is now likely to reach 16% of GDP this year. Coupled with Japan's relative success in containing the virus without draconian measures so far, and the likelihood of effective vaccines being available in the coming months, the government's latest fiscal arrow should help ensure a strong recovery and to get back to pre-virus levels by Q3 2021 – around the same time as the US and much sooner than the Eurozone.

World growth. World growth will have been in recession in 2020. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus.

Until recent years, world growth has been boosted by increasing **globalisation** i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last thirty years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. The Chinese government has targeted achieving major world positions in specific key sectors and products, especially high tech areas and production of rare earth minerals used in high tech products. It is achieving this by massive financial support, (i.e. subsidies), to state owned firms, government directions to other firms, technology theft, restrictions on market access by foreign firms and informal targets for the domestic market share of Chinese producers in the selected sectors. This is regarded as being unfair competition that is putting western firms at an unfair disadvantage or even putting some out of business. It is also regarded with suspicion on the political front as China is an authoritarian country that is not averse to using economic and military power for political advantage. The current trade war between the US and China therefore needs to be seen against that backdrop. It is, therefore, likely that we are heading into a period where there will be a **reversal of world globalisation and a decoupling of western countries** from dependence on China to supply products. This is likely to produce a backdrop in the coming years of weak global growth and so weak inflation.

Summary

Central banks are, therefore, likely to come under more pressure to support growth by looser monetary policy measures and this is likely to result in more quantitative easing and keeping rates very low for longer. It will also put pressure on governments to provide more fiscal support for their economies.

If there is a huge surge in investor confidence as a result of successful vaccines which leads to a major switch out of government bonds into equities, which, in turn, causes government debt yields to rise, then there will be pressure on central banks to actively manage debt yields by further QE purchases of government debt; this would help to suppress the rise in debt yields and so keep the total interest bill on greatly expanded government debt portfolios within manageable parameters. It is also the main alternative to a programme of austerity.

INTEREST RATE FORECASTS

Brexit. The interest rate forecasts provided by Link in the main report were predicated on an assumption of a reasonable agreement being reached on trade negotiations between the UK and the EU by 31.12.20. There is therefore no need to revise these forecasts now that a trade deal has been agreed.

Brexit may reduce the economy's potential growth rate in the long run. However, much of that drag is now likely to be offset by an acceleration of productivity growth triggered by the digital revolution brought about by the COVID crisis.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably now skewed to the upside, but is still subject to some uncertainty due to the virus and the effect of any mutations, and how quick vaccines are in enabling a relaxation of restrictions.

- There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, could impact gilt yields, (and so PWLB rates), in the UK.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- UK government takes too much action too quickly to raise taxation or introduce austerity measures that depress demand in the economy.
- UK - Bank of England 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. The ECB has taken monetary policy action to support the bonds of EU states, with the positive impact most likely for "weaker" countries. In addition, the EU agreed a €750bn fiscal support package. These actions will help shield weaker economic regions for the next tw0 or three years. However, in the case of Italy, the cost of the virus crisis has added to its already huge debt mountain and its slow economic growth will leave it vulnerable to markets returning to taking the view that its level of debt is unsupportable. There remains a sharp divide between northern EU countries favouring low debt to GDP and annual balanced budgets and southern countries who want to see jointly issued Eurobonds to finance economic recovery. This divide could undermine the unity of the EU in time to come.
- Weak capitalisation of some European banks, which could be undermined further depending on extent of credit losses resultant of the pandemic.
- German minority government & general election in 2021**.** 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. The CDU has done badly in subsequent state elections but the SPD has done particularly badly. Angela Merkel has stepped down from being the CDU party leader but she intends to remain as Chancellor until the general election in 2021. This then leaves a major question mark over who will be the major guiding hand and driver of EU unity when she steps down.
- Other minority EU governments**.** Austria, Sweden, Spain, Portugal, Netherlands, Ireland and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.
- Austria, the Czech Republic, Poland and Hungary now form a strongly anti-immigration bloc within the EU. In November, Hungary and Poland threatened to veto the 7 year EU budget until a compromise was thrashed out in late 2020. There has also been a rise in anti-immigration sentiment in Germany and France.
- Geopolitical risks, for example in China, Iran or North Korea, but also in Europe and other Middle Eastern countries, which could lead to increasing safe haven flows.

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

- UK - a significant rise in inflationary pressures e.g. caused by a stronger than currently expected recovery in the UK economy after effective vaccines are administered quickly to the UK population, leading to a rapid resumption of normal life and return to full economic activity across all sectors of the economy**.**

- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a rapid series of increases in Bank Rate to stifle inflation.

