Scottish Borders COUNCIL

AUDIT AND RISK
MONDAY, 19TH JANUARY, 2015

A MEETING of the AUDIT AND RISK will be held in the COUNCIL HEADQUARTERS, COUNCIL HEADQUARTERS, NEWTOWN ST BOSWELLS on MONDAY, 19 JANUARY 2015 at 10.15 am

J. J. WILKINSON,
Clerk to the Council,

12 January 2015

BUSINESS		
1.	**Apologies for Absence.**	
2.	**Order of Business.**	
3.	**Declaration of Interest.**	
4.	**Minute.** (Pages 1 - 6) Minute of Meeting of the Audit Committee held on 10 November 2014 to be noted and signed by the Chairman. (Copy attached.)	4 mins
5.	**Draft Treasury Management Strategy 2015/16.** (Pages 7 - 50) Consider report by Chief Financial Officer on the Council's draft Treasury Management Strategy 2015/16 for review and scrutiny prior to presentation for Council approval. (Copy attached.)	30 mins
6.	**External Audit Scottish Borders Council Audit Strategy and Plan Overview 2014/15.** (Pages 51 - 76) Consider strategy and plan overview report by KPMG on how they will deliver their external audit for Scottish Borders Council for the year ended 31 March 2015. (Copy attached)	20 mins
7.	**Internal Audit Work 2014/15 to December 2014.** (Pages 77 - 96) Consider a report by Chief Officer Audit & Risk on recent work carried out by Internal Audit, including the recommended audit actions agreed by Management to improve internal controls and governance arrangements, and internal audit work currently in progress. (Copy attached)	15 mins
8.	**Risk Management Review and Revised Policy Statement.** (Pages 97 - 106) Consider report by Chief Officer Audit & Risk on the outcomes of the Risk Management Review including the recommendations for improvement to refine the risk management arrangements at the Council to ensure their	15 mins

	ongoing effectiveness, and the revised Corporate Risk Management Policy. (Copy attached.)	
9.	**Any Other Items Previously Circulated.**	
10.	**Any Other Items which the Chairman Decides are Urgent.**	

NOTES

1. **Timings given above are only indicative and not intended to inhibit Members' discussions.**

2. **Members are reminded that, if they have a pecuniary or non-pecuniary interest in any item of business coming before the meeting, that interest should be declared prior to commencement of discussion on that item. Such declaration will be recorded in the Minute of the meeting.**

Membership of Committee:- Councillors M Ballantyne (Chair), W Archibald, J Campbell, A J Nicol, S Scott and B White (Vice-Chairman)
Mr D Gwyther, Mr G Tait.

Please direct any enquiries to Pauline Bolson. Tel: 01835 826503
Email: PBolson@scotborders.gov.uk

Item No. 4

SCOTTISH BORDERS COUNCIL
AUDIT COMMITTEE

MINUTE of MEETING of the AUDIT COMMITTEE held in the Council Chamber, Council Headquarters, Newtown St. Boswells on 10 November 2014 at 10.15 a.m.

Present: -	Councillors M. Ballantyne (Chairman), J. Campbell, S. Scott. Mr D.Gwyther, Mr G. Tait.
Apologies:-	Councillors W. Archibald, A. Nicol, B. White.
Also present:-	Councillor G. Edgar.
In Attendance:-	Chief Financial Officer, Chief Officer - Audit and Risk, Service Director Commercial Services, Chief Legal Officer, Democratic Services Officer (F. Walling), Mr M. Swann – KPMG, Mr. A. Clark – Audit Scotland.

WELCOME

1. The Chairman welcomed to the meeting Mr Antony Clark from Audit Scotland and Mr Matthew Swann from KPMG.

ORDER OF BUSINESS

2. The Chairman varied the order of business as shown on the Agenda and the Minute reflects the order in which the items were considered at the meeting.

MINUTE

3. There had been circulated copies of the Minute of 23 September 2014.

DECISION
APPROVED for signature by the Chairman.

SCOTTISH BORDERS COUNCIL SHARED RISK ASSESSMENT 2015-2018

4. With reference to paragraph 7 of the Minute of 24 June 2014, Mr Antony Clark, Assistant Director Audit Scotland, was in attendance to give a presentation on the 2015/16 Shared Risk Assessment (SRA) process. Mr Clark summarised the revised process for 2015/16 as being shorter, sharper and more focused. He gave a reminder of the reasons for the introduction of Shared Risk Assessment which followed the key recommendation in the Crerar report to introduce a scrutiny 'gatekeeping' role. The parts of the scheme which were working well included improved scheduling and co-ordination of local government scrutiny activity, the minimisation of duplication and overlap in planned scrutiny activity and better use being made of shared information and intelligence. Not working quite as well was the aim to deliver tailored scrutiny plans which reflected local risks and circumstances nor the promotion of innovative and flexible scrutiny responses. Mr Clark summarised what was still to be improved in the process that culminated in an Assurance and Improvement Plan (AIP) detailing the rolling 3-year forward scrutiny plan for the Council. Although Councils generally valued the process it was felt that engagement with them was still inconsistent. The process had reduced the scrutiny burden but rather than being linked with local risks, ministerial-driven inspection programmes were creating new potential scrutiny 'burden' risks. An unintended consequence of a more proportionate and risk-based approach to planning scrutiny was that high performing Councils were subject to less scrutiny weakening the evidence base of good and innovative practice. Furthermore it was suggested that the time and effort taken to prepare and publish AIPs was sometimes greater than the value and impact that the SRA brought.

5. Mr Clark went on to outline what had been changed in the revised SRA process. The SRA scope would exclude outcomes and public service reform but include improvement support from bodies such as Education Scotland. The SRA scope would now inform Care Inspectorate scheduling of children's services and older people's inspections. Further changes would be a reduction in size of the SRA template and length of the Local Scrutiny Plan and streamlined Question and Answer arrangements. The changes should result in a more efficient process; scope for more application of professional judgement; streamlined reporting with a clearer focus on locally tailored scrutiny plans; and overall a shorter, sharper and better process. Mr Clark proceeded to answer Members' questions. With regard to the apparent shift away from a focus on outcomes Mr Clark explained that outcomes would still be captured in the context of the main services that contributed to them. With regard to the level of local engagement he emphasised the need to ensure planning for inspection reflected local issues. The Chairman thanked Mr Clark for his presentation.

DECISION
NOTED the presentation.

PROPERTY MANAGEMENT

6. Service Director Commercial Services, Andrew Drummond-Hunt, was in attendance to give a presentation updating members on estate management and the expenditure on Council Properties including the Economic Development portfolio. The presentation began with an overview of Scottish Borders Council Property and Estates. Charts showing the analysis of the Council's property indicated that by far the largest asset class was the school estate, by asset value this was 64% and by floor area 52%. Scottish Borders Council spent £5 per square metre on maintenance, this being augmented by the Property and Asset Programme in the capital programme which brought the spend up to around £7 per square metre. This compared with a 2009 local authority average of £11 per square metre and a Scottish Futures Trust (SFT) recommendation of £35 per square metre. A challenge was that construction inflation was set to increase significantly over the next three years. A further chart, showing how the total revenue budget of £1.8m per annum was spent on property maintenance, showed the statutory planned maintenance in the areas of electrical testing (7%), legionellosis (3%) and asbestos and indicated that 57% of the budget was reactive spend covering critical repairs such as plumbing and electrical faults, boiler/heating faults, roof leaks, health and safety repairs etc. 33% was spent on planned repairs to replace life-expired components such as roof coverings, boilers, re-wiring, fire alarm systems etc. The current maintenance backlog was reported to be £26.1m. Using the Government Scoring system for overall condition 6.4% of the Council's estate was in Condition A, 70.5% in Condition B, 20.9% in Condition C and 2.2% in Condition D. However Mr Drummond- Hunt advised that the scoring system was not fool proof in that it did not necessarily reflect the severity or cost implications of a particular problem that may exist within a property. The presentation went on to focus on the Council's commercial estate. There were 228 industrial units, 31 shops and 31 offices/yards etc. with a total asset value of £9.04m, the annual income receivable representing a 12% return. In addition there were 54 development sites for sale or lease. Maintenance spend on commercial property was £3 per square metre with the tenant being responsible for internal repairs. The commercial estate was geared well for local businesses, with a current occupancy rate of approximately 90%. A recent change of policy had resulted in an emphasis on the provision of serviced sites for sale or lease rather than buildings to let. Maintenance and capital spend was insufficient over the long term to regenerate the built estate and consideration should be given to selling commercial buildings that were becoming obsolete and perhaps 'top slicing' the income for investment to regenerate the estate.

7. Mr Drummond-Hunt summarised the Council's current programme of property rationalisation and circulated schedules of current and recent sales and a list of potential industrial property sales. The amount anticipated to be raised over the next 5 years was £8.62m. Currently capital receipts from sales were used to fund the Council's capital

programme. Other considerations within the property rationalisation programme were to encourage economic development and stimulate affordable housing, as well as rationalisation reviews in conjunction with service and estate strategy reviews. In summary: there was a need to carry out rationalisation to keep the estate sustainable as maintenance resources were under severe pressure; the Council had a large successful commercial estate but would be unable to sustain the built commercial assets in the long term; the focus would therefore be on serviced site sales/leasing and the prudent rationalisation of the built commercial estate. In the discussion that followed Members recognised that rental income contributed to the overall income budget and that insufficient resources had been allocated for maintenance of the Council's estate, which was needed to protect that income. Likewise one element of the capital plan was funded by sales of property. Mr Drummond-Hunt drew attention to the difficult choices facing the Council in terms of which properties to sell and which to retain. It was noted that the capital plan concentrated on new buildings rather than investment in older property. With regard to the serviced sites Members accepted that their provision addressed market failure and that this was a vital contribution from the Council towards economic development in the Borders. It was agreed that, following the outcome of service reviews, a comprehensive Asset Management Plan covering all property asset classes was needed to enable an active property rationalisation programme to be taken forward.

DECISION
NOTED the presentation.

<u>INTERNAL AUDIT RECOMMENDATIONS 2013/14 FOLLOW-UP</u>

8. With reference to paragraph 8 of the Minute of 21 April 2014, there had been circulated copies of a report by the Chief Officer Audit and Risk providing details of all Priority 1 (High Risk) and related Priority 2 (Medium Risk) recommendations issued by Internal Audit during 2013/14 and management's progress in addressing these. A table within the report highlighted the latest position with regard to internal audit recommendations arising from previous years. In 2012/13 there had been 26 recommendations, all of which had been implemented. In 2013/14 a total of 51 recommendations had been made of which 27 had been implemented, 22 were not yet due and 2 were overdue though in some cases revised target completion dates had been agreed. An appendix to the report provided details of seven Priority 1 and six related Priority 2 recommendations issued by Internal Audit during 2013/14 and the progress by Management in implementing these to address internal control, risk and governance issues. For those actions not yet completed an explanation had been provided of the reason for delay in implementation, including in some cases where there were dependencies on computer based systems and where appropriate revised timescales had been agreed for their full implementation.

9. With regard to one Priority 1 and related Priority 2 recommendations in respect of Income Charging, Billing and Collection Finance Business Partner, Paul McMenamin, was in attendance to give a presentation on a review of the policy on External Fees and Charges. Mr McMenamin explained that the purpose of the policy was to set out the broad principles that should govern charging for services where the Council has discretion; to establish greater transparency, consistency and fairness to the process of charge-setting; and to assist the Council in achieving its corporate objectives. The Council currently charged for 584 different services across 20 generic service areas. The aims of the policy were listed which concluded with the need to strike a fair balance between the financial needs of the Council and the social needs of its customers. The progress made with the review was outlined by Mr McMenamin. All Council fees and charges were now included in a single booklet by service area, which was presented to Council for approval as part of the annual budget-setting process. Service managers were required to review all charges each year in line with the policy. The review of Fees and Charges was therefore now a prescribed 'annual event' within the Financial Planning process as well as informing day-to-day service and financial planning and management across departments. There was a clear linkage between the Council's policies on Charging, Debt Recovery and Income Management. The

presentation went on to give examples of changes made across services which were associated with the policy review.

10. The Chief Financial Officer, David Robertson, gave Members further information in respect of the Priority 1 recommendation about the identification and training of staff in connection with raising invoices, income collection and debt recovery. He advised that e-learning training was now available with checks being made that all relevant staff had accessed and followed-through this training. With regard to the Priority 2 recommendation to make available necessary tools to distribute a range of performance reports to management Mr Robertson advised that a suite of reports had been created but full implementation awaited the roll-out of Office 2010/Windows 7 within the Finance service. At Mr Robertson's request a revised target completion date of March 2015 was agreed by the Committee for this action. With regards the one Priority 1 recommendation in connection with ICT Infrastructure Mr Robertson referred to the difficulties of operating on software systems within the Council that did not have a common interface. Research was currently being carried out in the market with a view to formulating a bid for an appropriate new finance system through the budget process. Members of the Committee supported this move and emphasised the importance of a having a strategy across the Council that prevented the introduction of a unilateral software system which did not provide interrelationship with other parts of the service. With regard to the three Priority 1 and two Priority 2 recommendations in connection with the Social Care Charging Review, Principal Assistant Social Care and Health, Jane Douglas, attended the meeting to give further information on the progress made to improve practices within this complex end-to-end process. She explained that some processes had been held up through the introduction of Frameworki Finance system (Fwi). However in the interim to enable monthly monitoring of billing a manual reporting system was being developed to reflect the agreed measures and standards which were in place. Further information on the progress in response to the two Priority 1 and three Priority 2 recommendations made in relation to Data Security and Information Management was given by the Chief Legal Officer, Nuala McKinlay, who in recent days had taken over responsibility for the Information Management team. She explained that, despite endeavours by the Corporate Transformation and Services Director to re-shape the service, progress had not been as expected due to two members of staff leaving the organisation, resulting in significant under-staffing of the service. However despite this backdrop the Corporate Transformation and Services Director had put in place significant improvements in processes which had been reflected in improved response times to Freedom of Information requests in recent months. At Mrs McKinlay's request revised target completion dates of April 2015 were agreed by the Committee for three of the actions. She confirmed that re-establishing the Information Governance Group was a priority to facilitate full implementation of the recommended improvements.

DECISION
AGREED:-

(a) **to APPROVE the progress by management in implementing the seven Priority 1 (High Risk) and the six related Priority 2 (Medium Risk) recommendations issued by Internal Audit during 2013/14 to appropriately address the identified control weaknesses;**

* **(b)** **to RECOMMEND to Council that the business case for a new finance system be prioritised as part of the budget process and to monitor progress on that recommendation; and**

(c) **to request that the Chief Officer Audit and Risk bring back a further report monitoring progress in line with the revised target completion dates.**

<u>INTERNAL AUDIT MID-TERM PERFORMANCE REPORT 2014/15</u>

11. With reference to paragraph 9 of the Minute of 10 March 2014, there had been circulated copies of a report by the Chief Officer Audit and Risk. The purpose of the report was to

inform the Audit Committee of the progress Internal Audit had made, in the first 6 months of the year to 30 September 2014, towards completing the Internal Audit Annual Plan 2014/15, in order that the Committee may monitor the adequacy of the performance of Internal Audit. Internal Audit had made progress towards completing the Internal Audit Annual Plan 2014/15 despite the need to reschedule some of the planned audits to the second half of the year. In contrast some internal audit work that was originally scheduled for completion in the 3rd quarter had been accelerated. Internal Audit was currently on target to complete its Annual Plan 2014/15. An appendix to the report provided details of the half yearly progress by Internal Audit with the delivery of its programme of work and a table within the report summarised the Internal Audit activity for the 6 months to 30 September 2014. The work Internal Audit had carried out in the first half of the year equated to Productive Days Achieved as a percentage of Productive Days as per the Audit Plan of 113% (CIPFA Directors of Finance PI for Internal Audit services) and 68% completion of planned audits. 66% of the half-year actual audit hours and 59% of the half-year actual audit numbers related to completion of high risk audits and potentially high risk contingency and consultancy audit work to demonstrate a risk-based approach to the completion of the Internal Audit Annual Plan 2014/15. Not all planned audits had been completed in the 6 months to 30 September 2014 and reasons were given for this. A further table set out the Internal Audit planned work for the second half of the year to complete the 2014/15 Plan. The report advised that the Local Authority Accounts (Scotland) Regulations 2014 came into force on 10 October 2014. These regulations would apply to the statutory Annual Accounts commencing with the financial year 2014/15. The provision in the regulations for internal audit applied from 10 October 2014 which required a local authority to operate a professional and objective internal auditing service. The Public Sector Internal Audit Standards (PSIAS) required the chief audit executive (Chief Officer Audit & Risk) to carry out an annual internal self-assessment against the PSIAS and develop a Quality Assurance and Improvement Plan (QAIP). A table within the report provided a summary overview of the outcome of the 2013/14 internal self-assessment against the PSIAS carried out by one of the Senior Internal Auditors as reflected in the QAIP.

DECISION
APPROVED the progress Internal Audit had made towards completing the Internal Audit Annual Plan 2014/15.

<u>TREASURY MANAGEMENT MID-YEAR REPORT 2014/15</u>

12. With reference to paragraph 5 of the Scottish Borders Council Minute of 6 February 2014, there had been circulated copies of a report by the Chief Financial Officer. The report presented the mid-year report of treasury management activities for 2014/15, in line with the requirements of the CIPFA Code of Practice, including Prudential and Treasury Management Indicators, and sought comments from the Audit Committee prior to consideration of the report by Council. The report provided a mid-year report on the Council’s treasury activity during the six month period to 30 September 2014 and demonstrated that Treasury activity in the first six months of 2014/15 has been undertaken in full compliance with the approved Treasury Strategy and Policy for the year. The appendix to the report contained an analysis of the performance against targets set in relation to Prudential and Treasury Management Indicators, and proposed revised estimates of these indicators in light of the 2013/14 outturn and experience in 2014/15 to date for Council approval. The Chief Financial Officer, in his summary of the mid-year report, referred to the intention to use the Swedish bank Svenska Handelsbanken for short term deposits. This institution met the Creditworthiness Policy set out in the 2014/15 Treasury Management Strategy in full and was currently graded for investing up to 1 year with a similar long term credit rating as HSBC Bank plc. In addition Sweden still had a AAA sovereign debt rating from all three rating agencies which was higher than the UK. The proposal was to open a call account with Svenska Handelsbanken which meant that the Council would have instant access to the money deposited. No changes were required to the Treasury policy or strategy documents as a result of using Svenska Handelsbanken.

Members discussed the report and received answers to their questions from the Chief Financial Officer.

DECISION

(a) **NOTED that treasury management activity in the six months to 30 September 2014 was carried out in compliance with the approved Treasury Management Strategy and Policy.**

(b) **AGREED to the presentation of the Treasury Mid-Year Report 2014/15, as appended to the report, to Council for approval of the revised indicators.**

MEMBER

Councillor Scott left the meeting which subsequently was left without a quorum of Members.

PENSION FUND REFORMS

13. The planned presentation, on pension fund reforms and implications for the Council, was deferred to the next meeting.

DECISION
NOTED

OVERVIEW OF LOCAL GOVERNMENT IN SCOTLAND 2014

14. The Chairman referred to an informal meeting held prior to the main Audit Committee meeting when a self-evaluation was carried out using the checklist contained in Appendix 2 to the Accounts Commission's 'An Overview of Local Government in Scotland 2014' report published in March 2014. No gaps were identified for Members of the Audit Committee, in terms of training needs, and no recommendations were made as a result of the discussion. It was agreed that there was a difficulty in interpretation of the questions on the checklist, in the context of the role of the Committee, but that they provided a useful aide-memoire for future self-evaluation. A document, 'Audit Committee Members – Knowledge and Skills Framework' which is Appendix C of CIPFA 'audit committees' Guidance 2013, was handed out to Members for their information and to facilitate future discussion.

DECISION
NOTED

The meeting concluded at 1.25 p.m.

Item 5

DRAFT TREASURY MANAGEMENT STRATEGY 2015/16

Report by Chief Financial Officer

AUDIT AND RISK COMMITTEE

19 January 2015

1 PURPOSE AND SUMMARY

1.1 **This report is to enable the Audit and Risk Committee to undertake their scrutiny role in relation to the Treasury Management activities of the Council. It presents the proposed Treasury Management Strategy 2015/16 for consideration prior to Council approval.**

1.2 The Treasury Management Strategy is the framework which ensures that the Council operates within prudent, affordable limits in compliance with the CIPFA Code.

1.3 The Treasury Management Strategy 2015/16 is to be submitted to Council on 12 February 2015, is included in this report at Appendix A and reflects the impact of the draft Administration's Financial Plans for 2015/16 onwards on the prudential and treasury indicators for the Council.

2 RECOMMENDATIONS

2.1 It is recommended that the Audit and Risk Committee considers whether to make any comments or recommendations on the draft Treasury Management Strategy 2015/16 prior to presentation to the Council for approval.

3 BACKGROUND

3.1 The Audit and Risk Committee is responsible for scrutinising the Treasury Management Strategy in line with recommended practice set out in the CIPFA (Chartered Institute of Public Finance & Accountancy) Code (ie, *Treasury Management in the Public Services: Code of Practice and Cross-sectoral Guidance Notes*).

