Public Document Pack

AUDIT COMMITTEE
MONDAY, 12 FEBRUARY 2024

A MEETING of the AUDIT COMMITTEE will be held VIA MICROSOFT TEAMS on MONDAY, 12

FEBRUARY 2024 at 10.00 am

All attendees, including members of the public, should note that the public business in this meeting will be livestreamed and video recorded and that recording will be available thereafter for public view for 180 days.

N. MCKINLAY,
Director Corporate Governance,

5 February 2024

BUSINESS		
1.	**Apologies for Absence**	
2.	**Order of Business**	
3.	**Declarations of Interest**	
4.	**Minute**	5 mins
	(a) **Minute - 13 November 2023** (Pages 3 - 8) Consider Minute of the Meeting held on 13 November 2023 for approval and signature by the Chair. (Copy attached.)	
	(b) **Audit Committee Action Tracker** (Pages 9 - 10) Consider update on Audit Committee actions. (Copy attached.)	
5.	**Director Risk Management Presentation** Consider presentation on corporate risks by Director Finance and Procurement.	30 mins
6.	**Draft Treasury Management and Investment Strategy 2024-25** (Pages 11 - 66) Consider report by Director Finance and Procurement. (Copy attached.)	20 mins
7.	**Internal Audit Work to December 2023** (Pages 67 - 78) Consider report by Chief Officer Audit and Risk. (Copy attached.)	15 mins

8.	**Progress on Implementation of Internal Audit Recommendations Q3 2023-24** (Pages 79 - 86) Consider report by Chief Officer Audit and Risk. (Copy attached.)	15 mins
9.	**Account Commission Local Government in Scotland Financial Bulletin 2022-23** (Pages 87 - 120) Consider report by Audit Scotland. (Copy attached.)	15 mins
10.	**Any Other Items Previously Circulated**	
11.	**Any Other Items which the Chair 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 E. Thornton-Nicol (Chair), N. Richards (Vice-Chair), J. Anderson, J. Cox, M. Douglas, J. PatonDay, E. Robson, S. Scott, F. Sinclair, Mr S. Whalley and Mr P. Whitfield

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SCOTTISH BORDERS COUNCIL
AUDIT COMMITTEE

MINUTES of Meeting of the AUDIT COMMITTEE held in via Microsoft Teams on Monday, 13 November 2023 at 10.00 am

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Present:- Councillors E. Thornton-Nicol (Chair), N. Richards (Vice-Chair), M. Douglas, J. PatonDay, E. Robson, S. Scott, F. Sinclair, Mr S. Whalley and Mr P. Whitfield

Apologies:- Councillors J. Anderson, P. Brown and J. Cox

In Attendance:- Director Finance and Procurement, Director People, Performance and Change, Chief Officer Audit and Risk, Principal Internal Auditor (S. Pow), Chief Officer Finance and Procurement Services (L. Turner), Ms J. Law (Audit Scotland) and Democratic Services Officer (W. Mohieddeen).

1. **MINUTE**

There had been circulated copies of the Minute of the Meeting held on 25 September 2023. With reference to paragraph 2.5, Mr Whalley advised that the point he was trying to make was there was an apparent governance failure.

DECISION
AGREED to approve the Minute for signature by the chair subject to the addition of the following: "Mr Whalley advised the Committee that there appeared to be an apparent governance failure."

2. **AUDIT COMMITTEE ACTION TRACKER**

2.1 There had been circulated copies of the Audit Committee Action Tracker and the Chief Officer Audit and Risk summarised for Members.

2.2 In response to questions from Members, the Chief Officer Audit and Risk advised that the Committee that a paper on implementation of Internal Audit recommendations was included in the agenda which indicated that a second piece of Internal Work as part of the approved Plan would look in depth at completed Internal Audit recommendations. As part of the process a check would be made on evidence of what had been achieved on improvement actions and the evaluation of the effects that it had made on business continuity management systems.

DECISION
NOTED the Action Tracker.

3. **DIRECTOR RISK MANAGEMENT PRESENTATION**

3.1 The Chair introduced the Director People, Performance and Change to give a presentation on corporate risks in the People Performance and Change service and summarised the various responsibilities of the directorate. Performance indicators were agreed to report to the Executive Committee. A performance dashboard on risks was published to the SBC website to aid transparency. With regard to staff recruitment and retention, a number of critical areas including recruitment within care and HGV drivers faced challenges also seen nationwide. Mitigating work took place with Eildon Housing to provide social housing for a number of key workers. Within Human Resources, there may be an adverse effect on maintaining staff morale and delivery if employee cases were not dealt with promptly. Since May 2023, cases have steadily increased which affected service capacity which meant that the risk maintained at a heightened level. Payroll processing faced a risk associated with experienced staff soon leaving the service. Access to training was dependent on the stability of the IT network. Staff behaviour associated reputational risk to Scottish Borders Council. The Director People, Performance and Change advised that SBC was in the process of transitioning the Fit for 2024 transformation programme to a ‘business as usual’ model that would work alongside the target operating model. A report would be presented to Scottish Borders Council outlining the next steps in 2024.

3.2 The Chair thanked the Director People, Performance and Change for the presentation and noted the importance of recruitment and retention as one of the largest employers in the Scottish Borders. In response to Members questions, the Director People, Performance and Change advised that a key success to retaining staff in SBC included flexible working where people valued their home-work balance which also helped to bring younger people into the workforce. A cascade system was in place so that the wider service were aware of risks and how they impacted on each team. With regards to recruitment to the region, promotion in recruitment included promotion of the region and its selling points which included schools and lifestyle. There was a significant demand for HGV drivers and the payrate was sometimes not competitive with other organisations. SBC trained existing staff such as loaders in refuse work to obtain their HGV licence, however this was not a quick process.

DECISION
NOTED the report.

4. **MID-YEAR TREASURY MANAGEMENT REPORT 2023-24**

4.1 There had been circulated copies of a report by Director Finance and Procurement which presented the mid-year report of treasury management activities for 2023-24, in line with the requirements of the CIPFA Code of Practice, including Prudential and Treasury Management Indicators, and sought comments from Audit Committee prior to consideration of the report by Council. The report was required as part of the Council’s treasury management control regime. It provided a mid-year report on the Council’s treasury activity during the six-month period to 30 September 2023 and demonstrated that Treasury activity in the first six months of 2023-24 had been undertaken in full compliance with the approved Treasury Strategy and Policy for the year. Appendix 1 of 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 2022-23 out-turn and experience in 2023-24 to date for Council approval.

4.2 The Chair noted that the presentation by Link on capital strategy and treasury management in November 2023 was beneficial to have received in time for the Mid-Year Treasury Management report. With regards to not undertaking debt rescheduling, the Director Finance and Procurement advised that this had been based on advice from Link due to higher interest rates not being conducive to undertaking voluntary debt rescheduling. SBC had an ambitious capital programme that may lead to peaks in loan charges which would put pressure on the 5-year revenue plan. As part of long-term planning strategy, underspend in loan charges was used to create and build a treasury reserve to smooth peaks in loan charges. Indicators that approval from Council was sought formed the basis of calculations for 2024-25. In response to a question from Mr Whitfield, the Director Finance and Procurement advised that 20% of borrowing over 10 years was a lower limit and that the upper limit may need to be highlighted. The 10 years and above category of borrowing was around 78% of borrowing which gradually reduced over other categories. Lower and upper bandings of borrowing would be added to the report to Council.

DECISION

(a) **NOTED that treasury management activity in the six months to 30 September 2023 was carried out in compliance with the approved Treasury Management Strategy and Policy;**

(b) **AGREED**

(i) **to the presentation of the Treasury Management Mid-Year Report 2023-24, as contained in Appendix 1, to Council for approval of the revised indicators; and,**

(ii) **to include upper and lower parameters of borrowing to the report for Council.**

5. **INTERNAL AUDIT WORK TO OCTOBER 2023**
There had been circulated copies of a report by Chief Officer Audit and Risk that provided members of the Audit 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. The work Internal Audit carried out in the period from 1 August to 27 October 2023 associated with the delivery of the approved Internal Audit Annual Plan 2023-24 was detailed in this report. A total of 4 final Internal Audit reports had been issued. There were 2 recommendations made associated with 1 of the reports (0 High-rated; 2 Medium-rated; 0 Low-rated). An Executive Summary of the final Internal Audit assurance 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, was shown in Appendix 1 of this report. The SBC Internal Audit function conformed to the professional standards as set out in Public Sector Internal Audit Standards (PSIAS) (2017) including the production of the report to communicate the results of the reviews. Members discussed the SLACIAG development session for Chairs and Vice Chairs for audit committees and noted that further work was being considered set up a forum for chairs across local authorities.

DECISION

(a) **NOTED:**

(i) **the Executive Summaries of the final Internal Audit assurance reports issued in the period from 1 August to 27 October 2023 (Appendix 1) associated with the delivery of the approved Internal Audit Annual Plan 2023-24;**

(ii) **the Internal Audit Consultancy and Other Work carried out in accordance with the approved Internal Audit Charter;**

(iii) **the assurance provided on internal controls and governance arrangements in place for the areas covered by this Internal Audit work; and,**

(b) **AGREED to approve the minor amendments to the Internal Audit Annual Plan 2023-24, as set out in paragraph 4.8 of the report.**

MEMBER
Cllr Sinclair joined the Meeting during discussion of the above item.

6. **INTERNAL AUDIT MID-TERM PERFORMANCE REPORT 2023-24**
6.1 There had been circulated copies of a report by Chief Officer Audit and Risk that informed the Audit Committee of the progress Internal Audit had made, in the first 6 months of the year to 30 September 2023, towards completing the approved Internal Audit Annual Plan

2023-24. It also summarised the statutory obligations for Internal Audit and requirements of the Public Sector Internal Audit Standards. The Internal Audit Annual Plan 2023-24 that was approved by the Audit Committee on 13 March 2023 set out the audit coverage for the year utilising available Internal Audit staff resources to enable the Chief Officer Audit & Risk (the Chief Audit Executive (CAE)), to provide the statutory annual Internal Audit opinion regarding the adequacy and effectiveness of governance, risk management and internal controls within the Council. Appendix 1 of the report provided details of the half-yearly progress by Internal Audit with the delivery of its programme of work, which indicated good progress. The programme of work for the six months from October 2023 to March 2024 based on the available resources indicated that the Internal Audit Annual Plan 2023-24 can be delivered in full. Internal Audit assurance services were also provided to the Scottish Borders Council Pension Fund and the Scottish Borders Health and Social Care Integration Joint Board to meet their obligations. Separate Internal Audit plans and reports were presented to their respective Management and boards/committees for assurance purposes. The report also summarised the statutory obligations for Internal Audit and the requirements of the Public Sector Internal Audit Standards (PSIAS) with which the SBC Internal Audit function conformed.

6.2 The Chief Officer Audit and Risk summarised the report and answered Members' questions and advised that the Chartered Institute of Internal Auditors were a global organisation that set global internal audit standards and determined that the standards needed some enhancement to improve governance and internal control. The consultation process was useful especially in reflecting the views from smaller internal audit teams in Scottish local authorities. Concerns were raised about the possible constrained system of performing external quality assessments every five years. The Chief Officer Audit and Risk advised that the consultancy report on partnering was in draft form still though the distribution list for its dissemination had not yet been determined. With regard to skills within internal audit teams, SBC had access to SLACIAG's computer audit sub-group to cover broader IT content such as data analytics and other emerging areas. Discussions had been taking place with Scottish Councils to share internal audit programmes and for training sessions to take place. With regards to the scope of internal audit including external providers, the entirety of business applications were subject to audit. IT general controls audit had a specific scope on use of business applications. Specific audit work had been done previously on contract management with Live Borders.

DECISION

(a) NOTED the progress Internal Audit has made towards completing the Internal Audit Annual Plan 2023-24; and,

(b) AGREED that the Committee was satisfied with the Performance of the Internal Audit service.

7. **PROGRESS ON IMPLEMENTATION OF INTERNAL AUDIT RECOMMENDATIONS Q2 2023-24**

7.1 There had been circulated copies of report by Chief Officer Audit and Risk that provided an update to Members of the Audit Committee on the status of the implementation by Management of audit recommendations made and agreed in Internal Audit reports. Internal Audit was an independent appraisal function established for the review of the internal control system as a service to Scottish Borders Council. It objectively examined, evaluated and reported on the adequacy of internal control as a contribution to the proper, economic, efficient and effective use of resources and the management of risk. The Internal Audit activity added value to the organisation (and its stakeholders) when it considered strategies, objectives, and risks; strived to offer ways to enhance governance, risk management and control processes (by way of making audit recommendations); and objectively provided relevant assurance. The Remit of the Audit Committee included the function to consider "all matters relating to the implementation of recommendations contained within internal audit reports", as part of its high-level oversight of the framework of internal control, risk management and governance within the Council.

7.2 The Chief Officer Audit and Risk summarised the report and answered Members' questions. The Chief Officer Audit and Risk noted that it was routine to report to CMT each quarter and that comments from Audit Committee may be presented. The Chief Officer Audit and Risk advised that the audit actions whose dates that were extended and reforecast were highlighted in the comments section of the Appendix. The Chair expressed disappointment that Internal Audit recommendations were not being completed by Management on timey. The Chair suggested to the Committee that the recommendation be amended so that the report was noted and that an updated report be presented to the Committee for the next quarter with an expectation that there would be improvement in the progress made.

DECISION

(a) NOTED:

(i) the progress made by Management in implementing Internal Audit recommendations to improve internal controls and governance, and mitigate risks;

(ii) that Internal Audit will continue to monitor the completion of outstanding recommendations and will provide update reports to this Committee

(b) AGREED that the Committee was not satisfied with the progress and that an updated report be presented at the end of the next quarter with an expectation that there would be improvements in progress made.

CHAIR
Cllr Thornton-Nicol left the Meeting and Cllr Richards assumed the Chair.

8. **COUNTER FRAUD CONTROLS ASSESSMENT 2023-24**
There had been circulated copies of a report by Chief Officer Audit and Risk that made the Audit Committee aware of the findings and necessary actions arising from the Integrity Group's assessment of counter fraud controls. Having robust fraud prevention and investigation arrangements in place contributed to safeguarding the Council's financial resources, for delivery of services, as part of protecting the public purse. A focus on prevention and detection and promotion of a counter fraud culture across the Council to improve its resilience to fraud, taking account of reducing resources, were associated with the Counter Fraud Strategy 2021-2024 that was approved by Council in December 2021. The purpose of the Integrity Group was to improve the Council's resilience to fraud, theft, corruption, and crime. One way it could achieve that is self-assessing the Council's arrangements against best practice and agreeing any appropriate actions to continuously improve the arrangements in place. This report referred to a national fraud report published by Audit Scotland, which set out recommendations for public sector organisations. Part of the Audit Committee's role was to oversee the framework of internal financial control including the assessment of fraud risks and to monitor counter fraud strategy, actions and resources. Assurances about the effectiveness of the Council's existing systems and arrangements for the prevention, detection and investigation of fraud could be taken from the outcomes contained within the report. The Chief Officer Audit and Risk summarised the report and answered Members questions. It was advised that the corporate fraud officer retired in December 2020, and the post was subsequently removed from the establishment to achieve approved budget reductions. There had been many counter fraud improvement actions that the corporate fraud officer had developed which were included in the appendix of the report.

DECISION

(a) NOTED the findings from the Integrity Group's assessment of counter fraud controls 2023-24 in response to fraud risks set out in Appendices 1 and 2 of the report; and,

(b) AGREED the ongoing Management actions to enhance the Council's resilience to fraud, as summarised in the Action Plans set out in Appendices 1 and 2 of the report.

CHAIR
Cllr Thornton-Nicol rejoined the meeting and resumed the Chair.

9. **NATIONAL FRAUD INITIATIVE 2022-2023 EXERCISE - SELF-APPRAISAL REVIEW DATA MATCHES AND RECORDING OF OUTCOMES PHASES**
There had been circulated copies of a report by Chief Officer Audit and Risk that made the Audit Committee aware of the outcomes of the completion of the Self-Appraisal Checklist (Review Data Matches and Recording of Outcomes Phases) by the Integrity Group, as part of the Council's participation in the National Fraud Initiative (NFI) 2022-2023 Exercise. The Council was committed to minimising the risk of loss due to fraud, theft, corruption or crime and to taking appropriate action against those who attempt to defraud the Council, whether from within the authority or from outside. The primary responsibility for the prevention, detection and investigation of fraud rested with Management, supported by the Integrity Group. Part of the Audit Committee's role was to oversee the framework of internal financial control including the assessment of fraud risks and to monitor counter fraud strategy, actions and resources. Assurances about the Council's participation in the National Fraud Initiative (NFI) 2022-2023 Exercise could be taken from the Actions and Self-Appraisal contained within the report. The Chief Officer Audit and Risk summarised the report and answered Members' questions.

DECISION
NOTED:

(a) the Progress Update by the Integrity Group on Management Actions in response to the Recommendations arising from the 'National Fraud Initiative in Scotland 2022', as summarised in the Action Plan set out in Appendix 1 of the report; and,

(b) the outcomes of the completion of the Self-Appraisal Checklist (Review Data Matches and Recording of Outcomes Phases) by the Integrity Group as part of the Council's participation in the National Fraud Initiative (NFI) 2022-2023 Exercise, as set out in Appendix 2 of the report.

The meeting concluded at 12.20 pm.

ACTION TRACKER

SCOTTISH BORDERS COUNCIL AUDIT COMMITTEE 2023/24

Notes:-
1. *Paragraphs Marked with a * require full Council approval before action can be taken*
2. *Items for which no actions are required are not included*

TITLE	DECISION REQUIRING ACTION	DIRECTORATE/ SECTION	RESPONSIBLE OFFICER	STATUS
13 March 2023				
Director Risk Management Presentation	**AGREED that the Director Infrastructure and Environment would bring back an update on service risks following the establishment of the Project Programme Management Office (PMO).**	Infrastructure and Environment	John Curry	Internal Audit follow-up re Capital Investment is ongoing: PMO Role Specification and Terms of Reference of Strategic Asset Management Group. Cycle of Directors' risk presentations agreed to March 2024 – propose Director I&E update April 2024.
10 May 2023				
Progress Update on LDS Financial Management Recommendation	**AGREED:** **(i) To pursue a joint IJB/SBC audit committee review of the LDS progress on the financial management recommendations by May 2024; and,** **(ii) To recommend to the Integration Joint Board Audit Committee to look at Best Value of the service to ensure it is operating accordingly**	Health & Social Care IJB	Chris Myers / Simon Burt	Oversight and scrutiny by the IJB Audit Committee in accordance with its monitoring of IJB Directions, which includes learning disability services as a delegated service. Next meeting of IJB AC is scheduled in March 2024.
Counter Fraud Annual Report 2022-23	**AGREED that the Chief Officer Audit and Risk would present to the Committee, after the counter fraud maturity assessment, a report on counter fraud effectiveness.**	Audit & Risk	Jill Stacey	Integrity Group will conduct the counter fraud maturity assessment during 2023/24 and report outcomes within Counter Fraud Annual Report 2023/24 to Audit Committee in April 2024.
25 September 2023				
External Audit Annual Audit Reports 2022/23	**AGREED to request updates from the Director – Finance and Procurement on progress against the agreed actions in the Action Plans from within the SBC 2022/23 Annual Audit Report and the Best Value thematic report.**	Finance	Suzy Douglas	Propose update report to Audit Committee in April 2024, noting that many of the agreed actions in the Action Plans have an agreed completion date of 31 March 2024.

TITLE	DECISION REQUIRING ACTION	DIRECTORATE/ SECTION	RESPONSIBLE OFFICER	STATUS
13 November 2023				
Mid-Year Treasury Management Report 2023-24	**AGREED to include upper and lower parameters of borrowing to the report for Council.**	Finance	Suzy Douglas	Agreed amendments were included in Mid-Year Treasury Management Report 2023/24 that was presented to and approved by Council on 23 November 2023. *Complete*
Progress on Implementation of Internal Audit Recommendations Q2 2023-24	**AGREED that the Committee was not satisfied with the progress and that an updated report be presented at the end of the next quarter with an expectation that there would be improvements in progress made.**	Audit & Risk	Jill Stacey	Progress on Implementation of Internal Audit Recommendations Q3 2023/24 is included in agenda for Audit Committee 12 February 2024. *Complete*

Scottish Borders COUNCIL

TREASURY MANAGEMENT STRATEGY 2024/25

Report by Director of Finance and Procurement

AUDIT COMMITTEE

12 February 2024

1 PURPOSE AND SUMMARY

1.1 **This report is to enable the Audit Committee to undertake their scrutiny role in relation to the Treasury Management activities of the Council. It presents the proposed Treasury Management Strategy for 2024/25 for consideration prior to Council approval.**

1.2 CIPFA (Chartered Institute of Public Finance and Accountancy) defines Treasury Management as 'The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks'. 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 2024/25 to be submitted to Council on 29 February 2024 is included in this report at Appendix 1 and reflects the impact of the Administration's draft Financial Plans for 2024/25 onwards on the prudential and treasury indicators for the Council.

