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AUDIT AND RISK COMMITTEE
MONDAY, 18TH JANUARY, 2016

A MEETING of the AUDIT AND RISK COMMITTEE will be held in the COUNCIL CHAMBER, COUNCIL HEADQUARTERS, NEWTOWN ST BOSWELLS on MONDAY, 18 JANUARY 2016 at 10.15 am.

As previously agreed, there will be a meeting of Members of the Committee at 9.30 a.m. prior to the main meeting.

J. J. WILKINSON,
Clerk to the Council,
11 January 2016

BUSINESS		
1.	**Apologies for Absence**	
2.	**Order of Business**	
3.	**Declaration of Interest**	
4.	**Minute** (Pages 1 - 8) Minute of Meeting of the Audit and Risk Committee held on 23 November 2015 to be approved and signed by the Chairman. (Copy attached.)	4 mins
5.	**Risk Management in Services** Presentation by Service Director Neighbourhood Services and Service Director Commercial Services on the strategic risks facing their respective Services and the internal controls and governance in place to manage / mitigate those risks to demonstrate how risk management is embedded within services. (Verbal presentation)	15 mins
6.	**Treasury Management Strategy 2016/17** (Pages 9 - 52) Consider report by Chief Financial Officer on the Council's draft report and Treasury Management Strategy 2016/17 for review and scrutiny prior to presentation for Council approval. (Copy attached.)	30 mins
7.	**External Audit Scottish Borders Council Audit Strategy and Plan Overview 2015/16** (Pages 53 - 80) 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 2016. (Copy attached)	15 mins
8.	**Internal Audit Work 2015/16 to December 2015** (Pages 81 - 96)	15 mins

	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.)	
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), J. Campbell, I. Gillespie, A. J. Nicol, S. Scott and B White (Vice-Chairman). Mr P McGinley, Mr M Middlemiss and Mr H Walpole.

Please direct any enquiries to Pauline Bolson. Tel: 01835 826503
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SCOTTISH BORDERS COUNCIL
AUDIT AND RISK COMMITTEE

MINUTES of Meeting of the AUDIT AND RISK held in Council Headquarters, Council Headquarters, Newtown St Boswells on Monday, 23rd November, 2015 at 2.00 pm

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Present:-	Councillors M. Ballantyne (Chair), W. Archibald, J. Campbell, I. Gillespie, A. J. Nicol, S. Scott and B White (Vice-Chairman)
In Attendance:-	Chief Financial Officer, Chief Officer Audit and Risk, Corporate Transformation and Services Director (for Item 5), Service Director Neighbourhood Services (for Items 7 and 8), Chief Social Work Officer (for Item 9), Clerk to the Council, Democratic Services Officer (P Bolson).

1. **ORDER OF BUSINESS.**
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.

2. **WELCOME**
The Chairman advised that three new external members had been appointed to the Audit and Risk Committee and welcomed to the meeting Mr Paul McGinley, Mr Michael Middlemiss and Mr Howard Walpole followed by introductions by those present. Councillor Iain Gillespie was also welcomed to the meeting following his recent appointment to the Committee.

DECISION
NOTED.

3. **MINUTE**

3.1 There had been circulated copies of the Minute of 28 September 2015.

DECISION
APPROVED for signature by the Chairman.

3.2 With reference to paragraph 4(b) of the Minute, Members were advised that a report on Grants and Loans to Third Parties would be presented at the next meeting of the Audit and Risk Committee on 18 January 2016.

DECISION
NOTED that a report on Grants and Loans to Third Parties would be presented at the next meeting of the Audit and Risk Committee on 18 January 2016.

4. **TREASURY MANAGEMENT MID-YEAR REPORT 2015/16**
There had been circulated copies of a report by the Chief Financial Officer which detailed the mid-year treasury management activities for 2015/16, in line with the requirements of the CIPFA Code of Practice and which included Prudential and Treasury Management Indicators. Following consideration by the Audit and Risk Committee, the report would then be presented to Council for approval. Appendix 1 to the report contained an analysis of the performance against the targets set in relation to Prudential and Treasury Management Indicators and proposed revised estimates of these indicators in light of the 2014/15 outturn and experience in 2015/16 to date for discussion by the Committee prior to presentation to Council for approval.

4.2 Ms Mirley, Corporate Finance Manager, made reference to her presentation during the Informal Briefing Seminar for all Elected Members on Borrowing and Treasury Management in Councils preceding this Committee meeting and referred to section 2.3 of

Appendix 1 to the report, advising Members that this was a summary of the interest rates forecast by Capita Asset Services, the Council's treasury adviser. The report explained that the current approved budget for 2015/16 was £50.7m, a reduction of £7.7m from the originally agreed figure. This had been due to adverse timing movements in some areas of the Capital Plan and the report detailed the key drivers of the changes. An increase of £10.1m within Place department was linked to movements to the re-profiling post-contract award for the Selkirk Flood Protection Project and the acceleration of £1m for Roads investment; a reduction in estimated expenditure of £13.3m within People department as a result of the adjustment to remove Kelso High School project which would now be fully funded via a revenue grant from the Scottish Government; a reduction of £4.2m from the Chief Executive department in relation to the Next Generation Broadband (BDUK) project which was being funded from the General Capital Grant retained by the Scottish Government; and the removal of £0.3m for emergency and unplanned schemes. In addition, there had been a reduction in the approved budget for Funding for Other Relevant Expenditure by £16m which was largely related to the lack of uptake of borrowing by Registered Social Landlords (RSLs) and the National Housing Trust project via Bridge Homes LLP. Ms Mirley explained that the Scottish Government's guidance criteria for lending identified the Local Authority as the "lender of last resort", making it more difficult to lend to RSLs and had resulted in a lack of uptake.

4.3 With regard to the Capital Financing Requirement (CFR), the report explained that this had been recalculated in light of the changes to the Capital Plan and noted a reduction in the amount required from £276.1m to £266.6m. Ms Mirley referred to the funding section within the Capital Investment Plan and explained that any need to fund a notional amount would not necessarily require borrowing and might, for example, be funded using the Council's cash flow. The report explained the management of under / over borrowing against the CFR and noted that historically long term borrowing had been by fixed rate maturity loans. Ms Mirley advised that this was not necessarily how the Council would proceed inthe future and it was noted that variable rate loans might be considered if there was a prolonged period of low interest rates. In terms of risk, Ms Mirley confirmed that the Council could access cash reserves but there was a risk if those reserves were insufficient to cover requirements.

DECISION

(a) NOTED that treasury management activity in the six months to 30 September 2015 had been carried out in compliance with the approved Treasury Management Strategy and Policy; and

* **(b) AGREED TO RECOMMEND that the Treasury Management Mid-Year report 2015/16, as contained in Appendix 1 to the report, be presented to Council for approval of the revised indicators.**

5. **INTERNAL AUDIT WORK 2015/16 TO OCTOBER 2015**

5.1 There had been circulated copies of a report by the Chief Officer Audit and Risk which provided the Audit and Risk Committee with details of the recent work carried out by Internal Audit and the recommended audit actions agreed by management to improve internal controls and governance arrangements and Internal Audit work in progress. The work Internal Audit had carried out in the period from 29 August to 31 October 2015 to deliver the Internal Audit Annual Plan 2015/16 was detailed in the report. During the reporting period 5 final internal audit reports had been issued. There were 4 recommendations made (0 Priority 1 High Risk, 1 Priority 2 Medium Risk, and 3 Priority 3 Low Risk) specific to three of the reports. Management had agreed to implement the recommendations to improve internal controls and governance arrangements. The report also detailed the Internal Audit Reviews which were either underway or nearing completion. An executive summary of the final internal audit reports issued, including audit objective, findings, good practice, recommendations and the Chief Officer Audit and Risk's independent and objective opinion on the adequacy of the control environment and governance arrangements within each audit area, was detailed in Appendix 1 to the report.

5.2 With reference to the Corporate Transformation Cultural Services Review, Members requested clarification regarding membership and purpose of the Joint Officer Working Group and the Member Reference Group, both of which had been set up as part of the process to consider an Integrated Culture and Sport Trust. Members were advised by Mr Dickson, Corporate Transformation and Services Director, that each of the two Groups had specific input into the process as detailed in Appendix 1 and this ensured that key stakeholders in cultural services were involved. Members were further advised that the Performance Management Framework was due for completion by the end of February 2016 and that recommendations would be presented to the Executive Committee by the end of March 2016. In the interim, the Chief Officer Audit and Risk would sit as a member of the Integrated Trust Project Board and provide support in terms of governance, risk and internal control whilst the Senior Internal Auditor would continue to work with the project team. With regard to the Authorised Signatories process for both salaries and creditors' payments, Ms Stacey confirmed the interim audit recommendation that access to the Council systems should be allocated to the duties of a particular post and not to the individual officer to ensure the relevant security measures were in place when there was movement of staff both within and out with the Council. In respect of the LEADER Programme, it was acknowledged that criteria for state aid could be confusing and that this could affect a number of services across the Council. On that basis, a framework to ensure that all officers within the Council were following the same standards was required and Mr Bryan McGrath, Chief Officer Economic Development and Lead Officer for this Programme, would be involved in the development of this. Mr McGrath had agreed the Priority 3 recommendation within the Audit Review and acknowledged that it covered the European Fisheries Fund Programme as well. In response to a question on European Fisheries funding, Mr Robertson confirmed that any uncommitted monies would be used within the Eyemouth area. Ms Stacey confirmed the process by which recommendations from Internal Audit reviews were followed up and that any non-completion of such recommendations were reported to the Audit and Risk Committee as standard practice.

5.3 With regard to the Public Service Network (PSN) Compliance, the Corporate Transformation and Services Director explained that compliance with PSN was mandatory to ensure the security of the Council's network and that of the data held within it. Certification of compliance was required on an annual basis. Mr Dickson explained that there had been a number of issues which had delayed the project prior to SBC's successful accreditation in August 2015 and that there were a range of lessons learned from this process. In response to a question regarding access to Covalent for the new external Members of the Audit and Risk Committee, Ms Stacey advised that currently the Committee received output from Covalent as required with officers accessing the system directly.

DECISION

(a) NOTED the final reports issued in the period from 29 August to 31 October 2015 to deliver the Internal Audit Annual Plan 2015/16;

(b) ACKNOWLEDGED that it was satisfied with the recommended audit actions agreed by Management.

6. INTERNAL AUDIT MID TERM PERFORMANCE MONITORING REPORT 2015/16

6.1 There had been circulated copies of a report by the Chief Officer Audit and Risk informing the Committee of the progress Internal Audit had made in the first six months of the year to 30 September 2015 towards completion of the Internal Audit Annual Plan 2015/16, and included a summary of outcomes of assessments of the Internal Audit Service against the Public Sector Internal Audit Standards. The report advised that based on the planned staffing levels within the period from October 2015 to March 2016, it was anticipated that the Internal Annual Audit Plan would be delivered in full. The report went on to explain that interim changes to the Corporate Management structure meant that the Chief Officer Audit and Risk now reported directly to the Service Director Regulatory Services (also the Monitoring Officer of the Council). This would not affect the role of the Audit and Risk Committee in considering reports by the Chief Officer Audit and Risk.

6.2 Internal Audit's function, as set out in the Public Sector Internal Audit Standards (PSIAS), included the requirement to carry out a self-assessment against the PSIAS and develop a Quality Assurance and Improvement Plan (QAIP). A summary overview of this self-assessment was included in the report and it was noted that these self-assessments were also subject to an External Quality Assessment (EQA) every five years. A "peer review" framework was agreed by the Scottish Local Authorities Chief Internal Auditors Group (SLACIAG) and SBC had participated in a pilot framework along with five other Local Authorities. Renfrewshire Council visited SBC in October 2015 and the subsequent report concluded that the SBC Internal Audit Service generally conformed to PSIAS and identified a number of areas of good practice.

6.3 With regard to the planned Audit Reviews for Risk Management and Counter Fraud in 2015/16, Members were advised that the Chief Officer Audit and Risk would be considered to be the client with the Internal Audit Manager (IAM) fulfilling the Chief Audit Executive (CAE) role to ensure independence and objectivity and to meet the requirements of PSIAS. Following further discussion in respect of the line management structure and the potential or perceived impairment to objectivity where the IAM's normal reporting line was to the Chief Officer Audit and Risk, it was agreed that the relevant officers should discuss whether it would be of prudent to change the line management of the Internal Audit Manager during the short period in which he was acting in the role of CAE and to bring further information back to the Committee at its meeting in January 2016. In response to a question on how subjects for review were selected, Ms Stacey clarified that the range and breadth of audit areas for inclusion within the internal audit annual plan includes sufficient work to enable CAE to prepare an annual internal audit opinion on the adequacy of the Council's overall control environment, and to provide assurance to Management and the Audit and Risk Committee, as set out in the Internal Audit Strategy and Annual Plan. With reference to paragraph 4.1 of the report, it was noted that planned days of Internal Audit work on some Reviews did not always match the actual days completed and that in order to provide clarity, it was agreed that additional information would be added to future reports to explain any significant differences.