4 TREASURY MANAGEMENT STRATEGY 2014/15

4.1 **Appendix 1** contains the draft Treasury Management Strategy for 2015/16 for consideration by the Audit and Risk Committee.

4.2 This is based on the Administration's current draft Financial Capital Plans for the 2015/16 to 2017/18 yet to be published and as such may be subject to change as these will not be presented to Council for approval until 12 February 2015.

4.3 The significant changes from the 2014/15 strategy , , are the:

- the removal of an allocation of £13m for Registered Social Landlord (RSL) on-lending within the other relevant capital expenditure amounts following the publication of new guidance relating to on lending. The Council was a full participant in the COSLA/ Scottish Government working group which established this new framework;

- the cross referencing to the Council's overall Financial Strategy;

- the incorporation of reference to the Treasury Management Earmark Balance; and,

-the ability to undertake treasury management for subsidiary companies.

4.4 Within the Appendix, Annex A contains a summary of the proposed indicators contained within the Strategy.

4.5 There are no major changes proposed to the Creditworthiness Policy to be applied as part of the Investment Strategy; however, continuing regulatory changes in the banking sector leading to the withdrawal of implied sovereign support is anticipated to have an effect on ratings applied to institutions. Viability, Financial Strength and Support Ratings previously applied will effectively become redundant in relation to the Creditworthiness Policy. (**Annex E** of the Strategy provides additional information)

5 IMPLICATIONS

5.1 Financial

There are no additional financial implications in relation to this report its content specifically relating to the financing and investment activities of the Council.

5.2 Risk and Mitigations

The key purpose of presenting the Treasury Management Strategy for Audit and Risk Committee scrutiny is to ensure that the members are satisfied with this element of the risk management framework for the treasury management function within the Council. These strategies provide the parameters and guidance for the investment and borrowing decisions for the Council.

5.3 Equalities

It is anticipated that there are no adverse equality implications arising from the proposals in this report.

5.4 Acting Sustainably

There are no direct economic, social or environmental issues with this report which would affect the Council's sustainability policy.

5.5 Changes to Scheme of Administration or Scheme of Delegation

No changes to the Scheme of Administration or Scheme of Delegation are required as a result of this report.

6 CONSULTATION

6.1 The Monitoring Officer, the Chief Legal Officer, the Service Director Strategy and Policy, the Chief Officer Audit and Risk, the Chief Officer HR and the Clerk to the Council are being consulted in the preparation of this report for Council and any comments will be incorporated into the final Council report.

Approved by

David Robertson
Chief Financial Officer **Signature ....**

Author(s)

Name	Designation and Contact Number
Lynn Mirley Kirsty Robb Neil Campbell	Corporate Finance Manager, 01835 825016 Capital & Investment Manager, 01835 825249 Senior Finance Officer, 01835 82400, Ext 5495

Background Papers:

Previous Minute Reference:

Note – You can get this document on tape, in Braille, large print and various computer formats by contacting the address below. The Capital & Investments Team can also give information on other language translations as well as providing additional copies.

Contact us at: Capital & Investments Team, Finance, Scottish Borders Council, Council Headquarters, Newtown St Boswells, Melrose, TD6 0SA Tel: 01835 825249 Fax 01835 825166. email: mailto:treasuryteam@scotborders.gov.uk

APPENDIX 1

SCOTTISH BORDERS COUNCIL

TREASURY MANAGEMENT STRATEGY
(incorporating the Annual Investment Strategy) 2015/16

Finance
Chief Executive Department
Version 2
Approved: xxxx 2015

CONTENTS

Section		Page
1	Purpose and Scope	3
2	Background	4
3	The Capital Prudential Indicators 2015/16 – 2017/18	5
4	Treasury Management Strategy	8
5	Investment Strategy 2015/16	15
6	Performance Indicators	22
7	Monitoring and Reporting	23
8	Treasury Management Consultants and Advisers	24
9	Member and Officer Training	24
	ANNEXES	
Annex A	Summary of Prudential and Treasury Indicators	26
Annex B	Interest Rate Forecast 2014 - 2018	27
Annex C	Economic Background	28
Annex D	Credit and Counterparty Risk Management – Permitted Investments, Associated Controls and Limits	31
Annex E	Credit Ratings	37
Annex F	Benchmarking and Monitoring Security, Liquidity and Yield	38
	Glossary of Terms	39

1 Purpose and Scope

1.1 The Council is required to receive and approve, as a minimum, three main reports on treasury activity each year, which incorporate a variety of policies, estimated and actual figures.

a) Treasury Management Strategy 2015/16 (this report).
This report is the most important of the three reports and covers:

- The capital plans of the Council (including prudential indicators);
- The treasury management strategy (how the investments and borrowings are organised), including treasury indicators, and
- An investment strategy (investment options and limits applied).

b) Mid Year Treasury Management Report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and assess whether the actual treasury strategy is adhering to the approved strategy, or whether any policies require revision.

c) Annual Treasury Report - This provides details of a selection of actual prudential and treasury indicators compared to the estimates within the strategy and the performance of actual treasury operations.

1.2 Scrutiny
These reports are required to be adequately scrutinised by committee before being recommended to the Council. This role is undertaken by the **Audit and Risk Committee**.

1.3
The treasury management issues covered by this report are:

Capital Issues
- the capital plans and associated prudential indicators

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

1.4 These elements cover the requirements of the Local Government in Scotland Act 2003, the CIFPA Prudential Code (the Prudential Code), the CIPFA Treasury Management Code (the Code) and Scottish Government Investment Regulations.

1.5 Treasury Management Consultants

The Council uses Capita Asset Services as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions remains with the Council at all times and will ensure that it does not rely solely upon information and advice from its external service providers.

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

1.6 The Treasury Management Strategy covers the treasury management activities for the Council (including any subsidiary organisations), the cash managed by the Council on behalf of the Scottish Borders Council Pension Fund, the Common Good and Trust Funds.

2 Background

2.1 The Council is required to operate a balanced budget, which broadly means that cash received during the year will meet cash expenditure. A major aspect 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 low risk appetite, ensuring adequate liquidity before considering investment return.

2.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, being essentially 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 any debt previously drawn may be restructured to meet Council risk or cost objectives.

2.3 The Prudential and Treasury Indicators (summarised in **Annex A**) consider the affordability and impact of capital expenditure decisions, and set out the Council's overall capital framework. These Indicators have been developed in line with both the Prudential and Treasury Codes. The treasury service considers the effective funding of these decisions. Together they form part of the process which ensures the Council meets its balanced budget requirement under the Local Government Finance Act 1992. The Treasury Management Strategy therefore forms an integral part of the Council's overall Financial Strategy covering both its revenue and capital budgets.

2.4 CIPFA defines treasury management as:

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

3 The Capital Prudential Indicators 2015/16 – 2017/18

The Council's 5 year Financial Strategy sets out the parameters for its financial management. The Financial Strategy is required to:

(i) Raise the funds required by the Council to meet approved service levels in the most effective manner;
(ii) Manage the effective deployment of those funds in line with the Council's corporate objectives and priorities; and
(iii) Provide stability in resource planning and service delivery as expressed through revenue and capital budgets and approved Corporate Plans.

As part of achieving these aims the Financial Strategy sets out to continue to invest in infrastructure through a sustainable capital programme financed by £20.7m capital financing revenue implications per annum (reducing to £19.9m per annum from 2017/18). This creates the affordability and sustainability financial boundaries for the development of the Council's Capital Financial Plan.

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

3.1 Capital Expenditure (Prudential Indicator PI-1)

a) This prudential Indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this planning cycle. The Capital Financial Plan for 2015/16 – 2024/25 includes the following capital expenditure forecasts:

Capital Expenditure (PI-1) £m	**2014/15 Estimate**	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**
Place	26.4	21.1	21.4	9.7
People	5.1	24.5	15.0	7.9
Chief Executive	6.1	9.5	10.6	7.3
Emergency & Unplanned Schemes	0.2	0.3	0.3	0.3
Total	**37.8**	**55.4**	**47.3**	**25.2**

3.2 Other Relevant Expenditure

a) The Council anticipates to have additional expenditure which, for the purposes of the Treasury and Prudential Indicators, will be treated as capital expenditure. This expenditure relates to initiatives where the Council has applied, or is planning to apply, for a Consent to Borrow from the Scottish Government. The key area not included in paragraph 3.1 is borrowing to lend in respect of an affordable house building programme in partnership with the Scottish Futures Trust (Bridge Homes LLP). The estimated amounts are as follows:

Other Relevant Expenditure £m	**2014/15 Estimate**	**2015/16 Estimate**	**2016/17 Estimate**	**2017/18 Estimate**
Bridge Homes LLP (Affordable house building programme)	3.0	12.0	3.8	-
Total	**3.0**	**12.0**	**3.8**	**-**

b) The Council was an active participant in the development of funding mechanisms for affordable housing through a working group established by the Scottish Government. In order to standardise the approach to supporting Registered Social Landlords (RSLs) through on-lending arrangements the Scottish Government has issued guidance around the parameters under which Consent to Borrow to lend to RSLs is given.

c) Previously the Council had included up to £13m over the three years for the provision of loans to RSLs, however it is now anticipated that the changes in the commercial lending markets has led to RSL's being able to secure funding elsewhere and therefore the meeting of requirements of the Scottish Government guidance have become more challenging. This has resulted in the Council removing an allocation within Other Relevant Expenditure for this purpose. However, in the event that circumstances change a report will be brought to Council to request consideration of the changing of the Prudential Indicators to enable on-lending to proceed.

3.3 Capital Financing Assumptions

a) The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a financing need.

Capital Expenditure £m	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Capital Expenditure	27.6	37.8	55.4	47.3	25.2
Other Relevant Expenditure	2.3	3.0	12.0	3.8	-
Total Expenditure	**29.9**	**40.8**	**67.4**	**51.1**	**25.2**
Financed by:					
Capital receipts	2.4	1.2	1.7	1.4	2.6
CFCR	0.4	0.2	0.8	0.8	-
Developer Contributions	0.5	0.3	0.2	0.1	0.1
Govt. General Capital Grants	2.2	9.7	15.2	12.0	12.0
Govt. Specific Capital Grants	10.2	14.2	25.5	15.1	0.2
Other Grants & Contributions	2.4	2.0	2.1	3.5	1.8
Plant & Vehicle Fund	0.4	2.0	-	-	-
Net financing need for the year	**11.4**	**11.2**	**21.9**	**18.2**	**8.5**

3.4 The Council's Borrowing Need (the Capital Financing Requirement – Prudential Indicator PI-2)

a) 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 underlying borrowing need. Any capital expenditure identified above, which has not immediately been paid for (e.g. via grants), will increase the CFR. The CFR does not increase indefinitely, as scheduled debt amortisation (loans pool charges) broadly reduces the borrowing need in line with each asset's life.

b) The CFR includes any other long term liabilities (e.g. PPP schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council had £58.1m of liabilities relating to such schemes within the 2013/14 long term liabilities figure.

c) The Council is asked to approve the CFR projections below:

Capital Financing Requirement (PI-2) £m	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Total CFR (PI-2) *	**258.9**	**259.0**	**270.7**	**279.3**	**279.0**
Movement in CFR represented by:					
Net financing need for the year (above)		11.2	21.9	18.2	8.5
Less scheduled debt amortisation and other financing movements		(11.1)	(10.2)	(9.6)	(8.8)
Movement in CFR		**0.1**	**11.7**	**8.6**	**(0.3)**

* *The CFR for this calculation includes capital expenditure to 31 March of each financial year.*

The significant increase between 2014/15 and 2015/16 is driven by the shift in the net financing need for the year as detailed in the table in section 3.3 a). The main drivers for is the Bridge Homes LLP funding requirement of £12m in 2015/16 as detailed in 3.2 a) and the increase in the capital expenditure plans for 2015/16 compared with 2014/15 as driven by the proposals in the Capital Financial Plan 2015/16 - 2024/25 as summarised in 3.1 a).

3.5 Affordability Prudential Indicators

a) Further 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 updated indicators are as follows:

Ratio of financing costs to net revenue stream (Prudential Indicator PI-3)

b) 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.

%	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Ratio of Financing Costs to Net Revenue Stream (PI-3) *(inc. PPP repayment costs)*	9.4	9.4	10.0	9.7	9.4

The estimates of financing costs include current commitments and the proposals in the Financial Plans for 2015/16.

Incremental impact of capital investment decisions on council tax (Prudential Indicator PI-4)

c) This indicator identifies the revenue costs associated the operational three year capital programme detailed in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period

£	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate
Incremental (Saving)/Cost Impact of Capital Investment Decisions on the Band D Council Tax (PI-4)	0.00	0.00	(0.02)

4 Treasury Management Strategy

The capital expenditure plans set out in Section 3 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. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury/prudential indicators, the current and projected debt positions and the annual investment strategy.

4.1 Current Portfolio Position

a) The Council's treasury portfolio position at 31 March 2014, with forward projections, is summarised below. The table shows the actual external debt, against the Council's borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£m as at 31 March	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Borrowing	173.6	188.1	189.5	189.5
Other Long Term Liabilities	55.9	54.2	52.4	50.7
Total Gross Borrowing (Prudential Indicator PI-5)	**229.5**	**242.3**	**241.9**	**240.2**
CFR – the borrowing need *	**279.3**	**279.0**	**283.1**	**283.1**
(Under) / Over Borrowing (Prudential Indicator PI-6)	**(49.8)**	**(36.7)**	**(41.2)**	**(42.9)**

** The CFR for this calculation includes the current and two future years projected capital expenditure see 4.1 b)*

b) Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these (PI-6) is that the Council needs to ensure that its gross debt figure (shown above) 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 2015/16 and following two financial years. This allows some flexibility for limited borrowing for future years, but ensures that borrowing in advance of need is not undertaken for revenue purposes.

c) The Council has complied with this prudential indicator in the current year and no difficulties are currently envisaged for the future. This view takes into account current commitments, existing plans, and the proposals in the Financial Plans for 2015/16.

4.2 Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary (Prudential Indicator PI-7)

a) This is the limit which external borrowing 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.

Operational boundary £m	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Total Operational Boundary (PI-7a)	**243.6**	**241.9**	**240.2**
Less: Other long term liabilities	(54.2)	(52.4)	(50.7)

Operational Boundary exc. Other Long Term Liabilities (PI-7b)	**189.4**	**189.5**	**189.5**

The Authorised Limit for External Debt (Prudential Indicator PI-8)

b) A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

c) This is the statutory limit (Affordable Capital Expenditure Limit) determined under section 35(1) of the Local Government in Scotland 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.

d) The proposed Authorised Limit for the Council is as follows:

Authorised Limit £m	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Total Authorised Limit (PI-8a)	**314.9**	**301.6**	**314.2**
Less: Other long term liabilities	(54.2)	(52.4)	(50.7)
Authorised Limit exc. Other Long Term Liabilities (PI-8b)	**260.7**	**249.2**	**263.5**

4.3 Prospects for Interest Rates

a) The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table and commentary below gives the central view of Capita Asset Services.

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Mar 2015	0.50	2.20	3.40	3.40
Jun 2015	0.50	2.20	3.50	3.50
Sep 2015	0.50	2.30	3.70	3.70
Dec 2015	0.75	2.50	3.80	3.80
Mar 2016	0.75	2.60	4.00	4.00
Jun 2016	1.00	2.80	4.20	4.20
Sep 2016	1.00	2.90	4.30	4.30
Dec 2016	1.25	3.00	4.40	4.40
Mar 2017	1.25	3.20	4.50	4.50
Jun 2017	1.50	3.30	4.60	4.60
Sep 2017	1.75	3.40	4.70	4.70
Dec 2017	1.75	3.50	4.70	4.70
Mar 2018	2.00	3.60	4.80	4.80

b) UK GDP growth surged during 2013 and the first half of 2014. Since then it appears to have subsided somewhat but still remains strong by UK standards and is expected to continue likewise into 2015 and 2016. There needs to be a significant rebalancing of the economy away from consumer spending to manufacturing, business investment and exporting in order for this recovery to become more firmly established. One drag on the economy has been that wage inflation has only recently started to exceed CPI inflation, so enabling disposable income and living standards to start improving. The recent plunge in the price of oil brought CPI inflation down to a low of 1.0% in November, the lowest rate since September 2002.

c) Inflation is expected to stay around or below 1.0% for the best part of a year; this will help improve consumer disposable income and so underpin economic growth during 2015. However, labour productivity needs to improve substantially to enable wage rates to increase and further support consumer disposable income and economic growth. In addition, the encouraging rate at which unemployment has been falling must eventually feed through into pressure for wage increases, though current views on the amount of hidden slack in the labour market probably means that this is unlikely to happen early in 2015.

d) The US, the biggest world economy, has generated stunning growth rates of 4.6% (annualised) in Q2 2014 and 5.0% in Q3. This is hugely promising for the outlook for strong growth going forwards and it very much looks as if the US is now firmly on the path of full recovery from the financial crisis of 2008. Consequently, it is now confidently expected that the US will be the first major western economy to start on central rate increases by mid 2015.

e) The current economic outlook and structure of market interest rates and government debt yields have several key treasury management implications:

- Greece: the general election on 25 January 2015 may bring a political party to power which is anti EU and anti austerityHowever, the indirect effects of the likely strenthening of anti EU and anti austerity political parties throughout the EU is much more difficult to quantify;

- As for the Eurozone in general, concerns in respect of a major crisis subsided considerably in 2013. However, the downturn in growth and inflation during the second half of 2014, and worries over the Ukraine situation, Middle East and Ebola, have led to a resurgence of those concerns as risks increase that it could be heading into deflation and prolonged very weak growth. Sovereign debt difficulties have not gone away and major concerns could return in respect of individual countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise to levels that could result in a loss of investor confidence in the financial viability of such countries. Counterparty risks therefore remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2015/16 and beyond;
- Borrowing interest rates have been volatile during 2014 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. The closing weeks of 2014 saw gilt yields dip to historically remarkably low levels after inflation plunged, a flight to quality from equities (especially in the oil sector), and from the debt and equities of oil producing emerging market countries, and an increase in the likelihood that the ECB will commence quantitative easing (purchase of EZ government debt) in early 2015. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt;
- There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

f) **Annex C** contains a more comprehensive Economic Background narrative from Capita Asset Services.

4.4 Borrowing Strategy

a) The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded by external loan debt as the cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy remains both prudent and cost effective as investment returns are low and counterparty risk is relatively high.

b) Against this background and the risks within the economic forecast, caution will be adopted with the 2015/16 treasury operations. The Chief Financial Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates,* (e.g. due to a marked increase of risks around 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.

- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast,* perhaps arising from a faster than currently anticipated unwinding of quantitative easing in the US, or an unexpected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.

c) Any decisions will be reported to Members at the next available opportunity.

Treasury Management Limits on Activity

d) 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:

(i) Upper limits on fixed interest rate exposure (Treasury Indicator TI-1)

This covers a maximum limit for borrowing exposure to fixed interest rates, based on the debt position net of investments.

(ii) Upper limits on variable interest rate exposure (Treasury Indicator TI-2)

This identifies a maximum limit for borrowing exposure to variable interest rates based upon the debt position net of investments.

(iii) Maturity structure of borrowing (Treasury Indicator TI-3)

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.

(iv) The following table highlights the proposed treasury indicators and limits:

£m	2015/16	2016/17	2017/18
Interest rate exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt (TI-1)	243.6	241.9	240.2
Limits on variable interest rates based on net debt (TI-2)	85.3	84.7	84.1
Maturity Structure of fixed interest rate borrowing 2015/16 (TI-3)			
		Lower	**Upper**
Under 12 months		0%	20%
12 months to 2 years		0%	20%
2 years to 5 years		0%	20%
5 years to 10 years		0%	20%
10 years and above		20%	100%

4.5 Policy on borrowing in advance of need

a) The Council will not borrow in advance of its needs, purely in order to profit from the investment of the extra sums borrowed.

b) Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

c) Borrowing in advance is defined as any borrowing undertaken by the local authority which will result in the total external debt of the local authority exceeding the capital financing requirement (CFR) of the local authority for the following twelve month period. This twelve month period is on a rolling twelve month basis.

d) The Chief Financial Officer has the authority to borrow in advance of need under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. The Chief Financial Officer will adopt a cautious approach to any such borrowing and a business case to support the decision making process must consider:

- the benefits of borrowing in advance,
- the risks created by additional levels of borrowing and investment, and
- how far in advance it is reasonable to borrow considering the risks identified

e) Any such advance borrowing should be reported through the mid-year or annual Treasury Management reporting mechanism.

4.6 Debt Rescheduling

a) As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

b) The reasons for any rescheduling to take place will include:

- the generation of cash savings and/or discounted cash flow savings
- helping to fulfil the treasury strategy
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

c) Consideration will also be given to identify if there is any 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.

d) All rescheduling will be reported to the **Executive** at the earliest meeting following its action.