2 RECOMMENDATIONS

3.1 **It is recommended that the Committee considers whether to make any comments or recommendations on the draft Treasury Management Strategy for 2024/25 prior to presentation to Council for approval.**

3 BACKGROUND

4.1 The Audit Committee is responsible for scrutinising the Treasury Management Strategy in line with recommended practice set out in the CIPFA Code (i.e. Treasury Management in the Public Services: Code of Practice and Cross-Sectorial Guidance Notes).

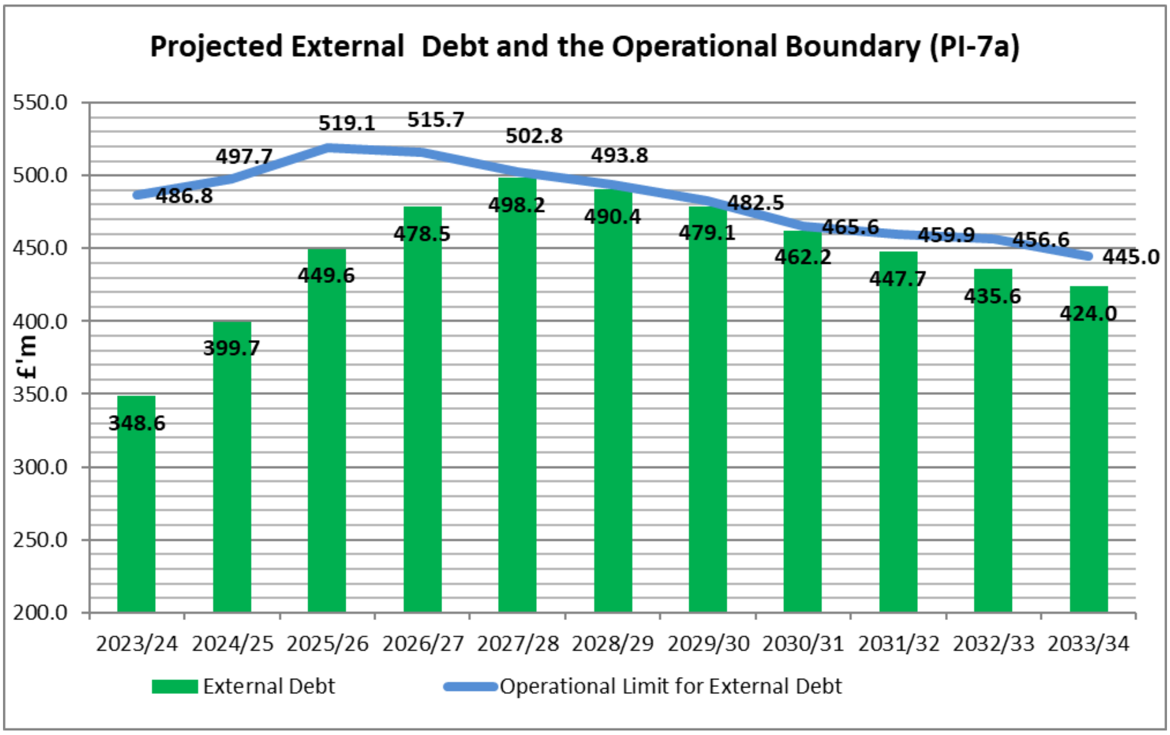
4 TREASURY MANAGEMENT STRATEGY 2024/25

4.1 Appendix 1 contains the draft Treasury Management Strategy for 2024/25 for consideration by the Audit Committee.

4.2 This is based on the current draft Financial Capital Plans for 2024/25 to 2033/34, yet to be published and as such is subject to change as these plans will not be presented to Council for approval until 29 February 2024.

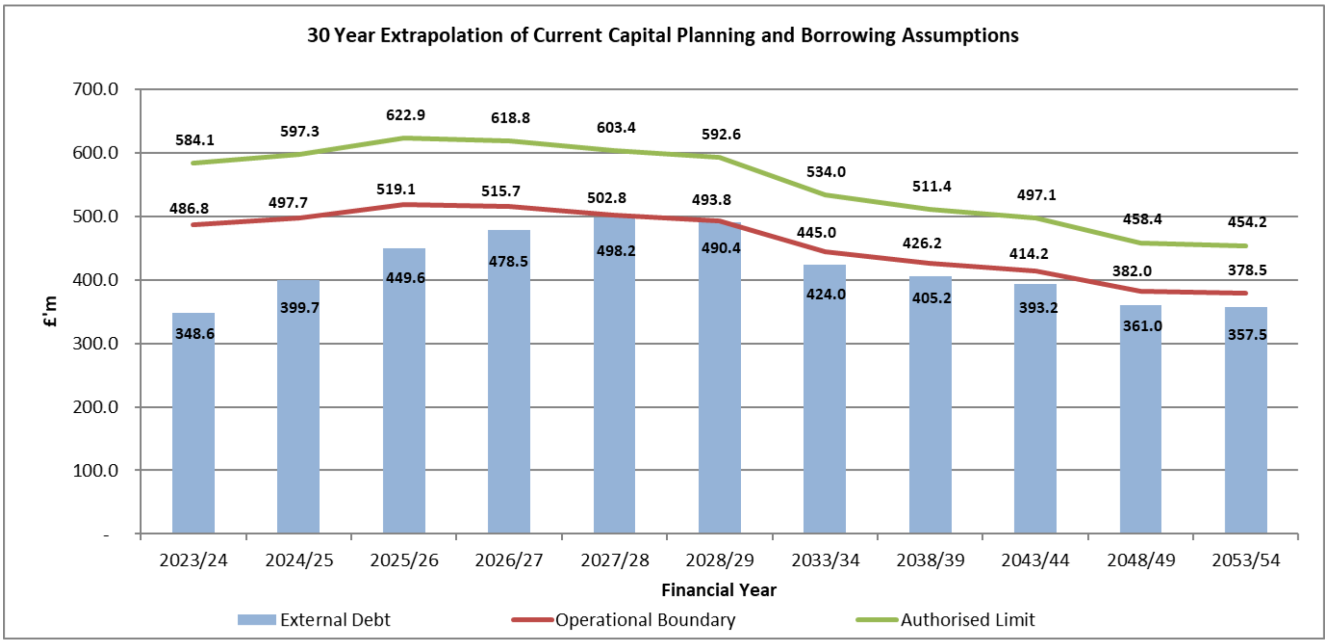
4.3 Appendix 1, Annex A contains a summary of the proposed indicators within the strategy.

4.4 The table below shows the "Operational Boundary" against the anticipated levels of external borrowing. The external borrowing levels should not normally exceed the operational boundary limit, defined by the Prudential Framework. The gap between these two elements as seen in the table, consistently shows that the Council maintains an "under-borrowed" position. The gap however is reducing over the years due to the ambitious capital programme.



4.5 The chart below details projected external borrowing for the next 5 financial years and then at each 5 year interval up to 2053/54. Alongside this, the Operational Boundary and Authorised Limit are also shown. The chart is designed to inform long term scenario planning in line with best practice.

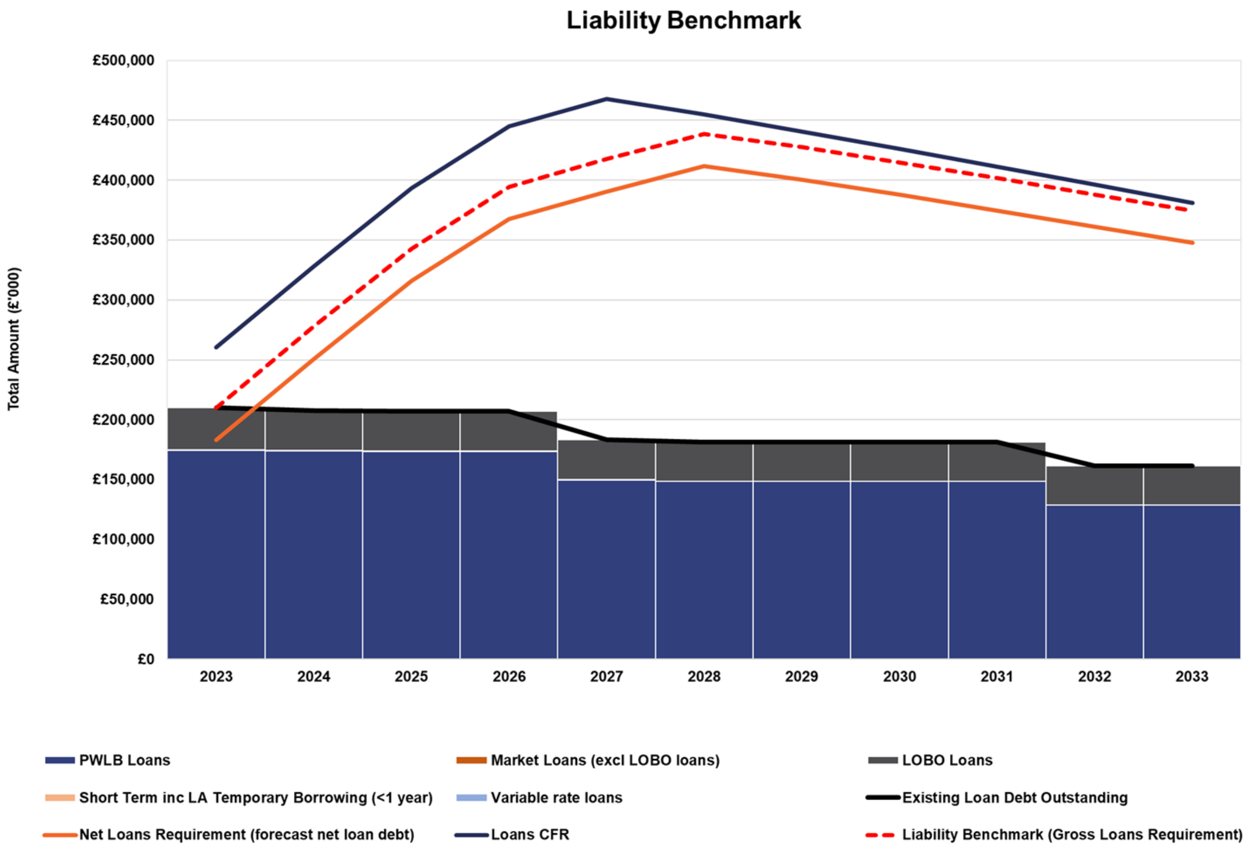
It should be noted that from 2032-33, the first year outwith the current 10 year Capital Plan, a 10 year average capital expenditure, and annual borrowing requirement of £10.5m, has been assumed.



4.6 A third prudential indicator is the Liability Benchmark (LB). The Council has measured the LB for a 10 year period in line with the Capital Plan. There are four components to the LB: -

1. Existing loan debt outstanding
2. Loans CFR
3. Net loans requirement
4. Liability benchmark (or gross loans requirement)

The measurement on the graph below shows the Council to be in an under-borrowed position with a requirement for further borrowing in future years. The Council will actively monitor the progress of the Capital Plan and align forecast spend to the most efficient borrowing options available at that time.



4.7 The implementation of IFRS16 has been deferred until 1st April 2024. When implemented this will mean that leases which were previously off balance sheet and funded via revenue sheet will now be included. Leases form part of the other long term liability figures which make up the Prudential Indicators that will be reported in the Treasury Management Strategy Statement for 2025/2026.

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 to Audit Committee is to ensure that the members are satisfied with this element of the risk management framework for the treasury management function within the Council. The risks to delivering the Strategy have been identified within the Strategy itself at Appendix 1. Controls and mitigating actions have been implemented, monitored and reviewed in line with the Council's Risk Management Policy. The Strategy provides the parameters and guidance for the investment and borrowing decisions for the Council.

5.3 Integrated Impact Assessment

There is no impact or relevance to Equality Duty or the Fairer Scotland Duty for this report. This is a routine financial monitoring report which forms part of the governance of the Treasury function within the Council.

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

5.5 **Climate Change**
There are no direct carbon emissions impacts as a result of this report.

5.6 **Rural Proofing**
It is anticipated there will be no adverse impact on the rural area from the proposals contained in this report.

5.7 **Data Protection Impact Statement**
There are no personal data implications arising from the proposals contained in this report.

5.8 **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 Chief Legal Officer (including as Monitoring Officer), the Chief Officer Audit and Risk, Director People Performance & Change, Communications and the Clerk to the Council are being consulted and any comments received will be reported to the meeting.

Approved by

Suzy Douglas **Signature ....**
Director of Finance and Procurement

Author(s)

Name	Designation and Contact Number
Suzy Douglas	Director of Finance and Procurement (X5881)

Background Papers:
Previous Minute Reference: not applicable

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

Contact us at Finance and Procurement, Scottish Borders Council, Council Headquarters, Newtown St Boswells, Melrose, TD6 0SA Tel: 01835 825249 Fax 01835 825166. email: mailto:t&cteam@scotborders.gov.uk

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APPENDIX 1

SCOTTISH BORDERS COUNCIL

TREASURY MANAGEMENT STRATEGY
(incorporating the Annual Investment Strategy) 2024/25

CONTENTS

1 Purpose and Scope

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

a) **Treasury Management Strategy** (this report) – The first, and most important of the three reports, is forward looking and covers:

- The capital plans of the Council (including prudential indicators);
- A policy for the statutory repayment of loans fund advances, (how residual capital expenditure is charged to revenue over time);
- The Treasury Management Strategy (how the investments and borrowings are organised), including treasury indicators, and
- An Annual Investment Strategy (the parameters on how investments are to be managed).

b) **Mid Year Treasury Management Report** – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.

c) **Annual Treasury Report** – This is a backward-looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

d) **Quarterly reports** – In addition to the three major reports detailed above, from 2023/24 quarterly reporting (end of June/end of December) is also required. However, these additional reports do not have to be reported to Council but do require to be adequately scrutinised. This role is undertaken by the **Executive Committee** and the information is contained within the quarterly Capital Report. (These reports, specifically, should comprise updated Treasury/Prudential Indicators.)

1.2 Scrutiny
The 3 main reports are required to be adequately scrutinised by committee before being recommended to the Council. This role is undertaken by the **Audit Committee**.

1.3 Treasury Management Strategy for 2024/25
The strategy for 2024/25 covers two main areas:

Capital Issues
- the capital expenditure plans and the associated prudential indicators;
- the statutory loans fund repayment policy.

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
- the policy on use of external service providers

1.4 These elements cover the requirements of the Local Government in Scotland Act 2003, the CIFPA (Chartered Institute of Public Finance and Accountancy) Prudential Code (the Prudential Code), the CIPFA Treasury Management Code (the Code) and Scottish Government loans fund repayment regulations and investment regulations, particularly Finance Circulars 5/2010 and 7/2016.

1.5 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 continue to address this important issue by:

a) Elected Members
- Working with members of the Audit Committee to identify their training needs
- Working with Link Treasury 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, depending on need, 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).

1.6 Treasury Management Consultants

The Council uses Link Group, Link Treasury Services Limited as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions always remains with the Council and will ensure that undue reliance is not placed upon the services of our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

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

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

1.8 2021 revised CIPFA Treasury Management Code and Prudential Code – changes which will impact on future TMSS/AIS reports and the risk management framework

CIPFA published the revised Codes on 20th December 2021 and has stated that revisions need to be included in the reporting framework from the 2023/24 financial year. This Council, therefore, has to have regard to these Codes of Practice when it prepares the Treasury Management Strategy Statement and Annual Investment Strategy, and also related reports during the financial year, which are taken to Full Council for approval.

The revised Treasury Management Code requires all investments and investment income to be attributed to one of the following three purposes: -

Treasury management
Arising from the organisation's cash flows or treasury risk management activity, this type of investment represents balances which are only held until the cash is required for use. Treasury investments may also arise from other treasury risk management activity which seeks to prudently manage the risks, costs or income relating to existing or forecast debt or treasury investments.

Service delivery
Investments held primarily and directly for the delivery of public services including housing, regeneration and local infrastructure. Returns on this category of investment which are funded by borrowing are permitted only in cases where the income is "either related to the financial viability of the project in question or otherwise incidental to the primary purpose".

Commercial return
Investments held primarily for financial return with no treasury management or direct service provision purpose. Risks on such investments should be proportionate to an authority's financial capacity – i.e., that 'plausible losses' could be absorbed in budgets or reserves without unmanageable detriment to local services. A Council must not borrow to invest primarily for financial return.

The revised Treasury Management Code requires an authority to implement the following: -

1. **Adopt a new liability benchmark treasury indicator** to support the financing risk management of the capital financing requirement; this is to be shown in chart form for a minimum of ten years, with material differences between the liability benchmark and actual loans to be explained;

2. **Long-term treasury investments**, (including pooled funds), are to be classed as commercial investments unless justified by a cash flow business case;

3. **Pooled funds** are to be included in the indicator for principal sums maturing in years beyond the initial budget year;

4. Amendment to the **knowledge and skills register** for officers and members involved in the treasury management function - to be proportionate to the size and complexity of the treasury management conducted by each authority;

5. **Reporting to members is to be done quarterly**. Specifically, the Director of Finance and Procurement is required to establish procedures to monitor and report performance against all forward-looking prudential indicators at least quarterly. The Director is expected to establish a measurement and reporting process that highlights significant actual or forecast deviations from the approved indicators. However, monitoring of prudential indicators, including forecast debt and investments, is not required to be taken to Full Council and should be reported as part of Council's integrated revenue, capital and balance sheet monitoring;

6. **Environmental, social and governance (ESG)** issues to be addressed within a Council's treasury management policies and practices (Annex D).

The main requirements of the Prudential Code relating to service and commercial investments are: -

1. The risks associated with service and commercial investments should be proportionate to their financial capacity – i.e. that plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services;

2. An authority must not borrow to invest for the primary purpose of commercial return;

3. It is not prudent for local authorities to make any investment or spending decision that will increase the CFR, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority, and where any commercial returns are either related to the financial viability of the project in question or otherwise incidental to the primary purpose;

4. An annual review should be conducted to evaluate whether commercial investments should be sold to release funds to finance new capital expenditure or refinance maturing debt;

5. A prudential indicator is required for the net income from commercial and service investments as a proportion of the net revenue stream;

6. Create new Investment Management Practices to manage risks associated with non-treasury investments, (similar to the current Treasury Management Practices).

An authority's Capital Strategy or Annual Investment Strategy should include: -

1. The authority's approach to investments for service or commercial purposes (together referred to as non-treasury investments), including defining the authority's objectives, risk appetite and risk management in respect of these investments, and processes ensuring effective due diligence;

2. An assessment of affordability, prudence and proportionality in respect of the authority's overall financial capacity (i.e. whether plausible losses could be absorbed in budgets or reserves without unmanageable detriment to local services);

3. Details of financial and other risks of undertaking investments for service or commercial purposes and how these are managed;

4. Limits on total investments for service purposes and for commercial purposes respectively (consistent with any limits required by other statutory guidance on investments);

5. Requirements for independent and expert advice and scrutiny arrangements (while business cases may provide some of this material, the information contained in them will need to be periodically re-evaluated to inform the authority's overall strategy);

6. State compliance with paragraph 51 of the Prudential Code in relation to investments for commercial purposes, in particular the requirement that an authority must not borrow to invest primarily for financial return.

1.9 International Financial Reporting Standard (IFRS) 16 – Leasing

The CIPFA LAASAC Local Authority Accounting Code Board deferred implementation of IFRS16 until 1st April 2024, the 2024/25 financial year. From this date, most leases which were previously off balance sheet and funded via revenue, will now be included as part of the other long term liabilities. The full impact of this change will be reflected in the Financial Statements for the year to 31 March 2025 and the Prudential and Treasury Indicators in the Treasury Management Strategy Statement for 2025/2026 onwards.

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2 Background

2.1 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

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

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 The contribution the treasury management function makes to the Council is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

2.5 Whilst any loans to third parties, commercial investment initiatives or other non-financial investments will impact on the treasury function, these activities are generally classed as non-treasury activities and are separate from the day to day treasury management activities.

2.6 CIPFA defines treasury management as:

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

3 The Capital Prudential Indicators 2024/25 – 2028/29

The Council's Financial Strategy sets out financial resource and management parameters within which it will deliver its Council Plan. The Financial Strategy brings together various elements, 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 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.

To adhere to these Principles, the Financial Strategy states that the Council will adopt Financial Objectives to:

"ensure capital borrowing is within prudential borrowing limits and sustainable in the longer term. In this regard it is important to recognise the capital investment decisions taken now have long term borrowing implications and these have the potential to place a significant burden on future tax payers".

The draft revenue budget sets loans charges associated with capital borrowing over the next 5 years at £18.2m in 2024/25, rising to £26.9m in 2028/29.