DECISION

(a) APPROVED the progress made by Internal Audit towards completion of the Internal Audit Annual Plan 2015/16; and

(b) AGREED that:-

(i) the Committee was satisfied with the performance of the Internal Audit Service; and

(ii) in terms of demonstrating transparency and ethics, the Chief Financial Officer, Service Director Regulatory Services and Chief Officer Audit and Risk would consider whether it would be prudent to change the line management of the Internal Audit Manager during the short period in which he was acting in the role of Chief Audit Executive to carry out the planned Audit Reviews for Risk Management and Counter Fraud; and

(iii) additional information would be included in future reports to explain any significant differences between the planned and actual number of days of work carried out on Internal Audit reviews.

ADJOURNMENT

The meeting was adjourned for a short break at 3.50pm and reconvened at 3.55pm.

MEMBER
Councillor Nicol joined the meeting.

7. **HOUSING BENEFITS OVERPAYMENT AND DEBT RECOVERY**
With reference to paragraph 8 of the Minute of 11 May 2015, there had been circulated copies of a report by the Service Director Neighbourhood Services giving details of the performance of Housing Benefits overpayments and debt recovery during the first half of 2015/16. The report noted that the value of overpayments outstanding at the beginning of quarter three in 2015/16 was £1.5m in comparison to £1.1m in 2014/15. SBC awarded Housing Benefits payments in the region of £30m during 2013/14 and 2014/15 and of this, £746,340 (2.5%) was overpaid in 2013/14. During 2014/15, overpayment increased to £1,016,215 (3.3%). The report further advised that the number and value of overpayments had increased from quarter three as a result of new initiatives from the Department of Work and Pensions (DWP) which allowed better matching of data across organisations. The report also identified that the percentage of debt recovered in the first two quarters of 2015/16 had increased to 62.2%. Ms Craig explained that, following the implementation of Universal Credit, further digitisation of the application process for benefit was anticipated. Other measures being developed for improvement in debt recovery included the renegotiation of contracts for Sheriff Officers from April 2016 with built-in performance indicators on debt recovery; and further discussions with the DWP in relation to recovering debt from other benefits that individuals received. Discussion followed and Ms Craig explained the reasons for inaccurate claims being submitted included the complexity of some of the application forms and failure to advise the appropriate Authority of changes to circumstances. With regard to the recovery of costs where debts were pursued, Members were advised by Mr Grant, Customer Services Manager, that these were not currently passed on to the debtor but were covered by the Council. Debtors were consulted with regard to their repayment plan and generally deductions would be made directly from any payments where the debtor was still in receipt of benefits. In response to a Member's question, Ms Craig indicated that it was much more effective to prevent overpayments occurring in the first place rather than pursuing debt recovery and work with the DWP was now moving forward in this direction. A further update report would be presented to the Committee in six months.

DECISION
(a) NOTED the comparative activity relating to Housing Benefit overpayments and debt recovery during the period 1 April to 30 September 2015; and

(b) AGREED that a further performance report be presented to the Audit and Risk Committee in six months.

8. **BENEFITS PERFORMANCE AUDIT ANNUAL UPDATE 2014/15**
There had been circulated copies of a report by Audit Scotland on the Benefits Performance Audit Annual Update for 2014/15. Audit Scotland officers were on site at the Council during May 2014 to carry out a performance audit of the Council's Housing Benefit service. The results of this audit highlighted areas of good practice within the Council and the report commented that only one risk to continuous improvement had been identified.

DECISION
NOTED the report.

MEMBERS
Councillors White and Scott left the meeting during consideration of the following item.

9. **RISK MANAGEMENT ACROSS ADULT SOCIAL CARE SERVICES**

9.1 Members were advised that the presentation on Risk Management across Adult Care Services was being presented to the Committee as part of the scheduled call back programme for services across the Council.

9.2 There were circulated at the meeting copies of the presentation by Ms Torrance, Chief Social Work Officer. Ms Torrance explained that managing risk was a core requirement of adult health and social care services and as such, a number of robust tools were available to assist in the process. A client-centred approach was essential to ensure that individuals' needs and rights were considered throughout the process and Ms Torrance emphasised that operation risks were collectively managed across teams and services through the effective use of a management process, from the Social Worker to the Care Manager and Team Leader. Ms Torrance explained the different levels of risk management from strategic to directorate/service to operational and summarised the risk management structure for each, emphasising that the key purpose at all levels was to keep people safe. Members were advised of a number of key factors and major changes which had affected risk management, such as Health and Social Care Integration and the resultant adjustments to the delivery of Adult Care Services across the Borders; the creation of SBCares and management of risk in relation to ALEOs; corporate changes and the need to ensure that staff understand the process; demographic changes requiring the redesign of services; Council-wide financial pressures; and SBC's reputation in ensuring protection of those in receipt of the service and the wider public.

9.3 In terms of the tools and techniques for managing risk, Ms Torrance explained that the creation of SBCares involved stakeholder engagement and discussions with Unions to ensure that all parties were involved in the process. Training was provided for all frontline staff, managers and senior managers to ensure that they were equipped at an appropriate level to manage and mitigate risk. Regular monitoring of Risk Plans at all levels was a key part of the process and within social work practice risk management was an integral part of the social worker's role in terms of their case management. Other measures in place included the Chief Social Work Officer's Annual Report to Council on Risk Management, inspections by the Care Inspectorate, and self-evaluation within services which ensured that a robust and effective process existed.

9.4 Ms Torrance explained that measures were also in place to enable the effective governance of risk across the Adult Care Service. In terms of SB Cares, these measures included the appointment of an independent Chairperson and Members on the SB Cares Board; the setting up of the Limited Liability Partnership (LLP) Strategic Governance Group comprising four Elected Members; and the Performance/Finance Group which had responsibility for the day to day operational arrangements. In terms of progress made in the Health and Social Care Integration process, Ms Torrance explained to Members that an Integrated Joint Board had now been established and this board would receive reports on joint financing of Health and Social Care services. An Integration Scheme had been submitted to Scottish Ministers for approval and the Strategic Plan was currently out for consultation. Further progress would be reported in due course.

9.5 A number of questions were raised in relation to the management of risk and Ms Torrance provided clarification to Members. She emphasised that risk management was viewed as having a watching brief rather that reacting when something happened and as such, risks were re-assessed and moved in status as required. Escalation of risks within the service, to People Department Management Team and to Corporate Management Team, as required, ensured that each was dealt with by the appropriate level of management. Ms Torrance acknowledged that external risks such as a need for care at home providers to be brought back to in-house delivery presented challenges to the Council and that these would be addressed under the Health and Social Care Integration agenda. Ms Torrance confirmed that special placements such as those to other Local Authorities were still required in some cases and needed to be managed within the system. The Chairman thanked Ms Torrance for her attendance.

DECISION
NOTED the presentation.

10. **CORPORATE RISK MANAGEMENT STRATEGY**
There had been circulated copies of a report by the Chief Officer Audit and Risk seeking agreement to present the revised Corporate Risk Management Strategy to Council for approval. Members were in agreement that the content of the document was appropriate but were concerned that the text did not flow in an easy-to-follow way and that the language was, on occasion, over-complicated. It was agreed that the Chief Officer Audit and Risk, in consultation with the Chairman, would revise the wording and language within the document and would circulate the amended Strategy to Members for information prior to its presentation to Council for approval.

DECISION
(a) NOTED the report;

(b) AGREED that the Chief Officer Audit and Risk, in consultation with the Chairman, would revise the wording and language within the document and that the amended Strategy would be circulated to Members for information; and

* **(c) AGREED TO RECOMMEND that the revised Corporate Risk Management Strategy be presented to Council for approval.**

The meeting concluded at 5.00 pm

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DRAFT TREASURY MANAGEMENT STRATEGY 2016/17

Report by Chief Financial Officer

AUDIT AND RISK COMMITTEE

18 January 2016

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 for 2016/17 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 Strategy for 2016/17 to be submitted to Council on 11 February 2016, is included in this report at Appendix 1 and reflects the impact of the Administration's draft Financial Plans for 2016/17 onwards on the prudential and treasury indicators for the Council.

2 RECOMMENDATIONS

2.1 **It is recommended that the Committee considers whether to make any comments or recommendations on the draft Treasury Management Strategy for 2016/17 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 and Accountancy) Code (i.e. Treasury Management in the Public Services: Code of Practice and Cross-sectorial Guidance Notes).

4 TREASURY MANAGEMENT STRATEGY 2016/17

4.1 Appendix 1 contains the draft Treasury Management Strategy for 2016/17 for consideration by the Audit and Risk Committee.

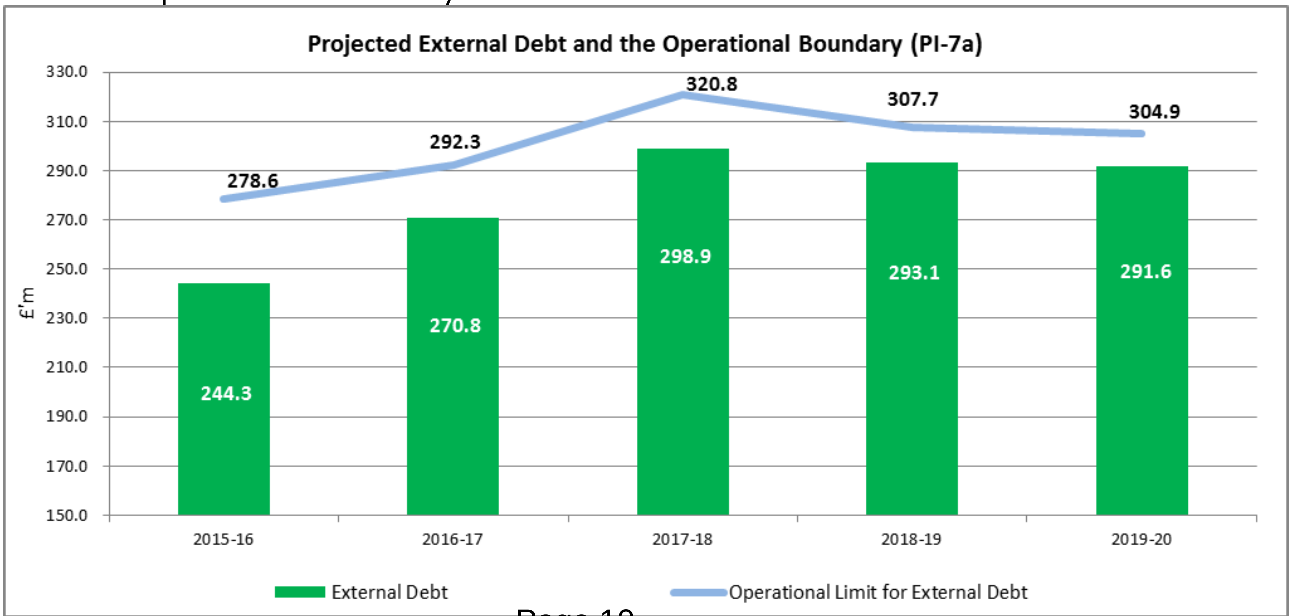
4.2 This is based on the Administration's current draft Financial Capital Plans for 2016/17 to 2025/26 yet to be published and as such is subject to change as these plans will not be presented to Council for approval until 11 February 2016.

4.3 Appendix 1, Annex A contains a summary of the proposed indicators within the strategy. The significant changes from the 2015/16 strategy are:

(a) Increase in the Capital Financing Requirement (CFR) for 2016/17 due to increased capital expenditure in 2016/17 resulting from new projects and from acceleration of a number of projects such as Broomlands, Langlee and 3G sports pitches, additionally borrowing requirements associated with the re-phasing of projects from 2015-16 into 2016-17 and future years have impacted on the total CFR.

(b) Increase in the Authorised Limit in 2017/18 associated with debt following the completion of Kelso High School and the resulting Long Term liability and the increase in external borrowing resulting from the capital plan.

4.4 The table below shows the "Operational Boundary" against the anticipated levels of external borrowing. The external borrowing levels should not exceed the operational boundary, i.e. the level of borrowing that is defined by the prudential framework as the limit which external borrowing is not normally expected to exceed. The gap between these two elements as seen in the table is narrowing each year and is indication that the Council is external debt is getting closer to the prudent affordability limit as defined by the Operational Boundary.



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 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 **Carbon Management**
There are no direct issues or consequences arising from this report which would affect the Council's carbon management.

5.6 **Rural Proofing**
There are no direct issues or consequences arising from this report which would affect the Council's rural proofing policy.

5.7 **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 Chief Officer Audit and Risk, the Chief Officer HR and the Clerk to the Council have been consulted and any comments received have been incorporated into the final report.

Approved by

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

Author(s)

Name	Designation and Contact Number
Lynn Mirley Kirsty Robb John Yallop	Corporate Finance Manager, 01835 825016 Capital and Investment Manager, 01835 825249 Senior Finance Officer. 01835 824000, Ext 5933

Background Papers:
Previous Minute Reference:

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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)
2016/17

Finance
Chief Executive Department
Version 1
Approved: [TBC]

CONTENTS

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 2016/17** (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 2016/17 – 2020/21

The Council's Financial Strategy sets out financial resource and management parameters within which it will deliver its Corporate Vision and Priorities. The Financial Strategy brings together various elements of financial policy and strategy, including the Treasury Management Strategy, and establishes the financial planning framework for the Council in terms of Revenue Expenditure and Capital Investment. The output from this framework is the Council's Financial Plan, approved annually in February, presenting the financial proposals for delivering its services and objectives.