4.7 Treasury Management Earmarked Balance

a) The Council identified, in conjunction with its advisors, that the increasing expectation of interest rate increases in the medium term exposed the Council to financing risk and that it was appropriate to identify approaches to manage this risk.

b) The Council approved the establishment of a Treasury Management Earmarked Balance (the Balance) within the General Fund Reserve for the purposes of managing its costs of treasury and financing activities and the associated financing risk.

c) The Balance creates an appropriate tactical mechanism to make financial provision in the current low interest rate environment to support the Council as interest rates increase and the financing need crystallises. This Balance will provide resource to smooth out potentially higher costs in the future, by having resources which can be used to mitigate costs i n the Council's revenue budget. [the wording of the report on the eramrkaed balance is quite specific it is carefully worded to ensure this balance can be used flexibly if needs be to support the "finances of the council- it is not therefore just about interest rates although this is the primary purpose

d) The Balance will be funded through the identification of opportunities to earmark funds due to short term savings on the Loans Charges revenue budget resulting from the current prudent approach to capital financing.

5 Investment Strategy

5.1 Investment Objectives and Policy

a) The Council's investment policy has regard to the Scottish Government's Investment (Scotland) Regulations (and accompanying Finance Circular) and the latest CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the Code").

b) The Council's primary investment objectives are:
   (i) The safeguarding or **security** of the re-payment of principal and interest of investments on a timely basis; and
   (ii) The **liquidity** of its investments

c) The Council will also aim to achieve the optimum return on its investments corresponding with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of its investments.

d) In accordance with the above guidance from the Scottish Government and CIPFA, and in order to minimise the risk to investments, the Council has below (see 5.3 below) clearly stipulated the minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk.

e) The aim of the creditworthiness policy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk. The intention of the approach is to provide security of investment and minimisation of risk.

f) The borrowing of monies purely to invest or on-lend, without relevant Scottish Government consent, is unlawful and this Council will not engage in such activity.

g) The Council will ensure its investments have sufficient liquidity. For this purpose it will set out procedures for determining the maximum periods over which funds may prudently be committed.

5.2 Council Permitted Investments

a) The Local Government Investments (Scotland) Regulations 2010 require the Council to give approval for all the types of investments to be used and set appropriate limits for the amount that can be held in each investment type. These types of investments are termed **Permitted Investments** and any investments used which have not been approved as a permitted investment will be considered ultra vires.

b) The permitted investment instruments which may be used by the Council (and its subsidiary organisations) in the forthcoming year are detailed in **Annex D**, and include the following:

Cash type instruments

- Deposits with the Debt Management Account Facility (DMADF) (UK Government)
- Deposits with other local authorities or public bodies
- Money Market Funds
- Call account deposit accounts with financial institutions (banks and building societies) meeting the Creditworthiness Policy
- Term deposits with financial institutions (banks and building societies) meeting the Creditworthiness Policy
- UK Government Gilts and Treasury Bills

Other investments

- Investment properties
- Loans to third parties, including soft loans
- National Housing Trust (NHT)
- Investments in and loans to local authority companies/partnerships
- Pooled Investment Vehicles
- Investment in the subordinated debt of projects delivered via the ‘HubCo’ model

c) Details of the risks, mitigating controls and limits associated with each of these permitted categories are shown in **Annex D.**

d) Common Good and Pension Fund permitted investments are also shown at **Annex D** and, where applicable, the same counterparty selection criteria as for the Council will be applied. [subsidiaries?]

e) The Treasury Management Strategy only applies to the funds managed in-house for the Pension Fund, as the externally invested funds are covered by the Pension Fund’s Statement of Investment Principles and other associated policy documents.

1.2 Creditworthiness Policy

a) This Council applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties (**Annex E**) are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies
- Credit Default Swaps (CDS) spreads to give early warning of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most creditworthy countries

b) Continuing regulatory changes in the banking sector leading to the withdrawal of implied sovereign support is anticipated to have an effect on ratings applied to institutions. Viability, Financial Strength and Support Ratings previously applied will effectively become redundant in relation to the Creditworthiness Policy. (**Annex E** provides additional information)

c) This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands*:*

Creditworthiness Colour Banding	Maximum Investment Duration
Yellow	5 years
Dark pink	5 years for Enhanced Money Market Funds (EMMFs) with a credit score of 1.25
Light pink	5 years EMMFs with a credit score of 1.5
Purple	2 years
Blue	1 year (only applies to nationalised or semi-nationalised UK Banks)
Orange	1 year
Red	6 months
Green	100 days
No colour	not to be used (ie don't invest)

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

d) The creditworthiness service provided by Capita uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undueweight to just one agency's ratings.

e) Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

f) Using the Capita Asset Services creditworthiness service, potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

g) There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but the counterparty may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

h) 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 supporting government

5.4 Country, Group and Sector Considerations

a) Due care will be taken to consider the country, group and sector exposure of the Council's investments.

Country Limits

b) If the institution is non-UK, then the country in which it is domiciled must have a minimum Sovereign long term rating of AAA.

c) No more than **10%** will be placed with any non-UK country at any time.

Institutional Sector Limits

d) These institutions must either be UK Local Authorities or UK Incorporated Institutions, UK Banks and Building Societies incorporated in the European Economic Area entitled to accept deposits through a branch in the UK. The Council may also use the UK Government including in the form of gilts and the Debt Management Account Deposit Facility (DMADF).

e) Limits will be applied to the overall amount lent out to any one sector at any one time in order to limit sector specific exposure risk, as follows:

UK Building Societies	**£25 m**
Banks	**£35 m**
UK Local Authorities	**£40 m**
UK Government Debt Management Office	**£unlimited**
UK Gilts and Treasury Bills	**£20 m**
Institutions covered by Government Guarantee	**£10 m**
Part Nationalised Banks	**£35 m**
Money Market Funds (AAA)	**£20 m**

These limits will be monitored regularly for appropriateness.

Group Limits

g) Limits will be applied to the overall amount lent out to institutions within the same group at any one time in order to limit group specific exposure risk, as follows, and subject to the parent company appearing on Capita Asset Services' creditworthiness list:

Group of Banks	**£10m**

Council's Own Banker

h) The Council's own banker (Bank of Scotland – part of Lloyds) will be maintained on the Council's counterparty list in situations where rating changes may mean this is below the above criteria. This is to allow the Council to continue to operate normal current account banking facilities and overnight and short-term investment facilities. However, in the event that the rating does change below the criteria, officers will review the situation carefully and identify any appropriate action required to manage the risk that this change creates for the Council.

5.5 Individual Institution Monetary Limits

a) The monetary limits for institutions on the Council's Counterparty List are as follows:

	Money Limit
UK Building Societies	£5m
Banks	£5m
UK Local Authorities (i)	£40m
UK Government Debt Management Office	Unlimited
UK Gilts & Treasury Bills	£20m
Government Guaranteed Institutions	£2m
AAA rated Money Market Funds	£5m
Council's Own Banker (ii)	£5m

(i) No individual limit will be applied on lending to a UK local authority, other than it must not exceed the relevant sector limit of £40m.

(ii) Further to Sections 5.4 and 5.5, in the event that the rating of the Council's own banker falls below the criteria, the time limit on money deposited with the bank will be reduced to an overnight basis.

b) As mentioned earlier, the treasury function manages the funds of the Council, any subsidiary organisations, the Pension Fund and the Common Good and Trust Funds. When applying the limits set out in the table above, these limits will apply to the cumulative investment with an institution from the Council, the Pension Fund and the Common Good Funds and Trust Funds.

5.6 The Monitoring of Investment Counterparties

a) All credit ratings will be monitored on a weekly basis. The Council is alerted to changes to ratings of all three agencies through its use of the creditworthiness service of Capita Asset Services.

- 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.

- In addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads 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.

b) If the Council has funds invested in an institution which is downgraded to below the acceptable rating criteria, the Council will enter discussions with the counterparty to establish if the funds can be returned early. This however this will be subject to an appropriate cost versus risk assessment of the specific situation.

c) The criteria for choosing counterparties set out above provide a sound approach to investment in "normal" market circumstances. Under exceptional market conditions, the Chief Financial Officer may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out in this Strategy. These restrictions will remain in place until the Chief Financial Officer is of an opinion that the banking system has returned to 'normal'. Similarly a restriction may be placed on the duration of investments.

5.7 Types of Investments

a) For institutions on the approved counterparty list, investments will be restricted to safer instruments (such as deposits). Currently this involves the use of money market funds, the DMADF and institutions with higher credit ratings than the minimum permissible rating outlined in the investment strategy, as well as the Council's own bank.

b) Where appropriate, investments will be made through approved brokers. The current list of approved brokers comprises:

- ICAP Securities Limited
- Sterling International Brokers Limited
- Tradition (UK) Limited

5.8 Investment Strategy and bank rate projections

In-house funds

a) 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).

Bank Rate

b) Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 4 of 2015. Bank Rate forecasts for financial year-ends (March) as at January 2015 are:

2014/2015	0.50%
2015/2016	0.75%
2016/2017	1.25%
2017/2018	2.00%

c) There are downside risks to these forecasts (i.e. start of increases in Bank Rate occurs later) if economic growth weakens. However, should the pace of growth quicken, there could be an upside risk.

Investment Treasury Indicator And Limit (Treasury Indicator TI-5)
Total Principal Funds Invested for greater than 364 days

d) 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.

e) The treasury indicator and limit proposed is:

Maximum principal sums invested > 364 days (TI-5)			
£m	**2015/16**	**2016/17**	**2017/18**
Principal sums invested > 364 days	20%	20%	20%

f) For positive cash balances and in order to maintain liquidity, the Council will seek to use overnight investment accounts, short term (< 1 month) notice accounts, money market funds and short-dated deposits (overnight to three months).

5.9 Risk Benchmarking

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. The purpose of the benchmarks are 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.

a) Security

The Council's **maximum** security risk benchmark for the current portfolio, when compared to historic default tables, is:

0.04% historic risk of default when compared to the whole portfolio.

b) Liquidity

In respect of this area the Council seeks to maintain:

- Bank Overdraft: £250,000
- Liquid short term deposits of at least £3,000,000 available with a week's notice.
- Weighted Average Life benchmark is **expected to be 0.5 years** (equivalent to an weighted average life of 6 months), with a **maximum of 1.00 years**

c) Yield

Local measures of yield benchmarks are:

Investments – **Internal returns above the 7 day LIBID rate**

d) At the end of the financial year, the Chief Financial Officer will report on its investment activity as part of the annual treasury report.

6 Performance Indicators

6.1 The CIPFA Code requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking.

6.2 Debt Performance Indicators

(i) Average "Pool Rate" charged by the Loans Fund compared to Scottish Local Authority average Pool Rate.

Target is to be at or below the Scottish Average for 2014/15.

(ii) Average borrowing rate movement year on year

Target is to maintain or reduce the average borrowing rate for the Council versus 2014/15.

6.3 **Investment Risk Benchmark Indicators** for Security, Liquidity and Yield, as set out in paragraph 5.9.

6.4 Loan Charges

a) Loan Charges for 2015/16 are expected to be at or below the Revenue Budget estimate contained in the Council's Financial Plans to be approved in February 2015, which are estimated as follows:

£m	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Interest on Borrowing	12.0	12.0	12.0
Investment income	(0.1)	(0.1)	(0.1)
Capital Repayments	8.8	8.8	8.0
Total Loan Charges *	**20.7**	**20.7**	**19.9**

**The Loan Charges exclude the capital element of PPP repayments.*

b) The above budget excludes the revenue impact of funding the cost of the NHT and the lending to RSLs and lending in respect of the Council-led house building programme with the Scottish Futures Trust, as these are assumed to be revenue neutral overall.

6.5 The indicators, based on actual performance for the year, will be included in the Treasury Management Annual Report for 2015/16.

7 Monitoring and Reporting

7.1 In line with the CIPFA Code the following formal reporting arrangements will be adopted:

Requirement	Purpose	Decision making body	Frequency
Treasury Management Policy Statement	Reviews and Revisions	Executive	As required
Treasury Management & Investment Strategy	Reporting of Annual Strategy	Council	Annually prior to start of new financial year
Treasury Management Strategy and / or Treasury Investment Strategy	Updates and revisions	Council	As appropriate
Treasury Management Mid-Year Report	Mid-Year Performance Report	Council	Annually in October/November of the current year
Treasury Management Annual Report	Annual Performance report for previous financial year	Council	Annually following the revenue outturn report to Executive
Treasury Management Monitoring Reports	Including Revenue Budget Monitoring	Executive	Revenue reported as part of the regular monitoring reports, otherwise as and when appropriate
Treasury Management Practices		Executive	As appropriate
Scrutiny of Treasury Management & Investment Strategy	Detailed scrutiny prior to annual approval by Council	Audit & Risk Committee	Annually
Scrutiny of Treasury Management Performance		Audit & Risk Committee	As appropriate

8 Treasury Management Consultants and Advisers

8.1 The Council uses Capita Asset Services as its external treasury management consultants. The company provides a range of services which include:

- Technical support on treasury matters, capital financing issues and the drafting of Member reports
- Economic and interest rate analysis
- Debt services which includes advice on the timing of borrowing
- Debt rescheduling advice surrounding the existing portfolio
- Generic investment advice on interest rates, timing and investment instruments
- Credit ratings/market information service

8.2 As part of the service provided, Capita meet with Council officers periodically to review the current Treasury Management and Investment Strategies and also review the service provided to the Council.

8.3 The Council recognises that responsibility for treasury management decisions remains with the Council at all times and will ensure that it does not only rely upon information and advice from our external service providers.

8.4 The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

9 Member and Officer Training

9.1 The increased Member consideration of treasury management matters and the need to ensure that officers dealing with treasury management are trained and kept up to date requires a suitable training process for Members and officers. This Council will address this important issue by:

a) Elected Members

- Working with members of the Audit Committee to identify their training needs
- Working with Capita Asset Services to identify appropriate training provision for elected members

b) Officers dealing with treasury management matters will have the option of various levels of training including:

- Treasury courses run by the Council's advisers
- Attendance at CIPFA treasury management training events
- Attendance at the CIPFA Scottish Treasury Management Forum and information exchanged via the Treasury Management Forum network
- On the job training in line with the approved Treasury Management Practices (TMPs).

ANNEXES

ANNEX A
SUMMARY OF PRUDENTIAL AND TREASURY INDICATORS

Indicator Reference	Indicator	Page Ref.	2015/16	2016/17	2017/18
PRUDENTIAL INDICATORS					
Capital Expenditure Indicator					
PI-1	Capital Expenditure Limits	5	£55.4m	£47.3m	£25.2m
PI-2	Capital Financing Requirement (CFR)	7	£270.7m	£279.3m	£279.0m
Affordability Indicator					
PI-3	Ratio of Financing Costs to Net Revenue (inc. PPP repayment costs)	7	10.0%	9.7%	9.4%
PI-4	Incremental (Saving)/Cost Impact of Capital Investment Decisions on Council Tax	7	£0.00	£0.00	(£0.02)
External Debt Indicators					
PI-5	Actual Debt	8	£242.3m	£241.9m	£240.2m
PI-7a	Operational Boundary (inc. Other Long Term Liabilities)	9	£243.6m	£241.9m	£240.2m
PI-7b	Operational Boundary (exc. Other Long Term Liabilities)	9	£189.4m	£189.4m	£189.4m
PI-8a	Authorised Limit (inc. Other Long Term Liabilities)	9	£314.9m	£301.6m	£314.2m
PI-8b	Authorised Limit (exc. Other Long Term Liabilities)	9	£260.7m	£249.2m	£263.5m
Indicators of Prudence					
PI-6	(Under)/Over Gross Borrowing against the CFR	8	£(36.7)m	£(41.2)m	£(42.9)m
TREASURY INDICATORS					
TI-1	Upper Limit to Fixed Interest Rates based on Net Debt	13	£243.6m	£241.9m	£240.2m
TI-2	Upper Limit to Variable Interest Rates based on Net Debt	13	£85.3m	£84.7m	£84.1m
TI-3	Maturity Structure of Fixed Interest Rate Borrowing 2012/13	13	**Lower**		**Upper**
	Under 12 months		0%		20%
	12 months to 2 years		0%		20%
	2 years to 5 years		0%		20%
	5 years to 10 years		0%		20%
	10 years and above		20%		100%
TI-4	Maximum Principal Sum invested greater than 364 days	20	20%	20%	20%

ANNEX B: INTEREST RATE FORECASTS 2014-18

Capita Asset Services Interest Rate View													
	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Bank Rate View	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	1.75%	2.00%
3 Month LIBID	0.50%	0.50%	0.60%	0.80%	0.90%	1.10%	1.10%	1.30%	1.40%	1.50%	1.80%	1.90%	2.10%
6 Month LIBID	0.70%	0.70%	0.80%	1.00%	1.10%	1.20%	1.30%	1.50%	1.60%	1.70%	2.00%	2.10%	2.30%
12 Month LIBID	0.90%	1.00%	1.10%	1.30%	1.40%	1.50%	1.60%	1.80%	1.90%	2.00%	2.30%	2.40%	2.60%
5yr PWLB Rate	2.20%	2.20%	2.30%	2.50%	2.60%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.60%
10yr PWLB Rate	2.80%	2.80%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
25yr PWLB Rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
50yr PWLB Rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
Bank Rate													
Capita Asset Services	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	1.75%	2.00%
Capital Economics	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	-	-	-	-	-
5yr PWLB Rate													
Capita Asset Services	2.20%	2.20%	2.30%	2.50%	2.60%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.60%
Capital Economics	2.20%	2.50%	2.70%	3.00%	3.10%	3.20%	3.30%	3.40%	-	-	-	-	-
10yr PWLB Rate													
Capita Asset Services	2.80%	2.80%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
Capital Economics	2.80%	3.05%	3.30%	3.55%	3.60%	3.65%	3.70%	3.80%	-	-	-	-	-
25yr PWLB Rate													
Capita Asset Services	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
Capital Economics	3.25%	3.45%	3.65%	3.85%	3.95%	4.05%	4.15%	4.25%	-	-	-	-	-
50yr PWLB Rate													
Capita Asset Services	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
Capital Economics	3.30%	3.50%	3.70%	3.90%	4.00%	4.10%	4.20%	4.30%	-	-	-	-	-

Please note – The current PWLB rates and forecast shown above have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012

Source: Capita Asset Services, January 2015

ANNEX C
Economic Background

UK

After strong UK GDP growth in 2013 at an annual rate of 2.7%, and then in 2014 0.7% in Q1, 0.9% in Q2 2014 (annual rate 3.2% in Q2), Q3 has seen growth fall back to 0.7% in the quarter and to an annual rate of 2.6%. It therefore appears that growth has eased since the surge in the first half of 2014 leading to a downward revision of forecasts for 2015 and 2016, albeit that growth will still remain strong by UK standards. For this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance. This overall strong growth has resulted in unemployment falling much faster than expected. The MPC is now focusing on how quickly slack in the economy is being used up. It is also particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back significantly above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be a major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates. Unemployment is expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in wage growth at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.

Also encouraging has been the sharp fall in inflation (CPI), reaching 1.0% in November 2014, the lowest rate since September 2002. Forward indications are that inflation is likely to remain around or under 1% for the best part of a year. The return to strong growth has helped lower forecasts for the increase in Government debt over the last year but monthly public sector deficit figures during 2014 have disappointed until November. The autumn statement, therefore, had to revise the speed with which the deficit is forecast to be eliminated.

Eurozone

The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In November 2014, the inflation rate fell further, to reach a low of 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB took some rather limited action in June and September 2014 to loosen monetary policy in order to promote growth. It now appears likely that the ECB will embark on full quantitative easing (purchase of EZ country sovereign debt) in early 2015.

Concern in financial markets for the Eurozone subsided considerably after the prolonged crisis during 2011-2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy, (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise for some countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed. The ECB's pledge in 2012 to buy unlimited amounts of bonds of countries which ask for a bailout has provided heavily indebted countries with a strong defence against market forces. This has bought them time to make progress with their economies to return to growth or to reduce the degree of recession. However, debt to GDP ratios (2013 figures) of Greece 180%, Italy 133%, Portugal 129%, Ireland 124% and Cyprus 112%, remain a cause of concern, especially as some of these countries are experiencing continuing rates of increase in debt in excess of their rate of economic growth i.e. these debt ratios are likely to continue to deteriorate. Any sharp downturn in economic growth would make these countries particularly vulnerable to a new bout of sovereign debt crisis. It should also be noted that Italy has the third biggest debt mountain in the world behind Japan and the US.

Greece
The general election due to take place on 25 January 2015 is likely to bring a political party to power which is anti EU and anti austerity. However, if this eventually results in Greece leaving the Euro, it is unlikely that this will directly destabilise the Eurozone as the EU has put in place adequate firewalls to contain the immediate fallout to just Greece. However, the indirect effects of the likely strengthening of anti EU and anti austerity political parties throughout the EU is much more difficult to quantify. There are particular concerns as to whether democratically elected governments will lose the support of electorates suffering under EZ imposed austerity programmes, especially in countries which have high unemployment rates. There are also major concerns as to whether the governments of France and Italy will effectively implement austerity programmes and undertake overdue reforms to improve national competitiveness. These countries already have political parties with major electoral support for anti EU and anti austerity policies. Any loss of market confidence in either of the two largest Eurozone economies after Germany would present a huge challenge to the resources of the ECB to defend their debt.