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

3.1 Capital Expenditure (Prudential Indicator PI-1)

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 2024/25 – 2033/34 includes the following capital expenditure forecasts for the first five years. 2023/24 projected outturn figures are also shown:

Capital Expenditure (PI-1)	**Estimate**					
£m	**2023/24**	**2024/25**	**2025/26**	**2026/27**	**2027/28**	**2028/29**
Assets & Infrastructure	46.5	20.8	14.8	13.0	12.9	12.5
Other Corporate Services	8.4	5.7	0.1	0.5	0.2	0.2
Children & Young People	35.0	68.8	51.9	32.9	21.9	2.5
Culture & Sport	1.0	0.4	2.0	0.8	0.8	0.8
Economic Regeneration	4.1	20.8	16.6	15.2	9.9	8.2
Housing Strategy & Services	1.0	0.5	0.5	0.5	0.5	0.5
Social Care Infrastructure	1.3	4.0	12.2	3.2	13.2	-
Emergency & Unplanned & Planned programme adjustments	-0.4	0.2	0.2	0.2	0.2	0.2
Total	**96.9**	**121.2**	**98.3**	**66.3**	**59.6**	**24.9**

3.2 Capital Financing Assumptions

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	**Estimate**					
£m	**2023/24**	**2024/25**	**2025/26**	**2026/27**	**2027/28**	**2028/29**
Capital Expenditure – per plan	96.9	121.2	98.3	66.3	59.6	24.9
Other Relevant Expenditure	-	-	-	-	-	-
Total Expenditure	**96.9**	**121.2**	**98.3**	**66.3**	**59.6**	**24.9**
Financed by:						
Capital receipts	2.1	3.9	1.5	1.5	1.5	-
CFCR	0.9	1.9	-	-	-	-
Developer Contributions	0.6	5.9	0.1	0.1	0.1	0.1
Govt. General Capital Grants	26.2	9.8	12.5	11.1	11.1	11.1
Govt. Specific Capital Grants	1.6	2.9	1.0	0.3	0.3	0.2
Other Grants & Contributions	11.2	19.1	17.2	15.6	9.8	8.1
Plant & Vehicle / Infrastructure Fund	6.4	2.0	2.0	2.0	2.0	2.0
Synthetic Pitch Replacement Fund	-	0.4	1.1	0.5	0.5	0.5
Net financing need for the year met by borrowing	**47.9**	**75.3**	**62.9**	**35.2**	**34.3**	**2.9**

3.3 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 indebtedness and so its underlying borrowing need. Any capital expenditure identified above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR. The CFR does not increase indefinitely, as prudent annual repayments from revenue need to be made which reflect the useful life of capital assets financed by borrowing. From 1 April 2016, authorities have been able to choose whether to use scheduled debt amortisation (loans pool charges), or another suitable method of calculation in order to repay borrowing. The Council calculates repayment of loans fund advances with reference to the life of an asset using the annuity method (option 3) – further details at 3.5 below.

b) The CFR also includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility by the PFI, PPP lease provider and so the Council is not required to separately borrow for these schemes. The Council has £111.3m of liabilities relating to such schemes within the 2023/24 long term liabilities figure. The CFR may be impacted by the changes under IFRS 16 (see 1.9 above).

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

Capital Financing Requirement (PI-2) £m	Actual	Estimate					
	22/23	23/24	24/25	25/26	26/27	27/28	28/29
Total CFR (PI-2) *	**347.7**	**415.5**	**480.7**	**532.4**	**555.3**	**576.5**	**565.3**
Movement in CFR represented by:							
Net financing need for the year (above)		**47.9**	**75.3**	**62.9**	**35.2**	**34.3**	**2.9**
Less scheduled debt amortisation and other financing movements		19.9	(10.1)	(11.2)	(12.3)	(13.1)	(14.1)
Movement in CFR		**67.8**	**65.2**	**51.7**	**22.9**	**21.2**	**(11.2)**

* *The CFR for this calculation includes projected capital expenditure to 31 March of each financial year and the retrospective service concession arrangements for 23/24.*

d) A key aspect of the regulatory and professional guidance is that elected members are aware of the size and scope of any commercial activity in relation to the authority's overall financial position. This Council does not currently have any commercial activity.

3.4 Liability Benchmark

The third prudential indicator is the Liability Benchmark (LB). The Authority is required to estimate and measure the LB for the forthcoming financial year and the following two financial years, as a minimum however CIPFA strongly recommends that the LB is produced for at least ten years. The Council has measured the LB for a ten year period in line with the Capital Plan as shown in the graph below.

There are four components to the LB: -

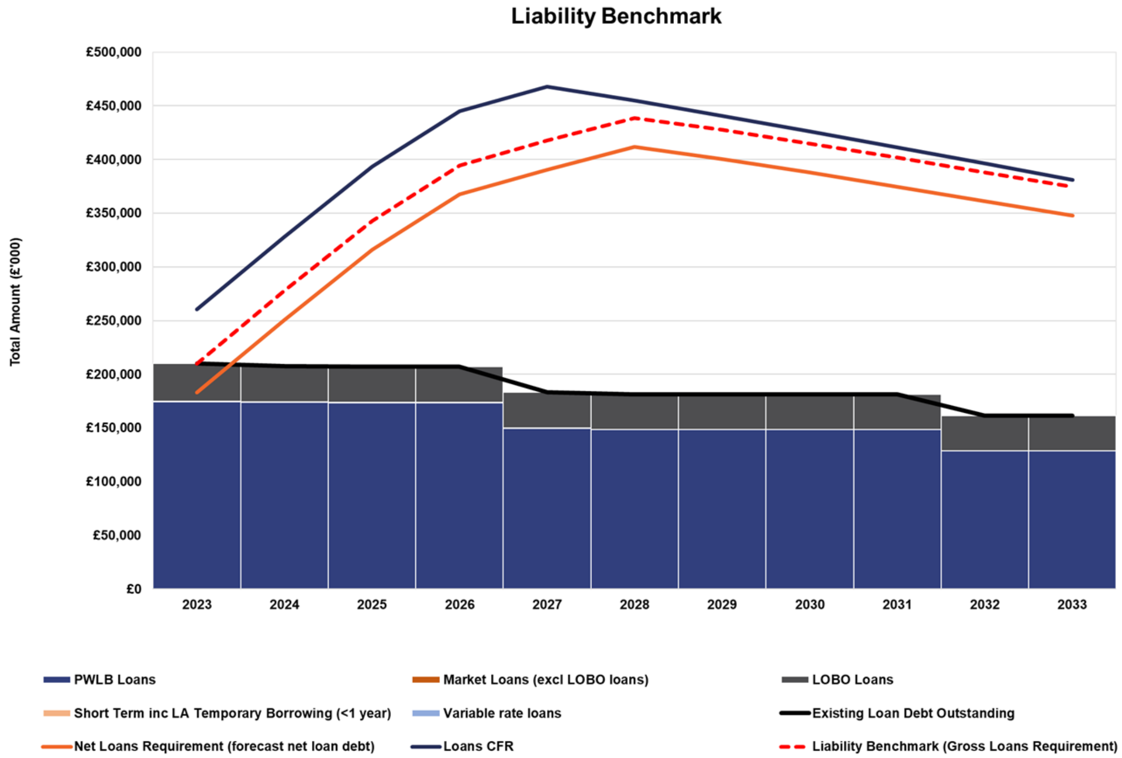
1 **Existing loan debt outstanding**: the Authority's existing loans that are still outstanding in future years, with no new borrowing added.

2 **Loans CFR**: this is calculated in accordance with the loans CFR definition in the Prudential Code and projected into the future based on approved prudential borrowing and planned Loans Fund advances/Loans Fund principal repayments.

3 **Net loans requirement**: this will show the Authority's gross loan debt less treasury management investments at the last financial year-end, projected into the future and based on its approved prudential borrowing, planned Loans Fund principal repayments and any other major cash flows forecast.

4 **Liability benchmark** (or gross loans requirement): this equals net loans requirement plus short-term liquidity allowance.

The graph below shows the Council to be in an under-borrowed position with a requirement for further borrowing in future years. The Council will actively monitor the progress of the Capital Plan and align forecast spend to the most efficient borrowing options available at that time.



3.5 Statutory Repayment of Loans Fund Advances

a) The Council is required to set out its policy for the statutory repayment of loans fund advances prior to the start of the financial year. The repayment of loans fund advances ensures that the Council makes a prudent provision each year to pay off an element of the accumulated loans fund advances made in previous financial years.

b) A variety of options are provided to Councils so long as a prudent provision is made each year. The Council is recommended to approve the following policy on the repayment of loans fund advances:-

For loans fund advances made before 1 April 2016, the policy will be to maintain the practice of previous years and apply the **Statutory Method (option 1)**, with all loans fund advances being repaid by the annuity method.

For loans fund advances made after 1 April 2016, the policy for the repayment of loans advances will be the:-

1. **Asset life method** – loans fund advances will be repaid with reference to the life of an asset using either the equal instalment or annuity method (option 3).

Under regulation 14 (2) of SSI 2016 No 123, the Council calculates the annuity rate based on historic annuity rates to ensure that it is a prudent application and it is currently 3.18%.

A consultation was issued for an amendment to the regulation 14 in December 2023 however no conclusion has been reached yet.

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 and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

4.1 Current Portfolio Position

a) The overall treasury management portfolio as at 31 March 2023 and for the position as at 31 December 2023 are shown below for both borrowing and investments.

TREASURY PORTFOLIO				
Treasury investments	actual **31.3.23** £000	actual **31.3.23** %	current **31.12.23** £000	current **31.12.23** %
Banks	2,163	7%	1,450	39%
DMADF (H.M.Treasury)	8,500	30%	0	0%
Money Market Funds	18,500	63%	2,250	61%
Total managed in house	**29,163**	**100%**	**3,700**	**100%**
Total managed externally	**0**	**0%**	**0**	**0%**
Total treasury investments	**29,163**	**100%**	**3,700**	**100%**
Treasury external borrowing				
Third party loans	600	0.3%	600	0.3%
PWLB	174,308	83%	173,737	84%
LOBOs	35,000	16.7%	33,000	15.7%
Total external borrowing	**209,908**	**100%**	**207,337**	**100%**
Net treasury investments / (borrowing)	**(180,745)**	**0**	**(203,637)**	**0**

b) The Council's forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying capital borrowing need, (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

as at 31 March £m	**Estimate**					
	2023/24	**2024/25**	**2025/26**	**2026/27**	**2027/28**	**2028/29**
Borrowing	237.3	289.5	340.5	370.5	391.5	385.0
Other Long Term Liabilities (Finance Leases)	111.3	110.2	109.1	108.0	106.7	105.4
Total Gross Borrowing (Prudential Indicator PI-5)	**348.6**	**399.7**	**449.6**	**478.5**	**498.2**	**490.4**
Capital Financing Requirement*	**532.4**	**555.3**	**576.5**	**565.3**	**552.6**	**539.5**
(Under) / Over Borrowing (Prudential Indicator PI-6)	**(183.8)**	**(155.6)**	**(126.9)**	**(86.8)**	**(54.4)**	**(49.1)**

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

c) Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these (PI-6) is that the Council needs to ensure that its gross debt figure (shown above in PI-5)) 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 2023/24 and the following two financial years. This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue or speculative purposes.

d) 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 2024/25.

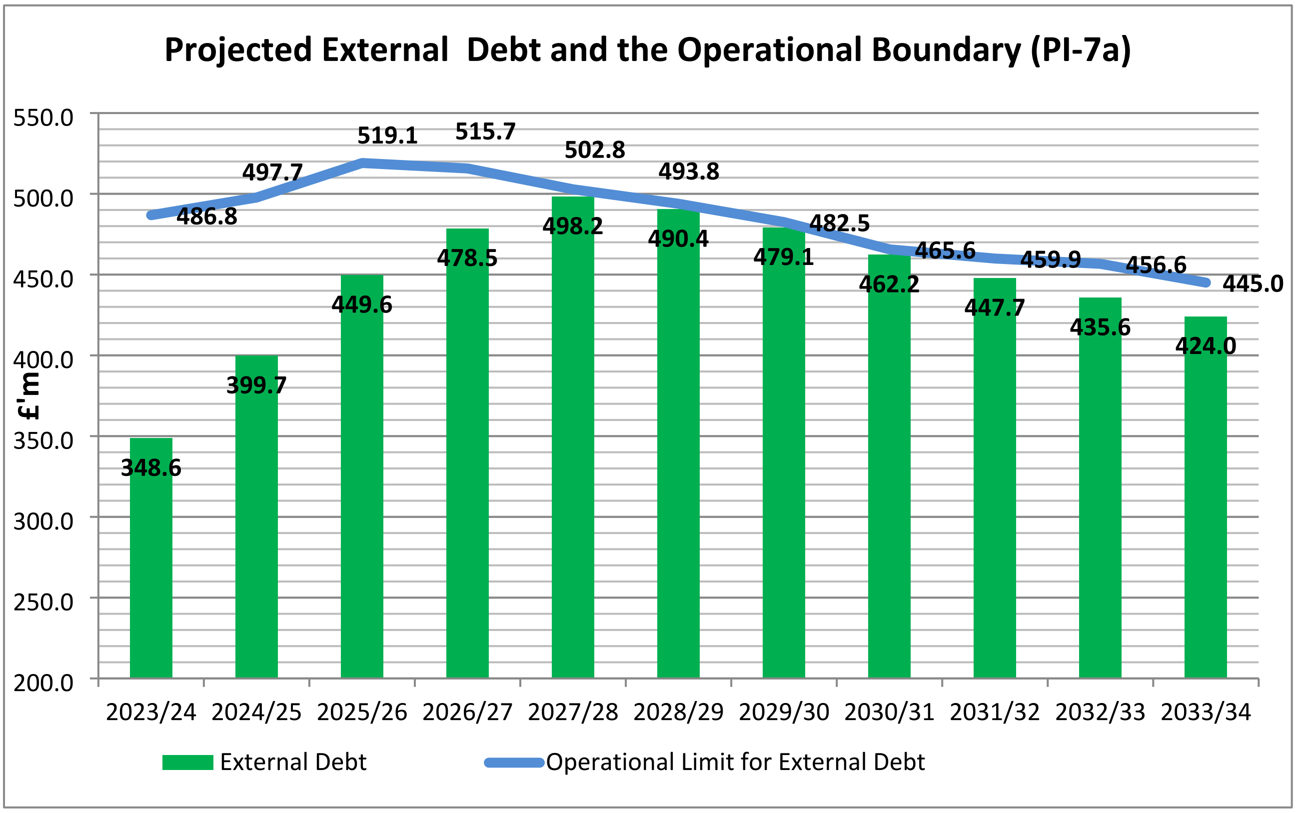
4.2 Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary (Prudential Indicator PI-7)

a) This is the limit beyond 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 and the ability to fund under-borrowing by other cash resources.

Operational boundary £m	Estimate					
	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
Total Operational Boundary (PI-7a)	**486.8**	**497.7**	**519.1**	**515.7**	**502.8**	**493.8**
Less: Other long term liabilities	(111.3)	(110.2)	(109.1)	(108.0)	(106.7)	(105.4)
Operational Boundary exc. Other Long Term Liabilities (PI-7b)	**375.5**	**387.5**	**410.0**	**407.7**	**396.1**	**388.4**

b) The following chart shows how the current and projected Operational Borrowing limit compare with the anticipated levels of gross external debt (PI-5).



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

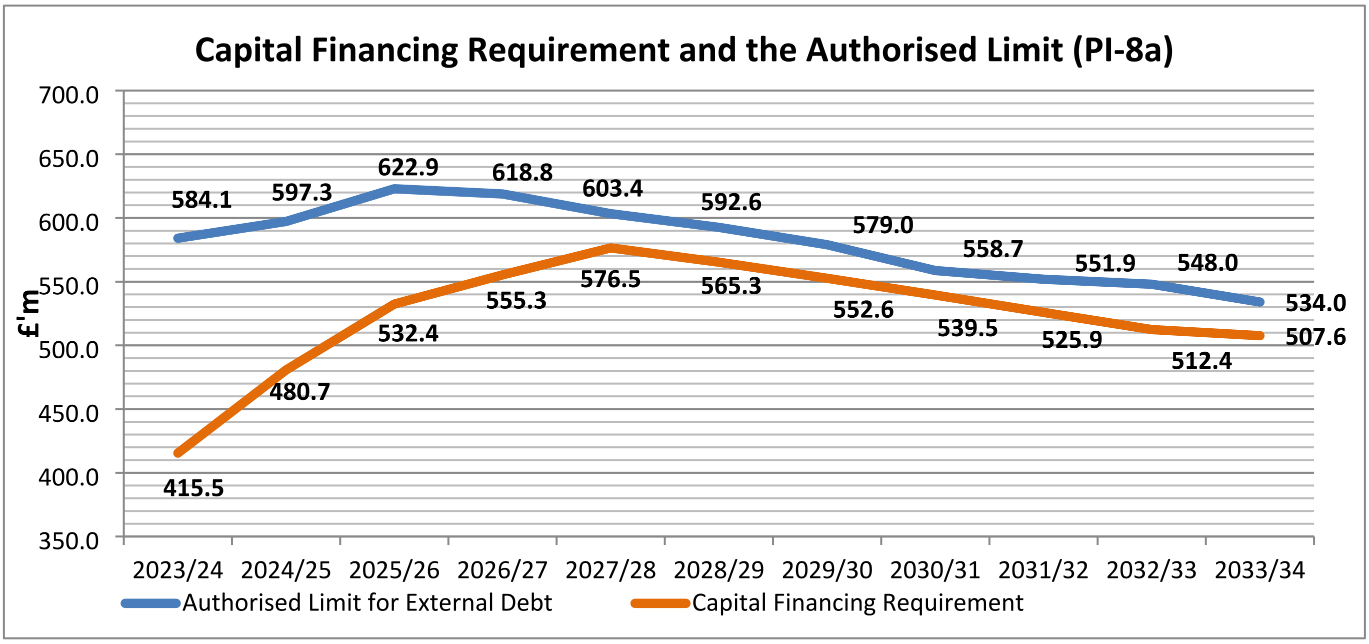
c) A further key prudential indicator represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be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

d) The authorised limits for external debt for the current year and two subsequent years are the legislative limits determined under Regulation 6(1) of the Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016.

e) The Council is asked to approve the following Authorised Limit, being the Operational Boundary (PI-7a) plus 20% margin:

Authorised Limit £m	Estimate					
	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
Total Authorised Limit (PI-8a)	**584.1**	**597.3**	**622.9**	**618.8**	**603.4**	**592.6**
Less: Other long term liabilities	(111.3)	(110.2)	(109.1)	(107.9)	(106.7)	(105.4)
Authorised Limit exc. Other Long-Term Liabilities (PI-8b)	**472.8**	**487.1**	**513.8**	**510.9**	**496.7**	**487.2**

f) The chart on the below shows how the current and projected Capital Financing Requirement (PI-2) compares to the Authorised Limit for External Debt (PI – 8a).



4.3 Prospects for Interest Rates

a) The Council has appointed Link Group as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates.

Link provided the following forecasts and associated commentary on 8th January 2024.

These are forecasts for certainty rates (gilt yields plus 80bps):

Link Group Interest Rate View 08.01.24	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
BANK RATE	5.25	5.25	4.75	4.25	3.75	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00
3 month ave earnings	5.30	5.30	4.80	4.30	3.80	3.30	3.00	3.00	3.00	3.00	3.00	3.00	3.00
6 month ave earnings	5.20	5.10	4.60	4.10	3.70	3.30	3.10	3.10	3.10	3.10	3.10	3.10	3.10
12 month ave earnings	5.00	4.90	4.40	3.90	3.60	3.20	3.10	3.10	3.10	3.10	3.10	3.20	3.20
5 yr PWLB	4.50	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.60	3.50	3.50	3.50
10 yr PWLB	4.70	4.50	4.40	4.30	4.20	4.10	4.00	3.90	3.80	3.70	3.70	3.70	3.70
25 yr PWLB	5.20	5.10	4.90	4.80	4.60	4.40	4.30	4.20	4.20	4.10	4.10	4.10	4.10
50 yr PWLB	5.00	4.90	4.70	4.60	4.40	4.20	4.10	4.00	4.00	3.90	3.90	3.90	3.90

Additional notes by Link on this forecast table: -

Our central forecast for interest rates was previously updated on 7 November and reflected a view that the Monetary Policy Committee (MPC) would be keen to further demonstrate its anti-inflation credentials by keeping Bank Rate at 5.25% until at least H2 2024. We expect rate cuts to start when both the CPI inflation and wage/employment data are supportive of such a move, and when there is a likelihood of the overall economy enduring at least a slowdown or mild recession over the coming months (although most recent GDP releases have surprised with their on-going robustness).

Naturally, timing on this matter will remain one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.

In the upcoming months, our forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but also international factors such as policy development in the US and Europe, the provision of fresh support packages to support the faltering recovery in China as well as the on-going conflict between Russia and Ukraine, and Gaza and Israel.

PWLB RATES

The short and medium part of the gilt curve has rallied since the start of November as markets price in a quicker reduction in Bank Rate through 2024 and 2025 than held sway back then. This reflects market confidence in inflation falling back in a similar manner to that already seen in the US and the Euro-zone. At the time of writing there is c70 basis points difference between the 5 and 50 year parts of the curve.

The balance of risks to the UK economy: -
The overall balance of risks to economic growth in the UK is even.

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

- **Labour and supply shortages** prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, could keep gilt yields high for longer).

- **The Bank of England** has increased Bank Rate too fast and too far over recent months, and subsequently brings about a deeper and longer UK recession than we currently anticipate.

- **Geopolitical risks,** for example in Ukraine/Russia, the Middle East, China/Taiwan/US, Iran and North Korea, which could lead to increasing safe-haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates: -

- Despite the tightening in bank rate to 5.25%, the **Bank of England allows inflationary pressures to remain elevated** for a long period within the UK economy, which then necessitates Bank Rate staying higher for longer than we currently project.