Appendix 2

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.	**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}) 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.	AAA long term ratings
b.	**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.	
c.	**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.	£3m
d.	**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.	£5m
e.	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).	£5m
f.	**Local Authorities**	£5m per authority
g.	**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	£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 COMMITTEE
27 January 2021

AUDIT SERVICES – ACTIVITY REPORT

SUMMARY REPORT

Purpose of the Report

1. To provide Members with a progress report of activity and proposed activity for the next period.

Summary

2. The report outlines progress to date on audit assignment work, consultancy/contingency activity.

Recommendation

3. It is recommended that the activity and results be noted and that the planned work is agreed.

Reasons

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

Andrew Barber
Audit & Risk Manager

Background Papers

(i) Internal Audit Charter
(ii) Departmental Audit Reports

Andrew Barber: Extension 156176

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.

MAIN REPORT

Information and Analysis

5. Members will be aware of a change in approach from traditional audit assignments to individual control testing and reporting. This requires a different approach in terms of reporting on activity and this will be developed further in the coming months. Additionally there is a move away from annual audit planning to quarterly planning to enable the service to respond more effectively to the changing risk environment.

6. 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.

7. Appendix 1 provides members with detailed feedback on the performance of the service and the position in relation to completion of audit work. This is a new version of the report and each section will be discussed in more detail in the following paragraphs.

8. The first section of the report is to provide members with feedback on the management of the risks on the corporate risk register. Testing has not yet been undertaken for all risks but where testing has been undertaken an assurance level is provided, at present risk EG&NS 9 has been identified as an area where further improvement is required as reflected in the current assessment of that risk. The areas not yet tested are included in the normal programme of work based on the audit risk assessment which takes account of the overall risk assessment.

9. The next section breaks down audit results against a set of key governance processes. As with the previous section where no assurance level is given testing is yet to be undertaken. No area is scoring below 70% which is the benchmark for substantial assurance.

10. The next section breaks down audit work by functional service area within the council this is a different type of breakdown to the processes previously discussed and includes planning information as well as feedback on the work undertaken during the period. For each service area we provide the overall numbers which includes testing undertaken in prior periods. We then identify the results of testing in the current period followed by planned work in the next period which is developed using the audit risk assessment and the pre-defined frequency of testing.

11. The final section is progress against our balanced scorecard. The key measures in this section are adequate resources and portfolio coverage. In terms of adequate resources we aim to have 15 days capacity spare to deal with any issues that may arise, currently we have less spare capacity but we do have sufficient capacity to undertake all of the work. Portfolio coverage identifies the number of controls that should be tested in the period, we are currently are behind schedule on this indicator due to the current working arrangements and the new process bedding in. The backlog of work is included in the planned work for the next quarter and as discussed in terms of adequate resources we have sufficient capacity to clear this backlog. All other indicators remain on track.

Outcome of Consultation

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

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Risk Summary

Where possible audit testing is linked directly to risks on the risk register, below is a summary of current assurance levels based on work completed to date.

ID	Risk	Assurance
C&A 1	Inability to contain placement costs for children looked after due to lack of sufficient in house placements	
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	
C&A 14a	Failure to respond appropriately to safeguard vulnerable adults, in line with national legislation and safeguarding adults procedures	100%
C&A 14b	Failure to respond appropriately to safeguard vulnerable children, in line with national legislation and safeguarding children, thresholds and procedures.	
C&A 15	Working with other local commissioners to ensure their understanding of their responsibilities within the Childhood pathway.	
C&A 16	Risk of unsuccessful mobilisation of new service - Support, Recovery and Treatment In Darlington through Empowerment (STRIDE).	
C&A 17	Impact of NECA not retaining the Drug & Alcohol Contract on the Stop Smoking Service - Will the provider be able to manage the Stop Smoking staff if the Gate is no longer used by the Service.	
C&A 18	Impact of COVID-19 on team capacity.	
C&A 19	New Director of Public Health transition.	
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	
C&A 3b	Inability to recruit and retain sufficient qualified suitably experienced social workers in Adult Services impacts on cost and quality of service	
C&A 5	Failure to identify vulnerable schools and broker appropriate support to address needs	
C&A 8a Adult	Increased demand for Adult Services impacts negatively on plans for budget efficiencies	
C&A 8b	Increased demand for Children's Services impacts negatively on budget	
C&A 9a	Market (Domiciliary Care Residential Care providers) failure following the Care Act/Living Wage	
C&A 9b	Market (Domiciliary Care Residential Care providers) for Vulnerable Families with Children (including SEND) experiences provider failure	
C1	Implementation of recommendations from the Capital Process Review is needed to improve effective capital project management	
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	
C18	COVID-19: 1. Health and safety of the Council workforce 2. Health and safety of the public of Darlington 3. The impact on the Economy of the Borough and its population 4. Financial impacts on the Council of increased costs and reduced income	
C3	Corporate Premises Risks	100%
C4	Business Continuity Plans not in place or tested for key critical services	97%