The Financial Strategy establishes that the Financial Principles underpinning the planning for the Council's future service delivery are 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 Corporate and Business Plans and the Revenue and Capital Financial Plan.

In order to adhere to these Principles, the Financial Strategy states that the Council will adopt Financial Objectives including to:

Maintain an affordable and sustainable capital investment programme financed in line with the Capital Investment Principles and supported by a prudent Treasury Management Strategy which safeguards the our assets.

The Revenue Financial Plan has identified that to manage the investment in infrastructure a capital programme financed by £20.2m capital financing revenue implications per annum (reducing to £19.1m per annum from 2018/19) 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 2016/17 – 2025/26 includes the following capital expenditure forecasts for the first five years:

Capital Expenditure (PI-1) £m	Estimate					
	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
Total	**50.9**	**54.5**	**32.8**	**28.0**	**29.0**	**34.1**

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 are 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	Estimate					
	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
Bridge Homes LLP (Affordable house building programme)	1.5	6.6	5.2	-	-	-

b) Previously the Council had included up to £5m 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 significantly reducing the 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	Estimate					
	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
Capital Expenditure	50.9	54.5	32.8	28.0	29.0	34.1
Other Relevant Expenditure	1.5	6.6	5.2	-	-	-
Total Expenditure	**52.4**	**61.1**	**38.0**	**28.0**	**29.0**	**34.1**
Financed by:						
Capital receipts	1.7	1.3	1.8	1.1	2.9	1.0
CFCR	1.1	0.2	0.2	0.3	-	-
Developer Contributions	0.3	0.1	0.5	0.1	0.1	0.1
Govt. General Capital Grants	11.0	11.2	11.0	11.0	11.0	11.0
Govt. Specific Capital Grants	15.7	9.0	0.2	1.9	5.4	14.9
Other Grants & Contributions	1.9	4.1	1.7	1.6	1.3	-
Plant & Vehicle Fund	2.6	2.0	2.0	2.0	2.0	2.0
Net financing need for the year	**18.1**	**33.2**	**20.6**	**10.0**	**6.3**	**5.1**

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 £54.3m of liabilities relating to such schemes within the 2015/16 long term liabilities figure. This increases by £21.3m in 2017/18 relating to funding arrangements for the construction of a new High School in Kelso.

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

Capital Financing Requirement (PI-2) £m	Actual 14/15	Estimate 15/16	16/17	17/18	18/19	19/20	20/21
Total CFR (PI-2) *	**259.9**	**267.3**	**294.4**	**297.9**	**302.2**	**301.5**	**299.2**
Movement in CFR represented by:							
Net financing need for the year (above)		18.1	33.2	20.6	10.0	6.3	5.1
Less scheduled debt amortisation and other financing movements		(10.7)	(6.1)	(17.1)	(5.7)	(7.0)	(7.4)
Movement in CFR		**7.4**	**23.3**	**3.4**	**4.1**	**(0.7)**	**(2.3)**

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

The significant increase between 2015/16 and 2016/17 driven by the shift in the net financing need for the year as detailed in the table in section 3.3 a). The main driver for the increase is an increased Capital Programme with significant additions in 2016-17 and the acceleration of projects into that year from future years. Additionally borrowing requirements associated with the re-phasing of projects from 2015-16 into 2016-17 and future years have impacted on the total CFR.

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.

%	Actual 14/15	15/16	16/17	17/18	18/19	19/20	Estimate 20/21
Ratio of Financing Costs to Net Revenue Stream (PI-3) *(inc. PPP repayment costs)*	9.3	8.9	9.4	10.1	9.6	9.6	9.6

The estimates of financing costs include current commitments and the proposals in the Financial Plans for 2015/16. The movements in the above ratio from 2016-17 onwards reflect a reduction in overall financial resources available to the Council.

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

£	Estimate 2016/17	2017/18	2018/19	2019/20	2020/21
Incremental (Saving)/Cost Impact of Capital Investment Decisions on the Band D Council Tax (PI-4)	(0.01)	(0.01)	(0.04)	(0.05)	(0.06)

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 2015, 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***.

as at 31 March £m	Estimate					
	2015/16	**2016/17**	**2017/18**	**2018/19**	**2019/20**	**2020/21**
Borrowing **Other Long Term Liabilities**	189.9 54.3	218.2 52.6	226.2 72.7	222.7 70.4	223.6 68.0	224.2 65.4
Total Gross Borrowing (Prudential Indicator PI-5)	**244.2**	**270.8**	**298.9**	**293.1**	**291.6**	**289.6**
CFR – the borrowing need *	**297.9**	**302.3**	**301.5**	**299.3**	**297.3**	**297.3**
(Under) / Over Borrowing (Prudential Indicator PI-6)	**(53.7)**	**(31.5)**	**(2.6)**	**(6.2)**	**(5.7)**	**(7.7)**

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

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 2016/17 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 long term future. This view takes into account current commitments, existing plans, and the proposals in the Financial Plans for 2016/17.

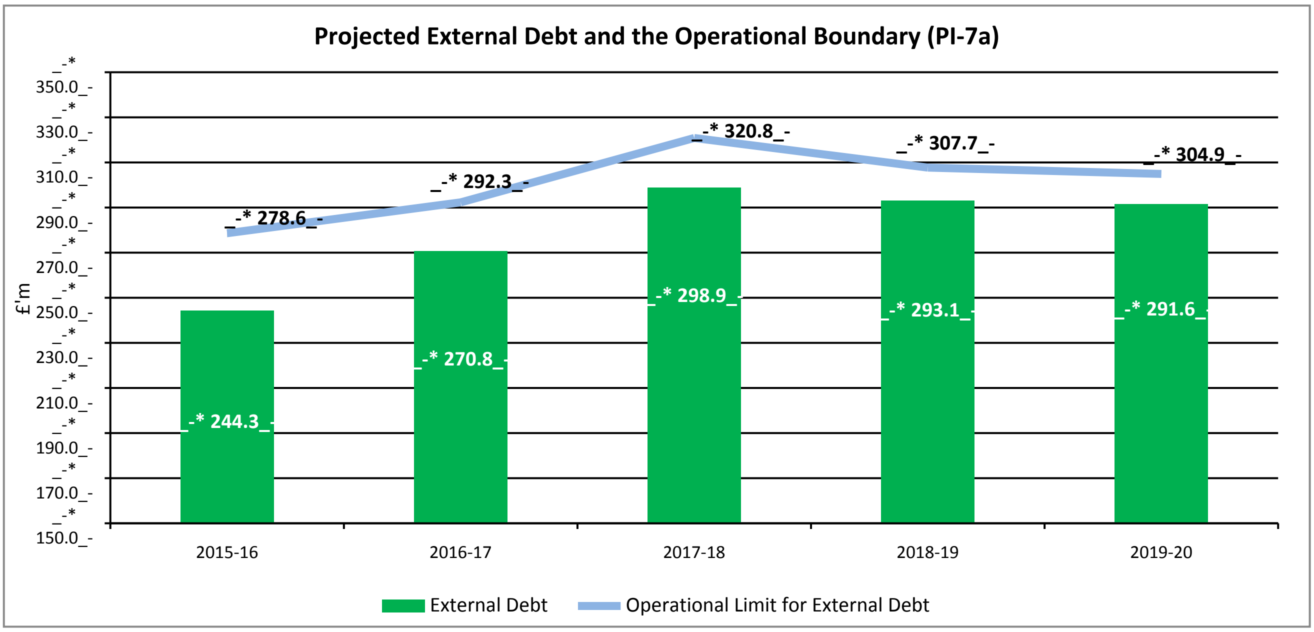
4.2 Treasury Indicators: Limits to Borrowing Activity

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	Estimate				
	2016/17	**2017/18**	**2018/19**	**2019/20**	**2020/21**
Total Operational Boundary (PI-7a)	**292.3**	**320.8**	**307.7**	**304.9**	**309.3**
Less: Other long term liabilities	(52.6)	(72.7)	(70.4)	(68.0)	(65.4)
Operational Boundary exc. Other Long Term Liabilities (PI-7b)	**239.7**	**248.1**	**237.3**	**236.9**	**243.9**

b) The following chart shows how the current and projected Operational Borrowing limit compare with the anticipated levels of actual debt.



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

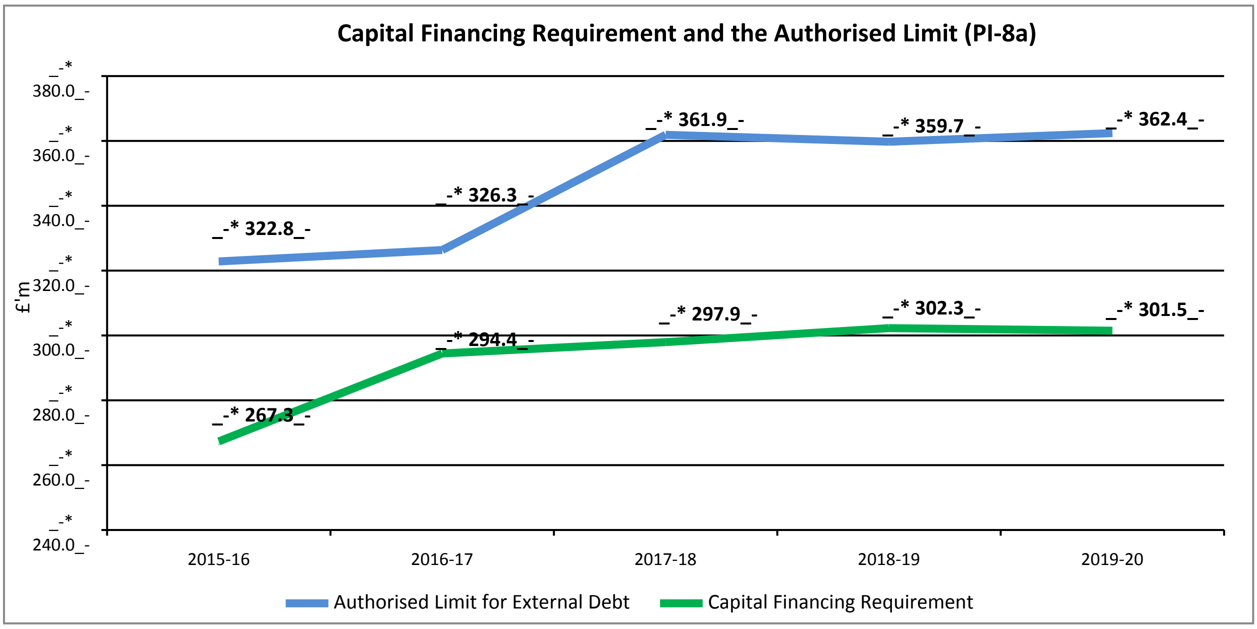
c) A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is ***prohibited***, and this limit needs to be set or revised by the full Council. It reflects the level of external borrowing which, while not desired, ***could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

d) 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.

e) The Council is asked to approve the following authorised limit:

Authorised Limit £m	**Estimate**				
	2016/17	**2017/18**	**2018/19**	**2019/20**	**2020/21**
Total Authorised Limit (PI-8a)	**326.3**	**361.9**	**359.7**	**362.4**	**357.9**
Less: Other long term liabilities	(52.6)	(72.7)	(70.4)	(68.0)	(65.4)
Authorised Limit exc. Other Long-Term Liabilities (PI-8b)	**273.7**	**289.2**	**289.3**	**294.4**	**292.5**

f) The chart on the following page shows how the current and projected Capital Financing Requirement compares the Authorised Limit for External Debt


Capital Financing Requirement and the Authorised Limit (PI-8a)
£'m
380.0
360.0
340.0
320.0
300.0
280.0
260.0
240.0
322.8
326.3
361.9
359.7
362.4
267.3
294.4
297.9
302.3
301.5
2015-16
2016-17
2017-18
2018-19
2019-20
Authorised Limit for External Debt
Capital Financing Requirement

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 2016	0.50	2.40	3.70	3.60
Jun 2016	0.75	2.60	3.80	3.70
Sep 2016	0.75	2.70	3.90	3.80
Dec 2016	1.00	2.80	4.00	3.90
Mar 2017	1.00	2.80	4.10	4.00
Jun 2017	1.25	2.90	4.10	4.00
Sep 2017	1.50	3.00	4.20	4.10
Dec 2017	1.50	3.20	4.30	4.20
Mar 2018	1.75	3.30	4.30	4.20
Jun 2018	1.75	3.40	4.40	4.30
Sep 2018	2.00	3.50	4.40	4.30
Dec 2018	2.00	3.50	4.40	4.30
Mar 2019	2.00	3.60	4.50	4.40

b) UK GDP growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and the 2015 growth rate is likely to be a leading rate in the G7 again, probably being second to the US. However, quarter 1 of 2015 was weak at +0.4% (+2.9% y/y) though there was a rebound in quarter 2 to +0.7% (+2.4% y/y) before weakening again to +0.5% (2.3% y/y) in quarter 3. The November Bank of England Inflation Report included a forecast for growth to remain around 2.5 – 2.7% over the next three years, driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that CPI inflation has fallen to, or near to, zero since February 2015 this year. Investment expenditure is also expected to support growth. However, since the August Inflation report was issued, worldwide economic statistics have distinctly weakened and the November Inflation Report flagged up particular concerns for the potential impact on the UK.