- **The pound weakens** because of a lack of confidence in the UK Government's pre-election fiscal policies, which may prove inflationary, resulting in investors pricing in a risk premium for holding UK sovereign debt.

- Projected **gilt issuance, inclusive of natural maturities and QT,** could be too much for the markets to comfortably digest without higher yields consequently.

LINK GROUP FORECASTS

We expect the Monetary Policy Committee (MPC) will keep Bank Rate at 5.25% until the second half of 2024, to combat on-going inflationary and wage pressures, even if they have dampened somewhat of late. We do not think that the MPC will increase Bank Rate above 5.25%.

Gilt yields and PWLB rates

The overall longer-run trend is for gilt yields and PWLB rates to fall back over the timeline of our forecasts, as inflation continues to fall through 2024.

Our target borrowing rates are set **two years forward** (as we expect rates to fall back) and the current PWLB (certainty) borrowing rates are set out below: -

PWLB debt	Current borrowing rate as at 08.01.24 p.m.	Target borrowing rate now (end of Q4 2025)	Target borrowing rate previous (end of Q3 2025)
5 years	4.53%	3.70%	3.80%
10 years	4.67%	3.90%	3.80%
25 years	5.19%	4.20%	4.20%
50 years	4.97%	4.00%	4.00%

Borrowing advice

Our long-term (beyond 10 years) forecast for Bank Rate remains at 3% and reflects Capital Economics' research that suggests AI and general improvements in productivity will be supportive of a higher neutral interest rate. As all PWLB certainty rates are currently significantly above this level, borrowing strategies will need to be reviewed in that context. Overall, better value can be obtained at the shorter end of the curve and short-dated fixed LA to LA monies should be considered. Temporary borrowing rates will remain elevated for some time to come but may prove the best option whilst the market continues to factor in Bank Rate reductions for 2024 and later.

Our suggested budgeted earnings rates for investments up to about three months' duration in each financial year are set out below.

Average earnings in each year	Now	Previously
2023/24 (residual)	5.30%	5.30%
2024/25	4.55%	4.70%
2025/26	3.10%	3.20%
2026/27	3.00%	3.00%
2027/28	3.25%	3.25%
2028/29	3.25%	3.25%
Years 6 to 10	3.25%	3.25%
Years 10+	3.25%	3.25%

As there are so many variables at this time, caution must be exercised in respect of all interest rate forecasts.

Our interest rate forecast for Bank Rate is in steps of 25 bps, whereas PWLB forecasts have been rounded to the nearest 10 bps and are central forecasts within bands of + / - 25 bps. Naturally, we continue to monitor events and will update our forecasts as and when appropriate.

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 with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as medium and longer dated borrowing rates are expected to fall from their current levels once prevailing inflation concerns are addressed by tighter near-term monetary policy. That is, Bank Rate remains elevated through to the second half of 2024.

b) Against this background and the risks within the economic forecast, caution will be adopted with the 2024/25 treasury operations. The Director of Finance and Procurement 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 borrowing rates,* then borrowing will be postponed.

• *if it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast,* fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

c) Any decisions will be reported to the appropriate decision-making body at the next available opportunity.

4.5 Policy on borrowing in advance of need

a) Borrowing in advance of need 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.

b) The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed.

c) 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.

d) The Director of Finance and Procurement 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 Director of Finance and Procurement 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) All rescheduling will be reported to the **Executive Committee** at the earliest meeting following its action.

4.7 New financial institutions as a source of borrowing and/or types of borrowing

a) Currently the PWLB Certainty Rate is set at gilts + 80 basis points for non-Housing Revenue Account borrowing. However, consideration may still need to be given to sourcing funding from the following sources for the following reasons:

- Local authorities (primarily shorter dated maturities out to 3 years or so – still cheaper than the Certainty Rate).
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of forward dates where the objective is to avoid a “cost of carry” or to achieve refinancing certainty over the next few years).
- Municipal Bonds Agency (possibly still a viable alternative depending on market circumstances prevailing at the time).

b) Our advisors will keep us informed as to the relative merits of each of these alternative funding sources.

5 Investment Strategy

5.1 Investment Objectives and Policy

a) The Council's investment policy implements the requirements of the following:-

- Local Government Investments (Scotland) Regulations 2010, (and accompanying Finance Circular 5/2010);
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2021, ("the Code");
- CIPFA Treasury Management Guidance Notes 2021.

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;
(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. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in periods up to 12 months with high credit rated financial institutions.

c) Minimum acceptable **credit criteria** are applied to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings (**Annex I**).

d) **Other information**: ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as "**credit default swaps**" and overlay that information on top of the credit ratings.

e) **Other information sources** used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

f) The Council has defined the list of **types of investment instruments** that are permitted investments authorised for use in **Annex D**. **Annex E** expands on the risks involved in each type of investment and the mitigating controls.

g) **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 5.3.

h) This authority has engaged **external consultants** to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

i) All investments will be denominated in **sterling.**

j) As a result of the change in accounting standards for 2023/24 under **IFRS 9,** the Council will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund.

k) The Council will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance. Regular monitoring of investment performance will be carried out during the year.

l) The above criteria are unchanged from last year.

5.2 Council Permitted Investments

The proposed criteria for permitted investments are shown in **Annex D** approval.

5.3 Creditworthiness Policy

a) The Council applies the creditworthiness service provided by the Link Group. 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 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) This modelling approach combines credit ratings, and any assigned Watches and Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads. 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 Ultra short dated bond funds with a credit score of 1.25
Light pink	5 years for Ultra short dated bond funds 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 do n'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

c) The Link creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

d) 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. More detail is seen in Annex I.

e) All credit ratings will be monitored on a real time basis. The Council is alerted to changes to ratings of all three agencies through its use of a creditworthiness service provided by the Link Group.

- 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 against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

f) Sole reliance will not be placed on the use of this external service. In addition, the Council will also use market data and market information, as well as information on any external support for banks to help support its decision-making process.

g) Significant levels of downgrades to Short and Long-Term credit ratings have not materialised since the crisis in March 2020. In the main, where they did change, any alterations were limited to Outlooks. Nonetheless, when setting minimum sovereign debt ratings, the Council will not set a minimum rating for the UK.

h) Although bank CDS prices, (these are market indicators of credit risk), spiked upwards during the days of the Truss/Kwarteng government, they have returned to more average levels since then. However, sentiment can easily shift, so it will remain important to undertake continual monitoring of all aspects of risk and return in the current circumstances. Link monitor CDS prices as part of their creditworthiness service to local authorities and the Authority has access to this information via its Link-provided Passport portal.

5.4 Country and Sector Considerations

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

Country Limits

b) The Council has determined that it will only use approved counterparties from the UK and from countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix F. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

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)	**£25 m**

These limits will be monitored regularly for appropriateness.

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, if 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.

Group Limits

c) 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 Link Groups' creditworthiness list:

Group of Banks **£10m**

Council's Own Banker

d) The Council's own banker (currently Royal Bank of Scotland) 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, if 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.

5.6 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 Debt Management Account Deposit Facility (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:

- BGC Brokers L.P.
- ICAP Securities Limited
- Sterling International Brokers Limited
- Tradition (UK) Limited

5.7 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). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

Investment returns expectations

b) The current forecast shown in paragraph 4.3, includes a forecast for Bank Rate to have peaked 5.25% in Q4 2023.

c) The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

Average earnings in each year	
2023/24 (residual)	5.30%
2024/25	4.55%
2025/26	3.10%
2026/27	3.00%
2027/28	3.25%
Years 6 to 10	3.25%
Years 10+	3.25%

Investment Treasury Indicator and Limit (Treasury Indicator TI-5)

d) This indicator is concerned with total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year end.

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

Maximum principal sums invested for longer than 365 days (TI-5)						
£m	**2023/24**	**2024/25**	**2025/26**	**2026/27**	**2027/28**	**2028/29**
Principal sums invested for longer than 365 days	20%	20%	20%	20%	20%	20%

e) 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).

5.8 Investment 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 benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or Annual Report.

a) Security

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

0.002% historic risk of default when compared to the whole portfolio.

b) Liquidity

In respect of this area the Council seeks to maintain:

- Bank Overdraft: £2,000,000
- Liquid short term deposits of at least £1,500,000 available with a week's notice.
- Weighted Average Life 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 are:

Investments – **Internal returns above the 365 day backward looking SONIA (Sterling Overnight Index Average) uncompounded rate**

At the end of the financial year, the Council 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 2023/24.

(ii) Average borrowing rate movement year on year

Target is to maintain or reduce the average borrowing rate for the Council versus 2023/24.

6.3 **Investment Risk Benchmark Indicators** for Security, Liquidity and Yield, as set out in paragraph 5.8.

6.4 Loans Charges

a) Loans Charges for 2024/25 are expected to be at or below the Revenue Budget estimate contained in the Council's Financial Plans to be approved in February 2024, which are estimated as follows:

£m	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
Total Loan Charges *	**13.6**	**18.2**	**20.9**	**23.8**	**25.7**	**26.9**

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

b) The expected outturn for 2023/24 reflects the cumulative adjustment for service concession arrangements. The above budgets exclude the revenue impact of funding the cost of the National Housing Trust (NHT) and the lending to Registered Social Landlords (RSL) 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 2024/25.

ANNEXES

ANNEX A
SUMMARY OF PRUDENTIAL AND TREASURY INDICATORS

Indicator Ref.	Indicator	Page Ref.	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
PRUDENTIAL INDICATORS								
Capital Expenditure Indicator								
PI-1	Capital Expenditure Limits (£m)	8	96.9	121.2	98.3	66.3	59.6	24.9
PI-2	Capital Financing Requirement (CFR) (£m)	10	415.5	480.7	532.4	555.3	576.5	565.3
Affordability Indicator								
PI-3	Ratio of Financing Costs to Net Revenue (inc. capital PPP repayment costs)	29	5.8%	7.5%	8.1%	8.9%	9.3%	9.6%
PI-4	Incremental movement of Capital Investment Decisions on Council Tax		£(0.09)	£(0.06)	£(0.05)	£(0.04)	£(0.02)	£(0.00)
External Debt Indicators								
PI-5	Actual Debt (£m)	12	348.6	399.7	449.6	478.5	498.2	490.4
PI-7a	Operational Boundary (inc. Other Long Term Liabilities) (£m)	13	468.8	497.7	519.1	515.7	502.8	493.8
PI-7b	Operational Boundary (exc. Other Long Term Liabilities) (£m)	13	375.5	387.5	410.0	407.7	396.1	388.4
PI-8a	Authorised Limit (inc. Other Long Term Liabilities) (£m)	14	584.1	597.3	622.9	618.8	603.4	592.6
PI-8b	Authorised Limit (exc. Other Long Term Liabilities) (£m)	14	472.8	487.1	513.8	510.9	496.7	487.2
Indicators of Prudence								
PI-6	(Under)/Over Gross Borrowing against the CFR (£m)	12	(183.8)	(155.6)	(126.9)	(86.8)	(54.4)	(49.1)
TREASURY INDICATORS								
TI-1	Upper Limit to Fixed Interest Rates based on Net Debt (£m)	30	486.8	497.7	519.1	515.7	502.8	493.8
TI-2	Upper Limit to Variable Interest Rates based on Net Debt (£m)	30	170.4	174.2	181.7	180.5	176.0	172.8
TI-3	Maturity Structure of Fixed Interest Rate Borrowing 2023/24	30	**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-5	Maximum Principal Sum invested greater than 365 days	25	20%	20%	20%	20%	20%	20%

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)

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	Estimate					
	22/23	23/24	24/25	25/26	26/27	27/28	28/29
Ratio of Financing Costs to Net Revenue Stream (PI-3) *(inc. capital PPP repayment costs)*	7.7%	5.8%	7.5%	8.1%	8.9%	9.2%	9.6%

The estimates of financing costs include current commitments, the revisions due to the rebasing of the service concession arrangements and the proposals in the Financial Plans for 2024/25. The movements in the above ratio from 2023/24 onwards reflect a real-time reduction in overall financial resources available to the Council.

Treasury Management Limits on Activity

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	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
Interest rate exposures						
	Upper	**Upper**	**Upper**	**Upper**	**Upper**	**Upper**
Limits on fixed interest rates based on net debt (TI-1)	486.8	497.7	519.1	515.7	502.8	493.8
Limits on variable interest rates based on net debt (TI-2)	170.4	174.2	181.7	180.5	176.0	172.8

Maturity Structure of fixed interest rate borrowing 2023/24 (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%

ANNEX B: INTEREST RATE FORECASTS 2024-27

[PWLB rates and forecast shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.] There are no changes to these forecasts as at 30.01.24.

Link Group Interest Rate View 08.01.24													
	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25	Mar-26	Jun-26	Sep-26	Dec-26	Mar-27
BANK RATE	5.25	5.25	4.75	4.25	3.75	3.25	3.00	3.00	3.00	3.00	3.00	3.00	3.00
3 month ave earnings	5.30	5.30	4.80	4.30	3.80	3.30	3.00	3.00	3.00	3.00	3.00	3.00	3.00
6 month ave earnings	5.20	5.10	4.60	4.10	3.70	3.30	3.10	3.10	3.10	3.10	3.10	3.10	3.10
12 month ave earnings	5.00	4.90	4.40	3.90	3.60	3.20	3.10	3.10	3.10	3.10	3.10	3.20	3.20
5 yr PWLB	4.50	4.40	4.30	4.20	4.10	4.00	3.80	3.70	3.60	3.60	3.50	3.50	3.50
10 yr PWLB	4.70	4.50	4.40	4.30	4.20	4.10	4.00	3.90	3.80	3.70	3.70	3.70	3.70
25 yr PWLB	5.20	5.10	4.90	4.80	4.60	4.40	4.30	4.20	4.20	4.10	4.10	4.10	4.10
50 yr PWLB	5.00	4.90	4.70	4.60	4.40	4.20	4.10	4.00	4.00	3.90	3.90	3.90	3.90

Interest Rate Forecasts								
Bank Rate	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
Link	5.25%	5.25%	4.75%	4.25%	3.75%	3.25%	3.00%	3.00%
Cap Econ	5.25%	5.00%	4.50%	4.00%	3.50%	3.00%	3.00%	3.00%
5Y PWLB RATE								
Link	4.50%	4.40%	4.30%	4.20%	4.10%	4.00%	3.80%	3.70%
Cap Econ	4.50%	4.30%	4.20%	4.00%	3.90%	3.80%	3.80%	3.70%
10Y PWLB RATE								
Link	4.70%	4.50%	4.40%	4.30%	4.20%	4.10%	4.00%	3.90%
Cap Econ	4.50%	4.40%	4.20%	4.10%	4.10%	4.10%	4.10%	4.10%
25Y PWLB RATE								
Link	5.20%	5.10%	4.90%	4.80%	4.60%	4.40%	4.30%	4.20%
Cap Econ	5.10%	4.80%	4.60%	4.30%	4.40%	4.40%	4.50%	4.60%
50Y PWLB RATE								
Link	5.00%	4.90%	4.70%	4.60%	4.40%	4.20%	4.10%	4.00%
Cap Econ	4.70%	4.60%	4.50%	4.30%	4.30%	4.30%	4.40%	4.40%

Source: Link Treasury Services, January 2024

ANNEX C: ECONOMIC BACKGROUND – supplied by Link

The third quarter of 2023/24 saw:

- A 0.3% m/m decline in real GDP in October, potentially partly due to unseasonably wet weather, but also due to the ongoing drag from higher interest rates. Growth for the second quarter, ending 30th September, was revised downwards to -0.1% and growth on an annual basis was also revised downwards, to 0.3%;

- A sharp fall in wage growth, with the headline 3myy rate declining from 8.0% in September to 7.2% in October, although the ONS "experimental" rate of unemployment has remained low at 4.2%;

- CPI inflation continuing on its downward trajectory, from 8.7% in April to 4.6% in October, then again to 3.9% in November;

- Core CPI inflation decreasing from April and May's 31 years' high of 7.1% to 5.1% in November, the lowest rate since January 2022;

- The Bank of England holding Bank Rate at 5.25% in November and December;

- A steady fall in 10-year gilt yields as investors revised their interest rate expectations lower.

The revision of GDP data in Q2 to a 0.1% q/q fall may mean the mildest of mild recessions has begun. Indeed, real GDP in October fell 0.3% m/m which does suggest that the economy may stagnate again in Q3. The weakness in October may partly be due to the unseasonably wet weather. That said, as the weakness was broad based it may also be the case that the ongoing drag from higher interest rates is more than offsetting any boost from the rise in real wages.

However, the rise in the flash composite activity Purchasing Managers Index, from 50.7 in November to 51.7 in December, did increase the chances of the economy avoiding a contraction in Q3. The improvement was entirely driven by the increase in the services activity balance from 50.9 to 52.7. (Scores above 50 point to expansion in the economy, although only tepid in this instance.) The press release noted that this was primarily driven by a revival in consumer demand in the technological and financial services sectors. This chimes with the further improvement in the GfK measure of consumer confidence in December, from -24 to -22.

The services PMI is now consistent with non-retail services output growing by 0.5% q/q in Q3, but this is in stark contrast to the manufacturing sector where the output balance slumped from 49.2 to 45.9 and, at face value, the output balance is consistent with a 1.5% q/q fall in manufacturing output in Q3.

The 0.3% m/m fall in retail sales volumes in October means that after contracting by 1.0% q/q (which was downwardly revised from -0.8% q/q) in Q2, retail activity remained weak at the start of Q3. That suggests higher interest rates are taking a bigger toll on real consumer spending.

Higher interest rates have filtered through the financial channels and weakened the housing market but, overall, it remains surprisingly resilient with the Halifax house price index recently pointing to a 1.7% year on year increase whilst Nationwide's December data pointed to a -1.8% year on year decrease. However, the full weakness in real consumer spending and real business investment has yet to come as currently it is estimated that around two thirds to a half of the impact of higher interest rates on household interest payments has yet to be felt.

Overall, we expect real GDP growth to remain subdued throughout 2024 as the drag from higher interest rates is protracted but a fading of the cost-of-living crisis and interest rate cuts in the second half of 2024 will support a recovery in GDP growth in 2025.

The labour market remains tight by historical standards, but the sharp fall in wage growth seen in October will reinforce the growing belief in markets that interest rates will be cut mid-2024. Wage growth eased in October much faster than the consensus expected. Total earnings fell by 1.6% m/m, which meant the headline 3myy rate eased from 8.0% in September to 7.2% in October. This news will be welcomed by the Bank of England. Indeed, the timelier three-month annualised rate of average earnings growth fell from +2.4% to -1.2%. Excluding bonuses, it fell from 5.3% to 2.0%. Furthermore, one of the Bank's key barometers of inflation persistence, regular private sector pay growth, dropped from 7.9% 3myy to 7.3%, which leaves it comfortably on track to fall to 7.2% by December, as predicted by the Bank in November.

The fall in wage growth occurred despite labour demand being stronger in October than expected. The three-month change in employment eased only a touch from +52,000 in September to +50,000 in October. But resilient labour demand was offset by a further 63,000 rise in the supply of workers in the three months to October. That meant labour supply exceeded its pre-pandemic level for the first time, and the unemployment rate remained at 4.2% in October. In the three months to November, the number of job vacancies fell for the 17th month in a row, from around 959,000 in October to around 949,000. That has reduced the vacancy to unemployment ratio as demand for labour eases relative to supply, which may support a further easing in wage growth in the coming months.

CPI inflation fell from 6.7% in September to 4.6% in October, and then again to 3.9% in November. Both these falls were bigger than expected and there are clear signs of easing in domestic inflationary pressures. The fall in core CPI inflation from 5.7% to 5.1% in November was bigger than expected (consensus forecast 5.6%). That's the lowest rate since January 2022. Some of the decline in core inflation was due to the global influence of core goods inflation, which slowed from 4.3% to 3.3%. But some of it was due to services inflation falling from 6.6% to 6.3%. The Bank views the latter as a key barometer of the persistence of inflation and it came in further below the Bank's forecast of 6.9% in its November Monetary Policy Report. This will give the Bank more confidence that services inflation is now on a firmly downward path.

The Bank of England sprung no surprises with its December monetary policy committee (MPC) meeting, leaving interest rates at 5.25% for the third time in a row and pushing back against the prospect of near-term interest rate cuts. The Bank continued to sound hawkish, with the MPC maintaining its tightening bias saying that "further tightening in monetary policy would be required if there were evidence of more persistent inflationary pressures". And it stuck to the familiar script, saying that policy will be "sufficiently restrictive for sufficiently long" and that "monetary policy is likely to need to be restrictive for an extended period of time". In other words, the message is that the MPC is not yet willing to endorse investors' expectations that rates will be cut as soon as May 2024.

Looking ahead, our colleagues at Capital Economics forecast that the recent downward trends in CPI and core inflation will stall over the next few months before starting to decline more decisively again in February. That explains why we think the Bank of England won't feel comfortable cutting interest rates until H2 2024.