C5	Council unable to meet its obligations under the information governance agenda	92%
EG&NS 1	Investment in regeneration projects is not delivered	
EG&NS 12	Planning Performance at risk of Standards Authority intervention	
EG&NS 13	Significant impacts arising from the reduction in available cash/resources to the local economy, Council's GF and HRA and businesses due to the impacts of increased levels of unemployment and Universal Credit payments	
EG&NS 14	Regulatory risks associated with provision of services including Street Scene Environmental Services, Building Services (Gas, Legionella, etc.) and the Lifeline service	
EG&NS 16	Delay in delivering replacement cremators resulting in failure of existing equipment and therefore closure of the service	
EG&NS 17	Impact of COVID-19 on customers and audiences on confidence to return to leisure and cultural facilities	
EG&NS 18	Impacts arising from the ability to progress and complete schemes/projects in the event of further COVID- 19 lockdowns	
EG&NS 19	Potential impact on public transport networks if commercial services do not recover or continue to receive support from Government and routes are withdrawn	
EG&NS 20	Inability to cope with significant increase in homelessness cases due to new requirements by MHCLG to accommodation everyone irrespective of status in order to limit spread of COVID-19 and also increased levels of homelessness due to increased relationship breakdowns and financial difficulties	
EG&NS 7	Financial implications of Maintaining and conserving key capital assets within the borough	
EG&NS 8	Ability to adequately address the affordable housing requirement	
EG&NS 9	Delay to new Local Plan	50%
RE 1	VAT partial exemption breech due to exempt VAT being close to the 5% limit	
RE 2	Fraud in general	
RE 26	Joint Venture Arrangements impacted by a slow down in house building	
RE 3	ICT security arrangements inadequate	
RE 5	Increased sickness absence adversely affects service delivery	
RE 9	Instability within financial markets adversely impacts on finance costs and investments	100%

Theme Summary

Audit testing is linked to a key governance theme, the results of work and overall assurance level against each theme is shown below.

Theme	Assurance	Audit Findings (By Impact)					
			VL	L	M	H	VH
1. Accuracy of Decision Making	98%	R	0	0	0	0	0
		A	0	0	3	0	1
		G	0	3	9	8	1
2. Monitoring of Decisions	100%	R	0	1	0	0	0
		A	0	1	0	1	0
		G	0	2	2	0	0
3. Information Governance	100%	R	0	0	0	0	0
		A	0	2	2	0	0
		G	1	3	9	2	0
4. Finance	100%	R	0	0	0	0	0
		A	0	0	0	0	0
		G	1	2	5	1	1
5. HR - Payments	100%	R	0	0	0	0	0
		A	0	0	0	0	0
		G	0	0	1	1	0
6. HR - Health & Safety	100%	R	0	0	0	0	0
		A	0	0	0	0	0
		G	0	1	2	0	0
7. HR - Management	100%	R	0	0	0	0	0
		A	0	0	0	0	0
		G	1	4	1	0	0
8. Recruitment	75%	R	0	0	0	0	0
		A	0	0	0	0	0
		G	0	2	0	0	0
9. HR - Training/Qualifications/Clearances	85%	R	0	0	0	0	0
		A	0	0	3	0	0
		G	0	6	4	1	0
10. Accuracy of Payments	100%	R	0	0	0	0	0
		A	0	0	0	0	0
		G	3	3	3	0	0
11. Income - Charging	83%	R	0	0	0	0	0
		A	0	1	0	0	0
		G	0	4	0	1	0
12. Income - Payments	70%	R	0	0	0	0	0
		A	0	1	0	0	0
		G	0	4	0	1	0
13. Cash Handling		R	0	0	0	0	0
		A	0	0	0	0	0
		G	0	0	0	0	0

14. Procurement/Sourcing	78%	R	0	0	0	0	0
		A	0	1	1	1	0
		G	0	4	1	0	1
15. Physical Assets/Locations	91%	R	0	0	0	0	0
		A	0	1	0	0	0
		G	0	5	6	3	1
16. Fraud		R	0	0	0	0	0
		A	0	0	0	0	0
		G	0	0	0	0	0
17. Business Continuity	100%	R	0	0	0	0	0
		A	0	1	0	0	0
		G	0	2	3	3	0
18. Procedures	100%	R	0	0	0	0	0
		A	0	0	0	0	0
		G	0	5	3	1	0
19. Performance Management	100%	R	0	0	0	0	0
		A	0	0	1	0	0
		G	0	0	0	3	1
20. ICT Infrastructure	91%	R	0	0	0	0	0
		A	0	0	0	0	0
		G	1	4	5	3	0
21. Handling of Requests/Incident Response	100%	R	0	0	0	0	0
		A	0	0	0	0	0
		G	0	1	0	0	0

Detailed Analysis by Service

This section of the report will present detail of work undertaken and work planned by Service area.