c) The Inflation Report was notably subdued in respect of the forecasts for inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. However, once the falls in oil, gas and food prices over recent months fall out of the 12 month calculation of CPI, there will be a sharp tick up from the current zero rate to around 1 percent in the second half of 2016. The increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon was the biggest since February 2013. There is considerable uncertainty around how quickly inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing Bank Rate.

d) The American economy made a strong comeback after a weak first quarter's growth at +0.6% (annualised), to grow by no less than 3.9% in quarter 2 of 2015, but then weakened again to 1.5% in quarter 3. The downbeat news in late August and in September about Chinese and Japanese growth and the knock on impact on emerging countries that are major suppliers of commodities, was cited as the main reason for the Fed's decision at its September meeting to pull back from a first rate increase. However, the nonfarm payrolls figure for growth in employment in October was very strong and, together with a likely perception by the Fed. that concerns on the international scene have subsided, has now resulted in an interest rate rise in December.

e) In the Eurozone, the ECB fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. This appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to a significant improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.0% y/y) but came in at +0.4% (+1.5% y/y) in quarter 2 and looks as if it may maintain this pace in quarter 3. However, the recent downbeat Chinese and Japanese news has raised questions as to whether the ECB will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

During July, Greece finally capitulated to EU demands to implement a major programme of austerity and is now cooperating fully with EU demands. An €86bn third bailout package has since been agreed though it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the resistance of the Syriza Government, elected in January, to EU demands. The surprise general election in September gave the Syriza government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so Greek exit from the euro may only have been delayed by this latest bailout.

f) Investment returns are likely to remain relatively low during 2016/17 and beyond;

- Borrowing interest rates have been highly volatile during 2015 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. Gilt yields have continued to remain at historically phenominally low levels during 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.

g) **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 2016/17 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 an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised 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 identifies 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	2016/17	2017/18	2018/19	2019/20	2020/21
Interest rate exposures					
	Upper	**Upper**	**Upper**	**Upper**	**Upper**
Limits on fixed interest rates based on net debt (TI-1)	292.3	321.1	308.0	304.9	309.3
Limits on variable interest rates based on net debt (TI-2)	102.3	112.4	107.8	106.7	108.2
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 2011 revised CIPFA Treasury Managemet in the Public Services Code of Practice and Cross Sectorial Guidance Notes ("the CIPFA TM Code").

b) The Council's primary investment objectives are as follows, in order of importance:

(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
(iii) The **returns on investments** that can be realised

The Council will therefore 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.

c) 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. The key ratings used to monitor counterparties are the Short and Long term ratings. The intention of the approach is to provide security of investment and minimisation of risk.

d) 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.

e) 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) 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 June 2016. Bank Rate forecasts for financial year-ends (March) as at January 2016 are:

2015/2016	0.50%
2016/2017	1.00%
2017/2018	1.75%
2018/2019	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	**2016/17**	**2017/18**	**2018/19**	**2019/20**	**2020/21**
Principal sums invested > 364 days	20%	20%	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 2015/16.

(ii) Average borrowing rate movement year on year

Target is to maintain or reduce the average borrowing rate for the Council versus 2015/16.

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 2016/17 are expected to be at or below the Revenue Budget estimate contained in the Council's Financial Plans to be approved in February 2016, which are estimated as follows:

£m	2016/17	2017/18	2018/19	2019/20	2020/21
Interest on Borrowing	11.5	11.7	11.7	11.7	11.7
Investment income	(0.1)	(0.1)	(0.1)	(0.1)	(0.1)
Capital Repayments	8.8	8.0	8.0	8.0	8.0
Total Loan Charges *	**20.2**	**19.6**	**19.6**	**19.6**	**19.6**

**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 2016/17.

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 Ref.	Indicator	Page Ref.	2016/17	2017/18	2018/19	2019/20	2020/21
PRUDENTIAL INDICATORS							
Capital Expenditure Indicator							
PI-1	Capital Expenditure Limits	5	£54.4m	£32.8m	£28.0m	£29.0m	£34.1m
PI-2	Capital Financing Requirement (CFR)	7	£294.4m	£297.9m	£302.3m	£301.5m	£299.3m
Affordability Indicator							
PI-3	Ratio of Financing Costs to Net Revenue (inc. PPP repayment costs)	7	9.4%	10.1%	9.6%	9.6%	9.6%
PI-4	Incremental (Saving)/Cost Impact of Capital Investment Decisions on Council Tax	7	(£0.01)	£(0.01)	(£0.04)	(£0.05)	(£0.06)
External Debt Indicators							
PI-5	Actual Debt	8	£270.8m	£298.9m	£293.1m	£291.6m	£289.6m
PI-7a	Operational Boundary (inc. Other Long Term Liabilities)	8	£292.3m	£320.8m	£307.7m	£304.9m	£309.3m
PI-7b	Operational Boundary (exc. Other Long Term Liabilities)	8	£239.7m	£248.1m	£237.3m	£236.9m	£243.8m
PI-8a	Authorised Limit (inc. Other Long Term Liabilities)	9	£326.3m	£361.9m	£359.7m	£362.4m	£357.9m
PI-8b	Authorised Limit (exc. Other Long Term Liabilities)	9	£273.7m	£289.1m	£289.3m	£294.4m	£292.4m
Indicators of Prudence							
PI-6	(Under)/Over Gross Borrowing against the CFR	8	£(31.4)m	£(2.5)m	£(6.1)m	£(5.6)m	£(7.6)m
TREASURY INDICATORS							
TI-1	Upper Limit to Fixed Interest Rates based on Net Debt	13	£292.3m	£320.8m	£307.7m	£304.9m	£309.3m
TI-2	Upper Limit to Variable Interest Rates based on Net Debt	13	£102.3	£112.4m	£107.8m	£106.7m	£108.2m
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	21	20%	20%	20%	20%	20%

ANNEX B: INTEREST RATE FORECASTS 2016-19

Capita Asset Services' Interest Rate View	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Bank Rate Forecast	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%	2.00%	2.00%	2.00%
3 month LIBID Forecast	0.60%	0.70%	0.80%	0.90%	1.10%	1.30%	1.40%	1.50%	1.80%	1.90%	1.90%	2.00%	2.00%	2.10%
6 month LIBID Forecast	0.80%	0.90%	1.00%	1.10%	1.30%	1.50%	1.60%	1.70%	2.00%	2.10%	2.10%	2.20%	2.20%	2.30%
12 month LIBID Forecast	1.10%	1.20%	1.30%	1.40%	1.60%	1.80%	1.90%	2.00%	2.30%	2.40%	2.40%	2.50%	2.50%	2.70%

Bank Rate	NOW	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Capita Asset Services	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%	2.00%	2.00%	2.00%
Capital Economics	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	-	-	-	-	-

5yr PWLB Rate	NOW	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Capita Asset Services	2.05%	2.30%	2.40%	2.60%	2.70%	2.80%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%
Capital Economics	2.05%	2.40%	2.60%	2.70%	2.80%	3.00%	3.10%	3.20%	3.30%	3.50%	-	-	-	-	-

10yr PWLB Rate	NOW	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Capita Asset Services	2.69%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%
Capital Economics	2.69%	2.80%	3.05%	3.05%	3.05%	3.30%	3.30%	3.55%	3.55%	3.80%	-	-	-	-	-

25yr PWLB Rate	NOW	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Capita Asset Services	3.38%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.30%	4.30%	4.40%	4.40%	4.40%	4.50%
Capital Economics	3.38%	3.35%	3.35%	3.45%	3.45%	3.55%	3.65%	3.75%	3.85%	3.95%	-	-	-	-	-

50yr PWLB Rate	NOW	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Capita Asset Services	3.19%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.20%	4.20%	4.30%	4.30%	4.30%	4.40%
Capital Economics	3.19%	3.40%	3.40%	3.50%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	-	-	-	-	-

Please note – The current PWLB rates and forecasts shown above have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.
December 2015 used as a base.

Source: Capita Asset Services, January 2015

ANNEX C
Economic Background

UK. UK GDP growth rates in of 2.2% in 2013 and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and the 2015 growth rate is likely to be a leading rate in the G7 again. However, quarter 1 of 2015 was weak at +0.4%, although there was a short lived rebound in quarter 2 to +0.7% before it subsided again to +0.5% (+2.3% y/y) in quarter 3. The Bank of England's November Inflation Report included a forecast for growth to remain around 2.5% – 2.7% over the next three years. For this recovery, however, to become more balanced and sustainable in the longer term, it still needs to move away from dependence on consumer expenditure and the housing market to manufacturing and investment expenditure. The strong growth since 2012 has resulted in unemployment falling quickly to a current level of 5.3%.

The MPC has been particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of CPI inflation in order to underpin a sustainable recovery. It has, therefore, been encouraging in 2015 to see wage inflation rising significantly above CPI inflation which has been around zero since February. The Inflation Report was notably subdued in respect of the forecasts for CPI inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. However, once the falls in oil, gas and food prices over recent months fall out of the 12 month calculation of CPI, there will be a sharp tick up from the current zero rate to around 1% in the second half of 2016. Indeed, the increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon it was the biggest since February 2013. Nevertheless, despite average weekly earnings ticking up to 3.0% y/y in the three months ending in September, this is unlikely to provide ammunition for the MPC to take action to raise Bank Rate in the near future as labour productivity growth has meant that net labour unit costs appear to be rising by about only 1% y/y. Having said that, at the start of October, data came out that indicated annual labour cost growth had jumped sharply in quarter 2 from +0.3% to +2.2%: time will tell if this is just a blip or the start of a trend.

There is, therefore, considerable uncertainty around how quickly inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing Bank Rate. There are also concerns around the fact that the central banks of the UK and US currently have few monetary policy options left to them given that central rates are near to zero and huge QE is already in place. There are, therefore, arguments that they need to raise rates sooner, rather than later, so as to have some options available for use if there was another major financial crisis in the near future. But it is unlikely that either would raise rates until they are sure that growth was securely embedded and 'noflation' was not a significant threat.

The forecast for the first increase in Bank Rate has, therefore, been pushed back progressively during 2015 from Q4 2015 to Q2 2016 and increases after that will be at a much slower pace, and to much lower levels than prevailed before 2008, as increases in Bank Rate will have a much bigger effect on heavily indebted consumers than they did before 2008.

The Government's revised Budget in July eased the pace of cut backs from achieving a budget surplus in 2018/19 to achieving that in 2019/20.

USA. GDP growth in 2014 of 2.4% was followed by Q1 2015 growth, which was depressed by exceptionally bad winter weather, at only +0.6% (annualised). However, growth rebounded very strongly in Q2 to 3.9% (annualised) before dipping again in Q3 to 1.5%.

Until the turmoil in financial markets in August, caused by fears about the slowdown in Chinese growth, it had been strongly expected that the Fed. may start to increase rates in September. However, the Fed pulled back from that first increase due to global risks which might depress US growth and put downward pressure on inflation, as well as a 20% appreciation of the dollar which has caused the Fed. to lower its growth forecasts. Although the non-farm payrolls figures for growth in employment in

August and September were disappointingly weak, the October figure was stunningly strong and, together with a likely perception by the Fed. that concerns on the international scene have subsided since August, has now resulted in an interest rate rise in December.

Eurozone. The ECB fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. This appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to a significant improvement in economic growth. GDP growth rose to 0.5% in Q1 2015 (1.0% y/y) but came in at +0.4% (+1.5% y/y) in Q2 and looks as if it may maintain this pace in Q3. However, the recent downbeat Chinese and Japanese news has raised questions as to whether the ECB will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

Greece. During July, Greece finally capitulated to EU demands to implement a major programme of austerity. An €86bn third bailout package has since been agreed although it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the initial resistance of the Syriza Government, elected in January, to EU demands. The surprise general election in September gave the Syriza government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so a Greek exit from the euro may only have been delayed by this latest bailout.

China and Japan. Japan is causing considerable concern as the increase in sales tax in April 2014 suppressed consumer expenditure and growth. In Q2 2015 quarterly growth shrank by -0.3% after a short burst of strong growth of 1.0% during Q1. Japan has been hit hard by the downturn in China during 2015. This does not bode well for Japan as the Abe government has already fired its first two arrows to try to stimulate recovery and a rise in inflation from near zero, but has dithered about firing the third, deregulation of protected and inefficient areas of the economy.

As for China, the Government has been very active during 2015 in implementing several stimulus measures to try to ensure the economy hits the growth target of 7% for the current year and to bring some stability after the major fall in the onshore Chinese stock market during the summer. Many commentators are concerned that recent growth figures could have been massaged to hide a downturn to a lower growth figure. There are also major concerns as to the creditworthiness of much of the bank lending to corporates and local government during the post 2008 credit expansion period. Overall, China is still expected to achieve a growth figure that the EU would be envious of. Nevertheless, concerns about whether the Chinese economy could be heading for a hard landing, and the volatility of the Chinese stock market, which was the precursor to falls in world financial markets in August and September, remain a concern.