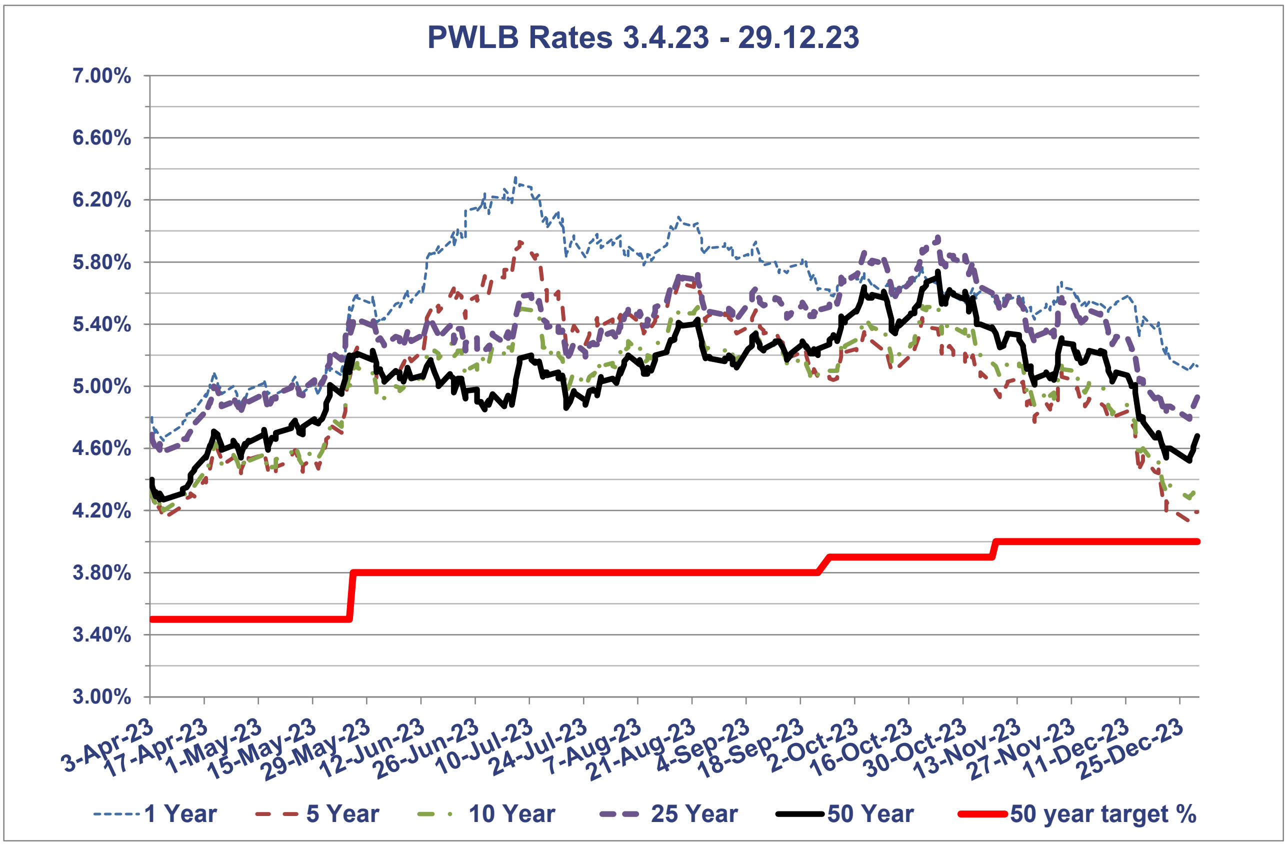
The fall in UK market interest rate expectations in December has driven most of the decline in 10-year gilt yields, which have fallen in line with 10-year US Treasury and euro-zone yields. 10-year gilt yields have fallen from 4.68% in October 2023 to around 3.70% in early January, with further declines likely if the falling inflation story is maintained.

Investors' growing expectations that the Fed will cut interest rates soon has led to an improvement in risk sentiment, which has boosted the pound and other risky assets. In addition, the rise in the pound, from $1.21 in November to $1.27 now, has also been supported by the recent relative decline in UK wholesale gas prices.

The further fall in 10-year real gilt yields in December has supported the recent rise in the FTSE 100. That said, the index remains 5% below its record high in February 2023. This modest rise in equities appear to have been mostly driven by strong performances in the industrials and rate-sensitive technology sectors. But UK equities have continued to underperform US and euro-zone equities. The FTSE 100 has risen by 2.2% in December, while the S&P 500 has risen by 3.8%.

This is partly due to lower energy prices, which have been a relatively bigger drag on the FTSE 100, due to the index's high concentration of energy companies.

In the chart below, the rise in gilt yields across the curve in the first half of 2023/24, and therein PWLB rates, is clear to see, prior to the end of year rally based on a mix of supportive domestic and international factors.



	1 Year	5 Year	10 Year	25 Year	50 Year
Low	4.65%	4.13%	4.20%	4.58%	4.27%
Date	06/04/2023	27/12/2023	06/04/2023	06/04/2023	05/04/2023
High	6.36%	5.93%	5.53%	5.96%	5.74%
Date	06/07/2023	07/07/2023	23/10/2023	23/10/2023	23/10/2023
Average	5.60%	5.09%	5.03%	5.35%	5.08%
Spread	1.71%	1.80%	1.33%	1.38%	1.47%

MPC meetings 2nd November and 14th December 2023

On 2nd November, the Bank of England's Monetary Policy Committee (MPC) voted to keep Bank Rate on hold at 5.25%, and on 14th December reiterated that view. Both increases reflected a split vote, the latter by 6 votes to 3, with the minority grouping voting for an increase of 0.25% as concerns about "sticky" inflation remained in place.

Nonetheless, with UK CPI inflation now at 3.9%, and core inflating beginning to moderate (5.1%), markets are voicing a view that rate cuts should begin in Q1 2024/25, some way ahead of the

indications from MPC members. Of course, the data will be the ultimate determinant, so upcoming publications of employment, wages and inflation numbers will be of particular importance, and on-going volatility in Bank Rate expectations and the gilt yield curve can be expected.

In addition, what happens outside of the UK is also critical to movement in gilt yields. The US FOMC has kept short-term rates in the range of 5.25%-5.50%, whilst the ECB has moved its Deposit rate to a probable peak of 4%. Markets currently expect both central banks to start cutting rates in 2024.

ANNEX D: TREASURY MANAGEMENT PRACTICE

PERMITTED INVESTMENTS, ASSOCIATED CONTROLS AND LIMITS

This Council approves the following forms of investment instrument for use as permitted investments

Treasury risks
All the investment instruments are subject to the following risks: -

1. **Credit and counter-party risk:** this is the risk of failure by a counterparty (bank or building society) to meet its contractual obligations to the organisation particularly because of the counterparty's diminished creditworthiness, and the resulting detrimental effect on the organisation's capital or current (revenue) resources. There are no counterparties where this risk is zero although AAA rated organisations have the highest, relative, level of creditworthiness.

2. **Liquidity risk:** this is the risk that cash will not be available when it is needed. While it could be said that all counterparties are subject to at least a very small level of liquidity risk as credit risk can never be zero, in this document, liquidity risk has been treated as whether or not instant access to cash can be obtained from each form of investment instrument. However, it has to be pointed out that while some forms of investment e.g. gilts, CDs, corporate bonds can usually be sold immediately if the need arises, there are two caveats: - a. cash may not be available until a settlement date up to three days after the sale b. there is an implied assumption that markets will not freeze up and so the instrument in question will find a ready buyer.

3. **Market risk:** this is the risk that, through adverse market fluctuations in the value of the principal sums an organisation borrows and invests, its stated treasury management policies and objectives are compromised, against which effects it has failed to protect itself adequately. However, some cash rich local authorities may positively want exposure to market risk e.g. those investing in investment instruments with a view to obtaining a long term increase in value.

4. **Interest rate risk**: this is the risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately. This authority has set limits for its fixed and variable rate exposure in its Treasury Indicators in this report.

5. **Legal and regulatory risk:** this is the risk that the organisation itself, or an organisation with which it is dealing in its treasury management activities, fails to act in accordance with its legal powers or regulatory requirements, and that the organisation suffers losses accordingly.

Controls on treasury risks

1. **Credit and counter-party risk:** this authority has set minimum credit criteria to determine which counterparties and countries are of sufficiently high creditworthiness to be considered for investment purposes. See paragraphs 5.3 and 5.4.

2. **Liquidity risk:** this authority has a cash flow forecasting model to enable it to determine how long investments can be made for and how much can be invested.

3. **Market risk:** this authority does not purchase investment instruments which are subject to market risk in terms of fluctuation in their value.

4. **Interest rate risk**: this authority manages this risk by having a view of the future course of interest rates and then formulating a treasury management strategy accordingly which aims to maximise investment earnings consistent with control of risk or alternatively, seeks to minimise expenditure on interest costs on borrowing. See paragraph 5.7.

5. **Legal and regulatory risk:** this authority will not undertake any form of investing until it has ensured that it has all necessary powers and also complied with all regulations. All types of investment instruments

Unlimited investments

Regulation 24 states that an investment can be shown as being 'unlimited' in terms of the maximum amount or percentage of the total portfolio that can be put into that type of investment. However, it also requires that an explanation must be given for using that category. The authority has given the following types of investment an unlimited category: -

1. **Debt Management Agency Deposit Facility.** This offers the lowest risk form of investment available to local authorities as it is effectively an investment placed with the Government. It is also easy to use as it is a deposit account and avoids the complications of buying and holding Government issued treasury bills or gilts. As it is low risk it also earns low rates of interest. However, it is very useful for authorities whose overriding priority is the avoidance of risk. The longest period for a term deposit with the DMADF is 6 months.

Environmental, Social & Governance (ESG) Considerations

This topic is becoming a more commonplace discussion within the wider investment community, including Local Authorities. While around two thirds of councils have declared a "climate emergency" to date, this has not translated into the incorporation of something more formal within their treasury-related Annual Investment Strategy. Changes to the CIPFA TM Code 2021 will see ESG incorporated into Treasury Management Practice 1. The following wording (page 18 of the Treasury Management Code) suggests the scope of what is included: "The organisation's credit and counterparty policies should set out its policy and practices relating to environmental, social and governance (ESG) investment considerations. This is a developing area, and it is not implied that the organisation's ESG policy will currently include ESG scoring or other real-time ESG criteria at individual investment level."

Furthermore, page 50 of the Treasury Management Code states "ESG issues are increasingly significant for investors and investment managers. This is better developed in equity and bond markets than for short-term cash deposits, and there is a diversity of market approaches to ESG classification and analysis. This means that a consistent and developed approach to ESG for public service organisations is currently difficult. Organisations are therefore recommended to consider their credit and counterparty policies in light of ESG information and develop their own ESG investment policies and treasury management practices consistent with their organisation's own relevant policies, such as environmental and climate change policies."

From Link's perspective, the most important issue is ensuring that there is a clear understanding of what "environmental, social and governance (ESG)" investment considerations means. It is about understanding the ESG "risks" that an entity is exposed to and evaluating how well it manages these risks, (all entities will be subject to these to one extent or other). It is NOT the same as Socially Responsible Investing, (typically where you apply negative screens), and equally, it is NOT the same as Sustainable Investing, (investing in products / companies based on expected sustainable and beneficial societal impact, alongside a financial return).

There is such a huge potential for misunderstanding which could have material unintended consequence i.e., limiting of potential counterparty options, thus decreasing diversification. The above could then lead to authorities widening credit criteria to take on more names, or those with a stronger "ESG" performance, which could then increase credit risk…which would place the cornerstone of prudent investing at risk.

The other factor, i.e., what local authorities can or already do to take this into account, is credit ratings. All the main agencies are now extoling how they incorporate ESG risks alongside more traditional financial risk metrics when assessing counterparty ratings. As such, you could argue that their incorporation is already being done, to an extent, by the use of mainstream rating agencies.

Also, a final note to point out is that given ESG risks are all about potential impact on entity enterprise value; the “G” (governance) is by far the most important one when considering treasury investments, the majority of which will be shorter-term in nature. This is because poor governance can have a more immediate impact on the financial circumstances of an entity and the potential for a default event that would impact the amount the local authorities receive back from their investments. Those financial institutions that are viewed as having poor/weak corporate governance are generally less well rated in the first instance or have a higher propensity for being subject to negative rating action. So, this element of ESG is of high importance to an investor that is following investment guidance with the security, liquidity and yield (SLY) principle at its core. Environmental & Social factors are also important, but more for the long-term impact, unless you are specifically going down the “impact” / “sustainable” type investment route…and there are not many options for that in respect of short-term investments.

Naturally, Link continues to look at ways in which we can incorporate these factors into our creditworthiness assessment service. However, the lack of consistency, as well as uncertainty as to how the Treasury Management Code may develop TMP1, means that although we continue to review the options and will update clients as progress is made, it is not practicable to expand broadly upon ESG matters at the current time.

ANNEX E: 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 Funds 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 and maximum 1 year	£5m and maximum 1 year	£40m and 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 has a “AAA” rated status from either Fitch, Moody’s or Standard and Poor’s.	£5m per fund/£25m total	£5m per fund/£25m total	£5m per fund/£25m total

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good & Trust Funds Limits	Pension Fund In-house Limits
d. Ultra-short dated bond funds **(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 they have a “AAA” rated status from either Fitch, Moody’s or Standard and Poor’s.	N/A	N/A	N/A
e. 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. Day to day investment dealing with these 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
f. 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 Poor’s. Day to day investment dealing with these 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

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits	Common Good & Trust Funds Limits	Pension Fund In-house Limits
g. 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					
a. Investment properties	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
b. Loans to third parties, including soft loans	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
c. Loans to a local authority company	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 requires Member approval and each application is supported by the service rational behind the loan and the likelihood of partial or full default.	£25m	N/A	N/A
d. National Housing Trust **(Very Low Risk due to Scottish Government Underwriting** Shareholdings in a local authority company	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. These are service investments which may exhibit market risk and are likely to be highly illiquid.	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
e. Shareholdings in a local authority company	These are service investments which may exhibit market risk and are likely to be highly illiquid.	Each equity investment in a local authority company 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
f. 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)	£600,000	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 Link Group, 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 by the Acting Chief Financial Officer, 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 F: APPROVED COUNTRIES FOR INVESTMENTS

This list is based on those countries which have sovereign ratings of AA- or higher, (we show the lowest rating from Fitch, Moody's and S&P) and also have banks operating in sterling markets which have credit ratings of green or above in the Link creditworthiness service.

Based on lowest available rating

AAA

a) Australia
b) Denmark
c) Germany
d) Netherlands
e) Norway
f) Singapore
g) Sweden
h) Switzerland

AA+

i) Canada
j) Finland
k) U.S.A.

AA

l) Abu Dhabi (UAE)

AA-

m) Belgium
n) France
o) Qatar
p) **U.K.**

[Ratings provided by Link Group as at 30 January 2024]

ANNEX G: SCHEME OF DELEGATION

Full Council

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

Boards/committees/council/responsible body

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

Body/person(s) with responsibility for scrutiny

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

THE TREASURY MANAGEMENT ROLE OF THE SECTION 95 OFFICER

The S95 (responsible) officer

- Take and/or authorise all operational decisions regarding the Council's investments and borrowing, in accordance with approved Treasury Management Strategy.
- Responsible for execution and administration of treasury management decisions in accordance with the Council's Treasury Management Strategy, and if (s)he is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.
- In terms of Treasury Management, from time to time, formulate suitable criteria for assessing and monitoring the credit risk of investment counterparties and construct a lending list defining appropriate limits.
- Borrow, in advance of need, 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. 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 investment risks created by the existence of investments at the same time as additional borrowing being outstanding; and
    - how far in advance it is reasonable to borrow, considering the risks identified. Any such advance borrowing shall be reported through the mid-year or annual Treasury Management reporting mechanism.
- Take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast contained in the Treasury Management Strategy.
- Maintain a counterparty list consistent with the Investment Counterparty Selection Criteria and revise the criteria and submit them to Committee for approval as necessary, and in addition, set out the types of investment to be made (Permitted Investments).
- Preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long-term timeframe
- Ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money.

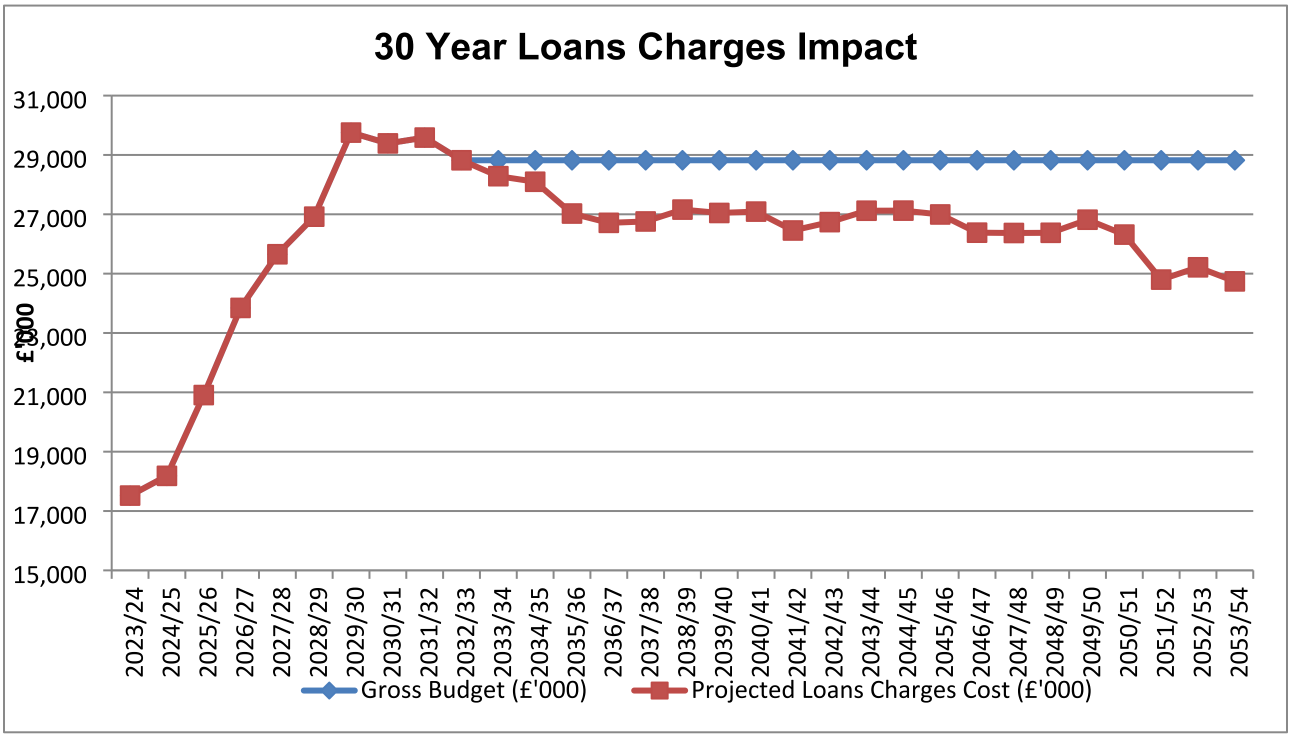
- Ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the Council.
- Ensure that the Council has appropriate legal powers to undertake expenditure on non-financial assets and their financing.
- Ensuring the proportionality of all investments so that the Council does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources.
- Ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities.
- Provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees ensuring that members are adequately informed and understand the risk exposures taken on by the Council.
- Ensuring that the Council has adequate expertise, either in house or externally provided, to carry out the above.
- Creation of Treasury Management Practices which specifically deal with how non-treasury investments will be carried out and managed, to include the following *(TM Code p54): -*
    - *Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;*
    - *Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;*
    - *Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;*
    - *Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;*
    - *Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.*

ANNEX H

Long Term (30 Year) Loans Charges Analysis

Current capital and revenue plans have been extrapolated over a 30 year period in order to assess the impact on the revenue Loans Charges budget. In line with assumptions made when assessing external debt and associated limits, long term capital planning will create an increasing charge which will require to be addressed through the revenue financial planning process. Movements in notional loans charges associated with internal borrowing also impact on these figures.

It should be noted that from 2033-34, the first year outwith the current 10 year Capital Plan, a 10 year average capital expenditure, and annual borrowing requirement of £10.5m, has been assumed and the gross budget remains at the 2033-34 amount.



ANNEX I: 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

ANNEX J: INVESTMENT PERFORMANCE/RISK BENCHMARKING

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 365 day backward looking SONIA (Sterling Overnight Index Average) uncompounded 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 - £2,000,000
Liquid short term deposits of at least £1,500,000 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 using the Creditworthiness service provided by Link Group. 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:

0.002% 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 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 reflects the fact that the British Government has never failed to make interest or principal payments on gilts as they fall due.
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 to demonstrate that local authorities have fulfilled the objectives of the Prudential Code.
QE	Quantitative Easing
SONIA	SONIA (Sterling Overnight Index Average), is the risk-free rate for sterling markets administered by the Bank of England.
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.
Statutory Reporting and Treasury team, Finance, Scottish Borders Council, Council HQ, Newtown St Boswells
01835 824000, t&cteam@scotborders.gov.uk

INTERNAL AUDIT WORK TO DECEMBER 2023

Report by Chief Officer Audit and Risk

AUDIT COMMITTEE

12 February 2024

1 PURPOSE AND SUMMARY

1.1 **The purpose of this report is to provide members of the Audit 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.**

1.2 The work Internal Audit has carried out in the period from 28 October to 31 December 2023 associated with the delivery of the approved Internal Audit Annual Plan 2023/24 is detailed in this report. A total of 6 final Internal Audit reports have been issued. There were 8 recommendations made associated with 4 of the reports (0 High-rated; 1 Medium-rated; 7 Low-rated).