Finance		VL	L	M	H	VH
	R	0	0	0	0	0
	A	0	0	0	0	0
	G	0	3	1	2	0

Results of Audit Testing for the period:	October 2020	to	December 2020

Controls Tested:	2

Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High
0	1	0	1	0	0	0	0	0	0	0	0	0	0	0

Planned Work		January 2021		to	March 2021				
Very Low		Low		Medium		High		Very High	
No	Time	No	Time	No	Time	No	Time	No	Time
1	2	3	1.25	8	7	6	6.5	2	1.5

Monitoring
0

Below is a full list of controls to be examnied in the next period.

	Frequency
Clear budget process and timetable is in place which could be followed by team members as and when required.	3
Focussed financial support to commercial ventures	3
Maintain formula and support for funding schools and high needs	6
Prepare statement of accounts	6
Participate in appropriate safeguarding processes and provider serious concern protocol	6
Appropriate financial monitoring is in place in respect of the Better Care Fund.	6
Timely and accurate financial assessments are undertaken for service users wishing to take up a service.	6
Appropriate arrangements are in place to continue managing clients finances in the event of disruption.	6
Deliver the efficiency programme in place with identified lead responsibilities	12
Treasury Management Strategy and its implementation meets the Prudential Code and Treasury Management Code of Practice.	12
Financial appraisal completed as part of business case/options appraisal	12

Undertake forward planning and projections of external factors in respect of income and expenditure and feed into MTFP.	12
Delivery of an effective Internal Audit Service in compliance with Accounts & Audit Regulations.	12
Prepare and submit financial returns by deadlines - RA/RO/Capital	12
Plans are in place to continue to deliver housing/council tax support during an emergency.	12
Income Recompense Scheme is appropriately reported and claimed.	12
Feedback on cases of identified fraud are acted upon appropriately.	24
Council Tax support/housing benefit overpayments are managed effectively.	24
Adequate procedures exist to deliver Council Tax/Benefits/Business Rate services.	24
Operate clear and robust insurance claim management and processing uninsured loss recovery.	48

		VL	L	M	H	VH
HR	R	0	0	0	0	0
	A	0	0	0	0	0
	G	1	6	2	0	0

Results of Audit Testing for the period:	October 2020	to	December 2020	Controls Tested:	1

Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High
0	1	0	0	0	0	0	0	0	0	0	0	0	0	0

Planned Work	January 2021	to	March 2021						
Very Low		Low		Medium		High		Very High	
No	Time	No	Time	No	Time	No	Time	No	Time
0	0	1	0.25	3	2.5	1	0.25	0	0

Monitoring
0

Below is a full list of controls to be examnied in the next period.

	Frequency
Posts requiring a DBS check are identified and requirements are in line with legislation.	6
Corporate initiatives are in place to help prevent sickness absence.	12
Procurement of contracts in place for provision of employee therapy is undertaken in line with contract procedure rules and appropriate monitoring undertaken.	12
There is a system of performance management in place to establish the effectiveness of HR policies, procedures and initiatives.	12
Employee hard copy files are adequately safeguarded.	24

		VL	L	M	H	VH
Health & Safety	R	0	0	0	0	0
	A	0	0	0	0	0
	G	0	0	0	0	0

Results of Audit Testing for the period:	October 2020	to	December 2020	Controls Tested:	0

Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High
0	0	0	0	0	0	0	0	0	0	0	0	0	0	0

Planned Work		January 2021		to	March 2021				
Very Low		Low		Medium		High		Very High	
No	Time	No	Time	No	Time	No	Time	No	Time
0	0	1	1	1	1	0	0	0	0

Monitoring
0

Below is a full list of controls to be examnied in the next period.

	Frequency
Appropriate checks have been undertaken prior to placing someone on the Employee Protection Register.	12
Undertake health & safety investigations	24

		VL	L	M	H	VH
Strategy, Performance & Communications	R	0	0	0	0	0
	A	0	1	0	0	0
	G	2	3	1	0	0

Results of Audit Testing for the period:	October 2020	to	December 2020	Controls Tested:	0

Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High
0	0	0	0	0	0	0	0	0	0	0	0	0	0	0

Planned Work		January 2021		to	March 2021				
Very Low		Low		Medium		High		Very High	
No	Time	No	Time	No	Time	No	Time	No	Time

Monitoring

0	0	1	2	1	0.5	0	0	1	0.5		0

Below is a full list of controls to be examnied in the next period.

	Frequency
An approved Council Plan is in place which sets out the priorities of the council.	3
Website and Intranet content is relevant and up to date.	6
Communication activities are aligned with corporate priorities and are delivered consistently and effectively.	12

		VL	L	M	H	VH
Children's Services	R	0	0	0	0	0
	A	0	0	1	2	0
	G	0	0	2	4	1

Results of Audit Testing for the period:	October 2020	to	December 2020		Controls Tested:	7

Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High
0	0	1	2	1	0	0	1	2	0	0	0	0	0	0

Planned Work		January 2021		to		March 2021					
Very Low		Low		Medium		High		Very High			Monitoring
No	Time	No	Time	No	Time	No	Time	No	Time		
0	0	1	0.25	7	12.75	4	4.75	7	6.25		0

Below is a full list of controls to be examnied in the next period.