USA
The U.S. Federal Reserve ended its monthly asset purchases in October 2014. GDP growth rates (annualised) for Q2 and Q3 of 4.6% and 5.0% have been stunning and hold great promise for strong growth going forward. It is therefore confidently forecast that the first increase in the Fed. rate will occur by the middle of 2015.

China
Government action in 2014 to stimulate the economy appeared to be putting the target of 7.5% growth within achievable reach but recent data has indicated a marginally lower outturn for 2014, which would be the lowest rate of growth for many years. There are also concerns that the Chinese leadership has only started to address an unbalanced economy which is heavily over dependent on new investment expenditure, and for a potential bubble in the property sector to burst, as it did in Japan in the 1990s, with its consequent impact on the financial health of the banking sector. There are also concerns around the potential size, and dubious creditworthiness, of some bank lending to local government organisations and major corporates. This primarily occurred during the government promoted expansion of credit, which was aimed at protecting the overall rate of growth in the economy after the Lehmans crisis.

Japan
Japan is causing considerable concern as the increase in sales tax in April 2014 has suppressed consumer expenditure and growth to the extent that it has slipped back into recession in Q2 and Q3. The Japanese government already has the highest debt to GDP ratio in the world.

CAPITA ASSET SERVICES FORWARD VIEW

Economic forecasting remains difficult with so many external influences weighing on the UK. Our Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data transpires over 2015. Forecasts for average earnings beyond the three year time horizon will be heavily dependent on economic and political developments. Major volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, or the safe haven of bonds.

The overall longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. Increasing investor confidence in eventual world economic recovery is also likely to compound this effect as recovery will encourage investors to switch from bonds to equities.

The overall balance of risks to economic recovery in the UK is currently evenly balanced. Only time will tell just how long this current period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

The interest rate forecasts in this report are based on an initial assumption that there will not be a major resurgence of the EZ debt crisis. There is an increased risk that Greece could end up leaving the Euro but if this happens, the EZ now has sufficient fire walls in place that a Greek exit would have little immediate direct impact on the rest of the EZ and the Euro. It is therefore expected that there will be an overall managed, albeit painful and tortuous, resolution of any EZ debt crisis that may occur where EZ institutions and governments eventually do what is necessary - but only when all else has been tried and failed. Under this assumed scenario, growth within the EZ will be weak at best for the next couple of years with some EZ countries experiencing low or negative growth, which will, over that time period, see an increase in total government debt to GDP ratios. There is a significant danger that these ratios could rise to the point where markets lose confidence in the financial viability of one, or more, countries, especially if growth disappoints and / or efforts to reduce government deficits fail to deliver the necessary reductions. However, it is impossible to forecast whether any individual country will lose such confidence, or when, and so precipitate a sharp resurgence of the EZ debt crisis. While the ECB has adequate resources to manage a debt crisis in a small EZ country, if one, or more, of the larger countries were to experience a major crisis of market confidence, this would present a serious challenge to the ECB and to EZ politicians.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.
- UK strong economic growth is weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU, US and China.
- A resurgence of the Eurozone sovereign debt crisis.
- Recapitalisation of European banks requiring more government financial support.
- Monetary policy action failing to stimulate sustainable growth and to combat the threat of deflation in western economies, especially the Eurozone and Japan.

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include:

- An adverse reaction by financial markets to the result of the UK general election in May 2015 and the economic and debt management policies adopted by the new government.
- ECB either failing to carry through on recent statements that it will soon start quantitative easing (purchase of government debt) or severely disappointing financial markets with embarking on only a token programme of minimal purchases which are unlikely to have much impact, if any, on stimulating growth in the EZ.
- The commencement by the US Federal Reserve of increases in the central rate in 2015 causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities, leading to a sudden flight from bonds to equities.
- A surge in investor confidence that a return to robust world economic growth is imminent, causing a flow of funds out of bonds into equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

Source: Capita Asset Services, January 2015

Annex D

Credit and Counterparty Risk Management

Permitted Investments, Associated Controls and Limits for Scottish Borders Council, Common Good and Trust Funds and In-house Managed Pension Fund

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good & Trust Fund Limits	Pension Fund In-House Limits
Cash type instruments					
a. Deposits with the Debt Management Account Facility (UK Government) **(Very low risk)**	This is a deposit with the UK Government and, as such, counterparty and liquidity risk is very low, and there is no risk to value. Deposits can be between overnight and 6 months.	Little mitigating controls required. As this is a UK Government investment, the monetary limit is unlimited to allow for a safe haven for investments.	£unlimited, maximum 6 months.	£unlimited, maximum 6 months.	£unlimited, maximum 6 months.
b. Deposits with other local authorities or public bodies **(Very low risk)**	These are considered quasi UK Government debt and, as such counterparty risk is very low, and there is no risk to value. Liquidity may present a problem as deposits can only be broken with the agreement of the counterparty, and penalties can apply. Deposits with other non-local authority bodies will be restricted to the overall credit rating criteria.	Little mitigating controls required for local authority deposits, as this is a quasi UK Government investment. Non-local authority deposits will follow the approved credit rating criteria.	£40m, maximum 1 year.	£5m, maximum 1 year.	£40m, maximum 1 year.
c. Money Market Funds (MMFs) **(Very low risk)**	Pooled cash investment vehicle which provides very low counterparty, liquidity and market risk. These will primarily be used as liquidity instruments.	Funds will only be used where the MMFs are Constant Net Asset Value (CNAV), and the fund has a "AAA" rated status from either Fitch, Moody's or Standard & Poors.	£5m per fund/£20m overall	£5m per fund/£20m overall	£5m per fund/£20m overall

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good & Trust Fund Limits	Pension Fund In-House Limits
d. Call account deposit accounts with financial institutions (banks and building societies) **(Low risk depending on credit rating)**	These tend to be low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. Whilst there is no risk to value with these types of investments, liquidity is high and investments can be returned at short notice.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's. The selection defaults to the lowest available colour band / credit rating to provide additional risk control measures. Day to day investment dealing with this criteria will be further strengthened by use of additional market intelligence.	As shown in the counterparty section criteria above.	As shown in the counterparty section criteria above.	As shown in the counterparty section criteria above.
e. Term deposits with financial institutions (banks and building societies) **(Low to medium risk depending on period & credit rating)**	These tend to be low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. Whilst there is no risk to value with these types of investments, liquidity is low and term deposits can only be broken with the agreement of the counterparty, and penalties may apply.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poors. The selection defaults to the lowest available credit rating to provide additional risk control measures. Day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	As shown in the counterparty section criteria above.	As shown in the counterparty section criteria above.	As shown in the counterparty section criteria above.

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good & Trust Fund Limits	Pension Fund In-House Limits
f. UK Government Gilts and Treasury Bills **(Very low risk)**	These are marketable securities issued by the UK Government and, as such, counterparty and liquidity risk is very low, although there is potential risk to value arising from an adverse movement in interest rates (no loss if these are held to maturity).	Little counterparty mitigating controls are required, as this is a UK Government investment. The potential for capital loss will be reduced by limiting the maximum monetary and time exposures.	£20m, maximum 1 year.	£5m, maximum 1 year	£20m, maximum 1 year.

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good & Trust Fund Limits	Pension Fund In-House Limits
Other types of investments					
g. Investment properties **(Medium Risk)**	These are non-service properties which are being held pending disposal or for a longer-term rental income stream. These are highly illiquid assets with high risk to value (the potential for property prices to fall or for rental voids).	In larger investment portfolios, some small allocation of property based investment may counterbalance/compliment the wider cash portfolio. Property holding will be revalued regularly and reported annually with gross and net rental streams.	£30m	£25m	N/A
h. Loans to third parties, including soft loans **(Low to Medium Risk depending on Credit Risk)**	These are service investments either at market rates of interest or below market rates (soft loans). These types of investments may exhibit credit risk and are likely to be highly illiquid.	Each third party loan requires Member approval and each application is supported by the service rational behind the loan and the likelihood of partial or full default.	£25m	£1m	N/A
i. National Housing Trust **(Very Low Risk due to Scottish Government Underwriting)**	These are loans to a Special Purpose Vehicle to allow it to purchase new homes under the NHT umbrella. These loans represent either 65% or 70% of the purchase price, the remainder being funded by the developer. The loan is redeemed after a 5 to 10 year period when the properties are sold.	Loan redemption arises when the homes are sold. Interest payments are made to the Council by the SPV from rental payments in the intervening period. Both the loan amount and associated interest payments are underwritten by Scottish Government.	£8m	N/A	N/A

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good & Trust Fund Limits	Pension Fund In-House Limits
j. Loans to a local authority company or partnership **(Low Risk)**	These are service investments either at market rates of interest or below market rates (soft loans). These types of investments may exhibit credit risk and are likely to be highly illiquid	Each loan to a local authority company/LLP requires Member approval and each application is supported by the service rational/business case behind the loan and the likelihood of partial or full default. In general these loans will involve some form of security or clear cashflow that is available to service the debt.	**£25M**	N/A	N/A
k. Shareholdings in a local authority company / Corporate membership of local authority partnerships	These are service investments which may exhibit market risk and are likely to be highly illiquid.	Each equity investment in a local authority company/partnership requires Member approval and each application will be supported by the service rational behind the investment and the likelihood of loss.	**£1m**	N/A	N/A
l. Pooled Investment Vehicles **(Low to Medium Risk)**	These use an investment vehicle, for long term capital growth and income returns. These are liquid assets in the sense that there is a realizable market value, however there is a high risk of volatility in the short and medium term in relation to market values and dividend income streams.	The Common Good and Trust Funds Investment Strategy sets out the risk/return criteria and the asset allocation for these investments. It also sets out the mechanisms for monitoring and managing the performance of the funds. Using a Multi Asset fund to increase the diversification to manage the volatility risk of specific asset	£0	All balances nominated by the Common Good & Trust Fund Working Groups as approved by Council up to a maximum of £7.5m.	N/A

		classes.			
m. Investment in the Subordinated Debt of projects delivered via the 'HubCo' model **(Very Low Risk)**	These are investments that are exposed to the success or failure of individual projects and are highly illiquid.	The Council and Scottish Government (via the SFT) are participants in and party to the governance and controls within the project structure. As such they are well placed to influence and ensure the successful completion of the project's term. These projects are based on robust business cases with a cashflow from public sector organisations (i.e. low credit risk)	£250,000	N/A	N/A

The Monitoring of Investment Counterparties

The status of counterparties will be monitored regularly. The Council receives credit rating and market information from Capita Asset Services, including 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 and if required new counterparties which meet the criteria will be added to the list.

Use of External Fund Managers

It is the Council's policy to use external fund managers to manage the investment portfolios of the Scottish Borders Council Pension Fund and the pooled investment fund of the Common Good and Trust Funds. This Annex reflects the approved policies around the Common Good and Trust Fund Investment Strategy but specifically excludes, as allowed by regulations, the work undertaken by External Fund Managers in relation to the Scottish Borders Council Pension Fund.

ANNEX E

Credit Ratings

Long and Short Term Credit Ratings

Audit Commission Grading#	**Fitch**		**Moody's**		**Standard and Poor's**	
	Long Term	**Short Term**	**Long Term**	**Short Term**	**Long Term**	**Short Term**
Extremely strong grade	AAA	F1+	Aaa	P-1	AAA	A-1+
Very strong grade	AA+ AA AA-	F1+ F1+ F1+	Aa1 Aa2 Aa3	P-1 P-1 P-1	AA+ AA AA-	A-1+ A-1+ A-1+
Strong grade But susceptible to adverse conditions	A+ A A-	F1+ / F1 F1 F1	A1 A2 A3	P-1 P-1 / P-2 P-1 / P-2	A+ A A	A-1+ / A-1 A-1 A-1 / A-2
Adequate Grade	BBB+ BBB BBB-	F2 F2 / F3 F3	Baa1 Baa2 Baa3	P-2 P-2 / P-3 P-3	BBB+ BBB BBB-	A-2 A-2 / A-3 A-2
Speculative Grade	BB+ BB BB-	B B B	Ba1 Ba2 Ba3	NP * NP NP	BB+ BB BB-	B-1 B-2 B-3
Very Speculative Grade	B+ B B-	B B B	Ba1 Ba2 Ba3	NP NP NP	B+ B B-	- - -
Vulnerable Grade	CCC CCC CCC CC C	C C C C C	Caa1 Caa2 Caa3 - Ca	NP NP NP NP NP	CCC+ CCC CCC- CC C	C C C C C
Defaulting Grade	D	D	C	NP	D	D

for the purpose of standardisation based on Standard and Poor's credit rating definitions.
* NP – Not Prime

Source: Audit Commission adaptation of information from Fitch, Moody's and Standard & Poor's

Viability, Financial Strength and Support Ratings

Continuing regulatory changes in the banking sector designed to see greater stability, lower risk and the removal of expectations of Government financial support should an institution fail. This withdrawal of implied sovereign support is anticipated to have an effect on ratings applied to institutions. This will result in the key rating agency information used to monitor counterparties will be the Short Term and Long Term ratings only. Viability, Financial Strength and Support Ratings previously applied will effectively become redundant. This change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes

As a result of these rating agency changes, the credit element of creditworthiness methodology applied by Capita Asset Services will focus solely on the Short and Long Term ratings of an institution. Rating Watch and Outlook information will continue to be assessed where it relates to these categories. This is the same process for Standard & Poor's that has always taken, but a change to the use of Fitch and Moody's ratings. Furthermore, Credit Default Swap prices will continue to be used as an overlay to ratings in our new methodology.

Annex F

Benchmarking and Monitoring Security, Liquidity and Yield

The consideration and approval of security and liquidity benchmarks are also part of Member reporting. These benchmarks are targets and so may be breached from time to time. Any breach will be reported, with supporting reasons, in the annual treasury report.

Yield
These benchmarks are currently widely used to assess investment performance. Local measures of yield benchmarks are:

- Investments – **Internal returns above the 7 day LIBID rate**

Security and liquidity benchmarks are already intrinsic to the approved treasury strategy through the counterparty selection criteria and some of the prudential indicators. Benchmarks for the cash type investments are below. In the other investment categories, appropriate benchmarks will be used where available.

Liquidity
This is defined as an organisation "having adequate, though not excessive, cash resources, borrowing arrangements, overdrafts or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives" (CIPFA Treasury Management Code of Practice). In respect of liquidity, the Council seeks to maintain:

- Bank overdraft - £250,000
- Liquid short term deposits of at least £3,000,000 available with a week's notice.

The availability of liquidity in the portfolio can be benchmarked by the monitoring of the Weighted Average Life (WAL) of the portfolio – shorter WAL would generally embody less risk. In this respect, the proposed benchmark to be used is:

- **WAL benchmark is expected to be 0.5 years, with a maximum of 1.00 years**.

Security of the investments
In the context of benchmarking, assessing security is a much more subjective area to assess. Security is currently evidenced by the application of minimum credit quality criteria to investment counterparties, primarily through the use of the Creditworthiness service provided by Capita Asset Services. Whilst this approach embodies security considerations, benchmarking levels of risk is more problematic. One method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the Council's investment strategy.

The Council's maximum security risk benchmark for the whole portfolio, when compared to these historic default tables, is:

- **0.04% historic risk of default when compared to the whole portfolio.**

These benchmarks are embodied in the criteria for selecting cash investment counterparties and these will be monitored and reported to Members in the Annual Treasury Management Report. As this data is collated, trends and analysis will be collected and reported.

GLOSSARY OF TERMS

CIPFA	Chartered Institute of Public Finance and Accountancy
CIPFA Code	Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes
CFR	Capital Financing Requirement is the estimated the level of borrowing or financing needed to fund capital expenditure.
Consent to Borrow	Para 1 (1) of Schedule 3 of the Local Government (Scotland) Act 1975 (the 1975 Act) effectively restricts local authorities to borrowing only for capital expenditure. Under the legislation Scottish Ministers may provide consent for local authorities to borrow for expenditure not covered by this paragraph, where they are satisfied that the expenditure should be met by borrowing.
Gilts	A gilt is a UK Government liability in sterling, issued by HM Treasury and listed on the London Stock Exchange. The term "gilt" or "gilt-edged security" is a reference to the primary characteristic of gilts as an investment: their security. This is a reflection of the fact that the British Government has never failed to make interest or principal payments on gilts as they fall due.
LIBID	London Interbank Bid Rate The rate at which banks bid on Eurocurrency Deposits, being the rate at which a bank is willing to borrow from other banks.
MPC	Monetary Policy Committee
NHT	National Housing Trust initiative undertaken in partnership with the Scottish Futures Trust.
Other Long Term Liabilities	Balance sheet items such as Public Private Partnership (PPP), and leasing arrangements which already include borrowing instruments.
PPP	Public-Private Partnership.
Prudential Indicators	The Prudential Code sets out a basket of indicators (the Prudential Indicators) that must be prepared and used in order to demonstrate that local authorities have fulfilled the objectives of the Prudential Code.
QE	Quantitative Easing
Treasury Indicators	These consist of a number of Treasury Management Indicators that local authorities are expected to 'have regard' to, to demonstrate compliance with the Treasury Management Code of Practice.

You can get this document on tape, in Braille, large print and various computer formats by contacting the address below.

Capital & Investments Team, Corporate Finance, Scottish Borders Council, Council HQ, Newtown St Boswells
01835 824000, treasuryteam@scotborders.gov.uk

KPMG

cutting through complexity

Scottish Borders Council

Audit strategy review and plan

Year ending 31 March 2015

DRAFT: 9 January 2015

For Audit Committee consideration on 19 January 2015

DRAFT

Contents

DRAFT

The contacts at KPMG in connection with this report are:

Hugh Harvie
Partner, KPMG LLP

Tel: 0131 527 6682
Fax: 0131 527 6666
hugh.harvie@kpmg.co.uk

Matt Swann
Senior Manager, KPMG LLP

Tel: 0131 527 6662
Fax: 0131 527 6666
matthew.swann@kpmg.co.uk

Rhona Mitchell
Assistant Manager, KPMG LLP

Tel: 0141 228 4295
Fax: 0141 204 1584
rhona.mitchell@kpmg.co.uk

	Page
Executive summary	2
Audit strategy and planning	3
Other audit areas	13
Delivery of the audit	17
Appendices	20

About this report

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ("the *Code*").

This report is for the benefit of Scottish Borders Council ("Council") and is made available to Audit Scotland and the Accounts Commission (together "the beneficiaries"), and has been released to the beneficiaries on the basis that wider disclosure is permitted for information purposes, but that we have not taken account of the wider requirements or circumstances of anyone other than the beneficiaries.

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scope and objectives section of this report.

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the beneficiaries) for any purpose or in any context. Any party other than the beneficiaries that obtains access to this report or a copy and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the beneficiaries.

Complaints

If at any time you would like to discuss with us how our services can be improved or if you have a complaint about them, you are invited to contact Hugh Harvie, who is the engagement leader for our services to Scottish Borders Council, telephone 0131 527 6682 email: hugh.harvie@kpmg.co.uk who will try to resolve your complaint. If your problem is not resolved, you should contact Alex Sanderson, our Head of Audit in Scotland, either by writing to him at Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EG or by telephoning 0131 527 6720 or email to alex.sanderson@kpmg.co.uk. We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied with how your complaint has been handled you can refer the matter to Russell Frith, Assistant Auditor General, Audit Scotland, 110 George Street, Edinburgh, EH2 4LH.

Executive summary

DRAFT

Planning for our audit takes into account the broad risk profile of the Council and includes consideration of other areas of assurance such as the Shared Risk Assessment.

Context

Our audit is undertaken in accordance with appointment terms made by the Accounts Commission, Audit Scotland's *Code of Audit Practice* and International Standards on Auditing (UK & Ireland).

Our approach to the Council's audit is risk-based, focussing on our understanding of the Council and the wider environment in which it operates, while also reflecting the expectations of Audit Scotland.

Significant risks

International Standard on Auditing (UK and Ireland) 315: *Identifying and assessing risks of material misstatement through understanding the entity and its environment* requires the auditor to determine whether any of the risks identified as part of our risk assessment are significant risks and therefore requiring specific audit consideration.

With the exception of the required two fraud risks identified in International Standard on Auditing (UK and Ireland) 240, which are set out further later in this report, we have not identified any significant risks of material misstatement as a result of our planning and risk assessment.

Shared Risk Assessment ("SRA")

The approach is informed through participation in the local area network ("LAN") of local audit and inspection representatives and the annual SRA process which is part of a simplified and coherent approach to delivering local government scrutiny. A key aspect of this agenda is to better coordinate and streamline scrutiny and achieve greater effectiveness, while at the same time protecting the independence of scrutiny bodies. Scrutiny bodies that engage with local government established a shared assessment of the risks in each council and developed a range of proportionate approaches in response to the risk assessment.