1.3 An Executive Summary of the final Internal Audit assurance 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) (2017) including the production of this report to communicate the results of the reviews.

2 RECOMMENDATIONS

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

a) Notes the Executive Summaries of the final Internal Audit assurance reports relating to with work Internal Audit has carried out in the period from 28 October to 31 December 2023 (Appendix 1) associated with the delivery of the approved Internal Audit Annual Plan 2023/24;

b) Notes the Internal Audit Consultancy and Other Work carried out in accordance with the approved Internal Audit Charter;

c) Acknowledges the assurance provided on internal controls and governance arrangements in place for the areas covered by this Internal Audit work; and

d) Approve the minor amendments to the Internal Audit Annual Plan 2023/24, as set out in paragraph 4.9.

3 BACKGROUND

3.1 The Internal Audit Annual Plan 2023/24 was approved by the Audit Committee on 13 March 2023. To facilitate operational delivery an Internal Audit Programme of Work has been developed which provides an indication of when work is scheduled during the year, taking account of discussions with Management and availability of Internal Audit resources.

3.2 For each assurance audit: prior to commencement, an Audit Assignment detailing the scope, objectives and timing is agreed with the relevant Director and Service Management; at the conclusion of the fieldwork, a Draft Report is issued to the relevant Director and Service Management for response on the factual accuracy and acceptance of the findings and recommendations, as appropriate; and a Final Report is then issued.

4 PROGRESS UPDATE

4.1 Internal Audit has carried out the following work in the period from 28 October to 31 December 2023 associated with the delivery of the Annual Plan 2023/24.

4.2 The SBC Internal Audit function conforms to the professional standards as set out in Public Sector Internal Audit Standards (PSIAS) (2017) including the production of this report to communicate the results of the reviews.

Completed Internal Audit Assurance Reports

4.3 Internal Audit issued final assurance reports on the following subjects:

- Record to Report (R2R)
- Sales to Cash
- Schools Financial and Business Administration Processes
- Scottish Government Community Led Local Development (CLLD) Fund
- Flood Protection
- IT Environmental & General Controls

4.4 An Executive Summary of the final Internal Audit assurance reports issued, including audit objective, findings, good practice and 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.

4.5 The definitions for Internal Audit assurance categories are as follows:

Level	Definition
Full assurance	A sound system of governance, risk management and control exists, with internal controls operating effectively and being consistently applied, to support the achievement of objectives. Minor improvements might be required.
Substantial assurance	There is a generally sound system of governance, risk management and control in place. Some issues, non-compliance or scope for improvement were identified which may put at risk the achievement of objectives.
Moderate assurance	Whilst there is a system of governance, risk management and control in place, there are weaknesses in the system that leaves some risks not addressed, and there is evidence of non-compliance with some of the controls.
Limited assurance	Significant gaps, weaknesses or non-compliance were identified. Improvement is required to the system of governance, risk management and control to effectively manage risks to the achievement of objectives.
No assurance	Immediate action is required to address fundamental gaps, weaknesses or non-compliance identified. The system of governance, risk management and control is inadequate to effectively manage risks to the achievement of objectives.

Current Internal Audit Assurance Work in Progress

4.6 Internal Audit assurance work in progress to complete the delivery of the Internal Audit Annual Plan 2023/24 consists of the following:

Audit Area	Audit Stage
Cost of Living Crisis Support (*originally Benefits Assessments audit in Plan split into 2*)	Testing further information provided
Sustainable Environment - Climate Change	Initial discussions on findings/observations with Sustainability Board of Officers
Staff Recruitment and Retention	Testing underway
UK Government Shared Prosperity Fund	Testing underway
Management of Capital Programme and Projects	Testing underway
Corporate Transformation Programme	Planning the Engagement

Changes to Internal Audit Planned Assurance Work

4.7 It was highlighted within the cover report for the Internal Audit Strategy and Annual Plan 2023/24 that "the Plan should be considered to be flexible and will be periodically reviewed, and amended as required, to reflect any new arrangement or changing risks and priorities. Any amendments relating to the Council will be brought to Council Management Team and the Audit Committee for approval."

4.8 The planned Financial Governance assurance audit on 'VAT' has been removed from the Internal Audit Annual Plan 2023/24 and deferred to 2024/25 in agreement with the Director Finance & Procurement. The associated Commentary in the Plan is:

"Review of the VAT treatment of supplies and services made by the Council to customers."

This change to the timing of Internal Audit assurance work is to avoid over-burdening the Income & Reconciliations team in the Finance Service with more than one audit in-year, and will not impair the Internal Audit assurance work required to inform the Chief Officer Audit & Risk's annual audit opinion. This will allow the Income & Reconciliations team to focus on the implementation of the recommendations to improve debt management practices, arising from the recent Sales to Cash audit.

4.9 The following minor amendments have been made to assurance audits in the Internal Audit Annual Plan 2023/24 to ensure each audit engagement reflects the specific risks and areas of assurance required by the relevant Directors and Service Managers consistent with the Council's objectives:

- Staff Recruitment and Retention (*2 separate audit engagements re-integrated to one audit as originally set out in Plan to align with progress with change activity*)
- Residential Care Homes Administration Processes (*added to 2023/24 Plan on request; originally in Plan 2022/23 deferred in agreement with Director*)

This demonstrates the increased emphasis on our agile approach to design risk-based audit engagements that determine the priorities of the Internal Audit activity in the Plan on a rolling basis throughout the year.

Internal Audit Consultancy and Other Work

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

a) Provide 'critical friend' internal challenge and assurance through engagement in meetings of change programmes and projects (Fit for 2024 / Digital Transformation Programme Boards, Information Governance Group, Sustainability Board, and Digital Security Board).

b) Continuous audit work as a 'critical friend' in the development of a property asset management review activity led by the Infrastructure & Environment directorate. Significant activity included the working group.

c) Carried out a specific review of the controls over the consumption of utilities (energy and water), as part of Property Asset Management assurance, to confirm on a sample basis that utility bills at the time of payment relate to property that form part of the Council's estate.

d) Quarterly updates to Council Management Team on the status of in-progress Internal Audit recommendations to ensure senior management oversight of progress with their implementation to demonstrate continuous improvement. The Follow-Up Review of In Progress Internal Audit Recommendations as at Q3 2023/24 is presented as a separate report to the Audit Committee this cycle, as requested.

e) The Chief Officer Audit & Risk is the Chair of the Scottish Local Authorities Chief Internal Auditors Group (SLACIAG), a member of the Chartered Institute of Internal Auditors (CIIA) Local Authority Forum, and a member of the Heads of Internal Audit and Risk UK Forum, which provide the opportunity to share good practice and to keep knowledge of new Internal Audit developments up to date. The virtual CIIA webinars in recent months covered the topics of 'Global Internal Audit Standards', 'Digital Services' and 'Review of 2023'. Others in the Internal Audit team are members of relevant specialist practitioners' forums, including Data Analytics, Counter Fraud, and Computer Audit.

f) The Chief Officer Audit & Risk delivered a presentation on 30 October 2023 covering an 'Overview of Role of Internal Audit' to members of the Audit Committee to assist their knowledge and understanding.

g) Internal Audit team members joined virtual Data & Information Strategy stakeholder sessions led by SBC project managers in late October 2023.

Recommendations

4.11 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:

High: Significant weakness in existing controls, leaving the Council or Service open to a very high risk of not achieving its strategic objectives or evidencing best value, 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 Director Assurance Statement on Internal Control and Governance.
Medium: Substantial risk of not achieving its strategic objectives or evidencing best value, requiring reasonably urgent action within three months of formally raising the issue.
Low: Moderate risk of not achieving its strategic objectives or evidencing best value, 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.
Outwith the report, Internal Audit informs operational managers about other matters as part of continuous improvement.

4.12 The table below summarises the number of Internal Audit recommendations made during 2023/24:

	2023/24 Number of Recs
High	0
Medium	1
Low	7
Sub-total reported this period	**8**
Previously reported	10
Total	**18**

Recommendations agreed with action plan	18
Not agreed; risk accepted	0
Total	**18**

5 IMPLICATIONS

5.1 **Financial**
There are no costs attached to any of the recommendations in this report.

5.2 **Risk and Mitigations**
During the development of the Internal Audit Annual Plan 2023/24 and at the start of each audit engagement, to capture potential areas of risk and uncertainty more fully, key stakeholders have been consulted and risk registers have been considered during discussions with the Corporate Risk Officer. The agreed Internal Audit recommendations are linked to relevant risks and risk registers in the Pentana system.

If audit recommendations are not implemented, there is a greater risk of loss and/or reduced operational efficiency and effectiveness, and Management may not be able to demonstrate effective management of risks through improved internal controls and governance.

5.3 **Integrated Impact Assessment**
There is no relevance to Equality Duty or the Fairer Scotland Duty for this report. This is a routine good governance report for assurance purposes, required under the Local Authority Accounts (Scotland) Regulations 2014 and the professional standards as set out in Public Sector Internal Audit Standards (PSIAS) (2017).

The Internal Audit work is carried out in accordance with the appropriate legislation and professional standards. The latter includes compliance by those in the Internal Audit function with the Code of Ethics set out in the PSIAS which is appropriate for the profession of Internal Audit founded as it is on trust placed in its objective assurance about risk management, internal control and governance.

The Internal Audit Strategy for 2023/24 has been amended to include integrated impact assessment compliance into all assurance audits as a cross-cutting risk to provide assurance that the underlying controls and processes in all Services are operating as intended to demonstrate the Council is fulfilling its Equality Duty and Fairer Scotland Duty.

5.4 **Sustainable Development Goals**
The recommendations in this report will not directly impact any of the 17 UN Sustainable Development Goals, based on completion of the checklist during the preparation of the Internal Audit Charter, and the Internal Audit Strategy and Plan 2023/24. Good governance is important to enable Scottish Borders Council to achieve its objectives, including those supporting sustainable development.

5.5 **Climate Change**
This report does not relate to any proposal, plan or project and as a result the checklist on Climate Change is not an applicable consideration.

The Internal Audit Strategy for 2023/24 has been amended to include integrating climate change into all assurance audits as a cross-cutting risk to provide assurance that the underlying controls and processes in all Services that support climate change commitments, plans and programmes are operating as intended.

During 2023/24 the Internal Audit function has adopted a continuous audit approach, including observation of the Sustainability Board, to assess the Council's governance arrangements and progress with the Climate Change Route Map Priority Actions to meet the Council's obligations.

5.6 **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.

5.7 **Data Protection Impact Statement**
There are no personal data implications arising from the content of this report.

5.8 **Changes to Scheme of Administration or Scheme of Delegation**
No changes are required to either the Scheme of Administration or the Scheme of Delegation as a result of the content in this report.

6 CONSULTATION

6.1 The Directors relevant to the Internal Audit reports issued have signed off the relevant Executive Summary within Appendix 1.

6.2 The Council Management Team have been consulted on this report by email on 31 January 2024 to acknowledge its content, assurance and actions therein.

6.3 The Director of Finance & Procurement, Director of Corporate Governance (and Monitoring Officer), Director of People Performance and Change, and Communications team have been consulted on this report by email as required practice.

Approved by

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

Author(s)

Name	Designation and Contact Number
Jill Stacey	Chief Officer Audit and Risk Tel 01835 825036
Scott Pow	Principal Internal Auditor

Background Papers: Appropriate Internal Audit files
Previous Minute Reference: Audit Committee 13 November 2023

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Contact us at Internal Audit intaudit@scotborders.gov.uk

Report	Summary of key findings and recommendations	Recommendations H	Recommendations M	Recommendations L	Status
Audit Plan Category: Financial Governance Corporate Risk: none - Core financial system Subject: Record to Report (R2R) No: 073/006 Date issued: 19 January 2024 Draft; 30 January 2024 Final Level of Assurance: Substantial	The purpose of the audit was to review Record to Report (R2R) processes, including controls within the core General Ledger system and Management monitoring and reporting. It is essential that the General Ledger provides a complete and accurate record of financial transactions over time as it holds the information required to prepare financial statements as well as providing the basis for budget monitoring. Internal Audit tested the end to end processes and associated key controls to ensure that sufficient functionality currently exists to provide Management with assurance over the correct operation of the Business World Record to Report (R2R) module. The following examples of good practice were found: • Bank and Feeder System reconciliations are completed and independently reviewed on a regular basis. • Control account balances in the trial balance agree with the balances in Accounts Payable and Accounts Receivable. Budget holders currently receive the primary information they require to manage their budgets via the monthly forecast reports issued, with some budget holders also having access to the Financial Information Centre Dashboard (FIC) on a prioritised basis, as licences are limited in number. The Business World ERP system will migrate to the cloud environment in the foreseeable future at which point FIC will be replaced with the Financial Plan Analysis (FPA) tool. Therefore, Internal Audit did not review FIC. Internal Audit are able to provide Substantial assurance. There is a generally sound system of governance, risk management and control in place. Some minor issues, non-compliance or scope for improvement were identified which may put at risk the achievement of objectives. Internal Audit have made the following recommendation: • Suspense accounts should be clearly identified and designated as such to assist with their regular clearance. (Low)	0	0	1	Finance Management have checked the factual accuracy of the report, accepted its findings, and agreed to implement the recommendation.

Report	Summary of key findings and recommendations	Recommendations			Status
		H	M	L	
Audit Plan Category: Financial Governance Corporate Risk: none - Core financial system Subject: Sales to Cash No: 086/017 Date issued: 28 November 2023 Draft; 18 December 2023 Final Level of Assurance: Moderate	The purpose of the audit was to review the controls in place throughout the Council to set fees and charges for services, raise invoices promptly, and collect debts efficiently resulting in debtors' balances that are complete, accurate and recoverable. The following examples of good practice were found: • Segregation of duties exists within the Service. • A positive approach to improvement opportunities and actions. Within the Income & Reconciliations Team there is a good working policy. Our fieldwork found evidence of monthly Team meetings where discussions were held relating to the recovery actions needed, and evidence of the annual Write Off report for the Executive Committee in accordance with the Financial Regulations. The testing of Invoices identified Services where timeliness of correct action being taken was not consistent with Debt Recovery policy. The SB Learn training course needs updating to reflect current policy, systems, and practices. Internal Audit are able to provide Moderate assurance. Whilst there is a system of governance, risk management and control in place, there are weaknesses in the system that leaves some risks not addressed, and there is evidence of non-compliance with some of the controls. Internal Audit have made the following recommendations: • The existing Debt Recovery policy should be reviewed for relevance and published to ensure awareness of expected practices across the Council. (Low) • A formal monitoring process should be established to notify Services whose invoices do not conform to policy. (Low) • The Service Manager should develop a performance framework giving a systematic approach to measuring, managing and improving the performance of the debt recovery process. (Low) • SB Learn training on Debt Recovery should be updated to align to current policy and practices. This should include a process for monitoring completion of the course by relevant staff. (Low)	0	0	4	Management in the Finance Service have confirmed the factual accuracy of the report, accepted its findings, and agreed to implement the recommendations. There is a strong commitment within the Income & Reconciliations team in the Finance Service to implement these recommendations to improve debt management practices, and work is already underway to achieve this.

Report	Summary of key findings and recommendations	Recommendations H	Recommendations M	Recommendations L	Status
Audit Plan Category: Internal Controls Corporate Risk: none - key controls in Schools Subject: Schools Financial and Business Administration Processes No: 127/036 Date issued: 19 December 2023 Draft; 04 January 2024 Final Level of Assurance: Moderate	The purpose of the audit was to ensure the internal financial controls and business administrative procedures are in place to ensure the efficient and effective use of resources in the school establishments. The school estate has 67 establishments within the Scottish Borders Council region. This is made up of 9 High schools and 58 Primary settings. The establishments have the responsibility for educating 14,758 young people (Primary pupils 7,995 and High school pupils 6,763). Internal Audit are able to provide Moderate assurance (whilst there is a system of governance, risk management and control in place, there are weaknesses in the system that leaves some risks not addressed, and there is evidence of non-compliance with some of the controls) regarding the implementation of the Inspire programme, the use of Cypads for ordering school meals, the continued improvement in use of Purchase Cards, the governance of School Funds, maintaining Inventories, the completion of Mandatory Training by teaching and support staff, the recording of pupil attendance, and full resolution of previous Internal Audit recommendations. Internal Audit acknowledge the improvements that have been made within some of these areas since the previous Internal Audit review, though further work is required to ensure completeness and consistency of practice in all Schools. Internal Audit have made the following recommendations: • Management should ensure a robust second line is in place to maximise adherence to the School Fund policy. This includes compliance functions to provide independent oversight and monitoring. (Low) • The Attendance policy should be fully revised and include monitoring and compliance reporting, ensuring collaboration between school office and teaching staff to minimise the Follow-up cases. (Medium)	0	1	1	Education Management have confirmed the factual accuracy of the report, accepted its findings, and agreed to implement the recommendations.

Report	Summary of key findings and recommendations	Recommendations H	Recommendations M	Recommendations L	Status
Audit Plan Category: Legislative and Other Compliance Corporate Risk: none (third party funder assurance) Subject: Scottish Government Community Led Local Development (CLLD) Fund No: 154/034 Date issued: 10 January 2024 Draft; 26 January 2024 Final Level of Assurance: Full	The purpose of the audit was to assess compliance with the requirements of the Funding Agreement and other relevant regulations. The Community Led Local Development Fund is a specific fund for rural areas of Scotland provided by the Scottish Government since 2022. The fund is distributed to Local Action Groups (LAGs) across rural Scotland. The Scottish Borders has its own LAG that is made up of Public, Private and Third Sector organisations. Scottish Borders Council is the Lead Partner for the LAG and distributes the funding based on the recommendations of the LAG. The terms of funding for the Community Led Local Development Fund are set out in the letter dated 15 August 2022 and is overseen by the Local Action Group (LAG) which assesses and, where appropriate, approves projects for funding in accordance with the conditions set out in the Offer of Grant. Internal Audit established that all the 42 projects funded in the financial year 2022/23 have been completed. Internal Audit also noted that the End of Grants Report required by the Scottish Government has been produced as required. Internal Audit ascertained that effective governance, management processes, and administration for the Community Led Local Development Fund are in place and adequate arrangements exist to ensure compliance with the relevant Funding Agreement and applicable regulations. Internal Audit selected a sample of funded projects and found them to be compliant with the conditions of the Offer of Grant. It was found that appropriate controls are in place over the administration of claims for projects within the Fund. Internal Audit are able to provide Full assurance. A sound system of governance and control exists, with internal controls operating effectively and being consistently applied, to support the achievement of objectives. Internal Audit made no recommendations.	0	0	0	Management in the Resilient Communities directorate have checked the factual accuracy of the report, and have accepted its findings.

Report	Summary of key findings and recommendations	Recommendations H	M	L	Status
Audit Plan Category: Asset Management Corporate Risk: Corporate Risk: CMT032 Climate Change Subject: Flood Protection No: 214/006 Date issued: 26 January 2024 Draft; 02 February 2024 Final Level of Assurance: Substantial	The purpose of the audit was to ensure that there is a structured framework, including community partner engagement, for investment in flood protection schemes and there are adequate operational and financial controls in place for the effective response to flooding to meet statutory obligations and to demonstrate efficient and effective use of resources. Flood risk management responsibilities and statutory obligations including those for the protection of Biodiversity are set out in various Acts. The obligations imposed by these Acts are clearly recognised and action taken to satisfy those obligations. Processes are in place which ensure that statutory obligations imposed upon the Council are complied with. The timing and frequency of inspections is determined by the assessed risk of flooding although inspections have been sporadic at times due to a lack of resources. A new flood technician has been employed and it is expected that the inspections will be fully up to date in accordance with the inspection schedule during 2024/25. A Flood Risk Management Plan has been produced and flood protection schemes are being progressed. Flood Protection schemes are typically expensive to deliver. There are clearly identified priorities that cannot be put in place until adequate financial backing is secured. Internal Audit are able to provide Substantial assurance. There is a generally sound system of governance, risk management and internal control processes in place. There is some scope for improvement relating to performance information to be able to demonstrate the achievement of objectives. Internal Audit have made the following recommendation: • Key performance indicators should be developed for water course inspections and related activities and performance measured against those indicators in order to assess service performance i.e. 2nd line monitoring of compliance with inspection routines. (Low)	0	0	1	Management have checked the factual accuracy of the report, accepted its findings, and agreed to implement the recommendation. This will be a linked action associated with the relevant service risk on River Course Inspections to formalise and integrate performance monitoring and risk management in this area.