	Frequency
Section 17 payments made in respect of children are appropriately managed.	3
Children's placements are monitored appropriately and opportunities for family reunification examined.	3
Children's Assessment procedures are comprehensive and up to date	3
Children's cases are appropriately supervised with regular discussion and appropriate recording.	3
Systems are updated with the relevant referral information	3
Accurate and timely assessment of children's referrals is undertaken.	3
The Troubled Families Initiative programme is managed effectively.	3
Staff assessing children's cases have the relevant qualifications and clearances.	6
Business continuity arrangements are in place to continue to deal with referrals.	6

Management and oversight of youth offending cases improve outcomes for young people involved in criminal justice system or at risk of becoming involved.	6
Breakdowns/transition arrangements and appeals are handled effectively.	6
Arrangements are in place to manage the breakdown of a placement	12
Health & safety of children's placements is monitored	12
Suitability of emergency unsupported placements.	12
Up to date and accessible procedures available to support the management of children's case files.	12
Pathway plans support care leavers in managing the transition from school to higher education, training or employment.	12
Training, support and development is in place for foster carers/special guardians.	12
Effective recruitment and retention of foster carers, including ongoing campaigns promoting the role.	12
Procedures ensure that staff are aware of the process for making a referral to children's social care.	24

		VL	L	M	H	VH
Adults	R	0	0	0	0	0
	A	0	0	2	1	1
	G	0	1	2	6	2

Results of Audit Testing for the period:	October 2020	to	December 2020	Controls Tested:	8

Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High
0	0	1	3	1	0	0	1	1	0	0	0	0	0	0

Planned Work		January 2021		to	March 2021					
Very Low		Low		Medium		High		Very High		Monitoring
No	Time	No	Time	No	Time	No	Time	No	Time	
0	0	1	1	6	7.75	4	3.5	7	8.5	0

Below is a full list of controls to be examnied in the next period.

	Frequency
Adult Services have a service strategy in place and delivery is being monitored.	3
An up to date strategic plan is in place for the Safeguarding Adults Board.	3
Adult Social Care cases are allocated appropriately considering caseloads and qualification requirements.	3
An appropriate ICT system(s) is in place to manage and safeguard adult social care information held.	3

Appropriate service provision has been identified to meet an Adult Social Care users individual needs, which is accurately charged for as required.	3
Where the Authority has Deputyship/Appointeeship, appropriate authorisation/legal documentation is in place	3
There is a system of performance management in place for adult social care.	3
Referral and Assessment Procedures (Adults) are comprehensive and up to date.	6
Adult Social Care case files are updated accurately and in a timely manner.	6
Accurate charges for contributions to care costs are made to service users.	6
All care packages are receiving appropriate approval, and include all relevant information.	6
Procedures for managing referrals (Children's) and undertaking initial assessments are comprehensive and up to date.	12
Update and report the risk diagnostic tool (RAG) to assist in risk management in all adults, public health and children's contracts	12
Crisis and emergency/settlement support	12
Advice, access to support and refuge accommodation for victims of domestic abuse.	12
Appropriate and timely response to a homelessness Duty to Refer request.	12
Provide effective short-term support to individuals following a discharge from hospital or to prevent hospital admission.	12
Specialist housing facilities meet demand, provide good quality accommodation and meet the needs of vulnerable residents.	24

		VL	L	M	H	VH
Education	R	0	0	0	0	0
	A	0	0	1	0	0
	G	0	7	3	1	1

Results of Audit Testing for the period:	October 2020	to	December 2020	Controls Tested:	3

Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High
0	1	2	0	0	0	0	0	0	0	0	0	0	0	0

Planned Work		January 2021		to	March 2021					
Very Low		Low		Medium		High		Very High		Monitoring
No	Time	No	Time	No	Time	No	Time	No	Time	
0	0	1	1	6	10.5	3	5.5	1	2.25	0

Below is a full list of controls to be examnied in the next period.

Frequency

Education, Health & Care Plans are completed appropriately and in a timely fashion	3
Sufficient school places are available to meet demand.	3
Attainment in schools is appropriately monitored.	6
Education, Health & Care Plans are appropriately monitored	6
School investment plan in place to ensure appropriate number and quality of places available.	6
A robust training and support regime is in place for new teachers	12
School places have been appropriately allocated.	12
Agreements for early years provision are in place and being complied with and monitoring visits are being undertaken.	12
Allocation of school budgets in line with funding formula.	12
Safeguarding training in schools is up to date and a safeguarding lead is in place.	12
Address patterns of absence and promote regular attendance at school.	12
Payments made to early years providers are accurate	24

		VL	L	M	H	VH
Public Health	R	0	0	0	0	0
	A	0	0	0	0	0
	G	0	0	0	0	0

Results of Audit Testing for the period:	October 2020	to	December 2020	Controls Tested:	0

Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High
0	0	0	0	0	0	0	0	0	0	0	0	0	0	0

Planned Work		January 2021		to		March 2021			
Very Low		Low		Medium		High		Very High	
No	Time	No	Time	No	Time	No	Time	No	Time
0	0	0	0	0	0	5	7.25	0	0

Monitoring
0

Below is a full list of controls to be examnied in the next period.