The most recent local scrutiny plan, previously assurance and improvement plan, identified the Council as low risk overall with only the area Governance and accountability as "scrutiny required", involving targeted work by external audit to contribute to the council's review of governance and accountability. This is part of a wider Council review which had not yet been concluded. We will update our understanding of this area and reflect this in our audit work.

Best Value

Under the Local Government in Scotland Act 2003 ("the 2003 Act"), auditors also have a duty to be satisfied that councils have made proper arrangements to secure best value. In response to these duties, the Accounts Commission introduced specific arrangements for the audit of Best Value and community planning under section 52 of the 2003 Act.

Currently, Best Value audits are carried out by central teams within Audit Scotland's best value scrutiny improvement group in partnership with local auditors.

Overall reporting

In addition to reporting on matters identified during our audit, as part of our audit appointment, we are also required to consider the Council's arrangements in a number of other areas and report our findings. These include:

- arrangements with respect to the National Fraud Initiative;
- the Council's response to specific national studies;
- review and reporting on various grant claims made by the Council;
- follow-up on the response to specific performance audits; and
- arrangements for reporting statutory performance indicators.

We will summarise our findings in our annual audit report which will be reported to the audit committee in September 2015.

Introduction

DRAFT

Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practice*. This specifies a number of objectives for our audit.

Page 54

The Accounts Commission has appointed KPMG LLP as auditors of the Council under the Local Government (Scotland) Act 1973 ("the Act"). The period of appointment is 2011-12 to 2015-16, inclusive.

Our responsibilities

We carry out our audit in accordance with our statutory responsibilities under the Act and in accordance with the International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board ("APB") and the wider responsibilities embodied the Code. Under this, auditors address and comment upon a number of objectives, together with complying with a number of obligations.

Auditors' objectives in relation to the *Code of Audit Practice* are to:

- audit the financial statements and place a certificate on the statements stating that the audit has been conducted in accordance with Part VII of the Act;
- satisfy ourselves that:
  - the financial statements have been prepared in accordance with all applicable statutory requirements;
  - proper accounting practices have been observed in the preparation of the financial statements;
  - the body has made proper arrangements for securing Best Value and is complying with its community duties; and
  - the local authority has made adequate arrangements for collecting, recording and publishing prescribed performance information;
- hear any objection to the financial statements lodged by an interested person.

We have a professional responsibility to report if the Council's financial statements do not comply, in any material respect, with the IFRS-based Code of Practice on Local Authority Accounting in the United Kingdom 2014-15, taking account of the international financial reporting standards issued by the International Accounting Standards Board and relevant guidance issued by the Chartered Institute of Public Finance and Accountability ("CIPFA") / Local Authorities (Scotland) Accounts Advisory Board ("LASAAC").

As part of our audit we also review financial information contained in the foreword to ensure it is consistent with the financial statements. We also review the corporate governance statement to ensure it has been prepared in accordance with the Code and other relevant guidance, taking account of the financial statements and other information gained by us as auditor.

International Standard on Auditing (UK and Ireland) 240: *The auditor's responsibility to consider fraud in an audit of financial statements* requires us to consider directly the possibility that management may choose to override the system of internal controls that otherwise may appear to be operating effectively. The Standard requires the auditor to maintain an attitude of professional scepticism, recognising the possibility that a material misstatement due to fraud could exist – notwithstanding the auditor's experience with regard to the honesty and integrity of management and those charged with governance.

In accordance with International Standard on Auditing (UK and Ireland) 260: *Communication with those charged with governance* we will report all non-material, non-trivial errors, which have not been adjusted.

The Council's responsibilities

The Council is responsible for financial statements which show a true and fair view of the Council's affairs, and for making available to us all the information and explanations we require for the purposes of our audit.

The Council is also responsible for establishing arrangements that ensure: fraud and other irregularity are prevented and detected; affairs are managed in accordance with proper standards of conduct; and Best Value is achieved. Further information in respect of the Council's responsibilities is shown in Appendix two.

Financial context

DRAFT

Our audit approach is risk-based, and focuses on the areas most likely to lead to material misstatement in the Council's financial statements.

Page 55

Audit Scotland's report *Responding to challenges and change: An overview of local government in Scotland* highlighted a number of service challenges for councils, with demand and resource pressures continuing to build, against a backdrop of reform in public services. The report highlights a large number of issues which councils face, the majority of which are applicable to the Council.

The Council is therefore operating in a challenging economic environment, with funding reductions and increasing expenditure pressures. These include Welfare Reform and the integration of Health and Social Care. In response the Council set a five year financial strategy from 2013-14. This strategy was developed so that the Council can assess the level of resources available and to ensure that the Council's financial plans remain prudent and sustainable in the context of the external environment. The Council must also comply with the requirements for a Single Outcome Agreement ("SOA") which is a mechanism for aligning public sector activity to national priorities.

The Council continues to have a comparatively low level of useable reserves proportionately in relation to other Scottish local authorities. It is recognised that this is partially due to the lack of housing stock. The Council regularly reviews the level of reserves required based upon specific costed allocations against its corporate risk register and ensures that the level of reserves is adequate to meet these. The Council has assessed that it is comparatively low risk and is therefore able to hold a lower level of useable reserves than other councils. We will continue to monitor this through discussion with management and comparisons with other local authorities.

Financial position – revenue

The financial outturn for 2013-14 was an underspend of £451,000 against the final, revised budget. This followed adjustments to the budget during the year to meet demand pressures, in particular in relation to social work. A large portion of this variance can be attributed to staff cost savings as a result of an interim management structure being in place pending the implementation of the new corporate management arrangements from 1 April 2014.

As part of our planning for this year's audit, we have reviewed the reported financial position to date. The November 2014 revenue monitoring report forecasts a break even position for the year against the budget.

In 2013-14, a number of measures alternative to those in the financial plan were required to be identified to deliver efficiency savings in the year. Performance to date indicates that the majority of 2014-15 savings are being delivered in line with the financial plan.

Financial position – capital

Total capital expenditure in 2013-14 was £27.6 million, compared to a budget of £29.9 million and expenditure of £23.3 million in 2012-13.

The £2.3 million under spend against budget was due to: (i) project re-profiling of £2.2 million and (ii) project under spend of £100,000. The re-profiling related to a number of capital projects, with the largest approximately £300,000. Although capital budget re-profiling in 2013-14 is at the lowest level when compared to the five preceding years, management should continue to explore the reasons for re-profiling in capital projects and any implications for capital budgeting in an attempt to continue to reduce the amount of re-profiling.

We will review the most recent capital forecast outturn for 2014-15 reported to the corporate management team as part of our interim audit.

Significant risks

DRAFT

International Standard on Auditing (UK and Ireland) 315 requires us to determine whether any of the risks identified through our risk assessment processes are significant.

We have identified two significant risks in our initial risk assessment for 2014-15. Our risk assessment procedures are ongoing and we provide updates on any emerging risks as they become apparent.

Audit approach

Our audit approach is based on an understanding of the characteristics, responsibilities, principal activities, risks and governance arrangements of Scottish Borders Council. We also consider the key audit risks and challenges in the local government sector generally.

Significant risks

International Standard on Auditing (UK and Ireland) 315: *Identifying and assessing risks of material misstatement through understanding the entity and its environment* requires the auditor to determine whether any of the risks identified as part of risk assessment are significant risks and therefore requiring specific audit consideration. In determining whether a risk is significant, judgement is applied in respect of the whether, for example, the risk is associated with the complexity of transactions, the degree of subjectivity involved in the measurement of financial information, whether the associated transactions are outside the normal course of business, or whether there is an associated risk of fraud.

We include two significant risks below.

Significant risk and implications	Our planned audit approach
Pervasive risk: fraud risk from management override of controls Professional standards require us to communicate the fraud risk from management override of controls as significant. Management is typically in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.	We have not identified any specific additional risks of management override relating to this audit. Our audit methodology incorporates the risk of management override as a significant risk. This includes: ▪ testing of journals at the year end, and during the year; ▪ review of unusual transactions in the year; ▪ enquiries with employees outside the finance department; ▪ a test of unpredictability; and ▪ controls testing, including higher level controls.
Financial position As highlighted earlier in this report, the Council is operating in a challenging economic environment, with funding reductions and increasing expenditure pressures. Recently the Council has underspent against budget in total. In 2013-14 the Council recorded an underspend of £451,000 against the final revised budget.	We will update our understanding of the Council's financial position and year end outturn position through review of quarterly reports and other management information. We will assess management's progress with implementation of efficiency savings. Commentary and analysis on these areas will be provided within the annual audit report. We will consider management's capital monitoring reports and provide commentary on the achievement of the capital budget and impact on the capital limits and associated borrowing during the year. We will perform controls testing over the budgeting procedures throughout the year. We will perform substantive procedures, including substantive analytical procedures, over income and expenditure comparing the final position to budget.

Significant risks (continued)

DRAFT

Significant risk and implications	Our planned audit approach
Pervasive risk: Fraud risk from income recognition Professional standards require us to make a rebuttable presumption that the fraud risk from income recognition is a significant risk.	The potential for revenue to be incorrectly recognised will be addressed through controls and substantive procedures. We will consider each source of income and analyse results against budgets and forecasts, performing substantive analytical procedures and tests of details. Part of the Council's income is received from non ring-fenced government grants. As government grants are agreed in advance of the year, with adjustments requiring Government approval, we do not regard the risk of fraud from this revenue recognition as significant. The other major sources of income are from annual local taxes and rental income (council tax and non-domestic rates). These revenues are prescribed by law and other specific regulations, which prescribe the period in which annual local taxes and rental income is recognised as revenue. This minimises the level of judgement required in revenue recognition by management and we do not regard the risk of fraud from this revenue recognition as significant. Sales income is recognised at point of sale, with an invoice raised when the service is delivered, minimising the judgement necessary. Therefore, we do not consider income recognition a significant risk.

For those balances not linked to a significant risk or other focus area, we will perform analytical reviews and specific item testing over material balances to consider material errors or disclosure errors.

Audit focus areas

DRAFT

We have developed an understanding of your key audit risk areas based on our initial risk assessment procedures, including discussions with management.

Our risk assessment procedures are ongoing throughout the audit, and we will update you in respect of any emerging risks as we become aware of them.

Property, plant and equipment

Under the Code and IFRS, property, plant and equipment ("PPE") is required to be held on the balance sheet at fair value, which for specialised assets is assumed to be depreciated replacement cost and for other PPE is open market value. In order to comply with these accounting requirements, Council assets are subject to rolling valuations on a department basis.

In accordance with the Council's valuation cycle, planning and economic development properties, surplus assets and the new West Linton primary school were subject to revaluation in 2013-14, the latter of which was a result of a prior year recommendation. A total downward revaluation of £8.3 million was reflected by the Council in its financial statements.

We will update our understanding of the assets to be valued as part of the 2014-15 cycle, taking into consideration our prior year discussions with management in respect of this programme. In line with the Council's valuation schedule, Common Good and Charitable Trust properties will be subject to revaluation.

We will review the valuations in detail, liaising with our internal experts to consider the Council's general approach. We will also consider the accounting implications of the valuations to ensure that they are appropriately reflected in the financial statements.

Accounting for landfill sites

During 2012-13, it was recognised that local authorities' accounting for landfill sites they operate may not be in accordance with IAS 37 *Provisions*. Under this standard, the future costs (including decommissioning, restoration and ongoing monitoring) should be capitalised when the landfill is brought into use and an associated provision created on the balance sheet which future costs would be charged against. The landfill asset is then amortised.

Management considered the future costs of relevant landfill sites and recognised a provision for relevant capital costs of decommissioning of £1.2 million at 31 March 2014. The Council is still determining its future strategy in relation to landfill and has not recognised obligations for ongoing aftercare and monitoring costs that may be incurred after decommissioning. Management disclosed a contingent liability in the 2013-14 financial statements in relation to these costs. Following discussions, we considered this to be in line with the guidance as there are a number of uncertainties relating to the estimation of these costs, not least the absence of a strategy which determines that these will fall to the Council.

For this year's audit, we will:

- update our understanding of the issue;
- consider management's accounting for landfill costs against relevant guidance; and
- review management's calculation of the level of provision required at 31 March 2015.

Audit focus areas (continued)

DRAFT

Employee benefits

The Council accounts for its participation in the Scottish Borders Council Pension Fund in accordance with IAS 19 *Employee benefits*, using a valuation report prepared by actuarial consultants. The Council's actuaries use membership data and a number of assumptions in their calculations based on market conditions at the year end, including a discount rate to derive the anticipated future liabilities back to the year end date and assumptions on future salary increases.

IAS 19 requires the discount rate to be set by reference to yields on high quality (i.e. AA rated) corporate bonds of equivalent term to the liabilities.

The Council adopted IAS 19 (Revised) in 2013-14 and we found that the Council has appropriately applied IAS 19 (Revised) in its financial statements by restating the prior year comparative information given in 2013-14 financial statements.

Our audit approach to IAS 19 includes:

- review of the financial assumptions underlying the actuaries' calculations and comparison to our central benchmarks;
- testing of the level of contributions used by the actuary to those actually paid during the year; and
- testing of membership data used by the actuary to data from the pension fund.

Page 59

Presentation of financial statements

DRAFT

The Council is required to prepare financial statements in accordance with the *Code of Practice on Local Authority Accounting in the United Kingdom 2014-15* (“the Code”).

While there are some changes in the content of the Code for 2014-15, the financial statements and underlying accounting policies are expected to remain substantially consistent with the previous year.

KPMG remains committed to working with management to enhance the clarity and impact of the financial statements, including the implications of the revisions to the Code.

Page 60

Code of practice on Local Authority Accounting in the United Kingdom 2014-15 (“the Code”)	The 2014-15 financial statements will be prepared in accordance with the *Code of practice on local authority accounting in the United Kingdom 2014-15 (*“the Code*”)* which is based on International Financial Reporting Standards (“IFRS”). The 2014-15 Code has a number of amendments from the 2013-14 version and management should reflect these changes to the reporting requirements in the draft financial statements. The amendments include: ▪ changes in respect any required restatement of the opening balance sheet; ▪ new group accounts accounting standards; and ▪ requirements for accounting for combinations of bodies and transfer of functions.

Changes to Local Authority Accounts (Scotland) Regulations

The Local Authority Accounts (Scotland) Regulations 2014 came in to force on 10 October 2014 to replace the 1985 regulations. The new regulations include a number of changes designed to help strengthen corporate governance processes. These amendments include:

- clarification of the composition of the annual accounts, requiring the inclusion of a management commentary, a statement of responsibilities, an annual governance statement and a remuneration report;
- changes to the process for approving the unaudited accounts, including a requirement for the audit and governance committee to consider the unaudited accounts by 31 August;
- changes to the process for approval of the audited annual accounts; and
- changes to the requirements for the publication of the audited annual accounts.

Financial reporting for charitable trusts

Since the change in regulations requiring that all charitable trust funds registered with the Office of the Scottish Charity Regulator (“OSCR”) are subject to audit, the Council has completed a rationalisation process which saw the number of registered trust funds significantly reduced in advance of 31 March 2014. In addition, the Council has made further changes during 2014-15 to the structure of its charitable bodies including the winding up of one entity and the registration of three new charitable entities. These will be subject to audit in addition to the Common Good Funds.

Group financial statements

DRAFT

IFRS and the Code require the Council to prepare group financial statements.

Page 61

The Council uses a range of service delivery vehicles to facilitate the discharge of its functions which, whilst technically independent, are effectively under the Council's influence or control. The Council is required under IFRS and the Code to prepare group financial statements which include the Council's interest in subsidiaries, associates and joint ventures. As part of the 2013/14 audit it was agreed that Scottish Borders Council were not required to produce group accounts following a period of consultation with KPMG. In forthcoming years the Council will be required to produce group accounts as a result of health and social care partnerships and plan to produce group accounts in 2014/15.

The Code requires the following statements to be prepared, together with appropriate notes:

- group comprehensive income and expenditure – this statement summarises the group's income and expenditure for the year;
- group balance sheet – this statement sets out the overall financial position of the group at the year end;
- group cash flow - the group cash flow statement includes the cash flows of the Council, Common Good Funds and Trust Funds. Cash receipts and payments that flow to and from the Council and its subsidiaries only (full group members) must be included. Cash flows to and from the Council to its associates are included within the cash flow statement of the Council; and
- movement in reserves – this statement summarises all movements in reserves.

Subsidiaries

These are entities in which the Council either:

- controls the majority of equity capital or equivalent voting rights;
- appoints the majority of the governing body; or
- exercises (or has the right to exercise) influence (i.e. give direction which must be complied with) over the entity's operating and financial policies.

The Council assessed its relationships with other entities in 2010-11 and concluded that only Trust Funds and Common Good Funds, in respect of which the Council is sole trustee, fall to be treated as subsidiaries. We reviewed this on appointment in 2011-12 and confirmed our agreement with the Council's view. We have refreshed our understanding and still consider the assessment appropriate.

As in the prior year, the Trust Funds and Common Good Fund bodies will be subject to a separate statutory audit by KPMG.

Associates

These are entities in which the Council can exercise a significant influence without support form other participants. The reassessment of relationships with other entities in 2011-12 concluded that the following required to be treated as associates:

- Borders Sport and Leisure Trust;
- Jedburgh Leisure Facilities Trust;
- Lothian and Borders Police Board; and
- Lothian and Borders Fire & Rescue Board.

Lothian and Borders Police Board and Lothian and Borders Fire & Rescue Board were abolished on 1 April 2013 following the creation of the Scottish Police Authority and the Scottish Fire and Rescue Service, therefore these are no longer accounted for as associates.

In the prior year we did not include either of the Council's associate leisure trusts in the scope of our audit. However our approach will be reviewed following the change to group accounts requirements in the 2014-15 Code.

Mandatory communications

DRAFT

Mandatory communications with those charged with governance as required by Auditing Standards are set out opposite.

These cover:

- **fraud;**
- **related party transactions; and**
- **independence.**

Area	Management responsibilities/action	KPMG response
Fraud risks	■ It is the responsibility of management to implement accounting and internal control systems which are designed to prevent and detect fraud and error. Such systems reduce but do not eliminate the risk of misstatements caused by fraud or error. ■ Those charged with governance must ensure, through oversight of management, the integrity of these systems and that appropriate controls are in place, including those for monitoring risk, financial control and compliance with laws. This is in the context of preparing financial statements that give a true and fair view and that do not contain material misstatements arising from fraudulent reporting (intentional misstatements/ omissions to deceive the financial statement user) or from the misappropriation of assets.	■ Our audit procedures are designed to have a reasonable chance of detecting misstatements as a result of fraud or error. The audit team will review and discuss fraud related risks and controls with internal audit, the chief financial officer and senior management. ■ Our risk assessment procedures will include a number of interviews with senior personnel concerning processes to identify and respond to risks of fraud.
Related party transactions	■ Management has processes in place to identify related party transactions and a number were disclosed in the 2013-14 financial statements. All material related party transactions must be disclosed in the financial statements.	■ We will ensure that there continue to be appropriate processes in place as part of the financial statements preparation process to identify any related party transactions.
Independence	■ Auditing Standards require us to consider our independence and related matters in our dealings with the Council.	■ We have provided our formal independence communication in appendix one. In respect of non-audit services provided to the Council we have completed internal conflict checks to confirm that the services may be provided with no threat to our audit independence.

Mandatory communications: audit materiality

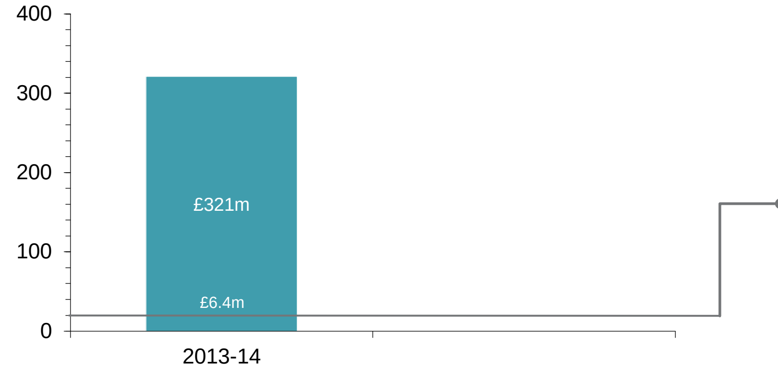
DRAFT

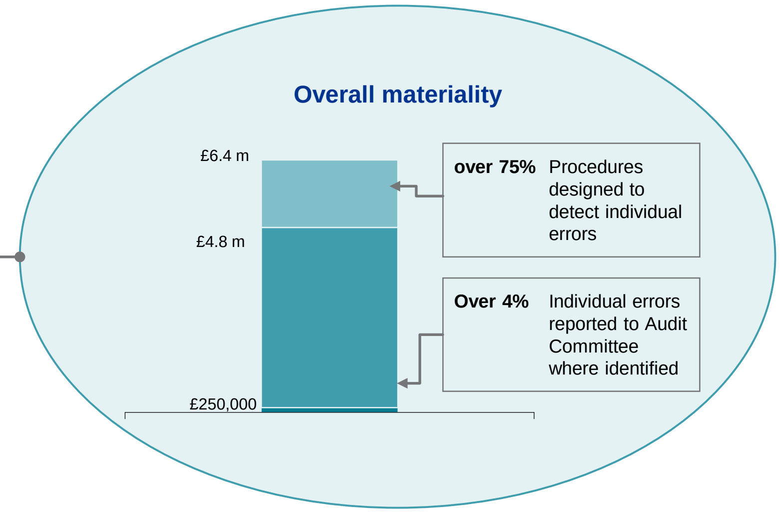
Our audit work is planned to detect errors that are material to the financial statements as a whole.