Report	Summary of key findings and recommendations	Recommendations			Status
		H	M	L	
Audit Plan Category: ICT Governance Corporate Risk: CMT002 IT Data and System Security Subject: IT Environmental & General Controls No: 230/009 Date issued: 19 December 2023 Draft; 20 December 2023 Final Level of Assurance: Not assessed at this time	The purpose of the audit was to assess the adequacy and effectiveness of the governance in place for cyber security including the progress of the Cyber Security Maturity Assessment improvement actions. The Digital Security Board was established in June 2023 with a purpose to define and deliver the strategy, governance procedures, advice and assurance to the Council on all matters concerning Digital and Cyber Security. The Board was created in response to the Cyber Security Maturity Assessment carried out by CGI. A Cyber Security Terms of Reference, Strategy, Roadmap and Action Plan are all in place. The Board reports to CMT and includes senior officers from both SBC and CGI, along with Internal Audit as a critical friend. As the Board has been recently established, evaluating the adequacy and effectiveness of the governance in place has not been possible at this time. Similarly, the progress of the improvement actions was difficult to assess stemming not only from the recent establishment of the Board but also due to the complexity and interconnecting aspects of the improvement actions which is currently being refined through the Roadmap. Initial findings are that the Board utilises an Action Tracker which could be developed to give a more robust audit trail of implementation. In addition, several actions on the tracker cover multiple findings and further development is required to ensure that all elements are addressed by the completion of relevant action. The associated risks also require to be reviewed to achieve better linkages with the risk register and the Action Plan i.e. as new Risk Mitigation actions or enhancements to the effectiveness of existing Internal Controls. Therefore, this work will be covered as a continuous audit in 2024/25 to ensure comprehensive coverage and that the implemented actions effectively and fully address the specific findings from the Cyber Security Maturity Assessment. Internal Audit will provide an assurance rating at the end of 2024/25.	0	0	0	Management have accepted the audit findings and the noted areas for development.

PROGRESS WITH IMPLEMENTATION OF INTERNAL AUDIT RECOMMENDATIONS Q3 2023/24

Report by Chief Officer Audit and Risk

AUDIT COMMITTEE

12 February 2024

1 PURPOSE AND SUMMARY

1.1 The purpose of the report is to provide a further requested update to Members of the Audit Committee on the status of the implementation by Management of audit recommendations made and agreed in Internal Audit reports.

1.2 Internal Audit is an independent appraisal function established for the review of the internal control system as a service to Scottish Borders Council. It objectively examines, evaluates and reports on the adequacy of internal control as a contribution to the proper, economic, efficient and effective use of resources and the management of risk.

1.3 The Internal Audit activity adds value to the organisation (and its stakeholders) when it considers strategies, objectives, and risks; strives to offer ways to enhance governance, risk management and control processes (by way of making audit recommendations); and objectively provides relevant assurance.

1.4 The Remit of the Audit Committee includes the function to consider "all matters relating to the implementation of recommendations contained within internal audit reports", as part of its high level oversight of the framework of internal control, risk management and governance within the Council.

2 RECOMMENDATIONS

2.1 I recommend that the Audit Committee:

a) Acknowledges the progress made by Management in implementing Internal Audit recommendations to improve internal controls and governance, and mitigate risks;

b) Considers whether it is satisfied with the progress or whether any further action is required; and

c) Notes that Internal Audit will continue to monitor the completion of outstanding recommendations and will provide update reports to this Committee.

3 BACKGROUND

3.1 Internal Audit is an independent appraisal function established for the review of the internal control system as a service to Scottish Borders Council. It objectively examines, evaluates and reports on the adequacy of internal control as a contribution to the proper, economic, efficient and effective use of resources and the management of risk.

3.2 The Internal Audit activity adds value to the organisation (and its stakeholders) when it considers strategies, objectives, and risks; strives to offer ways to enhance governance, risk management and control processes (by way of making audit recommendations); and objectively provides relevant assurance.

3.3 Management has the responsibility for ensuring that agreed audit actions are implemented to address the identified weaknesses and mitigate risks. At Internal Audit Final Report stage the Audit Recommendations are input to Ideagen Risk (previously Pentana), the Council's corporate performance management system. This is designed to assist with Management tracking of implementation, link with relevant risks, and evidence improvement.

3.4 The Remit of the Audit Committee includes the function to consider "all matters relating to the implementation of recommendations contained within internal audit reports", as part of its high-level oversight of the Councils' framework of internal control, risk management and governance.

3.5 Internal Audit continues to perform its standard quarterly follow-up activity to check that recommendations have been implemented and to ensure that the new controls had the desired effect on improving internal control and governance, and reducing risk.

3.6 Quarterly update reports on progress with implementation of Internal Audit recommendations have been presented to the Council Management Team (CMT) to enhance the senior Management monitoring and oversight of progress. The Q1 2023/24 Progress Update report was considered by CMT on 2 August 2023, the Q2 2023/24 Progress Update report was considered by CMT on 1 November 2023 then the Audit Committee on 13 November 2023. This Q3 2023/24 Progress Update report was presented to CMT on 29 January 2024 then on request to the Audit Committee on 12 February 2024.

4 PROGRESS UPDATE

4.1 Assigned Action Owners / Managers do not consistently update the Pentana Risk performance system on a regular basis. Therefore Internal Audit has utilised a more supportive approach to perform formal follow-up to ensure the position at Q3 2023/24 reflects a more accurate representation of the actual activity. The following table highlights the status as at 16 January 2024 of Internal Audit recommendations from current and previous years, shown in more detail in Appendix 1:

Year	Total	Implemented	Not Yet Due	Overdue
2021/22	32	21	4	7
2022/23	26	17	6	3
2023/24 to Dec	16	5	9	2

4.2 This Progress Update report reflects the ongoing nature of Internal Audit work and the associated improvements in governance, risk management and internal controls implemented by Management. Appendix 1 shows that, since the previous report to CMT on 1 November 2023 which was considered by the Audit Committee on 13 November 2023:

- Seven Internal Audit actions have been completed;
- Eight actions have shown an increase in % progress;
- One action has had an extension to due date granted;
- Twelve Internal Audit actions are overdue; and
- Six new Internal Audit actions have been added (two show progress).

4.3 The enhanced Internal Audit follow-up approach has revealed continuous improvements being demonstrated, most notably a good level of completions and increased % progress within the past three months. This is a reasonably good position against a backdrop of the ongoing challenging operating environment for the Council during this period. In contrast, the number of overdue actions indicates delay in completion/system update.

4.4 A further update on Management's progress with the implementation of Internal Audit recommendations will be included within the Internal Audit Annual Assurance Report 2023/24 for Scottish Borders Council, which is scheduled for presentation to the Audit Committee on 29 April 2024. The annual Internal Audit annual opinion will take account of the improvements in governance, risk management and internal controls that have been implemented by Management during the full year 2023/24.

4.5 In addition, Internal Audit have commenced an annual audit this quarter on a sample of Internal Audit actions that have been completed within the preceding calendar year. The purpose of this Follow-up activity will be to check the evidence that improvement action has been undertaken and to ensure that the new controls or governance had the desired effect on improving internal control and governance. The findings will be presented to the Council Management Team and then to the Audit Committee on 11 March 2024. This practice is to provide additional assurance on the evidence of improvement in internal controls, risk management and governance as part of its continuous improvement processes.

5 IMPLICATIONS

5.1 **Financial**
It is anticipated that efficiencies will arise either as a direct or indirect result of Management implementing the recommendations made by Internal Audit through improved internal controls and governance arrangements.

5.2 **Risk and Mitigations**
Internal Audit provides assurance to Management and the Audit Committee on the adequacy and effectiveness of internal controls and governance within the Council, including risk management, highlights good practice and makes recommendations.

It is anticipated that improved risk management or mitigation will arise as a direct result of Management implementing the Internal Audit recommendations which will evidence improvements in internal controls and governance arrangements. If the Internal Audit recommendations are not implemented then risks may be more likely to occur or have a greater impact if they do.

Internal Audit recommendations also highlight potential risks and are taken into account when risk registers are reviewed and new risks are identified. Internal Audit is the third line in the governance of risk.

5.3 **Integrated Impact Assessment**

There is no relevance to Equality Duty or the Fairer Scotland Duty for this report. This is a routine good governance report for assurance purposes, required under the Local Authority Accounts (Scotland) Regulations 2014 and the professional standards as set out in Public Sector Internal Audit Standards (PSIAS) (2017).

The Internal Audit work is carried out in accordance with the appropriate legislation and professional standards. The latter includes compliance by those in the Internal Audit function with the Code of Ethics set out in the PSIAS which is appropriate for the profession of Internal Audit founded as it is on trust placed in its objective assurance about risk management, internal controls and governance.

The Internal Audit Strategy for 2023/24 has been amended to include integrated impact assessment compliance into all assurance audits as a cross-cutting risk to provide assurance that the underlying controls and processes in all Services are operating as intended to demonstrate the Council is fulfilling its Equality Duty and Fairer Scotland Duty.

5.4 **Sustainable Development Goals**

The recommendations in this report will not directly impact any of the 17 UN Sustainable Development Goals, based on completion of the checklist during the preparation of the Internal Audit Charter, and the Internal Audit Strategy and Plan 2023/24. Good governance is important to enable Scottish Borders Council to achieve its objectives, including those supporting sustainable development.

5.5 **Climate Change**

This report does not relate to any proposal, plan or project and as a result the checklist on Climate Change is not an applicable consideration.

The Internal Audit Strategy for 2023/24 has been amended to include integrating climate change into all assurance audits as a cross-cutting risk to provide assurance that the underlying controls and processes in all Services that support climate change commitments, plans and programmes are operating as intended. Recommendations may arise from this work.

During the year 2023/24 the Internal Audit function has adopted a continuous audit approach, including observation of the Sustainability Board, to assess the Council's governance arrangements and progress with action plans to meet its climate change obligations and sustainable environmental programmes. Recommendations may arise from this work.

5.6 **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.

5.7 **Data Protection Impact Statement**

There are no personal data implications arising from the content of this report.

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

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

6 CONSULTATION

6.1 The Council Management Team has been consulted on this report by email on 29 January 2024 to ensure their awareness and oversight on a quarterly basis of the Progress made by relevant Management in implementing Internal Audit recommendations.

6.2 The Director - Finance and Procurement, Director – Corporate Governance (and Monitoring Officer), Director - People Performance and Change, and Communications team have been consulted on this report in line with required practice.

Approved by

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

Author(s)

Name	Designation and Contact Number
Jill Stacey	Chief Officer Audit and Risk Tel 01835 825036

Background Papers: Appropriate Internal Audit files and Pentana system
Previous Minute Reference: Audit Committee 13 November 2023

Note – You can get this document on tape, in Braille, large print and various computer formats by using the contact details below. Information on other language translations can also be given as well as provision of additional copies.

Contact us at Internal Audit intaudit@scotborders.gov.uk

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Internal Audit Recommendations Status Overdue and Not Yet Completed as at 31 December 2023

Report Type: Actions Report
Generated on: 16 January 2024

Action Code	Title	Progress	Original Due	Due Date	Status	Priority	Managed By
AUDIT.159	(2021) Sustainable Environment - Provision of Information for SSN Submission	60%	31-Dec-22	31-Dec-23	Overdue	Medium	Director Infrastructure & Environment
AUDIT.160	(2021) Sustainable Environment - External Validation/Peer Review	75%	30-Jun-22	30-Nov-23	Overdue	Medium	Director Infrastructure & Environment
AUDIT.162	(2021) Economic Development Industrial Property - balanced scorecard of KPIs	0%	30-Jun-23	31-Dec-23	Overdue	Medium	Director Infrastructure & Environment
AUDIT.163	(2021) Roads Asset Management - RAMP	80%	31-Mar-24	31-Mar-24	In Progress	Medium	Director Infrastructure & Environment
AUDIT.164	(2021) Roads Asset Management - Financial Plans	60%	31-Mar-25	31-Mar-25	In Progress	Medium	Director Infrastructure & Environment
AUDIT.165	(2021) Roads Asset Management - Performance Monitoring	55%	31-Mar-26	31-Mar-26	In Progress	Medium	Director Infrastructure & Environment
AUDIT.166	(2021) Capital Investment - Asset Mgt Plans	5%	31-Dec-23	31-Dec-23	Overdue	Medium	Director Infrastructure & Environment
AUDIT.168	(2021) Capital Investment - Risk Register	75%	30-Sep-22	31-Dec-23	Overdue	Medium	Director Infrastructure & Environment
AUDIT.170	(2021) IT Asset Management - Strategy	90%	30-Nov-22	30-Nov-23	Overdue	Medium	Director Strategic Commissioning and Partnerships
AUDIT.171	(2021) IT Asset Management - Business World	10%	31-May-23	29-Feb-24	In Progress	Low	Director Strategic Commissioning and Partnerships
AUDIT.172	(2021) IT Asset Management - Review of assets	80%	30-Nov-22	30-Nov-23	Overdue	Low	Director Strategic Commissioning and Partnerships
AUDIT.179	(2022) Winter Service - Cost/Benefit Analysis	50%	30-Sep-23	31-May-24	In Progress	Low	Director Infrastructure & Environment
AUDIT.180	(2022) Contract Management - Live Borders	20%	31-Dec-22	31-Dec-23	Overdue	Medium	Director Resilient Communities
AUDIT.181	(2022) LGBF - Live Borders	20%	31-Dec-22	31-Dec-23	Overdue	Low	Director Resilient Communities
AUDIT.193	(2022) Passenger Transport - Procedures/Flowcharts	70%	30-Apr-24	30-Apr-24	In Progress	Low	Director Infrastructure & Environment
AUDIT.194	(2022) Passenger Transport - Internal Transport Policy	95%	30-Apr-24	30-Apr-24	In Progress	Low	Director Infrastructure & Environment
AUDIT.195	(2022) Passenger Transport - Recharges to Clients	65%	31-Aug-23	29-Feb-24	In Progress	Low	Director Infrastructure & Environment
AUDIT.198	(2022) Fleet Management - Performance KPIs & Benchmarking	50%	30-Apr-24	30-Apr-24	In Progress	Medium	Director Infrastructure & Environment
AUDIT.201	(2022) Protective Services - PWS - Improvement Plan	0%	30-Jun-23	31-Mar-24	In Progress	Medium	Director Corporate Governance
AUDIT.202	(2022) Protective Services - PWS - Charges and income	0%	31-Dec-23	31-Dec-23	Overdue	Medium	Director Corporate Governance
AUDIT.204	(2023) Looked After Children - C&FSW	20%	29-Feb-24	29-Feb-24	In Progress	Low	Acting Director Social Work and Practice
AUDIT.207	(2023) Health and Safety - Overdue Actions Assure System	75%	31-Oct-23	29-Feb-24	In Progress	Medium	Director Corporate Governance
AUDIT.209	(2023) Complaints - Process Enhancements	0%	31-Oct-23	31-Oct-23	Overdue	Low	Director Resilient Communities
AUDIT.211	(2023) Biodiversity of the Scottish Borders	0%	23-Aug-24	31-Mar-25	In Progress	Low	Director Infrastructure & Environment
AUDIT.213	(2023) Pupil Equity Fund - Administration Overhead	0%	30-Nov-23	30-Nov-23	Overdue	Medium	Director Education & Lifelong Learning
AUDIT.214	(2023) Sales to Cash - Policy	80%	29-Feb-24	29-Feb-24	In Progress	Low	Director of Finance & Procurement
AUDIT.215	(2023) Sales to Cash - 2nd line monitoring	0%	29-Feb-24	29-Feb-24	In Progress	Low	Director of Finance & Procurement
AUDIT.216	(2023) Sales to Cash - performance monitoring	0%	31-May-24	31-May-24	In Progress	Low	Director of Finance & Procurement
AUDIT.217	(2023) Sales to Cash - e-Learning course	0%	31-Mar-24	31-Mar-24	In Progress	Low	Director of Finance & Procurement
AUDIT.218	(2023) Schools - School Funds 2nd line monitoring	0%	30-Jun-24	30-Jun-24	In Progress	Low	Director Education & Lifelong Learning
AUDIT.219	(2023) Schools - Attendance Policy revisions	10%	31-May-24	31-May-24	In Progress	Medium	Director Education & Lifelong Learning

Comments:

7 previous actions have been completed since last report 26 October 2023:
185 - (2022) Self Directed Support - Monitoring and Reporting; 188 - (2022) Members Allowances - Develop Policy; 189 - (2022) Members Allowances - Electronic Process; 205 - (2023) Resilience Planning - Policy and Website Content; 206 - (2023) Health and Safety - Quarterly Training Stats; 210 - (2023) Complaints - Mandatory Training Completion; 212 - (2023) Pupil Equity Fund - Schools Plans and Reports publish

8 previous actions have shown an increase in % progress since last report 26 October 2023:
163, 164 & 165 - (2021) Roads Asset Management - RAMP; Financial Plans; Performance Monitoring; 179 (2022) Winter Service - Cost/Benefit Analysis; 194 & 195 - (2022) Passenger Transport - Internal Transport Policy; Recharges to Clients; 204 - (2023) Looked After Children - C&FSW; 207 - (2023) Health and Safety - Overdue Actions Assure System

1 previous action has had an extension to due date granted by Internal Audit since last report 26 October 2023:
207 - (2023) Health and Safety - Overdue Actions Assure System

12 actions overdue - 0 actions overdue at last report 26 October 2023:
159 - (2021) Sustainable Environment - Provision of Information for SSN Submission; 160 - (2021) Sustainable Environment - External Validation/Peer Review; 162 - (2021) Economic Development Industrial Property - balanced scorecard of KPIs; 166 - (2021) Capital Investment - Asset Mgt Plans; 168 - (2021) Capital Investment - Risk Register; 170 - (2021) IT Asset Management - Strategy; 172 - (2021) IT Asset Management - Review of assets; 180 - (2022) Contract Management - Live Borders; 181 - (2022) LGBF - Live Borders; 202 - (2022) Protective Services - PWS - Charges and income; 209 - (2023) Complaints - Process Enhancements; 213 - (2023) Pupil Equity Fund - Administration Overhead

6 new actions since last report 26 October 2023:
214 - (2023) Sales to Cash - Policy; 215 - (2023) Sales to Cash - 2nd line monitoring; 216 - (2023) Sales to Cash - performance monitoring; 217 - (2023) Sales to Cash - e-Learning course; 218 - (2023) Schools - School Funds 2nd line monitoring; 219 - (2023) Schools - Attendance Policy revisions

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Local government in Scotland

Financial bulletin 2022/23

ACCOUNTS COMMISSION

Prepared by Audit Scotland
January 2024

Contents

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Key messages

Funding and outturn in 2022/23

1 Despite councils receiving more funding and income in cash terms, due to high inflation in 2022/23 total revenue funding from all sources fell by £619 million (2.8 per cent) in real terms to £21.3 billion compared to 2021/22.

2 Councils received more core revenue funding from the Scottish Government than in 2021/22, rising from £12.1 billion to £12.2 billion (0.7 per cent) in real terms. However, an increasing proportion is ring-fenced or provided with the expectation it will be spent on specific services. This means that the amount of funding available for councils to spend freely on local priorities is reducing. There are commitments in the Verity House Agreement to move to a default position of removing ring-fencing or direction of funding wherever possible.

3 There is pressure on all public-sector capital budgets, and this presents risks to the viability of local government capital programmes, many of which impact on key services (eg, the construction and maintenance of schools, libraries, roads). Capital funding from the Scottish Government rose in 2022/23 but remains lower than before the pandemic and has been volatile over the past decade. Driven by increased borrowing councils' capital expenditure increased in 2022/23 by 16 per cent in cash terms to £3.6 billion. Borrowing costs have reduced in recent years as many councils have used permitted financial flexibilities to reprofile debt payments. While helping with immediate budget pressures, these decisions defer costs to later years and do not tackle the underlying challenges to financial sustainability. Additional borrowing also places further pressure on revenue budgets over the longer term.

4 At the time of setting their 2022/23 budgets, councils anticipated budget gaps of over £476 million for the year, higher than the previous year. Councils are increasingly having to rely on savings and reserves to balance budgets. Achievement of savings targets was good in 2022/23 and improved on 2021/22. Greater transparency is required in the reporting of financial outturn in council accounts, including savings performance. This transparency and timely public engagement are essential as councils make increasingly difficult decisions to reduce or stop services to help balance budgets.

Councils' financial position and outlook from 2023/24

5 Despite the financial pressures of recent years, half of councils increased their usable reserves in 2022/23, and overall usable reserves grew to £4.45 billion. This is driven by growth in committed reserves. Some of this is remaining Covid-19 funding, some is attributable to the permitted use of financial flexibilities for the repayment of longer-term debt but there are also indications councils are building up reserves to manage the known financial challenges in future years. However, the lack of transparency in some councils' annual accounts makes it difficult to draw firm conclusions on councils planned use of reserves.

6 Local appointed auditors did not identify any councils in Scotland as being financially unsustainable in the short term. However, the financial outlook is extremely challenging with Scottish councils facing unprecedented financial and service demand pressures which present real risks for the future. Although Scottish Government core funding increased in cash and real terms in 2023/24, councils reported a significant increase in the total budget gap to £725 million.

7 Councils' medium- and longer-term financial plans demonstrate a clear recognition of the difficult financial context and the need to continue to innovate at pace and make difficult decisions to become more financially sustainable. But some councils are already experiencing significant resistance when seeking to make service reductions to balance budgets. This reinforces the need for effective consultation and engagement with communities on planned local service changes.

8 The Verity House Agreement includes a commitment to offer councils longer-term funding and greater local financial flexibility. These proposed changes will be important, in providing greater financial certainty to support better long-term planning and more flexible direction of resources to meet local need. However, the recent announcement of a proposed council tax freeze significantly reduces discretion and flexibility at individual council level. The impact this will have on financial sustainability is not yet known, but councils have placed an increased reliance on raising council tax to help deliver a balanced budget over the past two years.