	Frequency
Non-financial targets as set out in the Better Care Fund plan are being met.	6
Formal signed agreements in place between LA/CCG in accordance with relevant guidance	6

The council has a strategy in place to deliver public health services to the community.	6
Effective commissioning and procurement of public health services and programmes.	6
Public health research and local needs assessment.	6

		VL	L	M	H	VH
Legal	R	0	0	0	0	0
	A	0	1	0	0	0
	G	1	1	3	0	0

Results of Audit Testing for the period:	October 2020	to	December 2020	Controls Tested:	2

Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High
1	0	0	0	0	0	1	0	0	0	0	0	0	0	0

Planned Work		January 2021		to	March 2021				
Very Low		Low		Medium		High		Very High	
No	Time	No	Time	No	Time	No	Time	No	Time
0	0	1	0.5	2	3.5	0	0	0	0

Monitoring
0

Below is a full list of controls to be examnied in the next period.

	Frequency
Delivery of tender management plan	12
The Council maintains an accurate and up to date land charges register.	12
Accurate charging is made in accordance with approved scale of land charges and fees.	24

		VL	L	M	H	VH
Democratic Services & Registrars	R	0	0	0	0	0
	A	0	0	0	0	0
	G	0	5	1	0	0

Results of Audit Testing for the period:	October 2020	to	December 2020	Controls Tested:	0

Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High
0	0	0	0	0	0	0	0	0	0	0	0	0	0	0

Planned Work		January 2021		to		March 2021			
Very Low		Low		Medium		High		Very High	
No	Time	No	Time	No	Time	No	Time	No	Time
0	0	1	1	0	0	0	0	0	0

Monitoring
0

Below is a full list of controls to be examnied in the next period.

	Frequency
Sufficient and trained staff are available to support Elections held.	24

Information Governance		VL	L	M	H	VH
	R	0	0	0	0	0
	A	0	0	2	0	0
	G	0	1	2	0	1

Results of Audit Testing for the period:	October 2020	to	December 2020		Controls Tested:	3

Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High
0	0	1	0	1	0	0	1	0	0	0	0	0	0	0

Planned Work		January 2021		to		March 2021			
Very Low		Low		Medium		High		Very High	
No	Time	No	Time	No	Time	No	Time	No	Time
0	0	1	0.25	3	5	0	0	1	0.25

Monitoring
0

Below is a full list of controls to be examnied in the next period.

	Frequency
Update and report the strategic corporate risk register.	3
Requests for information are handled in line with requirements of the Freedom of Information Act.	12
Prepare annual governance statement	12
A central record of Information Asset Registers is maintained and checked for completeness.	12
Corporate privacy notices in place.	24

		VL	L	M	H	VH
Xentrall	R	0	0	0	0	0
	A	0	1	0	0	0
	G	1	15	19	9	1

Results of Audit Testing for the period:	October 2020	to	December 2020		Controls Tested:	13

Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High
0	1	7	4	0	0	0	0	0	0	0	0	0	0	0

Planned Work		January 2021		to	March 2021						
Very Low		Low		Medium		High		Very High			Monitoring
No	Time	No	Time	No	Time	No	Time	No	Time		
1	0.5	12	16.5	8	15.5	2	3.5	0	0		0

Below is a full list of controls to be examnied in the next period.

	Frequency
Appropriate formal documented ICT project management standards/policies have been established.	6
Appropriate periodic IT Health checks (or other equivalent exercises) are undertaken in order to identify and categorise significant security issues/vulnerabilities. Work is then undertaken to remediate these issues/vulnerabilities where appropriate.	6
ICT equipment located in computer facilities is adequately and appropriately protected from significant environmental threats.	12
Where applicable, appropriate internal disaster recovery arrangements (including backup, replication and snapshot facilities) are in place to cover significant ICT system/servers.	12
Network infrastructure/equipment is appropriately managed and protected.	12
Adequate and appropriate arrangements are in place in respect of business continuity and disaster recovery for the network infrastructure (including backup arrangements and arrangements to ensure network resilience).	12
HMRC reporting requirements are being complied with.	12
Information held in systems relating to HR are accurate and up to date.	12
The authority complies with HMRC CIS scheme.	12
Pension deductions are taken each month from employee's pay at the appropriate rate.	12
Remote access to facilities is adequately controlled.	24