Emerging countries. There are also considerable concerns about the vulnerability of some emerging countries and their corporates which are getting caught in a perfect storm. Having borrowed massively in dollar denominated debt since the financial crisis (as investors searched for yield by channelling investment cash away from western economies with dismal growth, depressed bond yields and near zero interest rates into emerging countries) there is now a strong flow back to those western economies with strong growth and an imminent rise in interest rates and bond yields.

This change in investors' strategy, and the massive reverse cash flow, has depressed emerging country currencies and, together with a rise in expectations of a start to central interest rate increases in the US, has helped to cause the dollar to appreciate significantly. In turn, this has made it much more costly for emerging countries to service their dollar denominated debt at a time when their earnings from commodities are depressed. There are also likely to be major issues when previously borrowed debt comes to maturity and requires refinancing at much more expensive rates.

Corporates (worldwide) heavily involved in mineral extraction and / or the commodities market may also be at risk and this could also cause volatility in equities and safe haven flows to bonds. Financial markets may also be buffeted by the sovereign wealth funds of those countries that are highly exposed to falls in commodity prices and which, therefore, may have to liquidate investments in order to cover national budget deficits.

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 evolves over time. Capita Asset Services undertook its last review of interest rate forecasts on 9 November 2015 shortly after the publication of the quarterly Bank of England Inflation Report. There is much volatility in rates and bond yields as news ebbs and flows in negative or positive ways. This latest forecast includes a first increase in Bank Rate in quarter 2 of 2016.

The overall trend in the longer term will be for gilt yields and PWLB rates to rise when economic recovery is firmly established accompanied by rising inflation and consequent increases in Bank Rate, and the eventual unwinding of QE. 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.

However, the overall balance of risks to our Bank Rate forecast is probably to the downside, i.e. the first increase, and subsequent increases, may be delayed further if recovery in GDP growth, and forecasts for inflation increases, are lower than currently expected. Market expectations in November, (based on short sterling), for the first Bank Rate increase are currently around mid-year 2016.

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 economic growth turns significantly 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.
- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or the start of Fed. rate increases, causing a flight to safe havens

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

- Uncertainty around the risk of a UK exit from the EU.
- The commencement by the US Federal Reserve of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to 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, November 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 classes.	£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

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good & Trust Fund Limits	Pension Fund In-House Limits
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 and plan overview

For the year ending 31 March 2016

7 January 2016

For audit and risk committee consideration on

18 January 2016

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Contents

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 ("the Council") and is made available to Audit Scotland and the Controller of Audit (together "the Beneficiaries"). This report has not been designed to be of benefit to anyone except the Beneficiaries. In preparing this report we have not taken into account the interests, needs or circumstances of anyone apart from the Beneficiaries, even though we may have been aware that others might read this report. We have prepared this report for the benefit of the Beneficiaries alone.

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 introduction and responsibilities 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 (under the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002, through a Beneficiary's Publication Scheme or otherwise) 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 the 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, 4th Floor, 102 West Port, Edinburgh, EH3 9DN.

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2015-16 audit strategy on a page

SIGNIFICANT RISKS AND OTHER MATTERS

From discussions with management and from our knowledge of the organisation and review of risk registers, we have considered areas of risk and audit focus. We have identified management override of controls and financial position as significant risks and have rebutted the revenue recognition risk. Other audit focus areas are:

- retirement benefits;
- provisions; and
- transport infrastructure assets.

MATERIALITY

MATERIALITY
£6.4 million
2% EXPENDITURE

REPORTING THRESHOLD
£250,000
4% MATERIALITY

WIDER SCOPE REQUIREMENTS

The audit will consider other areas:

- Audit Scotland's Code of Audit Practice ("the Code") and the audit dimensions set out in the 2016 code (in consultation)
- National Fraud Initiative
- Code of Practice on Local Authority Accounting in the United Kingdom disclosure
- Best Value
- Targeted follow up

KPMG TEAM

The leadership team benefits from strong continuity at all levels:

- Hugh Harvie – engagement partner;
- Matt Swann – engagement senior manager;
- Rhona Mitchell – engagement assistant manager;
- Claire McKenna – engagement in-charge.

We will harness the expertise of our valuation and pension specialists to support our audit work where necessary.

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Scoping and purpose

SECTION 2

Scope definition

The Accounts Commission has appointed KPMG LLP as auditor of the Council under the Local Government (Scotland) Act 1973 ("the Act"). The period of appointment is 2011-12 to 2015-16, inclusive. For the 2015-16 audit our appointment includes the audit of the Health and Social Care Integration Joint Board, established in April 2015.

Purpose

This document summarises our responsibilities as external auditor for the year ending 31 March 2016 and our intended approach to issues impacting the Council's activities in the year.

KPMG's planned audit work in 2015-16 will include:

- an audit of the financial statements and provision of an opinion on whether the financial statements:
  - give a true and fair view in accordance with applicable law and the 2015-16 Code of the state of the affairs of the group and of the local authority as at 31 March 2016 and of the income and expenditure of the group and the authority for the year then ended;
  - have been prepared in accordance with IFRS as adopted by the European Union, as interpreted and adapted by the 2015-16 Code, the requirements of the Local Government (Scotland) act 1973, the Local Authority Accounts (Scotland) Regulations 2014 and the Local Government Scotland Act 2003.
- a review and assessment of the Council's governance arrangements including: a review of the adequacy of internal audit and review of the governance statement;
- a review of National Fraud Initiative arrangements; and
- a review of arrangements for preparing and publishing statutory performance information.

Auditors and audited bodies' responsibilities are set out in Audit Scotland's Code of Audit Practice ("the Code"). This Code states the responsibilities in relation to:

- the financial statements;
- corporate governance and systems of internal control;
- prevention and detection of fraud and irregularities;
- standards of conduct and arrangements for the prevention and detection of bribery and corruption;
- arrangements for preparing and publishing statutory performance information;
- financial position; and
- Best Value, uses of resources and performance.

These responsibilities are outlined in appendix four.

Context

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Risk assessment

In an environment of public sector reform and continued financial pressures, Councils are faced with real term funding decreases combined with increasing demand for services.

The shared risk assessment process forms a local scrutiny plan for Councils each year. The local scrutiny plan for 2015-16 outlines a range of scrutiny activities, including:

- Progress with the council's Transformation agenda (including the impact of recent senior appointments such as the Service Director Children and Young People)
- Progress with further implementation of the health and social care agenda
- Bedding down of the SB Cares new model of service delivery

Financial position

A revised balanced budget has been approved for 2015-16, representing expenditure of £266.0 million. Financial monitoring as at 30 September 2015 show that this is projected to be achieved.

Good progress has been made in the delivery of planned efficiency savings 70% (£5.5 million) with achieved by 30 September 2015.

In the six months to 30 September 2015 37% of the Capital Plan has been delivered. It is expected that the remaining plan will be delivered by 31 March 2016.

Key developments

Key developments to be considered during the 2015-16 audit and included within our annual audit report include:

- the establishment of the Scottish Borders Health and Social Care Integration Joint Board;
- progress against efficiency savings;
- Audit Scotland's new best value approach for 2015-16 onwards;
- progress against the Council plan; and
- the impact of the results of the Scottish Parliamentary elections in May 2016.

Audit dimensions – as they develop we will consider the wider scope Audit Dimensions as set out in the Code of Audit Practice 2016 (in consultation). The audit dimensions put Best Value at the core.

Financial sustainability	Financial management	Governance and transparency	Value for money
Financial sustainability looks forward to the medium and longer term to consider whether the Council is planning effectively to continue to deliver its services or the way in which they should be delivered.	Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.	Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.	Value for money is concerned with using resources effectively and continually improving services.

Materiality

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

Audit differences will be raised with the audit and risk committee if they are material in size or material in nature. For 2015-16 we consider individual or aggregated financial statement errors of over £6.4 million (2015: £6.4 million) to be material.

To the extent that we identify misstatements above £250,000 (2014-15: £250,000) we report them to the audit and risk committee and assess whether the misstatement is indicative of a significantly deficient or materially weak control environment.

We recognise that matters can be important because of their nature regardless of their size, for example misstatements to key disclosures such as remuneration and related parties, and we will also report these to the audit and risk committee.

Page 58

MATERIALITY

£6.4 million

2% EXPENDITURE

REPORTING THRESHOLD

£250,000

4% MATERIALITY

DETERMINING MATERIALITY

We consider materiality by reference to the Council's total expenditure.

Audit Scotland guidance typically puts this percentage at not higher than 2% of the chosen gross metric (total expenditure).

We considered the Council's total expenditure of 2014-15 along with expectation for 2015-16 and consider the use of a materiality of £6.4 million, representing 2% of 2014-15 total expenditure to be appropriate.

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 set out our view of significant risks, along with our other audit focus areas, in terms of the comprehensive income and expenditure statement and the balance sheet.

COMPREHENSIVE INCOME AND EXPENDITURE

CAPTION	14-15 £'000
Gross income	(69,370)
Gross expenditure	321,892
Other operating expenditure	123
Financing and investment income and expenditure	20,731
Taxation and non-specific grant income	(273,555)
Other comprehensive income and expenditure	(44,745)
Total comprehensive income and expenditure	(44,924)

Fraud risk from income recognition

Financial position

Key

Significant audit risk

Other focus area

BALANCE SHEET

CAPTION	14-15 £'000
Property, plant and equipment	424,563
Other long term assets	5,223
Short term debtors	29,381
Cash and cash equivalents	14,997
Other current assets	1,018
Short term borrowing	(3,243)
Short term creditors	(49,026)
Provisions	(1,299)
Long term liabilities	(237,225)
Pension asset/ liability	(166,072)
Net assets including pension liability	18,317
Useable reserves	(27,896)
Unusable reserves	9,579

Fraud risk from income recognition

Transport infrastructure assets

Provisions

Retirement benefits

Page 59

DRAFT

Significant risks

RISK	WHY	AUDIT APPROACH
Fraud risk from management override of controls	Professional standards require us to communicate the fraud risk from management override of controls as a significant risk; as 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.	■ Our audit methodology incorporates the risk of management override as a default significant risk. We have not identified any specific additional risks of management override relating to the audit of the Council. ■ Strong oversight of finances by management provides additional review of potential material errors caused by management override of controls. ■ In line with our methodology, we will carry out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the organisation's normal course of business, or are otherwise unusual.
Fraud risk from income recognition	Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk.	■ 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. ■ We consider the fraud risk from recognition of other income to be significant. Other income relates primarily to sales or service income, and therefore we consider there to be potential judgement in recognising this income. ■ The potential for revenue to be incorrectly recognised will be addressed through controls testing 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.

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Significant risks

RISK	WHY	AUDIT APPROACH
Financial position	Delivering services in the environment of continued financial pressures and funding uncertainty remains a challenge for the sector. Recently the Council has underspent against budget in total. In 2014-15 the Council recorded an underspend of £0.4 million against the final, revised budget. In the aftermath of Storm Desmond Scottish Borders Council has notified the Scottish Government of their intention to make a claim for Bellwin funding to support recovery efforts. Whilst the Council undertakes robust financial planning, financial sustainability is a key risk due to the inherent risk in the sector environment.	■ 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 process including the monitoring of budgets throughout the year. We will perform substantive analytical procedures over income and expenditure comparing the final position to budget.

Other focus areas

FOCUS AREA	WHY	AUDIT APPROACH
Transport infrastructure assets	The 2016-17 Code will adopt requirements of the Code of practice on transport infrastructure assets (“the transport code”), which requires measurement of these assets on a depreciated replacement cost basis. This will represent a change in accounting policy from 1 April 2016 and require full retrospective restatement. Local authorities are advised to have implemented a robust project plan through 2015-16 to ensure preparedness for the requirements of the 2016-17 code.	We will consider the Council’s plan for the requirements of the transport code, including assessing the completeness of information for an opening balance sheet. We will evaluate the extent to which the Council is prepared for the change in accounting policy
Provisions	Management has considered the future capital costs and revenues associated with the decommissioning of open cells at its Easter Langlee landfill site, and a provision was recognised on the balance sheet at 31 March 2015 of £4.02 million. The Council received appropriate advice from internal and external specialists and we will continue to monitor the appropriateness of this provision. The Council has considered whether a provision should be made related to contributions related to the Borders Railway now that it is obliged to begin making payments to the Scottish Ministers. We concur with the view that no provision is required and we will continue to monitor the appropriateness of this conclusion as contributions are collected. Following a European Court of Justice ruling in May 2014, employers are required to pay holiday pay to staff at a rate commensurate with any commission or over time that they regularly earn, instead of at their basic pay level. Following legal advice, management implemented this process for holiday pay. Management is awaiting the outcome of recent legal proceedings to consider if there is a contingent liability that requires disclosure as at 31 March 2016.	Under IAS 37 a provision should be recognised when: ■ an entity has a present obligation as a result of a past event; ■ it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and ■ a reliable estimate can be made of the amount of the obligation. We will remain alert to legislative changes and consider the Council’s position in relation to the criteria. We will challenge and assess the judgements applied as at the year end and review recognition of any provisions, or disclosures of contingent liabilities.

Other focus areas

FOCUS AREA	WHY	AUDIT APPROACH
Retirement 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 calculation of the pension liability is inherently judgemental.	Our audit approach to IAS 19 includes: ■ review by KPMG specialists of the financial assumptions underlying actuarial calculations and comparison to our central benchmarks; ■ testing of scheme assets and rolled-forward liabilities; ■ testing of the level of contributions used by the actuary to those actually paid during the year; ■ testing of membership data used by the actuary to data from the Council; and ■ agreeing actuarial reports to financial statement disclosures.