Our materiality is based on total expenditure and takes into account the low risk nature of the Council.

Page 63

Total expenditure





Source: 2013-14 financial statements

Determining materiality

We consider quantitative and qualitative factors in setting materiality and in designing our audit procedures.

We have assessed our level of materiality this year based on our knowledge and understanding of the Council's risk profile and financial statements. Materiality has been set at £6.4 million which is approximately 2% of total expenditure in 2013-14. This will be revised once the draft financial statements for 2014-15 have been prepared.

We have taken into account the public interest factor inherent to our work when determining overall materiality, performance materiality and clearly trivial thresholds, in compliance with ISA 320 *Materiality in planning and performing an audit*. Therefore, we design our procedures to detect errors at a lower level of precision, i.e. £4.8 million and will report identified errors greater than £250,000 to the audit committee.

Reporting to audit committee

To comply with Auditing Standards, the following three types of audit differences will be reported to the audit committee:

- adjusted audit differences;
- unadjusted audit differences above our reporting threshold; and
- disclosure differences (adjusted and unadjusted).

Governance and scrutiny arrangements

DRAFT

We review governance and scrutiny arrangements in light of the SRA, Best Value and Single Outcome Agreement.

The SRA process has identified one area for targeted follow up by external audit in 2014-15.

Page 64

Shared Risk Assessment

Following the publication of the Crerar report in September 2007, the Scottish Government's response stated its aim of establishing a simplified and coherent approach to delivering local government scrutiny. A key aspect of this agenda is to better coordinate and streamline scrutiny and achieve greater effectiveness, while at the same time protecting the independence of scrutiny bodies.

Local area networks ("LANs") have been established for each council. These bring together local scrutiny representatives in a systematic way with the common aims of joint scrutiny scheduling and planning, sharing risk assessment and the delivery of a single corporate assessment through the Best Value 2 audit process. As your external auditor, we are a key member of the SRA process for the Council.

The role of the SRA process is to ensure that relevant data collected from councils and other sources by their organisation is analysed and bought to the LAN for discussion. All LAN members discuss and agree a SRA and identify a proportionate scrutiny response.

A national scrutiny plan sets out how Scotland's scrutiny agencies coordinate their work and focus on the key issues at each council. This plan is underpinned by a local scrutiny plan, previously an assurance and improvement plan, for individual councils.

The SRA process for 2014-15 identified:

- seventeen areas where no specific scrutiny is required; and
- one area requiring follow up by external audit in 2014-15 relating to the council's review of governance and accountability. This will be reflected in our audit procedures as appropriate.

Best Value and continuous improvement

Under the Local Government in Scotland Act 2003 ("the 2003 Act"), auditors have a duty to be satisfied that councils have made proper arrangements to secure best value. In response to these duties, the Accounts Commission introduced specific arrangements for the audit of Best Value and community planning under section 52 of the 2003 Act. Currently, Best Value audits are carried out by central teams within Audit Scotland's best value scrutiny improvement group in partnership with local auditors. The timing, nature and extent of these is now determined as part of the SRA process. A key component of the SRA will be the extent to which implementation of the existing Best Value improvement plan has had the anticipated impact. As your external auditor, we are responsible for conducting follow-up reviews to assess the Council's progress against its agreed improvement priorities.

The Council has put in place a corporate plan covering the period 2013 to 2018. This recognises the various challenges facing the Council at the moment and over the next five years identifying eight priorities driving the business. Management is now developing performance management arrangements to monitor performance and improvement against the corporate plan. We will review this progress during our final audit visit.

Governance statement

The Council is required to prepare and disclose a governance statement to detail the purpose of the framework of internal control, along with an analysis of its effectiveness. It should describe sources of assurance for members and senior officers and identifies areas for improvements to be focussed on in the future. We are required to review the governance statement against disclosure requirements and consider its content against our knowledge and understanding of Council. We will then report on our findings in our annual audit report.

Governance and scrutiny arrangements (continued)

DRAFT

Page 65

Single outcome agreement

Single outcome agreements (“SOAs”) are a mechanism for aligning public sector activity to national priorities and the Accounts Commission has no immediate plans to audit their delivery. Best Value 2 will draw upon evidence contained within a council's SOA in order to consider outcomes more widely, as planning for, and managing the delivery of, outcomes should be central to all aspects of a local authority's activity. Successful delivery of SOAs will depend on the degree to which they are supported by effective planning, budgeting and performance management arrangements at service-level, within councils and across partner agencies.

During the audit cycle, our responsibilities extend to updating our understanding on the approach the Council and its partners are taking to:

- developing governance and accountability arrangements to support the SOA in line with Scottish Government advice;
- ensuring explicit links are made between high-level SOA outcomes and more detailed service-level outcomes, outputs and activities – both within a council and across community planning partners;
- ensuring the SOA is supported by robust resource planning arrangements at a service-level within the Council and jointly with community planning partners;
- ensuring the SOA is supported by robust performance management and reporting:
- reporting progress towards SOA outcomes to the Scottish Government, in line with guidance on annual reporting; and
- undertaking Public Performance Reporting (“PPR”) on progress towards SOA outcomes.

We will include our findings in our 2014-15 annual audit report.

Integration of health and social care

In March 2014 the Public Bodies (Joint Working) (Scotland) Act was passed by the Scottish Government. This requires all councils and NHS Boards to formally and legally establish integration of health and social care by April 2016.

The Council has established a Shadow Integration Board to be in place until 1 April 2016, with the same responsibilities for services as the final Joint Integration Board will have when legislation has been fully enacted. The integration scheme is due to be submitted by March 2015, after which the strategic plan will be developed. We will continue to monitor the Council’s progress in the integration of health and social care, and report our findings in the annual audit report.

National Fraud Initiative

The National Fraud Initiative (“NFI”) is a data matching exercise which compares electronic data within and between participating bodies in Scotland to prevent and detect fraud. This exercise runs every two years and provides a secure website for bodies and auditors to use. NFI helps participating bodies to identify possible cases of fraud, and to detect and correct any under or overpayments. NFI also helps auditors to satisfy their duties to assess bodies’ arrangements for preventing, deterring and detecting fraud.

We are required by Audit Scotland to review the Council’s progress and engagement with the NFI process. We prepared a short return to Audit Scotland in December 2014 and we will report management’s progress to the audit and governance committee during the year.

Fraud returns

Audit Scotland’s *Code of Audit Practice* requires auditors to make submissions of instances of fraud and irregularity. We will liaise with your internal auditors and relevant finance staff in advance of completing these submissions.

Internal audit

DRAFT

We will liaise with your internal auditors to minimise duplication of effort.

Page 66

Internal audit arrangements

International Standard on Auditing (UK and Ireland) 610: *Considering the work of internal audit* requires us to:

- consider the activities of internal audit and their effect, if any, on external audit procedures;
- obtain a sufficient understanding of internal audit activities to assist in planning the audit and developing an effective audit approach;
- perform a preliminary assessment of internal audit when it appears that internal audit is relevant to our audit of the financial statements in specific audit areas; and
- evaluate and test the work of internal audit, where use is made of that work, in order to confirm its adequacy for our purposes.

We will continue our liaison with your internal auditors and maintain an understanding of their approach to ensure duplication of effort is minimised. We will review the internal audit work proposed or completed during our interim audit visit to determine the extent of assurance that can be taken from the work performed.

The general programme of work will be reviewed for significant issues to support our general work in assessing the Council's annual governance statement.

Performance management

DRAFT

We will review the Council's response to Audit Scotland national studies and will report our findings back to Audit Scotland.

Page 67

Local response to national studies

Audit Scotland periodically undertakes national studies on topics relevant to the performance of local government bodies on behalf of the Accounts Commission. While the recommendations from some of the studies may have a national application, elements of the recommendations are also capable of implementation at individual organisation level, as appropriate.

In order to ensure that added value is secured through the role of the Accounts Commission, Audit Scotland and its appointed auditors, will continue to ensure that audited bodies respond appropriately to reports from Audit Scotland's programme of national performance audits. We will therefore be required to make returns to Audit Scotland that performance reports have been considered by the Council and that action has been planned in response.

We will assess how the Council has responded to relevant national reports and prepare returns to Audit Scotland.

Targeted follow up of performance audit

Audit Scotland identifies a small number of reports each year as part of its targeted approach to following-up of performance audits. This will involve looking at what action has been taken by the Council and what difference this has made. We will include commentary in the annual audit report and may provide supplementary reports, where necessary.

Statutory performance indicators

The statutory deadline for publication by the Council of statutory performance indicators ("SPIs") is 30 September 2015. In 2009-10 there was a significant shift in approach, reflecting the changing environment in which local authorities operate. There were further changes to the requirements for auditors from 2013-14 onwards. SPIs are no longer specified and are drafted by the Council based on Audit Scotland categories as well as council plan and single outcome agreement objectives. The specified indicators have been replaced by the Scottish Local Government Benchmarking Framework, which compares performance across councils using a standard set of indicators. The results of this benchmarking are analysed in 'family groups' to ensure comparison is between authorities with similar characteristics.

Auditors must assess the adequacy of arrangements in place in local authorities for collecting and publishing information in relation to SPIs. We will complete a pro-forma schedule to reflect the audit work on SPIs in consultation with the Council and this will be submitted to Audit Scotland by 30 September 2015. Our annual audit report for 2014-15 will include a summary of this appraisal, the respective duties and responsibilities of the Council and us as auditor, any significant issues arising from the audit work and recommendations for improvement.

KPMG team; reporting

DRAFT

Team member	Role
Hugh Harvie *Engagement Partner* Telephone: 0131 527 6682 Email: hugh.harvie@kpmg.co.uk	Hugh has overall authority and responsibility for the audit engagements, including reporting on the financial statements, and will review key conclusions reached by the engagement team on all accounting and auditing matters. Hugh undertakes work across the public sector working with a range of councils and central government bodies.
Matt Swann *Audit Senior Manager* Telephone: 0131 527 6662 Email: matthew.swann@kpmg.co.uk	Matt serves as the day-to-day audit liaison between management and KPMG and a first point of contact. He also provides technical accounting, regulatory and other advice in the first instance. Matt has over 7 years of public sector audit experience working with a range of councils, charities and central government bodies
Rhona Mitchell *Assistant Manager* Telephone: 0141 228 4295 Email: rhona.mitchell@kpmg.co.uk	Rhona coordinates the onsite audit fieldwork, liaising directly with the key finance staff in respect of the preparation for, and conduct of the financial statements audit work. She provides continuity from 2013-14 and will build on her knowledge and experience of the Council in 2014-15.

Reporting

Through regular meetings at appropriate levels, there will be open and regular discussion between management, auditors and management. As a result, accounting and control issues can be identified and reported to allow you to manage them throughout the year.

Audit Scotland's *Code of Audit Practice* requires us to communicate to management findings arising as a result of the audit work completed. Reports to management will be submitted throughout the course of the year, with draft reports discussed and agreed with management and action plans developed to include the recommendations, target dates for implementation and the member of staff responsible for implementation.

We envisage submission of the following reports in respect of 2014-15:

- March 2015, interim management reporting based on the findings of our testing of financial, strategic and IT controls;
- September 2015, report to those charged with governance setting out findings surrounding the financial statements process; and
- October 2015, annual audit report to the Council and the Controller of Audit, including consideration of performance management arrangement and public performance reporting.

We will also submit information on the following areas to Audit Scotland during the year: NFI; fraud returns; Audit Scotland national reports; Best Value; grant claims; and statutory performance indicators.

Fee arrangements

DRAFT

Our audit fees are set according to the fee ranges set by Audit Scotland.

Page 69

Fee arrangements

Audit Scotland requires that the fee for our work is set within an indicative range, depending on the assessment of risk and other factors facing the Council. The indicative fee range is calculated using a number of inputs:

- a central estimate of the number of days need to do the audit;
- the average remuneration rate for the audit team;
- the contribution to travel and expenses within the sector;
- the contribution towards performance audits, where relevant; and
- the contribution towards other central costs not met by the Scottish Consolidated Fund.

The indicative fee ranges are based on the following assumptions to ensure an efficient audit process:

- draft report, financial statements and supporting work papers available at the start date of our on site visit agreed with officers preferably in electronic format;
- reliance on your internal controls;
- availability of key members of staff during the audit fieldwork; and
- completion within the agreed timetable.

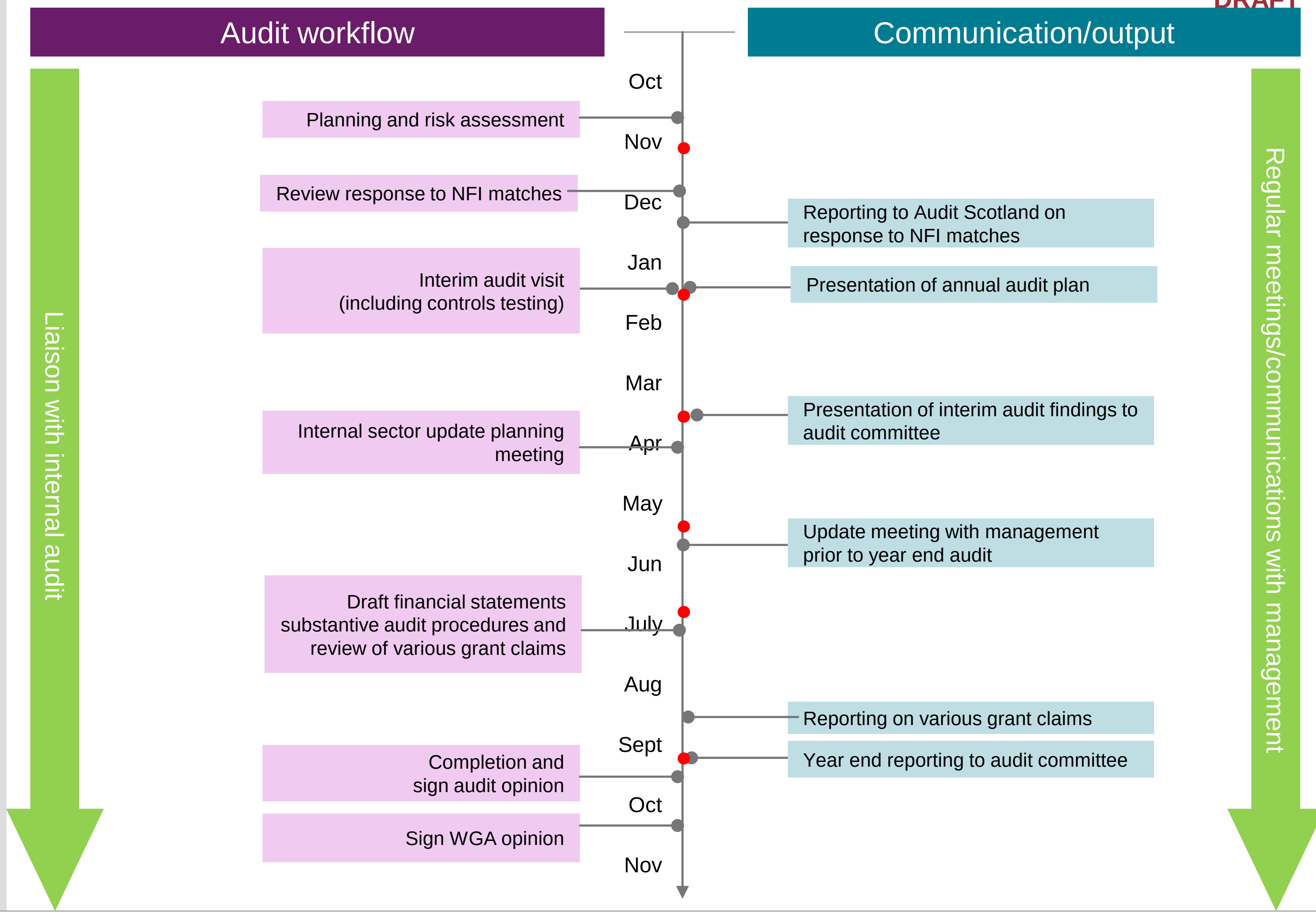
Audit Scotland has notified us that the fee range for 2014-15 is £267,230 to £326,610, with a mid-point of £296,920 (including VAT). This represents an increase of 1% from 2013-14. We have proposed a fee of £303,920, an increase of £7,000 on the mid-point. This is in respect of the audit of the charitable entities, the wind up of Scottish Borders Council Charitable Trusts and the three new charitable entities created in year. Should we be required to undertake significant additional audit work in respect of any of the areas of audit focus or other matters arise, we will discuss with management the impact of this on our proposed fee.

2014-15 audit timeline

DRAFT

Out timetable is largely unchanged from the prior year, but will be subject to refinement through discussions with management.

Page 70



● Audit committee meetings

cutting through complexity

Appendices

DRAFT

Independence

DRAFT

Auditing Standards require us to communicate to the audit committee in writing at least annually on any matters which may reasonably be thought to bear on our independence and set out the safeguards in place in relation to these matters and confirm that we are independent.

Page 72

Professional ethical standards require us to communicate to you as part of planning all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place that, in our professional judgement, may reasonably be thought to bear on KPMG LLP's independence and the objectivity of the Audit Partner and the audit team. This letter is intended to comply with this requirement although we will communicate any significant judgements made about threats to objectivity and independence and the appropriateness of safeguards put in place.

We are satisfied that our general procedures support our independence and objectivity, except for those detailed below where additional safeguards are in place.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP Audit Partners and staff annually confirm their compliance with our ethics and independence policies and procedures including in particular that they have no prohibited shareholdings. Our ethics and independence policies and procedures are fully consistent with the requirements of the APB Ethical Standards. As a result we have underlying safeguards in place to maintain independence through:

- Instilling professional values
- Communications
- Internal accountability
- Risk management
- Independent reviews.

Please inform us if you would like to discuss any of these aspects of our procedures in more detail.

Confirmation of audit independence

We confirm that as of 5 January 2015, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Partner and audit staff is not impaired.

This report is intended solely for the information of the audit committee and should not be used for any other purposes.

Yours faithfully

KPMG LLP

Audit Scotland code of audit practice – responsibilities of Scottish Borders Council

DRAFT

Page 73

Financial statements

Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources. Audited bodies are responsible for:

- ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority;
- maintaining proper accounting records;
- preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the relevant financial reporting framework (eg, the Financial Reporting Manual or an Accounting Code of Practice);
- preparing and publishing with their financial statements an annual governance statement, statement on internal control or statement on internal financial control and a remuneration report; and
- preparing consolidation packs and, in larger bodies, preparing a Whole of Government Accounts return.

Systems of internal control

Audited bodies are responsible for developing and implementing systems of internal control, including risk management, financial, operational and compliance controls. They are required to conduct annual reviews of the effectiveness of their governance, systems of internal control, or internal financial control, and report publicly that they have done so. Such reviews should take account of the work of internal audit and be carried out by those charged with governance, usually through bodies' audit committees.

Prevention and detection of fraud and irregularities

Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity. This includes:

- developing, promoting and monitoring compliance with standing orders and financial instructions;
- developing and implementing strategies to prevent and detect fraud and other irregularity;
- receiving and investigating alleged breaches of proper standards of financial conduct or fraud and irregularity; and
- participating, when required, in data matching exercises carried out by Audit Scotland.

Standards of conduct and arrangements for the prevention and detection of bribery and corruption

Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and should put proper arrangements in place for:

- implementing and monitoring compliance with appropriate guidance on standards of conduct and codes of conduct for members and officers;
- promoting appropriate values and standards; and
- developing, promoting and monitoring compliance with standing orders and financial instructions.

Audit Scotland code of audit practice – responsibilities of Scottish Borders Council (continued)

DRAFT

Page 74

Financial position

Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based having regard to:

- such financial monitoring and reporting arrangements as may be specified;
- compliance with any statutory financial requirements and achievement of financial targets;
- balances and reserves, including strategies about levels and future use; and
- the impact of planned future policies and foreseeable developments on their financial position.

Best Value

Achievement of Best Value or value for money depends on the existence of sound management arrangements for services, including procedures for planning, appraisal, authorisation and control, accountability and evaluation of the use of resources. Audited bodies are responsible for ensuring that these matters are given due priority and resources, and that proper procedures are established and operate satisfactorily.

Audit outputs

DRAFT

Our audit process will result in reporting on a number of outputs to the Council; these are listed in the table on the right.