Significant changes to the virtualised infrastructure are adequately managed. Allocation of resources in the virtualised environment is adequately and appropriately controlled.	24
The organisation's establishment is authorised by the managing body.	24
All variable payments other than overtime (control covered elsewhere) are supported by appropriate paperwork and details are promptly and accurately entered onto the system.	24
All fixed salary payments comply with policies and are supported by appropriate paperwork and details are promptly and accurately entered into the system.	24
Financial information is updated in a timely manner and recorded accurately within Business World On!	24
Standard exception reports are produced for subsequent investigation and clearance.	24
Secure procedures operate for immediate payments.	24
A record is kept of all accounts which are not dispatched at the time the accounts are raised. This record indicates why this action was taken, and where appropriate, records the agreement of the budget holder.	24
Amendments and credits can only occur with the authorisation of the responsible officer for the cost centre whose account was originally credited in error.	24
There are clearly defined guidelines and procedures for the recruitment process.	24
The appointment process is fair, robust and managed effectively.	24
Approved absence has been granted in-line with policy and promptly recorded and correctly authorised.	48

		VL	L	M	H	VH
Housing & Building Services	R	0	0	0	0	0
	A	0	0	1	0	0
	G	0	1	3	1	0

Results of Audit Testing for the period:	October 2020	to	December 2020		Controls Tested:	4

Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High
0	0	1	1	0	0	0	0	0	0	0	0	0	0	0

Planned Work		January 2021		to		March 2021			
Very Low		Low		Medium		High		Very High	
No	Time	No	Time	No	Time	No	Time	No	Time
0	0	5	3.75	1	0.5	2	1	2	6

Monitoring
0

Below is a full list of controls to be examnied in the next period.

	Frequency
Process council tax support claims	3
Process housing benefit claims	3
Early help and support provided by welfare support service	6
Accurate and timely returns are provided to support New Homes Bonus.	6
Prioritised support and provision to tackle fuel poverty and deliver the Affordable Warmth Strategy.	12
The authority has an adequate, appropriate and up to date Empty Homes Strategy in place.	24
The Travellers Site is secure and maintained effectively	24
Records relating to housing and housing related developments are accurate, up to date and appropriately safeguarded.	24
Decisions to write-off outstanding council tax and NNDR debts are appropriate and have been appropriately approved.	24
Decisions to write-off outstanding housing debts is appropriate and all steps taken to recover the amount.	24

		VL	L	M	H	VH
Community Services	R	0	1	0	0	0
	A	0	3	0	0	0
	G	0	10	10	1	0

Results of Audit Testing for the period:	October 2020	to	December 2020		Controls Tested:	8

Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High
0	2	4	0	0	0	0	0	0	0	0	0	0	0	0

Planned Work		January 2021		to	March 2021					
Very Low		Low		Medium		High		Very High		Monitoring
No	Time	No	Time	No	Time	No	Time	No	Time	
2	1.5	11	5.75	9	6.75	2	1.5	0	0	0

Below is a full list of controls to be examnied in the next period.

	Frequency
Planning and provision of school meals promotes healthy, nutritious eating in compliance with the School Food Standards.	6
Free school meals are provided to eligible pupils.	6
Arrangements are in place for inspection and maintenance of security and surveillance equipment.	12
Civic enforcement decisions are consistent, fair, proportionate and necessary; in line with legislation.	12

Community engagement and communication to highlight and reduce environmental crime.	12
Sensitive personal information in relation to Telecare clients is managed in line with GDPR.	12
Venues for events are appropriate.	12
Library stock is adequately recorded, managed and its condition is 'fit for purpose'.	12
Adequate performance information is maintained and is appropriately utilised within the Highways Department.	12
Trading standards investigations are recorded accurately either as a result of a programmed inspection or in response to a complaint and the results circulated as necessary including general guidance as necessary.	12
Appropriate and up to date emergency plans are in place to guide a coordinated response to a major incident.	12
Public Rights of Way Improvement Plan is in place and progress is being monitored.	24
Ticket sales and admission charges are recorded and income received in full.	24
Library income is securely held and effectively managed.	24
Response to requests for the removal of needles and syringes within two hours.	24
Effective performance management systems are in place to monitor levels of take up of leisure and culture activities with remedial action taken as necessary.	24
Provide a broad selection of accessible leisure and outdoor activities, representing value for money to the public.	24
Safeguarding of assets and equipment used in the delivery of arts and events.	24
Waste and recycling targets are achieved.	24
Parks and green spaces are identified, mapped and promoted.	24
Security and crime prevention measures are in place in relation to parks and green spaces.	24
Provision and upkeep of outdoor public seating and street furniture.	24
Prompt removal of graffiti from public land and street furniture.	48
Prompt and effective response to reports of stray or abandoned animals.	48

		VL	L	M	H	VH
Economic Growth	R	0	0	0	0	0
	A	0	0	2	0	0
	G	0	1	1	2	0

Results of Audit Testing for the period:	October 2020	to	December 2020		Controls Tested:	1

Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High
0	0	1	0	0	0	0	0	0	0	0	0	0	0	0

Planned Work	January 2021	to	March 2021

Very Low		Low		Medium		High		Very High	
No	Time	No	Time	No	Time	No	Time	No	Time
0	0	3	1.5	6	4.75	3	2.5	0	0

Monitoring
0

Below is a full list of controls to be examnied in the next period.