Presentation of financial statements

Code of practice on Local Authority Accounting in the United Kingdom 2015-16 ("the Code") Page 64	The 2015-16 financial statements will be prepared in accordance with the *Code of practice on local authority accounting in the United Kingdom 2015-16* which is based on International Financial Reporting Standards ("IFRS"). The 2015-15 Code has a number of amendments from the 2014-15 Code and management should consider if these changes will impact the financial statements. The amendments include: ■ adoption of IFRS 13 *Fair Value Measurement,* including consequential amendments as a result of adopting this standard; ■ amendments to underline the importance of the consideration of materiality when preparing disclosures; ■ amendments made as a result of the Local Authority Accounts (Scotland) Regulations 2014; and ■ some changes to section 4.10 on heritage assets to reflect that FRS 30 has been replaced by FRS 102. We consider that the adoption of IFRS 13 may have an impact on the Council's financial statements.
New Charities SORPs	In July 2014 the SORP Committee issued two new Charities SORPs to reflect the new UK accounting framework ('new UK GAAP'). The new SORPs provide a comprehensive framework for charity accounting that all charities that prepare accrual accounts must follow and apply to financial years beginning on or after 1 January 2015. The new framework provides a SORP to support each of the accounting standards from which charities can choose, depending on their size.. The FRSSE standard is due to be reviewed by 2016 and a change in the FRSSE will require a change in the FRSSE SORP. Charities adopting the FRSSE may face changing their accounting policies twice in succession. We will provide continued support to management in the consideration and implementation of the new Charities SORPs and how this applies to charitable entities.

Group financial statements

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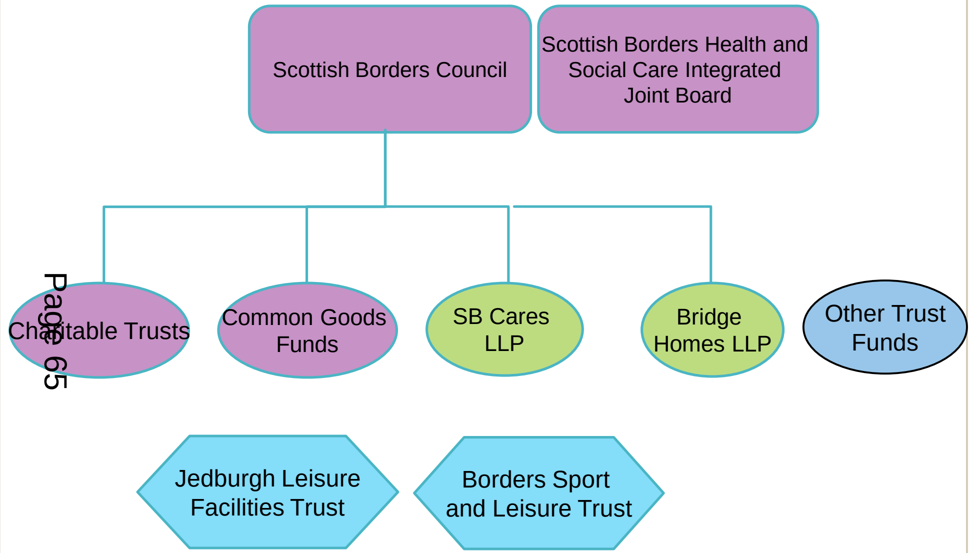
Group financial statements



Page 65

Key

- Included within scope of council audit appointment
- Not included within scope of council audit appointment
- Other trusts are not included within the scope of council audit appointment
- Not included within scope of council audit appointment and audited by KPMG.

Main body

Subsidiary

Associate

Charity accounts

As the trustees of the Charitable Trusts and Common Good Funds are members of the authority and it is registered with the Office of the Scottish Charity Regulator, an audit is required in line with the *Local Government (Scotland) Act 1973* (section 106 charities). We will complete an external audit of the charity's accounts, and report on this within our annual audit report to the Council.

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 Integration Joint Board ("IJB") was formally established on 1 April 2015 and met for the first time on 27 April 2015. The chief finance officer is yet to be appointed. Feedback on the submitted Scheme of Integration for the Scottish Borders was received from the Scottish Government on 29 May 2015. A revised Scheme of Integration was submitted on 16 October 2015.

Auditors are required to consider the Council's progress in the integration of health and social care, and report our findings in the annual audit report. Specifically, we will consider the date that the integrated joint boards became operational, review financial plans and comment on progress towards establishing effective governance arrangements for the new partnerships. We are the external auditor of the Scottish Borders Integration Joint Board, and will prepare a separate annual audit report to the IJB.

Approach to fraud

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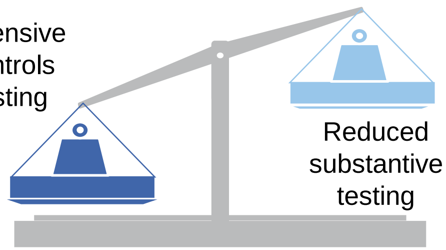
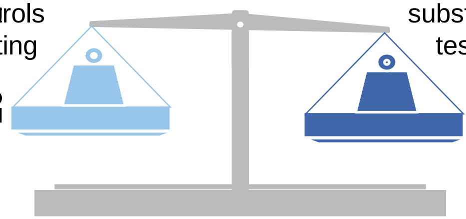
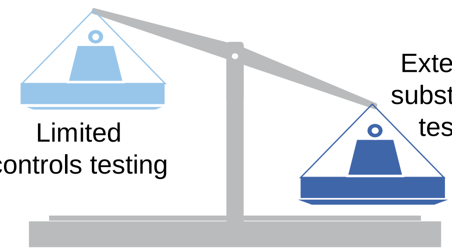
Discuss fraud	Assess fraud risk	Tailor audit response
■ Discussions with: – Audit and Risk Committee; – Chief Executive; – Chief Financial Officer; – Chief Officer Audit and Risk; and – Corporate Finance team members.	■ Preliminary fraud risk assessment: – Management oversight; – Internal control framework; – Nature of operations.	■ Our audit procedures are designed to have a reasonable chance of detecting misstatements as a result of fraud or error – Review and test the fraud risk assessment process, systems and controls to prevent, deter and detect fraudulent activity. – Evaluate the design of financial reporting controls during process testing to assess their effectiveness in detecting fraud. – Identify and select specific journal entries for detailed substantiation and consolidation journals for appropriate evidence and basis. – Review significant accounting estimates for management bias. ■ The audit team will review and discuss fraud related risks and controls with members of senior management. ■ We will incorporate an element of unpredictability into our testing, as individuals within the Council who are familiar with our audit procedures may be able to use that knowledge to conceal fraudulent financial reporting.

Page 66

Audit approach

Substantive testing

What we do	Accounts/transactions suited to this testing	KPMG's approach to:
 Extensive controls testing Reduced substantive testing	■ Low value transactions ■ High volume ■ Homogenous transactions ■ Little judgement	■ Payroll expenditure ■ Net cost of services
 Moderate controls testing Moderate substantive testing	■ Low/medium value ■ High/medium volume ■ Some areas requiring judgement	■ Income from trading activities ■ Debtors, creditors and accruals ■ Restricted/unrestricted funds (charities) ■ Investments and cash
 Extensive substantive testing Limited controls testing	■ High value ■ Low volume **or** ■ Unusual non-recurring ■ Accounting estimates ■ Significant judgments	■ Property, plant and equipment ■ Pension scheme liability ■ Journals ■ Property, plant and equipment ■ Taxation and non-specific grant income ■ Borrowings

Page 67

Wider scope requirements

Shared risk assessment

Local area networks ("LANs") are established for each local authority. These bring together local scrutiny representatives in a systematic way to agree a shared risk assessment. As external auditor, we are a key member of the shared risk assessment process for the Council.

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 for individual councils.

The 2015-16 SRA identified areas of scrutiny for the Council as:

- Progress with the council's Transformation agenda (including the impact of recent senior appointments such as the Service Director (Children and Young People)
- Progress with further implementation of the health and social care agenda
- Bedding down of the SB Cares new model of service delivery

Governance

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. We are required to review the governance statement against disclosure requirements and consider its content against our knowledge and understanding of the Council. We will report on findings in the annual audit report.

Best Value and continuous improvement

Best Value audits are carried out by central teams within Audit Scotland's performance audit and best value ("PABV") group in partnership with local auditors. The timing, nature and extent of these is determined as part of the SRA process.

The Accounts Commission has developed a new approach to Best Value in 2015-16, with emphasis on driving continuous improvement and providing a Best Value report for each Council at least once every five years. The new arrangements will develop a joint responsibility of best value between PABV and local auditors. Under the approach, our role will be expanded to include scoping, planning, gathering evidence and contributing to best value audit reports. The focus of our final year of appointment will be ensuring a smooth transition and preparing for the new approach. Linking in with the SRA process, we will work with other scrutiny bodies to prepare a baseline summary on best value for the Council.

Following the public pound

Local authorities have a statutory requirement to comply with the Code of Guidance on Funding External Bodies and Following the Public Pound ("the FtPP code"). Internal Audit has recently completed audit work on Grants and Following the Public Pound and has issued a report to Management which is currently in draft. As part of the audit we are required to consider the Council's arrangements to comply with the FtPP code. We will report any matters of non-compliance within our annual audit report. In future years, auditing of compliance with the FtPP code will be part of the new integrated best value audit approach.

Wider scope requirements (continued)

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. We will prepare a short return to Audit Scotland on the Council's progress and engagement with the NFI process during our interim audit.

Statutory performance indicators

The statutory deadline for publication by the Council of statutory performance indicators ("SPIs") is 30 September 2016. Auditors must assess the adequacy of arrangements for collecting and publishing information in relation to SPIs. We will complete a pro-forma schedule to reflect the audit work on SPIs for submission to Audit Scotland and include a summary within our annual audit report.

Targeted follow up – Scotland's public workforce

In November 2013 the Accounts Commission and Auditor General for Scotland published a report on Scotland's public sector workforce. It is our responsibility to establish the extent that the Council has implemented the recommendations to help identify any common and emerging issues across the public sector. We will perform targeted follow up work, submit a short questionnaire to Audit Scotland and report our findings in our annual audit report.

Internal audit

In accordance with International Standard on Auditing (UK and Ireland) 610: *Considering the work of internal audit, we* will continue liaison with internal audit and evaluate internal audit processes against Public Sector Internal Audit Standards. The general programme of work will be reviewed for significant issues to support our general work in assessing the Council's annual governance statement. Specific internal audit reviews which will be considered include payroll and other income.

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Timeline and reporting

26 NOVEMBER
Audit planning meeting, identification of key audit areas and agreement of audit logistics.

Page 70

DECEMBER
Planning and risk assessment

18 JANUARY
Presentation of Audit Strategy to audit and risk committee

12 JANUARY
Start of interim fieldwork

29 FEBRUARY
Submit NFI questionnaire

21 MARCH
Presentation of interim findings to audit and risk committee

MAY
Audit of SB Cares LLP

JUNE - SEPTEMBER
Review of grant claims

4 JULY
Final audit fieldwork commences

26 SEPTEMBER
Presentation of KPMG reporting documents to audit and risk committee

29 SEPTEMBER
Financial statements and WGA signed by KPMG and the Council.

Dec Jan Feb Mar Apr May Jun Jul Aug Sep Oct

2015 2016

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Audit outputs

Output	Description	Report date
NFI report	We report on the Council's actions to investigate and follow-up NFI matches.	By 29 February 2016
Audit strategy	Our strategy for the external audit of the Council, including significant risk and audit focus areas.	By 31 January 2016
Submit fraud returns	We report on any frauds over £5,000.	By 27 May 2016
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 May 2016
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 2016
Independent auditor's report	Our opinion on the Council's financial statements.	By 30 September 2016
Annual audit report to the Council and the Controller of Audit	We summarise our findings from our work during the year.	By 30 September 2016
Whole of Government Accounts	We report on the pack prepared for consolidation and preparation of the Whole of Government Accounts.	By 30 September 2016
Audit reports on grant claims and other returns	We will report on the following returns: - Education Maintenance Allowance return; - Criminal Justice Authority return; - Non Domestic Rate return; and - Housing Benefit Count return.	To submit by: - 31 July 2016; - 30 September 2016; - 9 October 2016; and - 30 November 2016.