Output	Description	Report date
Update NFI report	■ We report on the Council's actions to investigate and follow-up NFI matches.	■ By 31 December 2014
Audit strategy	■ Our strategy for the external audit for the year.	■ By 9 January 2015
Interim management report	■ We report our findings from our interim audit visit where we will update our planning for the year end and perform controls testing.	■ By 31 March 2015
Statutory performance indicators	■ We will report on arrangements for preparation of the Council's statutory performance indicators; this will be included in our annual audit report.	■ By 30 September 2015
Independent auditor's report	■ Our opinion on the Council's financial statements.	■ By 30 September 2015
Annual audit report to the Council and the Controller of Audit	■ We summarise our findings from our work during the year.	■ By 30 September 2015
Whole of Government Accounts	■ We report on the pack prepared for consolidation and preparation of the Whole of Government Accounts.	■ By 31 October 2015
Audit reports on grant claims and other returns	■ We will report on the following returns: ■ bus operator's grant return; ■ Housing Benefit Count return; ■ Education Maintenance Allowance return; and ■ Criminal Justice Authority Return.	■ In line with Audit Scotland's reporting timetable

cutting through complexity

Internal Audit Work 2014/15 to December 2014

Report by Chief Officer Audit & Risk

Audit & Risk Committee

19 January 2015

1 PURPOSE AND SUMMARY

1.1 **The purpose of this report is to provide the Audit & Risk Committee with details of:**

- **(a) the recent work carried out by Internal Audit and the recommended audit actions agreed by Management to improve internal controls and governance arrangements, and**
- **(b) internal audit work currently in progress.**

1.2 The Internal Audit Annual Plan 2014/15 was approved by the Audit Committee on 10 March 2014. The work Internal Audit has carried out in the period from 30 August to 19 December 2014 is detailed in this report. During this period a total of 10 final internal audit reports have been issued. There were 11 recommendations made (0 Priority 1 High Risk, 1 Priority 2 Medium Risk, and 10 Priority 3 Low Risk) specific to 4 of the reports. Management have agreed to implement the recommendations in all cases to improve internal controls and governance arrangements. The report goes on to detail current work in progress to deliver the Internal Audit Annual Plan 2014/15 and other productive work relevant to the Internal Audit function fulfilling its remit as set out in its approved Charter.

1.3 An executive summary of the final internal audit reports issued, including audit objective, findings, good practice, recommendations and the Chief Officer Audit & Risk's independent and objective opinion on the adequacy of the control environment and governance arrangements within each audit area, is shown in Appendix 1.

2 RECOMMENDATION

2.1 **I recommend that the Audit & Risk Committee:**

- **a) Notes the final reports issued in the period from 30 August to 19 December 2014, and**
- **b) Acknowledges that it is satisfied with the recommended audit actions agreed by Management to improve internal controls and governance arrangements.**

3 PROGRESS REPORT

3.1 The Internal Audit Annual Plan 2014/15 was approved by the Audit Committee on 10 March 2014. Internal Audit has carried out the following work in the period 30 August to 19 December 2014 to deliver the plan.

3.2 **Audit Reports**

Internal Audit issued final internal audit reports on the following subjects:

- Communications
- Overtime
- Earlston High School
- Eyemouth High School
- Hawick High School
- LEADER – Grant Funding Compliance
- European Fisheries Fund – Grant Funding Compliance
- Homecare
- St Ronan's Residential Home and Tweeddale Day Service
- Flood Risk and Coastal Management

3.3 An executive summary of each final internal audit report including audit objective, findings, good practice, recommendations and the Chief Officer Audit & Risk's independent and objective opinion on the adequacy of the control environment and governance arrangements within each audit area, is shown in Appendix 1 to this report.

The definitions for Internal Audit assurance categories are as follows:

Level of Assurance	**Definition**
Comprehensive assurance	Sound risk, control, and governance systems are in place. These should be effective in mitigating risks to the achievement of objectives. Some improvements in a few, relatively minor, areas may be required.
Substantial assurance	Largely satisfactory risk, control, and governance systems are in place. There is, however, some scope for improvement as current arrangements could undermine the achievement of objectives or leave them vulnerable to error or misuse.
Limited assurance	Risk, control, and governance systems have some satisfactory aspects. There are, however, some significant weaknesses likely to undermine the achievement of objectives and leave them vulnerable to an unacceptable risk of error or misuse.
No assurance	The systems for risk, control, and governance are ineffectively designed and operated. Objectives are not being achieved and the risk of serious error or misuse is unacceptable. Significant improvements are required.

3.4 **Current Work in Progress**

Internal Audit work in progress to deliver the Internal Audit Annual Plan 2014/15 consists of the following:

Audit Area	**Audit Stage**
Performance Management	Fieldwork is underway to follow-up on progress with implementation of Improvement Actions within the Annual Governance Statement 2013/14
Business Transformation Programme & Project Management	
Local Code of Governance	
Workforce Planning	
Financial Planning, Management Reporting and Efficiency Savings	
Data Security & Information Management	
Health & Social Care Integration Programme	
Income Charging, Billing & Collection	Drafting the Report
Passenger Transport	Drafting the Report
Capital Investment	Fieldwork nearly completed
Procurement to Payment – Contract Monitoring	Fieldwork nearly completed
Criminal Justice	Fieldwork underway
Neighbourhood Management	Fieldwork underway
Property Asset Management	Fieldwork underway
Economic Development & Regeneration	Audit Assignment approved
Revenues (Council Tax and Non Domestic Rates)	Audit Assignment approved
Benefits Assessment	Audit Assignment approved
Homelessness	Audit Assignment approved
ICT Infrastructure	Audit Assignment approved
ICT Business Systems	Audit Assignment approved

3.5 **Other Productive Work**

Internal Audit have been involved in the following to meet its aims and objectives, and its roles and responsibilities in accordance with the approved Internal Audit Charter:

- Internal Auditors are attending relevant seminars, development workshops and user groups, and feedback to colleagues as relevant.
- Attendance at Scottish Local Authorities Chief Internal Auditors Group (SLACIAG) meetings. The Chief Officer Audit & Risk is currently Chairman of this internal audit forum. Topics at November 2014 meeting included Health & Social Care Integration – Internal Audit Implications and Auditing Arms'-Length External Organisations (ALEOs)
- Offering advice on internal controls and governance to managers on request and a number of clients are proactively engaging internal audit in consultancy work as the Council's continues to transform its services. This included a Social Enterprise Review where we have identified the impact, issues and opportunities relating to the areas which would support and assist the Council in fulfilling its duties and responsibilities in respect of providing Best Value services and adopting

the Following the Public Pound principles. The report was issued to Management with the joint aims of providing the opportunity to increase awareness on Social Enterprise, and to promote ways of providing services utilising Social Enterprise at a time of significant funding constraints.

- Reviewing outstanding and overdue audit recommendations to ensure management action that has been taken has had the desired effect in improving internal controls and governance and is reflected in the corporate performance systems for reporting purposes. The standard follow-up process has a particular focus on Priority 1 and 2 recommendations and those audit recommendations arising from previous years that have not yet been implemented.
- Internal Audit has been offering advice on improvements to fraud prevention controls and detection processes put in place by management.

3.6 Recommendations in reports are suggested changes to existing procedures or processes, to improve the controls or to introduce controls where none exist. The grading of each recommendation reflects our risk assessment of non-implementation, being the product of the likelihood of the risk materialising and its impact. The gradings are:

a) **Priority 1**: Significant weaknesses in existing controls, leaving the Council or Service open to error, fraud, financial loss or reputational damage, where the risk is sufficiently high to require immediate action and to be included in the relevant risk register and for the matter to be reported in the relevant Assurance Statement on Internal Control and Governance;

b) **Priority 2**: Substantial weaknesses in existing controls, leaving the Council or Service open to high risk of error, fraud, financial loss or reputational damage requiring reasonably urgent action;

c) **Priority 3**: Moderate weaknesses in existing controls, leaving the Council or Service open to medium risk of error, fraud, financial loss or reputational damage requiring action to improve the efficiency, effectiveness and economy of operations or which otherwise require to be brought to the attention of senior management;

d) **Other**: Minor administrative weaknesses posing little risk of error, fraud, financial loss or reputational damage.

The action plans in audit reports address only recommendations rated **Significant, Substantial** or **Moderate**. Outwith the audit report, we inform local management about **Minor** matters.

3.7 **Recommendations**

	2014/15 Number of Recommendations
Reported this period	
Priority 1	0
Priority 2	1
Priority 3	10
Total reported this period	**11**
Previously reported	12
Total	**23**

Recommendations agreed with action plan	23
Not agreed; risk accepted	0
Total	**23**

4 IMPLICATIONS

4.1 Financial

(a) It is anticipated that cost efficiencies will arise as a direct result of Management implementing some of the recommendations made by Internal Audit during this period.

4.2 Risk and Mitigations

(a) Internal Audit provides assurance to management and the Audit Committee on the effectiveness of internal controls and governance within the Council. The Internal Audit Annual Plan 2014/15 has been developed using a risk-based approach which includes the use of the Risk Registers within Covalent as the basis of the audit coverage and consultation with appropriate stakeholders on the audit coverage. This will ensure that the Internal Audit plan continues to reflect the key risks facing the organisation.

(b) If audit recommendations are not implemented, there is a greater risk of financial loss and/or reduced operational efficiency and effectiveness, and management may not be able to demonstrate improvement in internal control and governance arrangements.

(c) No environmental risks arise as a direct result of this report.

4.3 Equalities

(a) It is anticipated there will be no adverse impact due to race, disability, gender, age, sexual orientation or religious/belief arising from the work contained in this report.

4.4 Acting Sustainably

(a) There are no direct economic, social or environmental issues with this report.

4.5 Carbon Management

(a) There are no direct carbon emissions impacts as a result of this report.

4.6 Rural Proofing

(a) This report does not relate to new or amended policy or strategy and as a result rural proofing is not an applicable consideration.

4.7 Changes to Scheme of Administration or Scheme of Delegation

(a) No changes to the Scheme of Administration or Scheme of Delegation are required as a result of this report.

5 CONSULTATION

5.1 The Corporate Management Team has been consulted on this report and any comments received have been taken into account.

5.2 The Chief Financial Officer, the Monitoring Officer, the Chief Legal Officer, the Service Director Strategy and Policy, the Chief Officer HR, and the Clerk to the Council have been consulted and any comments received have been incorporated into the report.

Approved by

Jill Stacey, Chief Officer Audit & Risk   Signature ....

Author(s)

Name	Designation and Contact Number
Jill Stacey	Chief Officer Audit & Risk Tel 01835 825036
James Collin	Internal Audit Manager Tel 01835 824000 Ext 5232

Background Papers: Appropriate Internal Audit files
Previous Minute Reference: Audit Committee 10 March 2014

Note – You can get this document on tape, in Braille, large print and various computer formats by contacting the address below. James Collin, Chief Executive's Department, can also give information on other language translations as well as providing additional copies.

Contact us at James Collin, Chief Executive's Department jcollin@scotborders.gov.uk

APPENDIX 1

Report	Summary of key findings and recommendations	Recommendations 1	Recommendations 2	Recommendations 3	Status
Subject: Communications No: 051/002 Date issued: 11 December 2014 Risk rating: Medium Level of Assurance: Comprehensive assurance	The purpose of the review was to ensure robust systems and procedures are in place to assist the Council deliver an effective, consistent and integrated approach to the way in which it communicates to the Borders community. Within the last year the Communications, Graphics teams and Print Manager have co-located. This has resulted in closer working, enhancing the working processes and ultimately the end to end service provided by the team including the range of products on offer. There is effective liaison and working relationships between the Communication team and its Client Departments. The base budget for the current financial year 2014-15 is £599k. Whilst completing the audit, it was announced that following an independent review by Sitemorse.com, SBC had been recognised as having the best local authority website in the UK. This is a major achievement and has built on their achievement 3 years ago when they were judged as the best in Scotland (out of 32 authorities) and third best out of 429 authorities in the UK. Internal Audit considers that the level of assurance we are able to give is comprehensive. Sound risk, control, and governance systems are in place. These should be effective in mitigating risks to the achievement of objectives. Some improvements in a few, relatively minor, areas are planned by Management including formal evaluation process on the effectiveness of communications and full handover of the Print Contract to the Communications team. We have made no recommendations.	0	0	0	Management have agreed the report findings. Work is continuing by Management to ensure completion of their improvement actions.

Report	Summary of key findings and recommendations	Recommendations			Status
		1	2	3	
Subject: Overtime No: 079/999/001 Date issued: 19 December 2014 Contingency Level of Assurance: Substantial Assurance	The purpose of the review, carried out in connection with the HR Shared Services audit, was to ensure there are adequate controls in place for authorisation of overtime hours to demonstrate efficient and effective use of staff resources. Analysis of Overtime data included comparing payments made across the last 3 financial years £3.8M (2011/12), £3.5M (2012/13) and £3.3M (2013/14) with the former Environment & Infrastructure and Social Work departments representing 61% and 26% (2011/12), 59% and 27% (2012/13) and 54% and 32% (2013/14) respectively of total spend. It is acknowledged that overtime is a necessary element for the continuation of the Council's services. However the findings of this audit indicate that there is an opportunity to improve controls and governance of workforce utilisation prior to commitment of overtime and to improve authorisation of overtime hours and claims in order to more easily demonstrate delivery of services at costs which represent good value for money and to ensure compliance with legislation. Internal Audit considers that the level of assurance we are able to give is substantial. Largely satisfactory risk, control, and governance systems are in place. There is, however, some scope for improvement as current arrangements could undermine the achievement of objectives or leave them vulnerable to error or misuse. Overtime is an area currently under review by Management and we hope the findings from this internal audit review will assist in their consideration on how to address the risks, issues and concerns.	0	1	2	Management have agreed to implement the recommendations Progress has been made already in respect of completing two of the three recommendations and the third will be implemented as part of Management Review of Overtime within the financial, business and workforce planning processes for 2015/16.

Report	Summary of key findings and recommendations	Recommendations			Status
		1	2	3	
Subject: Overtime (Cont'd)	We have made the following recommendations: • Where overtime hours are worked and claims are regularly made (and not seasonal), Management should consider, as part of its workforce planning arrangements, employing other members of staff working at basic rate rather than the overtime rate. (P3) • All Managers whose staff work additional hours which exceed the EU Working Time Directive should ensure that an "Opt Out" form is completed and retained. (P3) • Authorisation of overtime hours worked and claimed should be reviewed and revised as appropriate to ensure Line Managers fulfil their responsibility for authorising the hours worked and subsequent payments and to ensure that there is adequate segregation of duties. (P2)				

Report	Summary of key findings and recommendations	Recommendations			Status
		1	2	3	
Subject: Earlston High School No: 127/020 Date issued: 6 January 2015 Risk rating: Medium Level of Assurance: Comprehensive assurance	The purpose of the review was to assess whether adequate internal financial controls and administrative procedures are in place to ensure the effective use of resources. The scope of this audit was to examine and evaluate the key controls in the following areas: Petty cash imprests; Inventories; Staffing establishment and Workbook; Business Continuity Planning; School lets and Income Collection and Banking procedures; School Fund; Ordering/Invoice processing procedures; Data Protection / Confidential Waste Management. The building of Earlston High School was funded by a Private Public Partnership (PPP) scheme, and responsibility for Inventories, Security and Disposal of confidential waste lies with the management company, AMEY. The school operates very good financial procedures with experienced staff fully aware of the Financial Regulations and SBC policy. Internal Audit considers that the level of assurance we are able to give is comprehensive. Sound risk, control, and governance systems are in place. These should be effective in mitigating risks to the achievement of objectives. Some improvements in a few, relatively minor, areas may be required.	0	0	0	Management have agreed the report findings.

Report	Summary of key findings and recommendations	Recommendations			Status
		1	2	3	
Subject: Eyemouth High School No: 127/021 Date issued: 18 December 2014 Risk rating: Medium Level of Assurance: Comprehensive assurance	The purpose of the review was to assess whether adequate internal financial controls and administrative procedures are in place to ensure the effective use of resources. The scope of this audit was to examine and evaluate the key controls in the following areas: Petty cash imprests; Inventories; Staffing establishment and Workbook; Business Continuity Planning; School lets and Income Collection and Banking procedures; School Fund; Ordering/Invoice processing procedures; Data Protection / Confidential Waste Management. The building of Eyemouth High School was funded by a Private Public Partnership (PPP) scheme, and responsibility for Inventories, Security and Disposal of confidential waste lies with the management company AMEY. The business and administrative processes which are completed within the school are effective, and there is good evidence that they adhere to the Financial Regulations. Internal Audit considers that the level of assurance we are able to give is comprehensive. Sound risk, control, and governance systems are in place. These should be effective in mitigating risks to the achievement of objectives. Some improvements in a few, relatively minor, areas may be required.	0	0	0	Management have agreed the report findings.

Report	Summary of key findings and recommendations	Recommendations			Status
		1	2	3	
Subject: Hawick High School No: 127/022 Date issued: 18 December 2014 Risk rating: Medium Level of Assurance: Comprehensive assurance	The purpose of the review was to assess whether adequate internal financial controls and administrative procedures are in place to ensure the effective use of resources. The scope of this audit was to examine and evaluate the key controls in the following areas: Petty cash imprests; Inventories; Staffing establishment and Workbook; Business Continuity Planning; School lets and Income Collection and Banking procedures; School Fund; Ordering/Invoice processing procedures; Data Protection / Confidential Waste Management. The school operates very good business and administrative processes. All financial aspects are carried out effectively and comply with the Financial Regulations. Internal Audit considers that the level of assurance we are able to give is comprehensive. Sound risk, control, and governance systems are in place. These should be effective in mitigating risks to the achievement of objectives. Some improvements in a few, relatively minor, areas may be required.	0	0	0	Management have agreed the report findings.

Report	Summary of key findings and recommendations	Recommendations			Status
		1	2	3	
Subject: LEADER – Grant Funding Compliance No: 154/008 Date issued: 30 October 2014 Risk rating: Contingency Level of Assurance: Comprehensive Assurance	The purpose of the review was to assess compliance with the requirements of the SLA and relevant EC Regulations in observance of 5.6 of the SLA and Regulation (EC) 885/2006 Annex 1 Section 4b. The SLA for the LEADER Programme 2007-2013 between the Managing Authority, the Paying Agency and Scottish Borders Council requires that Internal Audit annually assess compliance by SBC with the terms of the SLA and that the resulting report is sent to them by 31 October of each year. We were pleased to see that recommendations arising from the 2013/14 internal audit review have been implemented, including strengthening of file compliance and documentary evidence of eligibility and transparency of procurement compliance at individual project level, and enhanced scrutiny of project application and assessment documentation. We would encourage continuing compliance in these important areas. It is our opinion that the Scottish Borders LEADER is managed well and administered effectively. This corresponds with the findings from the Managing Authority's annual audit visit (July 2014). From their findings came a number of remedial actions which the officers have confirmed they will implement. Specific procedures and measures have been put in place to enable compliance by SBC with the terms of the SLA and the EC Regulations. During the audit a specific review of one umbrella project was undertaken on request by SB LEADER team in response to their concerns raised. We consider the management action to conduct a remedial file review for eligibility of cost and validation of the supporting evidence for claims appropriate under the circumstances. We have recommended that management undertake a lessons learned review in light of the issues identified to inform future LEADER programme governance.	0	0	2	Management have agreed to implement the recommendations The final internal audit report has been submitted to the Scottish Government along with the Annual Confirmation Certificate.

Report	Summary of key findings and recommendations	Recommendations			Status
		1	2	3	
Subject: LEADER – Grant Funding Compliance (cont'd)	During the audit preparations for the new LEADER programme were reviewed. LEADER 2014-2020 will be delivered through the SRDP (Scottish Rural Development Programme) via the familiar and mandatory Community Led Local Development method and approach. The Scottish Government has published an ambitious timetable toward implementation of the programme. Scottish Borders LEADER team have been fully engaged with relevant stakeholders in the development of the new LEADER Programme 2014-2020 and are working closely with them towards implementation. These were presented to the Economic Development Group on 11 September 2014 along with a Report – *Future of EU Funding: LEADER & EMFF 2014-2020* stating how it is that they intend to deliver the LEADER for the new funding period, the main risks, governance structures intended to deliver, resources and budgets required. Internal Audit considers that the level of assurance we are able to give is comprehensive. Sound risk, control, and governance systems are in place. These should be effective in mitigating risks to the achievement of objectives. Some improvements in a few, relatively minor, areas may be required. We have made the following recommendations which are designed to enhance governance arrangements to ensure the Council continues to meet the robust compliance requirements of the EU and National Regulations and to mitigate against the risk of liability for decommitment of funds being passed to the lead partner for compliance failures: • Management should undertake a Lessons Learned Review of the governance issues identified in the dual management of the Umbrella project and the LEADER Programme. (P3) • Management should consider operational resource of the LEADER programme as distinct from facilitation and animation support in view of the burden of compliance and the associated consequences. (P3)				

Report	Summary of key findings and recommendations	Recommendations			Status
		1	2	3	
Subject: European Fisheries Fund – Grant Funding Compliance No: 154/009 Date issued: 30 September 2014 Risk rating: Contingency Level of Assurance: Comprehensive Assurance	The purpose of the review was to assess compliance with the requirements of the SLA which are derived from relevant EU Legislation and the European Fisheries Funds (Grants) (Scotland) Regulations 2007 (SSI 2007 No 307) (as amended). The European Fisheries Fund (EFF) the main financial instrument supporting the Common Fisheries Policy (est. 1983). The scope of this audit is Axis 4 which was launched in Scotland in January 2012 to provide £7.6M to local Scottish fishing communities affected by the decline in fishing activities. Scottish Borders Fisheries Local Action Group (SB FLAG), the delegated delivery partner for the programme in Scottish Borders under the SLA, was awarded £362k matched by SBC to total £720k. The following good practice was found: • The SB FLAG has been established as required by EC Regulation 1198/2006 Article 45 and is governed in accordance with Regulations. • There is robust internal control and project governance. • Fundamental eligibility is well considered by SB FLAG and SBC • There is effective scrutiny of claims by the Project Support Officers in compliance with SLA Annex B Ancillary Control 1(a) • There are sound financial controls for administration and distribution of EFF Axis 4 funding and robust claims procedure. Internal Audit considers that the level of assurance we are able to give is comprehensive. Sound risk, control, and governance systems are in place. These should be effective in mitigating risks to the achievement of objectives. Some improvements in a few, relatively minor, areas may be required. We found that in all but the production of an exceptions report, SB FLAG and SBC comply with the terms of the SLA. We highlight the importance of management implementing the previous internal audit recommendations and other improvement actions in full to avoid any risk of future de-commitment.	0	0	0	Management have agreed the report findings. The Management Summary and Appendix of the final internal audit report has been submitted to the Scottish Government by 30 September 2014 along with the Annual Report (SLA requirement).