	Frequency
Food & Hygiene premises rating system is updated regularly and published	6
Breaches of planning control are investigated and enforcement action initiated as necessary.	6
Support is provided to new and existing businesses.	6
The authority is committed to reducing it's carbon footprint and supporting residents and businesses to reduce theirs.	12
Building control decisions are appropriately authorised and made in line with Building Regulations.	12
Section 106 agreements utilised effectively and obligations are complied with.	12
Strategic plans and framework are in place to tackle poverty.	12
Tackling town centre property vacancies.	12
Promotion of the borough and town centres as a great place to invest, trade and visit.	12
Records relating to environmental health cases are appropriately recorded and managed.	24
Provision of green spaces is a consideration for new housing developments, regeneration schemes etc.	24
Financial assistance to businesses decisions are accurately recorded.	24

		VL	L	M	H	VH
Transport & Capital Projects	R	0	0	0	0	0
	A	0	0	1	0	0
	G	0	3	3	1	0

Results of Audit Testing for the period:	October 2020	to	December 2020

Controls Tested:	0

Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High	Very Low	Low	Medium	High	Very High
0	0	0	0	0	0	0	0	0	0	0	0	0	0	0

Planned Work	January 2021	to	March 2021

Very Low		Low		Medium		High		Very High	
No	Time	No	Time	No	Time	No	Time	No	Time
0	0	5	4.25	11	7.25	4	3.5	0	0

Monitoring
0

Below is a full list of controls to be examnied in the next period.

	Frequency
Ensure accurate monitoring of capital programme and schemes	6
Vehicles used in the provision of community transport services are suitable and meet requirements for servicing and road worthiness.	6
Client risk assessments are undertaken and appropriate arrangements are in place for provision of social care and education transport to clients.	6
Bridge Inspections are undertaken in accordance with an appropriate specified programme.	6
Appropriate business risk assessments are undertaken within the community transport service and measures are in place to ensure the health and safety of council employees.	12
Council employed drivers and passenger assistants hold the necessary clearances, licences, qualifications and training.	12
Contractors & Sub-Contractors involved in the provision of community transport hold necessary clearances, licences, qualifications and insurance.	12
Highway inspections are undertaken in accordance with an appropriate specified programme.	12
Street Lighting inspections and associated electrical testing are undertaken in accordance with an appropriate specified programme.	12
Car Parking Strategy in place which is up to date and considers resident, disabled and general parking requirements.	12
Road closures are undertaken following appropriate consultation and required notification are undertaken within appropriate timescales.	12
The highways network resilience to extreme events such as weather has been fully established and plans are in place to manage this.	12
The authority has an adequate, appropriate and up to date Highway Infrastructure Asset Management Strategy (HIAMS) in place.	12
Utility works are licensed, inspected and, where applicable, appropriate charges are issued and collected for overruns/fines.	12
Commitment to road safety and reducing road casualties.	12
Transport provision is in line with client eligibility criteria.	24
Procurement of transport routes, goods and services ensures compliance with value for money principles and contract procedure rules.	24
Payments made to community transport staff are appropriate, accurate and authorised.	24
The authority has undertaken appropriate consultation and produced an adequate, appropriate and up to date Local Transport Plan.	24
There is an effective appeals process for transport eligibility decisions.	24

Quality, Assurance & Improvement Process

Period	October 2020	to	December 2020

Stewardship (Coverage)			Stakeholders		
Measure	Target	Performance	Measure	Target	Performance
Adequate Resources	15	3.85	Reports Issued	Qtrly	Jan-21
Portfolio Coverage	108	56	Fraud Strategy Review	31/03/2021	Oct-20
Presentation of Annual Report (Annual)	June		Client Satisfaction	TBC	
Presentation of Activity Report	Qtrly	Jan-21	Submission of NFI Information	30/10/2020	30/10/2020
			Recommendation Implementation	TBC	

Process			People		
Measure	Target	Performance	Measure	Target	Performance
Self assessment against standards (Annual)	March		Productivity	75%	77.6%
External Assessment (Every 5 Years)	31/03/2023	N/A	Training (Per Financial Year)	20	1.4
Staff Meetings Held	7	10	Code of Conduct (Annual)	100%	100%
Up to Date Audit Manual	31/03/2021	On-going	Appraisals (Annual)	100%	100%