Page 71

Appendices

Mandated communications with the audit and risk committee

APPENDIX I

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Matters to be communicated	Link to Audit Committee papers
Independence and our quality procedures ISA 260 (UK and Ireland).	■ See next page
The general approach and overall scope of the audit, including levels of materiality, fraud and engagement letter ISA 260 (UK and Ireland).	■ Main body of this paper
■ Disagreement with management about matters that, individually or in aggregate, could be significant to the entity's financial statements or the auditor's report, and their resolution (AU 380).	■ In the event of such matters of significance we would expect to communicate with the audit and risk committee throughout the year. ■ Formal reporting will be included in our audit highlights memorandum for the September 2016 audit and risk committee meeting, which focuses on the financial statements.
■ Significant difficulties we encountered during the audit. ■ Significant matters discussed, or subject to correspondence, with management (ISA 260).	
■ Our views about the qualitative aspects of the entity's accounting and financial reporting. ■ The potential effect on the financial statements of any material risks and exposures, such as pending litigation, that are required to be disclosed in the financial statements (ISA 260 and ISA 540).	
■ Audit adjustments, whether or not recorded by the entity, that have, or could have, a material effect on its financial statements. We will request you to correct uncorrected misstatements (including disclosure misstatements) (ISA 450).	
■ The selection of, or changes in, significant accounting policies and practices that have, or could have, a material effect on the entity's financial statements (ISA 570).	
■ Material uncertainties related to events and conditions that may cast significant doubt on the entity's ability to continue as a going concern (ISA 570).	
■ Expected modifications to the auditor's report (ISA 705).	
■ Related party transactions that are not appropriately disclosed (ISA 550).	

Auditor independence

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 Hugh Harvie 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.

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 partners, directors 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; and
- Independent reviews.

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

There are no other matters that, in our professional judgement, bear on our independence which need to be disclosed to the audit and risk committee.

Confirmation of our audit independence

We confirm that as at 8 December 2015, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of Hugh Harvie and the audit team is not impaired.

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

Yours faithfully

KPMG LLP

Fees

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 needed to complete 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
- 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 full electronic files of 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
- completion within the agreed timetable

Audit Scotland has notified us that the fee range for 2015-16 is £269,902 to £329,876, with a mid-point of £299,889 (including VAT). This represents a 1% increase from 2014-15. We have proposed a fee of £306,889, an increase of £7,000 on the mid-point. This is in respect of the audit of the charitable entities.

Should we be required to undertake significant additional audit work in respect of any of the areas of audit focus or other matters arising, we will discuss with management the impact of this on our proposed fee.

As in 2014-15, an element of this fee will be allocated for our work on the audit of the financial statements of the Council's Pension Fund and we will agree this with officers for the purposes of the re-charge to, and disclosure in, the Pension Fund's financial statements.

In 2015-16 we will again audit Bridge Homes LLP and in addition we will audit SB Cares LLP for the first year. These bodies are outside of scope of section 106 and therefore require to be treated as separate engagements, with fees are agreed separately.

Audit Scotland code of audit practice – responsibilities of auditors and management

Responsibilities of auditors	Responsibilities of management
Financial statements	
Auditors are required to audit financial statements in accordance with the timescales set by Audit Scotland, which may be shorter than statutory requirements, and give an opinion on: ■ whether they give a true and fair view of the financial position of audited bodies and their expenditure and income; and ■ whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements. Auditors should review and report on, as appropriate, other information published with the financial statements, including the directors' report, annual governance statement, statement on internal control or statement on internal financial control and the remuneration report. Where required, auditors should also review and report on the Whole of Government Accounts return.	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 (e.g., 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.
Corporate governance arrangements	
Consistent with the wider scope of public audit, the Code gives auditors a responsibility to review and report on audited bodies' corporate governance arrangements as they relate to: ■ bodies' reviews of corporate governance and systems of internal control, including their reporting arrangements; ■ the prevention and detection of fraud and irregularity; ■ standards of conduct and arrangements for the prevention and detection of corruption; and ■ the financial position of audited bodies.	Through its chief executive or accountable officer, each body is responsible for establishing arrangements for ensuring the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies usually involve those charged with governance (including audit committees or similar groups) in monitoring these arrangements.

Audit Scotland code of audit practice – responsibilities of auditors and management

Responsibilities of auditors	Responsibilities of management
Systems of internal control	
Auditors are required to review and report on the compliance statements given by bodies under the relevant code or framework before their publication. This is discharged by reviewing and, where appropriate, examining evidence relevant to audited bodies' arrangements in accordance with any guidance issued by Audit Scotland. Auditors are not required to consider whether the statements cover all risks and controls, or form an opinion on the effectiveness of procedures, but report where compliance statements are not consistent with their knowledge of the body.	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	
Auditors should review and report on these arrangements. While auditors do not substitute for audited bodies own responsibilities, and are not responsible for preventing or detecting fraud or irregularity, they should be alert to the potential for breaches of procedures, and of fraud and irregularity. Auditors examine evidence that is relevant to these arrangements, particularly aspects of internal financial control such as segregation of duties, authorisation and approval processes and reconciliation procedures.	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.

Audit Scotland code of audit practice – responsibilities of auditors and management

Responsibilities of auditors	Responsibilities of management
Standards of conduct and arrangements for the prevention and detection of bribery and corruption	
Auditors should consider whether bodies have adequate arrangements in place to maintain and promote proper standards of financial conduct and to prevent and detect bribery and corruption. Auditors review and, where appropriate, examine evidence that is relevant to these arrangements and reporting their findings. While auditors are not responsible for preventing or detecting failure to maintain an appropriate level of integrity and openness, they should be alert to the potential for corruption and breaches of standards of conduct in all aspects of their work. If weaknesses in arrangements are identified or notified, auditors should report them promptly to management or those charged with governance.	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.
Financial position	
Auditors should consider whether audited bodies have established adequate arrangements to ensure that their financial position is soundly based, where appropriate, examining evidence that is relevant to the arrangements. Auditors should have regard to audited bodies': ■ financial performance in the period under audit; ■ compliance with any statutory financial requirements and financial targets; ■ ability to meet known or contingent statutory and other financial obligations; ■ responses to developments which may have an impact on their financial position; and ■ financial plans for future periods.	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.

Audit Scotland code of audit practice – responsibilities of auditors and management

Responsibilities of auditors	Responsibilities of management
Best Value, use of resources and performance	
The Local Government (Scotland) Act 1973 places a duty on the auditors of local government bodies to be satisfied that proper arrangements have been made for securing Best Value and complying with responsibilities relating to community planning. Auditors of local government bodies also have a responsibility to review and report on the arrangements that specified audited bodies have made to prepare and publish performance information in accordance with directions issued by the Accounts Commission. Auditors should undertake appropriate work to satisfy themselves that bodies have put in place adequate arrangements for the collection, recording and publication of statutory performance information by reviewing and examining evidence that is relevant to these arrangements in accordance with any guidance issued by Audit Scotland.	Local authorities have a statutory duty to make arrangements to secure Best Value; defined as the continuous improvement in the performance of functions. In securing Best Value, local authorities must maintain a balance of quality and cost considerations and have regard, among other things, to economy, efficiency and effectiveness (or 'value for money') and the need to meet equal opportunity requirements and contribute to the achievement of sustainable development. Local authorities also have a duty for community planning, which is to initiate, maintain and facilitate consultation among and with public bodies, community bodies and others about the provision of services in the area of the local authority and the planning of that provision. 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. The Local Government Act 1992 requires the Accounts Commission to specify information which local authorities must publish about their performance.

KPMG

cutting through complexity

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Agenda Item 8

ITEM

Internal Audit Work 2015/16 to December 2015

Report by Chief Officer Audit and Risk

Audit and Risk Committee

18 January 2016

1 PURPOSE AND SUMMARY

1.1 The purpose of this report is to provide the Audit and 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 work Internal Audit has carried out in the period from 1 November to 31 December 2015 to deliver the Internal Audit Annual Plan 2015/16 is detailed in this report. During this period a total of 7 final internal audit reports have been issued. There were 11 recommendations made (0 Priority 1 High Risk, 4 Priority 2 Medium Risk, and 7 Priority 3 Low Risk) specific to 4 of the reports. Management have agreed to implement the recommendations to improve internal controls and governance arrangements.

1.3 An Executive Summary of the final internal audit reports issued, including audit objective, findings, good practice, recommendations (where appropriate) and the Chief Officer Audit and 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.

1.4 The SBC Internal Audit function conforms to the professional standards as set out in Public Sector Internal Audit Standards (PSIAS) effective 1 April 2013 including the production of this report to communicate the results of the reviews.

2 RECOMMENDATIONS

2.1 I recommend that the Audit and Risk Committee:

a) Notes the final reports issued in the period from 1 November to 31 December 2015 to deliver the Internal Audit Annual Plan 2015/16; and

b) Acknowledges that it is satisfied with the recommended audit actions agreed by Management.

3 PROGRESS REPORT

3.1 The Internal Audit Annual Plan 2015/16 was approved by the Audit and Risk Committee on 23 March 2015. Internal Audit has carried out the following work in the period 1 November to 31 December 2015 to deliver the plan to meet its objective of providing an opinion on the efficacy of the Council's risk management, internal control and governance arrangements.

3.2 The SBC Internal Audit function conforms to the professional standards as set out in Public Sector Internal Audit Standards (PSIAS) effective 1 April 2013 including the production of this report to communicate the results of the reviews.

Audit Reports

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

- Grants and Following The Public Pound
- Tweedbank Primary School
- Denholm Primary School
- St Ronan's Primary School
- Homelessness – Rent Accounting System
- Waste and Recycling Services – Trade Waste
- ICT Operational Processes

3.4 An Executive Summary of the final internal audit report issued, including audit objective, findings, good practice, recommendations (where appropriate) and the Chief Officer Audit and 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, as outlined in the approved Internal Audit Charter, 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.

Current Work in Progress

3.5 Internal Audit work in progress to deliver the Internal Audit Annual Plan 2015/16 consists of the following:

Audit Area	**Audit Stage**
Creditors Payments	Fieldwork nearly completed
Salaries (including expenses)	Fieldwork nearly completed
Contract Management	Fieldwork underway
Capital Projects	Fieldwork underway
Corporate Transformation	Fieldwork underway
Information Governance	Fieldwork underway
Revenues (Council Tax and Non Domestic Rates)	Audit Assignment Issued

Other Productive Work

3.5 Internal Audit staff 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:

3.5.1 Attending relevant seminars, development workshops and user groups, and feedback to colleagues as relevant, to ensure their skills and knowledge are kept up-to-date and to fulfil their Continuing Professional Development (CPD) requirements.

3.5.2 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, for example, the Welfare Reform Programme, the Information Governance Group, and the Serious Organised Crime Officer Working Group. This period included observations which have arisen during our Primary Schools internal audit work regarding the business support resources and processes. We have identified the impact, issues and opportunities relating to the area to assist the provision of Best Value services through improving the effectiveness, efficiency and sustainability of the business support arrangements. The report was issued to Management with the aim of providing an opportunity to establish a cluster / locality forum to enable Primary Schools' business administration staff to network with their peers, share ideas and best practice, and to disseminate information.

3.5.3 Reviewing outstanding and overdue audit recommendations to ensure Internal Audit are satisfied that progress has been made to implement the previous internal audit recommendations and management actions, that actions taken have had the desired effect in improving internal controls and governance, and are reflected in the corporate performance systems for reporting purposes. There are no specific matters that Internal Audit requires to bring to the attention of Management and the Audit and Risk Committee relating to areas reviewed this period.

3.5.4 Offering advice on improvements to fraud prevention controls and detection processes put in place by Management. Internal Audit resources have also been deployed on corporate process reviews, for example, the Corporate Fraud Working Group.

Recommendations

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 the risk assessment of non-implementation, being the product of the likelihood of the risk materialising and its impact:

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 within one month of formally raising the issue. Added to the relevant Risk Register and included in the relevant Assurance Statement.

Priority 2: Substantial weaknesses in existing controls, leaving the Council or Service open to medium risk of error, fraud, financial loss or reputational damage requiring reasonably urgent action within three months of formally raising the issue.

Priority 3: Moderate weaknesses in existing controls, leaving the Council or Service open to low risk of error, fraud, financial loss or reputational damage requiring action within six months of formally raising the issue to improve efficiency, effectiveness and economy of operations or which otherwise require to be brought to the attention of senior management.

The action plans in audit reports address only recommendations rated Priority 1, 2 or 3. Outwith the report, Internal Audit informs operational managers about other matters as part of continuous improvement.

3.7 The table below summarises the number of internal audit recommendations made during 2015/16:

	2015/16 Number of Recommendations
Priority 1	0
Priority 2	4
Priority 3	7
Sub-total reported this period	**11**
Previously reported	5
Total	**16**

Recommendations agreed with action plan	16
Not agreed; risk accepted	0
Total	**16**

4 IMPLICATIONS

4.1 Financial

It is anticipated that cost efficiencies will arise as a direct result of Management implementing the recommendations made by Internal Audit.

4.2 Risk and Mitigations

(a) The Objectives of Internal Audit are set out in its Charter. "As part of Scottish Borders Council's system of corporate governance, Internal Audit's purpose is to support the Council in its activities designed to achieve its declared objectives." Internal Audit provides assurance to Management and the Audit and Risk Committee on the effectiveness of internal controls and governance within the Council. Specifically as "a contribution to the Council's corporate management of risk" this includes responsibility in "Assisting management to improve the risk identification and management process in particular where there is exposure to significant financial, strategic, reputational and operational risk to the achievement of the Council's objectives."

(b) Key components of the audit planning process include a clear understanding of the Council's functions, associated risks, and potential range and breadth of audit areas for inclusion within the plan. During the development of the Internal Audit Annual Plan 2015/16, to capture potential areas of risk and uncertainty more fully, key stakeholders have been consulted and risk registers have been considered.

(c) 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.

4.3 **Equalities**

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**

There are no direct economic, social or environmental issues in this report.