Report	Summary of key findings and recommendations	Recommendations			Status
		1	2	3	
Subject: Homecare No: 171/005 Date issued: 9 January 2015 Risk rating: High Level of Assurance: Substantial assurance	The purpose of the review was to assess whether the controls are adequate to ensure homecare provision is in place for those in need and financial controls and administrative procedures are sound to safeguard Council and clients funds. The Revised Budget for the Homecare service for 2014/15 is £5.6M Income and £5.75M Expenditure which is subject to review and change as part of the standard budget monitoring process. Management action will be taken to realign the budget to ensure it is realistic and achievable. This is of particular importance as Homecare is one of the services that are included in scope for the proposed transfer of Adult Care Services to an LLP. The Homecare service provides a range of support for daily living enabling individuals to continue living at home. In the in-house team there are currently 323 carers who provide support to approximately 815 service users (changes on a daily basis, depending upon client needs). Client care is also commissioned by the Council and provided by external agencies. Internal Audit considers that the level of assurance we are able to give is substantial, largely satisfactory risk, control, and governance systems are in place in respect of the management of home carers' rotas and the effective use of the real-time monitoring system for directly employed home carers for the delivery of services specified in the service users' care plans. There are, however, some improvements required relating to the arrangements for monitoring external carers' provision of service and for monitoring the financial and service performance of the Homecare service as a whole.	0	0	4	Management have agreed to implement the recommendations and progress has been made on the implementation of the improvement actions in advance of the proposed transfer of Adult Care Services to an LLP.

Report	Summary of key findings and recommendations	Recommendations			Status
		1	2	3	
Subject: Homecare (cont'd)	We have made the following recommendations: • Improved processes should be put in place to monitor external carers in order to confirm that charges are only made for services actually delivered. (P3) • Assessment should be made of whether time spent reorganising data within Call Confirm Live system would result in greater efficiency and savings in organising rotas and managing gaps due to changes. Available options to use software for scheduling rotas should be investigated. (P3) • Procedural guidelines of the management and administration of Client Funds / Corporate Appointeeship should be developed as part of completion of the management review of Client Funds / Corporate Appointeeship that is underway. Relevant training for staff on the new procedural guidance should be provided as part of their implementation to safeguard client funds and protect staff. (P3) • The performance information needs of managers at all levels should be assessed. Performance reports should either be written or commissioned from the software vendor to meet those informational needs. (P3)				

Report	Summary of key findings and recommendations	Recommendations 1	2	3	Status
Subject: St Ronan's Residential Home and Tweeddale Day Service No: 176/009 Date issued: 11 December 2014 Risk rating: Medium Level of Assurance: Comprehensive assurance	The purpose of the review was to assess whether adequate internal financial controls and administrative procedures are in place in Council-managed establishments. The Council provides a Residential Care and Day Service across the region. These take the form of 5 residential homes with a base budget of £5.080m and 6 day services with a base budget of £0.764m. The services are provided in various geographical locations ensuring availability to clients across the region. The two establishments chosen for review this year were St Ronan's Residential Home and Tweeddale Day Service. The scope of this audit was to examine and evaluate the key controls in the following areas: Petty cash imprests; Inventories; Stocks; Staffing establishment; Business Continuity Planning; Ordering/Invoice processing procedures; Income Collection and Banking arrangements; Welfare Fund management; Disbursement of Residents weekly allowances; Safekeeping of the Residents valuables / cash; Implementation of recommendations from Care Commission Reviews. There is clear evidence of good financial practices being operated within the two establishments reviewed. There is a very good working knowledge of the financial procedures and processes which should be followed. Internal Audit considers that the level of assurance we are able to give is comprehensive. Sound risk, control, and governance systems are in place. These should be effective in mitigating risks to the achievement of objectives. Some improvements in a few, relatively minor, areas may be required.	0	0	0	Management have agreed the report findings.

Report	Summary of key findings and recommendations	Recommendations			Status
		1	2	3	
Subject: Flood Risk and Coastal Management No: 214/005 Date issued: 10 December 2014 Risk rating: High Level of Assurance: Substantial assurance	The purpose of the review was to ensure there are adequate operational and financial controls in place for the effective response to flooding to meet agreed standards and to demonstrate efficient and effective use of resources. We found effective practices in operation in the following areas: • Responsibilities for flood risk management are clearly defined. • The Authority is either compliant with, or working towards compliance with, relevant legislation in the case of certain provisions of the Flood Risk Management (Scotland) Act 2009. • Inspection procedures are documented and take place at appropriate intervals based upon flood risk assessments. Internal Audit considers that the level of assurance we are able to give is substantial. Largely satisfactory risk, control, and governance systems are in place. There is, however, some scope for improvement as current arrangements could undermine the achievement of objectives or leave them vulnerable to error or misuse. We have made the following recommendations which are designed to enhance coastal management arrangements and to improve Flood Management service performance monitoring: • The Authority should develop its own Shoreline Management Plan which covers the whole of the Berwickshire Coast. (P3) • Performance of water course inspections and related activities against pre-determined targets should be assessed in order to confirm effective service delivery. All Flood Management performance measures should be periodically reported to Senior Management to demonstrate fulfilment of statutory obligations. (P3)	0	0	2	Management have agreed to implement the recommendations

This page is intentionally left blank

Risk Management Review and Revised Policy Statement

Report by Chief Officer Audit & Risk

Audit & Risk Committee

19 January 2015

1 PURPOSE AND SUMMARY

1.1 **The purpose of this report is to provide members with details of the outcomes from the risk management review and to seek agreement to recommend the revised Risk Management Policy for approval.**

1.2 Effective Risk Management is one of the foundations of effective Corporate Governance and is recognised as such in the Council's Local Code of Corporate Governance. The previous review of the Council's management of risk arrangements was undertaken during 2011 and the resulting Risk Management Policy was approved by Council in September 2011.

1.3 Good practice requirements signalled a need to review current policy, processes and strategy that underpin the Council's management of risk arrangements. The risk management review project commenced in March 2014 and the final phase to implement the recommendations is anticipated to be completed by the end of November 2014.

1.4 The report sets out the outcomes of the review of the Council's management of risk arrangements including current policy, strategy, processes and toolkits. It also describes the recommended improvements to refine the risk management arrangements at the Council to ensure their ongoing effectiveness.

1.5 A revised Risk Management Policy has been developed (see Appendix 1), which will be supported by revised Strategy, processes and training programme.

2 RECOMMENDATIONS

2.1 **I recommend that the Audit & Risk Committee:**

a) **Acknowledges that it is satisfied with the outcomes of the risk management review and endorse the recommendations for improvement to refine the risk management arrangements at the Council to ensure their ongoing effectiveness;**

b) **Agrees to recommend to Council that the revised Risk Management Policy (Appendix 1) be approved.**

3 RISK MANAGEMENT REVIEW BACKGROUND

3.1 Effective Risk Management is one of the foundations of effective Corporate Governance and is recognised as such in the Council's Local Code of Corporate Governance. Compliance with the principles of sound corporate governance requires the Council to adopt a coherent approach to the management of the risks that it faces every day. Common sense serves to underline the message that better and more assured risk management will bring many benefits to the Council and the people it serves.

3.2 The previous Risk Management review was undertaken during 2011 and the resulting revised Risk Management Policy was approved by Council in September 2011. Good practice requirements signalled a need to review current policy, processes and strategy that underpin the Council's management of risk arrangements. The risk management review project commenced in March 2014 and the final phase to implement the recommendations is anticipated to be completed by the end of November 2014.

3.3 The objectives of the risk management review were to:

- Assess efficacy of current risk management practices across the Council, and identify and implement improvements as required; and
- To ensure corporate, strategic, operational and project risk registers reflect the key risks facing the Council in respect of it delivering its corporate and business plans and priorities and are a tool to assist with the effective management of those risks.

3.4 This review linked into the work commenced across the Council on business planning process and implementation of the Performance Management Framework, and is linked to the following national and local priorities:

- Corporate Priority 8 - ensuring excellent, adaptable, collaborative and accessible public services
- National Outcome 16 - public services are high quality, continually improving, efficient and responsive to local people's needs

4 OUTCOMES OF THE RISK MANAGEMENT REVIEW

4.1 The risk management landscape is dynamic and, as local authorities increasingly move towards arms-length delivery of essential services and partnership arrangements, the spectrum of risks that SBC is exposed to also increases.

4.2 SBC recognise that risk management should be aligned with corporate objectives and will therefore be considered within the business planning process. This ensures that the risks to achieving these objectives are identified and prioritised.

4.3 The risk management review highlighted the following:

- Whilst risk management processes and procedures are being followed within the Council, it is not embedded into the Business Planning process and not clearly integrated into the decision making process;
- Management lack support and direction for the identification of risks and mitigating actions;
- Risk registers are in need of review to ensure that risks are specific, current and clearly identify mitigating actions to reduce the likelihood or impact if the risk materialises;

- Issues are often confused with risks which highlights the need for a clear corporate training programme to support managers;
- There is no procedure for the escalation of risk to ensure that corporate risks have oversight at the right level;
- A common risk management approach needs to include programmes and projects, and partnership and arms-length service delivery arrangements to ensure that risk management is applied consistently across the Council;
- Covalent will continue to be the electronic repository for risk registers but refinement of its use and reporting features will be undertaken to ensure that information is accurate, specific and relevant.

4.4 The recommended improvement actions arising from the risk management review are shown in the table below:

Risk management aspect	**Action including status**
Policy	Revised policy statement ready for consideration and formal approval.
Procedures and strategy	Final stages of updating procedures and developing procedure for the escalation of risk. Final stages of updating the strategy to implement the policy and procedures.
Alignment with Business Planning process	Work to incorporate risk management at the key stages of business planning has been undertaken with reporting on risk to follow the business planning and performance reporting schedule.
Training	The corporate training programme for managers has been reviewed, with a roll out date expected in January 2015.
Facilitated workshops	Pilot stage with Strategy & Policy directorate almost completed. Workshops timetabled for all Services using new techniques and templates alongside the key stages of business planning process.
Future use of Covalent	Outcomes from the risk register review with Strategy & Policy directorate to be uploaded into Covalent and standardised reports will be produced for approval for use across the Council. Mitigating actions will be linked to the relevant risks and to business plan objectives. Consider the input of Issues into Covalent under new coding as feedback suggests that it would be useful.

Risk management aspect	Action including status
Roles and Responsibilities	It is recognised that in order for risk management to be embedded at all levels support and direction is required from the most senior levels within the Council. All managers are tasked with the ownership of risks within their Services and will be required to ensure that they are reviewed and adequately mitigated. This will be supported by a central risk management function. This is reflected in the revised Risk Management policy statement.
Reporting	Reports will be standardised and will also incorporate high level dash-board style reporting to offer senior managers oversight of risks at a glance.

5 IMPLICATIONS

5.1 Financial

(a) There are no financial implications as a direct result of the report. All the costs involved are contained within the central Risk Management or departmental budgets. Any additional costs arising from enhanced risk mitigation will have to be considered and prioritised against other pressures in the revenue budget. Integration of Risk Management activity within the business planning process should assist in supporting specific business cases for appropriate budget allocations.

5.2 Risk and Mitigations

(a) The report sets out the need for and the outcomes of the review of the Councils' management of risk arrangements including current policy, processes and strategy. It also describes the recommended improvements to refine the risk management arrangements at the Council to ensure their ongoing effectiveness.

5.3 Equalities

(a) An Equalities Impact Assessment (EIA) scoping assessment was carried out on 6 November 2014 and has been issued to Corporate Equalities and Diversities Officer in accordance with current policy and practices. The outcome of the EIA is that it is anticipated there will be no adverse impact due to race, disability, gender, age, sexual orientation or religious/belief arising from the revised risk management policy.

5.4 Acting Sustainably

(a) There are no direct economic, social or environmental issues with this report.

5.5 Carbon Management

(a) There are no direct carbon emissions impacts as a result of this report.

5.6 **Rural Proofing**

(a) A Rural Proofing Checklist has been completed on 18 November 2014 in accordance with current Rural Proofing policy and practices. The outcome is that it is anticipated there will be no adverse impact on the rural area from the proposals contained in this report.

5.7 **Changes to Scheme of Administration or Scheme of Delegation**

(a) No changes to the Scheme of Administration or Scheme of Delegation are required as a result of this report.

6 CONSULTATION

6.1 The Corporate Management Team has been consulted on this report and the revised policy statement and any comments received have been taken into account.

6.2 The Chief Financial Officer, the Monitoring Officer, the Chief Legal Officer, the Service Director Strategy and Policy, the Chief Officer HR and the Clerk to the Council have been consulted on this report and the revised policy statement and any comments received have been incorporated into the report.

Approved by

Jill Stacey, Chief Officer Audit & Risk **Signature ....**

Author(s)

Name	Designation and Contact Number
Jill Stacey	Chief Officer Audit & Risk Tel 01835 825036
Justine Leuty	Risk and BCP Officer Tel 01835 824000 Ext 8076

Background Papers:
Previous Minute Reference:

Note – You can get this document on tape, in Braille, large print and various computer formats by contacting the address below. James Collin, Chief Executive's Department, can also give information on other language translations as well as providing additional copies.

Contact us at Justine Leuty, Chief Executive's Department jmleuty@scotborders.gov.uk

This page is intentionally left blank

RISK MANAGEMENT POLICY STATEMENT

Introduction
Scottish Borders Council (SBC), like all organisations, faces a wide range of risks at all levels of the organisation. The aim of this policy is to communicate why risk management should be undertaken, provide a common risk management language and a description of the approach that will be adopted by SBC to manage its risks. This policy is supported by the Risk Management Process Guide and Risk Management Strategy which is underpinned by the Management of Risk (M_o_R) Guide and its associated framework, principles, approach and processes.

SBC understands that effective Risk Management is one of the foundations of effective Corporate Governance which has been adopted in its Local Code of Corporate Governance. Compliance with the principles of sound corporate governance requires SBC to adopt a coherent approach to the identification and effective management of the risks with the outcome that better and more assured risk management will bring many benefits to SBC and the people it serves.

SBC recognise that risk management should be aligned with corporate objectives and will therefore be considered within the business planning process. This ensures that the risks to achieving these objectives are identified and prioritised. The risk management landscape is dynamic and, as local authorities increasingly move towards arms-length delivery of essential services and partnership arrangements, the spectrum of risks that SBC is exposed to also increases.

Therefore, SBC will continue to systematically identify, analyse, evaluate, control and monitor those risks that potentially endanger or have a detrimental effect upon its people, property, reputation and financial stability whether through core service delivery or through a programme of change.

Risk appetite and capacity
Risk appetite is how much risk SBC is willing to seek, accept or tolerate. This will differ dependent on the Perspective being assessed (Strategic long term, whether at Directorate or Corporate level; Programme/Project/Service level medium term or Operational short term). A consistent approach to identifying and analysing risk will therefore be followed, which will be consistent and compatible with SBC's capacity to bear and manage risk. This will be supported by the Risk Management Process Guide and Risk Management Strategy, to ensure that SBC, nor its stakeholders, are exposed to an unknown, unmanaged or unacceptable degree of risk.

Risk tolerance and thresholds
Risk tolerance will be determined by using a combination of the Risk Impact and Likelihood / Probability Matrix, as detailed in the Risk Management Process Guide; by the proximity of the risk; by considering the level of insurance cover in place (if applicable); and by determining whether a risk needs to be managed at a higher level because of the impact if the risk materialises.

Procedure for escalation and delegation
Escalation is the process whereby a risk has exceeded tolerance thresholds at the perspective in question and action or oversight is required at a more senior level. This could be because the impact if the risk materialises is too great to be managed at that level or because the risk is corporate wide. All managers have the responsibility to ensure that risks escalated to them are considered by following the Risk Escalation Procedure detailed in the Risk Management Process Guide. Escalated risks may be overseen at a higher level and actions to mitigate them delegated to another level within SBC or partner organisation.

Project level – Following discussion at project meeting, an Exception Report will be raised to the Project Executive. The risk will then be passed to the Programme Manager to escalate and/or manage appropriately.
Programme level – The Programme Manager will escalate the risk to the appropriate Service Director who will then make a decision on where the risk should be managed and/or what actions are to be taken.
Operational level – Every member of staff has a responsibility to report a risk to their line manager. The line manager must then decide at what level the risk should be managed and/or what actions are to be taken.

Roles and responsibilities

The Council will continue to support its people to develop the appropriate skills and competencies so as to enable them to manage risk effectively and will recognise risk management as a core management competency.

Corporate Management Team (CMT)

CMT will act as risk champions, driving risk from the top down, ensuring all major decisions are subject to a risk assessment and fostering a supportive culture where all members of staff are openly able to discuss and escalate risks to the appropriate level. CMT will regularly review the most serious risks threatening strategic objectives.

Audit Committee

The Audit Committee will oversee the adequacy and effectiveness of the Council's risk management arrangements.

Senior Management

Senior management will ensure that they understand the risk policy, process and reporting requirements; ensure risk registers are compiled and maintained for each Service, Programme or Project; escalate risks as required by this policy; support internal and external audits; and carry out the complete risk management process on all major activities.

Chief Officer Audit & Risk

The Chief Officer Audit & Risk will develop and maintain corporate risk management strategy, policy and procedures and ensure these are communicated effectively throughout the Council and that processes are in place to embed this in the Council's culture and working practices.

Senior Risk Officer

The Senior Risk Officer will support the management of risk by: monitoring that the processes and procedures are followed; monitoring that risk registers are in place and reviewed, aligned with the business planning process; preparing management reports; offering advice, guidance, training and support; and facilitating risk workshops.

Risk management process

Risk management is not a one-off exercise. It is a continuous process because the decision making processes it underpins are continuous. Risk management must become an integrated part of good management within SBC, but not be over bureaucratic and a process for its own justification. To these ends it will be aligned with the business planning process and reporting schedule. The process to be adopted is described in the document Risk Management Process Guide.

Key performance indicators and early warning indicators

Key performance indicators (KPIs) and early warning indicators (EWIs) will be regularly monitored as part of the business planning and performance management process. As risk management is inextricably linked to this process, monitoring of the KPI's and EWI's will ensure that potential areas of risk are identified and checked.

When risk management will be implemented
Risk management will be applied to every level within SBC, including programmes and projects. It will be part of the decision making process when developing and reviewing business plans and when considering alternative service delivery arrangements including partnership, arm's length external organisations and outsourcing.

Reporting
Reporting will be in line with the business planning process and include:

- Quarterly report to CMT and Bi-annual report to the Audit Committee on the status of key risks and risk management actions.
- Monthly report to the departmental management teams on the status of key risks and risk management actions.
- Services will submit monthly key performance indicator reports in line with the business planning process.
- Individual risk reports will be prepared prior to each partnership, contract or outsourcing decision.

Budget
All the costs involved are contained within the central Risk Management or departmental budgets. Any additional costs arising from enhanced risk mitigation will have to be considered and prioritised against other pressures in the revenue budget. Integration of Risk Management activity within the business planning process should assist in supporting specific business cases for appropriate budget allocations.

Quality Assurance
This policy will be subject to document control, version control, be reviewed at least annually, and be revised to reflect changes in legislation, risk management best practice, and significant changes in corporate governance.

Annual Review
Risk management procedures will be reviewed annually to ensure their continued relevance and effectiveness.

Glossary of terms
For risk management to be effective all participants must speak the same language. A detailed glossary of terms is included in the Risk Management Process Guide.

This page is intentionally left blank