4.5 **Carbon Management**

No direct carbon emissions impacts arise as a result of this report.

4.6 **Rural Proofing**

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**

No changes are required as a result of this report.

5 CONSULTATION

5.1 The Service Directors relevant to each of the internal audit reports have signed off the executive summaries within Appendix 1.

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

5.3 The Chief Financial Officer, the Monitoring Officer, the Chief Legal Officer, the Chief Officer HR, and the Clerk to the Council have been consulted on this report and any comments received have been incorporated into the report.

Approved by

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

Author(s)

Name	Designation and Contact Number
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James Collin	Internal Audit Manager Tel 01835 824000 Ext 5232

Background Papers: Appropriate Internal Audit files
Previous Minute Reference: Audit and Risk Committee 23 March 2015

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

Contact us at James Collin, Audit and Risk jcollin@scotborders.gov.uk

Report	Summary of key findings and recommendations	Recommendations			Status
		1	2	3	
Audit Plan Category: Financial Governance Subject: Grants and Following the Public Pound No: 004/002 Date issued: 11 January 2016 Level of Assurance: Substantial	The purpose of the review was to provide an overview of the governance framework in place at the Council with regard to grants received and grants disbursed, including Following the Public Pound (FtPP), and to evaluate its adequacy. The governance and administration of grants is very important. Not only does SBC have a statutory duty to Best Value, under the Local Government (Scotland) Act 2003, it also has a statutory duty to comply with Following the Public Pound (Audit Scotland COSLA Code of Practice). The fundamental control for all Council income receivable and expenditure is the revenue and capital budget. The Scheme of Delegation (2015), Scheme of Administration (2015) and Financial Regulations (2012) govern authorisation of grants applied for or claimed and grants disbursed. Internal Audit considers that the level of assurance we are able to give in respect of the internal control and governance of grants and following the public pound is substantial. Largely satisfactory risk, control, and governance systems are in place. There is, however, some scope for improvement. The Internal Audit recommendations made in this report are designed to ensure transparent and complete Management Information so that at any point in time it is possible to get a clear and accurate picture of all grants coming in and all grants going out of the Council, without further manipulation of data from other sources, and assurance from Management that they are being governed in the appropriate manner both by the Council and by the recipients. This will ensure that the Council is able to demonstrate within the forward planning process that there is alignment to its strategic priorities, to evidence compliance with Following the Public Pound, and to help with the identification of those communities that are not currently benefitting from grant funding in the Scottish Borders.	0	0	4	Management have accepted the report findings and agreed to implement the audit recommendations within appropriate timescales.

Report	Summary of key findings and recommendations	Recommendations 1	2	3	Status
Subject: Grants and Following the Public Pound	We have made the following recommendations to enhance the control of receipt and payment of grants: • The master Grants Received Register should be fully consolidated and reconciled to FIS on a quarterly basis. The information contained therein should be complete, accurate, timely, reconcilable to FIS and able to facilitate audit and to evidence following the public pound. It should be centrally accessible to all services that require such Management Information to help coordinate applications based on SBC's strategic priorities. (P3) • A Grants Disbursed Register should be populated with all awards made on a monthly basis. The information contained therein should be complete, accurate, timely, reconcilable to FIS and able to facilitate audit and to evidence following the public pound. It should be centrally accessible to all services that require such Management Information to help coordinate disbursements based on SBC's strategic priorities. (P3) • The Following the Public Pound Code of Practice (FPP) (2006) and other Grants Received and Grants Disbursed related procedures and guidelines should be updated and published on the Intranet. As a minimum the FPP basic requirements should be extended to encompass all arrangements not just those that fit the criteria. Each grant approved for distribution should be allocated an appropriate governance stream i.e. be covered by clear, up-to-date procedures and guidelines. (P3) • Management should ensure that there are clear monitoring arrangements within the up-to-date procedures and guidelines and that there is sufficient review activity taking place to confirm that the monitoring is being done, which will also alert Management to any developing risks and issues. (P3) The Internal Audit recommendation made within our report on the LEADER Programme (issued 21 October 2015) relating to state aid assessment, recording and reporting mechanisms applies equally to grants.				

Report	Summary of key findings and recommendations	Recommendations			Status
		1	2	3	
Audit Plan Category: Internal Controls Subject: Tweedbank Primary School No: 128/014 Date issued: 11 December 2015 Level of Assurance: Comprehensive	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; School lets; Income Collection and Banking procedures; School Fund; Ordering/Invoice processing procedures; Data Protection/Confidential Waste Management. The business and administrative processes within the school are effective 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 have been agreed during the audit visit to the School on 3 November 2015.	0	0	0	Management have agreed the report findings.

Report	Summary of key findings and recommendations	Recommendations			Status
		1	2	3	
Audit Plan Category: Internal Controls Subject: Denholm Primary School No: 128/015 Date issued: 15 December 2015 Level of Assurance: Comprehensive	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; School lets; Income Collection and Banking procedures; School Fund; Ordering/Invoice processing procedures; Data Protection/Confidential Waste Management. Denholm Primary is a shared headship school with Hobkirk Primary. However, in October 2015 it was agreed by Council that, due to falling numbers of pupils, Hobkirk Primary School would be mothballed. The timing of our visit to Denholm Primary (25 November 2015) was during the transitional period when not all the administrative functions from Hobkirk Primary had been finalised, therefore this report is solely based on Denholm Primary. The business and administrative processes within the school are effective 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.	0	0	0	Management have agreed the report findings.

Report	Summary of key findings and recommendations	Recommendations			Status
		1	2	3	
Audit Plan Category: Internal Controls Subject: St Ronan's Primary School No: 128/016 Date issued: 17 December 2015 Level of Assurance: Comprehensive	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; School lets; Income Collection and Banking procedures; School Fund; Ordering/Invoice processing procedures; Data Protection/Confidential Waste Management. The business and administrative processes within the school are effective and comply with the Financial Regulations. The audit site visit to the School took place on 4 November 2015. The business administrator utilises internet banking for paying of invoices which is a more secure method of payment and has proved to be more efficient and effective than administering petty cash, therefore no petty cash imprest is held at the School. St Ronan's Primary is a Community School and any booking or lets within the building are managed by the Community Centre Committee therefore this aspect was outwith the scope of this audit. 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.	0	0	0	Management have agreed the report findings.

Report	Summary of key findings and recommendations	Recommendations 1	Recommendations 2	Recommendations 3	Status
Audit Plan Category: Internal Controls Subject: Homelessness – Rent Accounting System No: 172/008 Date issued: 22 December 2015 Level of Assurance: Limited, with the exception of rental charges applied where assurance is substantial	The purpose of the review was to ensure that controls are in place to ensure efficient and effective use of social and private sector housing and B&B accommodation to ensure achievement of obligations for the homeless, specifically Rent Accounting processes and procedures, including collection and recovery of rents, training and guidance notes. This year's review has concentrated on the Northgate Rent Accounting System Phase 1. The Northgate Rent Accounting System was procured in November 2013 and the Homelessness service is currently implementing Phase 1 which has been live since April 2014. This is to deal with the significant increase in the number of temporary accommodation units managed by the service since 2014 when the Council brought in-house the Private Sector Leasing (PSL) scheme. Housing rental income has an expected value of approximately £1.5m per annum. An Action Plan was developed by Homelessness Management in July 2015 to address gaps and risks in the service's utilisation of the rent accounting system. This was updated in August 2015 and again in November 2015 to reflect the current position. There has been progress in some areas, but not all issues have yet been addressed. Management information is limited and further performance information is yet to be developed. With the recent restructure within the Homelessness service and the recruitment to vacant posts it is expected that the implementation of the Action Plan will be further progressed to address areas of improvement. Phase 2 implementation of the system will further enhance the management of temporary accommodation and includes modules for void management and repairs to properties. Project management resources for Phase 2 implementation should be identified and a project plan developed in due course.	0	3	0	Management have accepted the report findings and agreed to implement the recommendations within appropriate timescales. Internal Audit follow-up work will include following-up on progress with the implementation of Management Actions within the Action Plan as well as the Audit Recommendations within this report.

Report	Summary of key findings and recommendations	Recommendations			Status
		1	2	3	
Subject: Homelessness – Rent Accounting System (cont'd)	Internal Audit considers that the level of assurance we are able to give is limited, with the exception of rental charges applied where assurance is substantial. 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. Homelessness Management have developed an Action Plan to address gaps and risks in the service's utilisation of the rent accounting system. In addition to the identified areas of improvements set out in the Management Action Plan, Internal Audit have made the following recommendations: • The Rent Setting Policy should be updated in line with the Council's Fees and Charges Policy and take account of welfare reform developments, and a project plan should be developed for the implementation of rent increases on 1 April 2016 to ensure lessons are learned from the previous year. (P2) • A protocol should be developed for sharing information between Customer Services and Homelessness Services regarding any change in circumstances which involve a tenant in temporary accommodation to ensure tenants' accounts are accurate. (P2) • Homelessness Management should ensure there is sufficient segregation of duties for the financial management and administration of rent accounts. (P2)				

Report	Summary of key findings and recommendations	Recommendations			Status
		1	2	3	
Audit Plan Category: Internal Controls Subject: Waste and Recycling Services - Trade Waste No: 205/010 Date issued: 11 January 2016 Level of Assurance: Substantial with exception of stock control where limited	The purpose of the review was to ensure that operational and financial controls are in place for the effective delivery of waste and recycling services. The review for 2015/16 has focussed on Trade Waste income collection, debt recovery and streamlining of processes and systems to ensure income maximisation. The Council's Waste Services are highly regulated by various legislative requirements such as Waste (Scotland) Regulations 2012, indicating a high inherent risk assessment. Neighbourhood Services provides collection of approximately 74,500 tonnes of domestic and trade waste annually from around 57,000 households and 1,700 businesses across the region. Fees and charges are applied for a range of waste collection and disposal services. Trade Waste customers are invoiced annually in advance or pro rata for new customers requiring waste services part-way through the financial year, or if customers make changes to their contract covering recycling, bin servicing and trade waste sacks. Total trade waste income for 2014/15 was £451k. Effective controls were found in the following areas: • The Council meets all legislative requirements providing a Trade Waste Collection Service to businesses. • Appropriate processes and procedures are in place for the collection and recovery of income relating to the provision of Trade Waste Services. • Financial management information is reviewed and reported on a regular basis.	0	1	2	Management have accepted the report findings and agreed to implement the audit recommendations within appropriate timescales.

Report	Summary of key findings and recommendations	Recommendations 1	2	3	Status
Subject: Waste and Recycling Services - Trade Waste	Internal Audit considers that the level of assurance we are able to give is substantial for Trade Waste legislative compliance, customer contracts, income collection and recovery, and budgetary control. 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. However, we can only provide limited assurance for the stock control of Trade Waste assets and consumables. Risk, control, and governance systems have some satisfactory aspects. There are, however, some weaknesses likely to undermine the achievement of objectives and leave them vulnerable to an unacceptable risk of error or misuse. We have made the following recommendations which are designed to assist with continuous improvement in service delivery and contribute to demonstrating best value: • A review of the Trade Waste Management and Administration database system should be carried out to ensure that it is robust and fit for purpose to assist with future service delivery. (P3) • Stock Control processes should be introduced at Contact Centres and at the Depots for Trade Waste Assets and Consumables in accordance with the Council's Financial Regulations and procedures. (P2) • Regular performance reports should be provided for management review by the Trade Waste Team regarding contracts, numbers of customers, direct debit payees, debtors' limits, etc., to complement the financial management information regarding monitoring of budgets as part of future service delivery improvements. (P3)				

<table>
<tr><th rowspan="2">Report</th><th rowspan="2">Summary of key findings and recommendations</th><th colspan="3">Recommendations</th><th rowspan="2">Status</th></tr>
<tr><th>1</th><th>2</th><th>3</th></tr>
<tr><td>Audit Plan Category: ICT Governance

Subject: ICT Operational Processes

No: 233/022

Date issued: 11 January 2016

Level of Assurance: Substantial</td><td>The purpose of the review was to examine controls over ICT change management and incident management to ensure they are appropriate and effective. Specifically with ICT change management, the review considered the management of change originating from existing business arrangements and those identified as part of a corporate transformation project, examining the review and scrutiny arrangements for both.

The following examples of good practice were found:
• Changes or augmentations to IT infrastructure from Corporate Transformation projects are identified in relevant project initiation and monitoring documentation, and that there is evidence of appropriate engagement with IT staff in the preparation of business cases.
• There is an overall assessment of the implications of Corporate Transformation activity on the strategy for the IT service and meeting anticipated business needs in the future.

We reviewed the Incident Management Policy and were able to confirm that it had been adhered to and that ICT Major Incident Review Reports are published on the Intranet to share lessons learned and communicate with users.

Work is underway to improve oversight of the ICT strategy, its fit with corporate objectives and communication with stakeholders.

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.

We have made the following recommendation:
• A control needs to be introduced within the IT service to allow Management to gain assurance that the details of all Leavers, and other relevant changes, are recognised timeously in the IT systems e.g. a monthly reconciliation. (P2)</td><td>0</td><td>1</td><td>0</td><td>Management have accepted the report findings and agreed to implement the audit recommendation.</td></tr>
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