Recommendations

Councils should:

- Prioritise the achievement of recurring savings and avoid reliance on non-recurring savings to enhance longer-term financial sustainability (paragraph 29).
- Ensure that management commentaries are open and transparent, include a clear link between budget outturn and the financial performance in the accounts and report on the achievement of planned savings targets (paragraph 46).
- Provide clear statements about reserves policy and explicitly set out the purpose of committed reserves within their annual accounts. This will enhance the level of assurance that councils can provide regarding their ongoing financial sustainability (paragraph 55).
- Ensure effective and timely consultation and engagement with communities on the options that must be considered to achieve a balanced budget (paragraph 73).
- Strengthen their monitoring and reporting of financial resilience including clearer and more public-facing use of performance against financial resilience indicators and measures. Financial resilience indicators should be a component of councils' medium and longer-term financial plans to provide assurance that they are balancing short-term pressures with robust planning for long-term financial sustainability (paragraph 83).
- Work with the Scottish Government to build momentum and accelerate progress in the development of a fiscal framework for local government to enhance the clarity and certainty of budgets for councils in future years (paragraph 89).

About this report

1. This bulletin provides a high-level independent analysis of the financial performance of councils during 2022/23. The bulletin considers:

- councils' funding and expenditure in 2022/23
- councils' financial position at the end of 2022/23 and the financial outlook
- some of the potential impacts of the Verity House Agreement (New Deal with Local Government) made between COSLA and the Scottish Government in June 2023.

2. This bulletin is part of a series of outputs produced by the Accounts Commission which together provide an independent overview of the local government sector. In Spring 2024 we will publish a budget briefing examining the 2024/25 budgets set by councils, including analysis of anticipated budget gaps and actions to set a balanced budget.

Methodology

3. Our primary sources of information for this bulletin are councils' 2022/23 accounts, a data request issued to auditors in October 2023 and Scottish Government budget documents.

4. The analysis of accounts is based on audited accounts where available. As at our 6 November 2023 deadline, 18 councils' accounts were still to be certified; therefore, the analysis in this bulletin is based on 14 sets of audited accounts and 18 sets of unaudited accounts.

5. We received 30 data requests back from auditors. In places our analysis is therefore based on a sample rather than the full population. Returns were not received for two councils.

6. Scottish Government funding analysis uses the spring revision funding position unless otherwise stated.

7. When looking at trends, we convert some financial data to real terms using GDP deflators. This adjusts financial information from past and future years to prices for the year under review, ie 2022/23. This is to take account of inflation so that the trend information is comparable. Any financial trend data (both capital and revenue) relating to funding, income or expenditure will be shown in real terms. The exception to this is that any financial information from the councils' accounts' balance sheet remains in cash terms, even when looking at a trend. This includes reserves, debt and borrowing. These are not adjusted to real terms as they are already subject to revaluation to reflect current prices.

1. Funding and outturn

Revenue funding and income

Total funding and income fell by 2.8 per cent in real terms in 2022/23 compared to the previous year

8. In 2022/23, Scotland's 32 councils received a total of £21.3 billion in revenue funding and income (funding for day-to-day spending). In cash terms this is £757 million more than the year before but in real terms (that is adjusting for inflation) it represents a real-terms decrease of 2.8 per cent (£619 million).

9. Revenue funding and income comes from a variety of sources. Almost 60 per cent of total revenue funding comes from the Scottish Government (Exhibit 1).

Exhibit 1.
Sources of funding and income 2022/23 compared to 2021/22, real terms (£ billion)

	2021/22	2022/23
Interest receivable	0.03	**0.11**
Housing Revenue Account rents	1.42	**1.36**
Customer and client receipts	1.85	**1.82**
Council tax	2.82	**2.75**
Grants including Scottish Government and other sources	4.01	**3.56**
Non-domestic rates	2.23	**2.77**
Cost of living award grant	0.00	**0.28**
General revenue grant Covid-19 funding	0.55	**0.00**
General revenue grant	9.09	**8.72**
Total funding and income (£ billion)	22.00	**21.38**

Source: Councils' annual accounts 2022/23 (audited and unaudited) and 2021/22 (audited)

10. The source of the largest increase in funding was non-domestic rates, although levels are still below pre-pandemic levels (Exhibit 16, page 28).

11. The largest decreases were to grants, which fell by 11 per cent in real terms compared to 2021/22, and housing rents which, despite a cash increase of 2.3 per cent, fell by 4.1 per cent in real terms.

12. Council tax is an important source of income for councils, accounting for 13 per cent (£2.7 billion) of total funding in 2022/23. Councils received more income from council tax, due to an overall increase of 4.5 per cent in the amount of council tax billed and an increase in in-year collection rates of 0.5 per cent (from 95.7 per cent to 96.2 per cent). However, the amount received has not kept pace with inflation and in real terms this represents a fall in income of 2.5 per cent compared to 2021/22.

Core revenue funding from the Scottish Government to councils increased in cash and real terms from 2021/22 to 2022/23

13. Scottish Government core revenue funding to councils amounted to £12.2 billion in 2022/23. This is an increase to core funding in both cash and real terms from the previous year (Exhibit 2).

Exhibit 2.
Scottish Government core revenue 2021/22 and 2022/23

	Cash terms			Real terms		
Scottish Government revenue funding	**2021/22 £ million**	**2022/23 £ million**	**change %**	**2021/22 £ million**	**2022/23 £ million**	**change %**
Core revenue	**11,384**	**12,231**	**7.4%**	**12,144**	**12,231**	**0.7%**
General revenue grant	8,489	8,679	2.2%	9,056	8,679	-4.2%
Non-domestic rates	2,090	2,766	32.3%	2,230	2,766	24.1%
Specific revenue grants	805	786	-2.4%	859	786	-8.5%

Source: Scottish Government budget documents (spring revision)

14. The increase in core revenue funding was driven by a significant increase in income from non-domestic rates. The general revenue grant and specific revenue grants both fell in real terms.

15. In 2021/22, councils received an additional £0.5 billion in non-recurring revenue funding from the Scottish Government to support their Covid-19 response. When this is included, councils experienced a real terms reduction of 3.6 per cent in revenue funding from the Scottish Government in 2022/23 compared to 2021/22. In 2022/23, a one-off grant of £278 million was received by councils, to distribute the £150 Cost of Living Award to eligible households.

An increasing proportion of Scottish Government funding is formally ring-fenced or provided with the expectation it will be spent on specific services

16. Specific revenue grants funding totalled £786 million in 2022/23 and must be used to fund specific policies or initiatives such as for early learning and childcare expansion and the pupil equity fund.

17. In addition to specific revenue grants, other funding received by councils is directed for national policy initiatives. Though not formally ring-fenced, this funding is provided with the expectation that it will be spent on specific services.

18. Examples of directed funding in 2022/23 include: £140 million for Local Government pay deals, £145 million for additional teachers and support staff and £234 million for the annual pay uplift to social care staff in commissioned services.

19. We calculate that ring-fenced and directed funding increased to 25.7 per cent in 2022/23 (Exhibit 3).

Exhibit 3.
Proportion of Scottish Government funding to local government that is ring-fenced or directed

Source	2021/22 £ million	2022/23 £ million
From initial allocation		
Specific revenue grant	805	786
Directed funding within general revenue grant	347	475
Directed funding from transfers from other portfolios	488	648
From in year allocations		
Directed funding from budget revisions and recalculations	1,061	1,236
Total ring-fenced or directed funding	**2,701**	**3,145**
Total revenue funding	**11,384**	**12,231**
Percentage ring-fenced or directed	**23.7%**	**25.7%**

Note: We have updated our methodology from last year. This changes the total ring-fenced amount for 2021/22 from 23.1% to 23.7%.

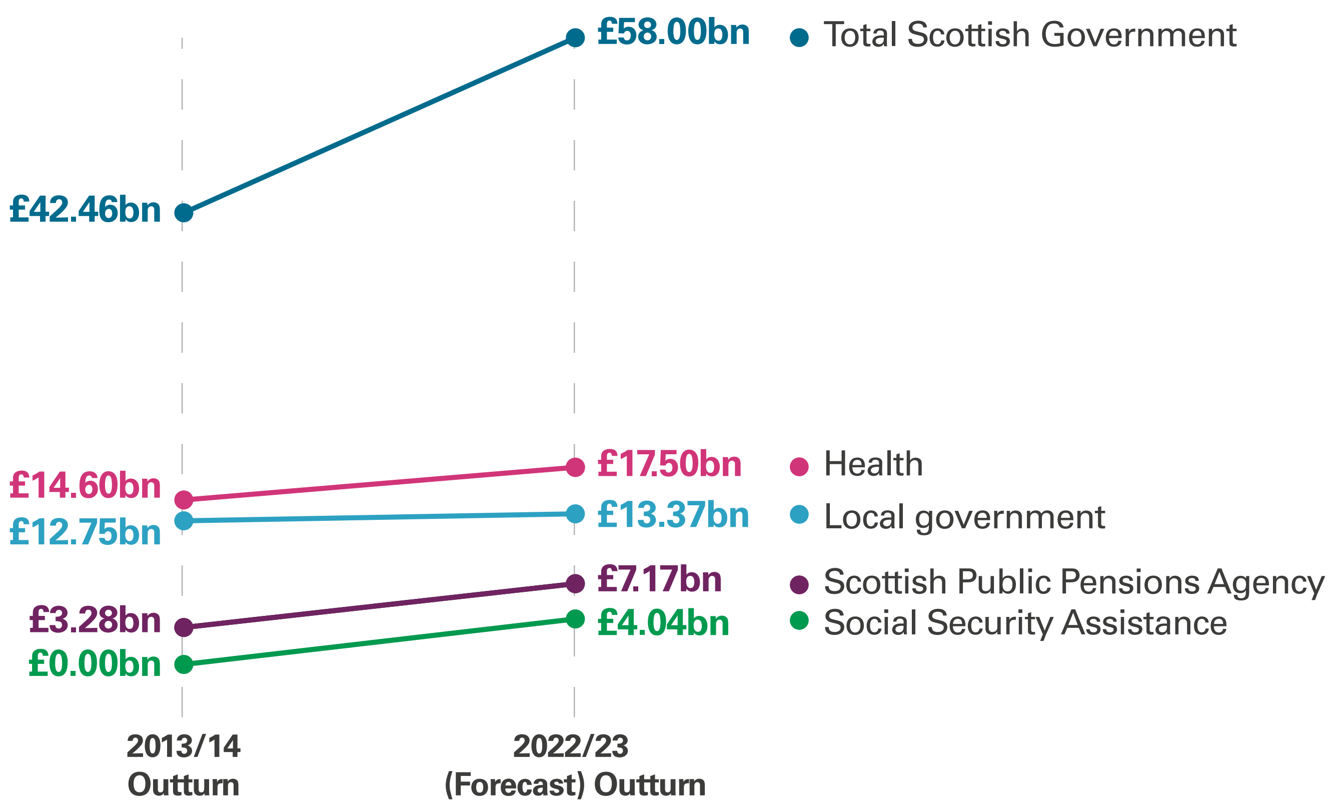
Source: Scottish Government budget documents and financial circulars

20. While directed funding is important to help deliver national priorities, it restricts councils from making decisions about how funds can be used at a local level to meet local need. The Verity House Agreement, signed in June 2023, includes a commitment to a default position of ending ring-fencing or directed funding unless there is a clear joint understanding of the rationale for such arrangements. We discuss this further in Part 2 of the report.

Over the last decade, the proportion of the Scottish Budget allocated to local government has been reduced

21. Local government is the second largest area of Scottish Government spending; however, this proportion has reduced over the last decade. In 2013/14 local government (capital and revenue) accounted for 30 per cent of the total spend. In 2022/23, it had fallen to 23 per cent. Over this period, local government spend has been relatively static in real terms while total Scottish Government spend increased by 37 percent. Areas of growth include health and social security (Exhibit 4).

Exhibit 4.
Local government spend (outturn) compared to other areas of the Scottish Budget, 2013/14 to 2022/23, real terms



Source: Scottish Budget 2023/24, Annex D: Outturn Comparison 2013/14 to 2021/22 and Scottish Budget 2024/25, Annex H: Outturn Comparison 2014/15 to 2022/23

Council budget-setting

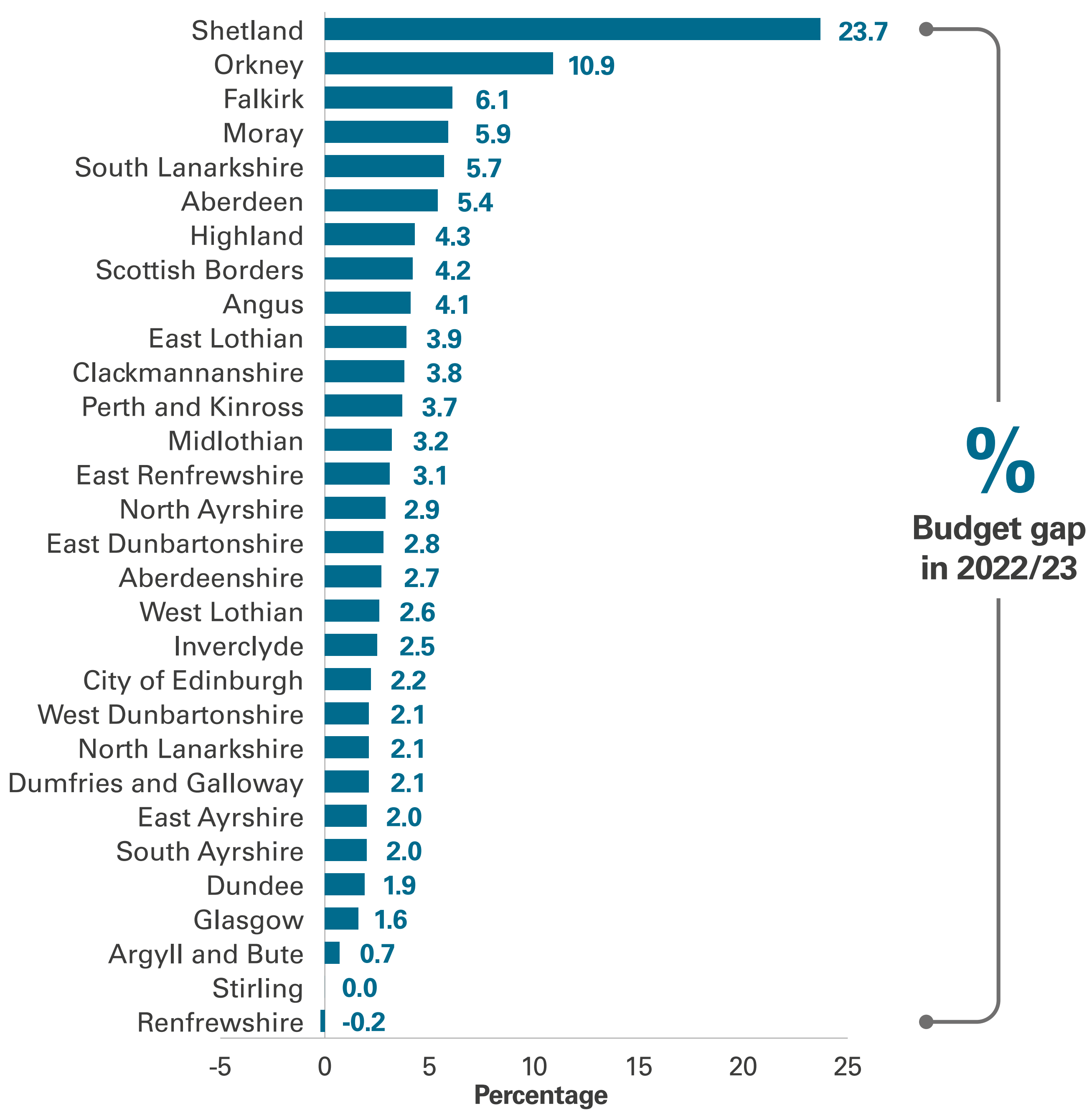
At the time of setting their 2022/23 budgets, councils in our sample identified budget gaps of over £476 million for the year

22. At the time of budgeting, the 30 councils in our sample identified **budget gaps** totalling £476 million for 2022/23, compared to £350 million for the same sample of councils for 2021/22. This represents a budget gap of 2.9 per cent of the net cost of services (Exhibit 5).

Budget gaps reflect a point in time when councils begin to set their budgets and is the difference between anticipated expenditure and funding and income.

Exhibit 5.

Budget gap as a percentage of net cost of services, 2022/23



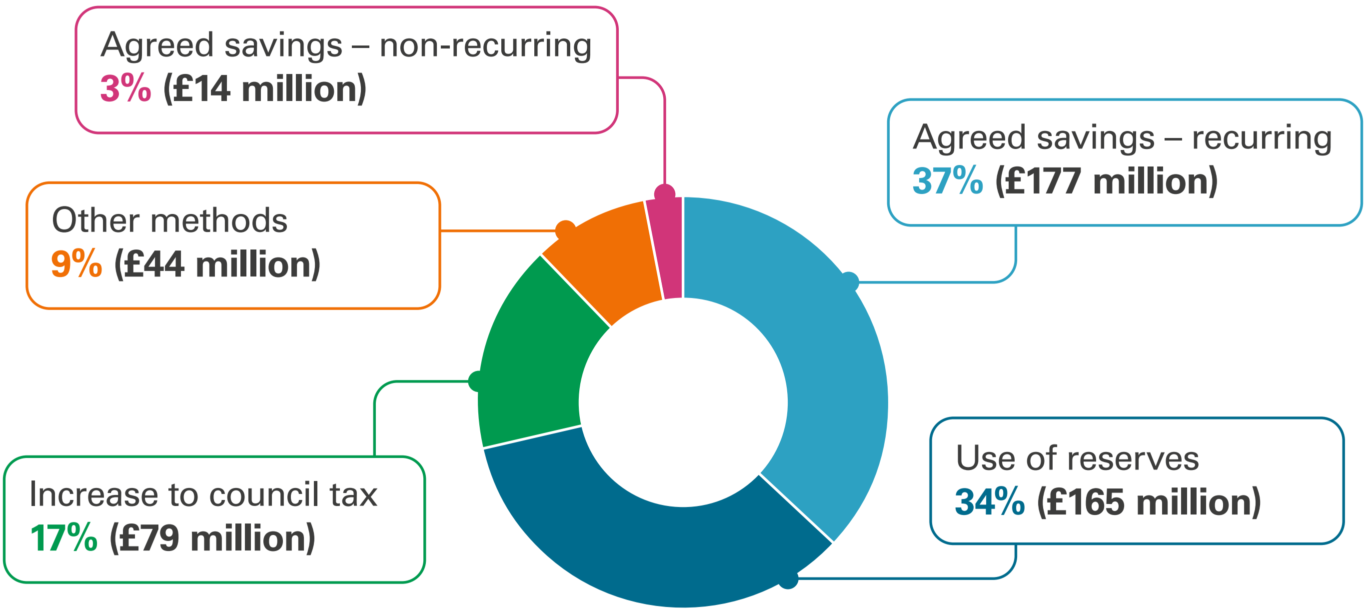
Source: Auditor data returns (30 councils in the sample)

23. Within our sample, the budget gap for 2022/23 ranged from a surplus of £1.1 million (0.2 per cent of net cost of services) in Renfrewshire to a gap of £53 million (5.7 per cent net cost of services) in South Lanarkshire. Shetland had the largest budget gap as a proportion of net cost of services, at 23.7 per cent (with a value of £34 million). One council, Stirling, reported no budget gap.

Councils largely relied on reserves and making recurring savings to deliver a balanced budget

24. From our sample of 30 councils, a range of bridging actions were used to set balanced budgets for 2022/23 (Exhibit 6).

Exhibit 6.
Councils' bridging actions to set their 2022/23 budget



Note: The chart elements add up to £479 million which is higher than the total anticipated budget gap. This is because Dundee identified bridging actions of greater value than their budget gap to allow for additional expenditure in priority areas.

Source: Auditor data returns (30 councils in the sample)

25. Use of reserves and making **recurring savings** were expected to bridge 71 per cent (£342 million) of the budget gap. The relative use of reserves to bridge the budget gap has doubled from 17 per cent in 2021/22 to 34 per cent in 2022/23.

26. Examples of other bridging actions include the use of:

- fiscal flexibilities for service concessions and capital receipts
- additional Scottish Government funding
- increased service charges
- non-recurring Covid-19 funding
- a reduction in IJB funding.

These actions are largely non-recurring and therefore not sustainable.

Recurring savings are savings, that once achieved, recur year-on-year from that date. Non-recurring savings are one-off savings that apply to one financial year and do not result in ongoing savings in future years.

Outturn

Achievement of savings targets was high, but improvements are required in the transparency of reporting

27. From our sample of 30 councils, the aggregate savings target for 2022/23 was £216 million.[1] Three councils did not have a savings target.

28. Twenty-five councils provided information about savings performance in 2022/23. Fourteen councils (56 per cent) achieved their savings target in full or more and a further eight councils (32 per cent) achieved over 80 per cent. Overall, 98 per cent of the aggregate savings target was met. This compares to 92 per cent across all councils in 2021/22 (Exhibit 7, page 14).

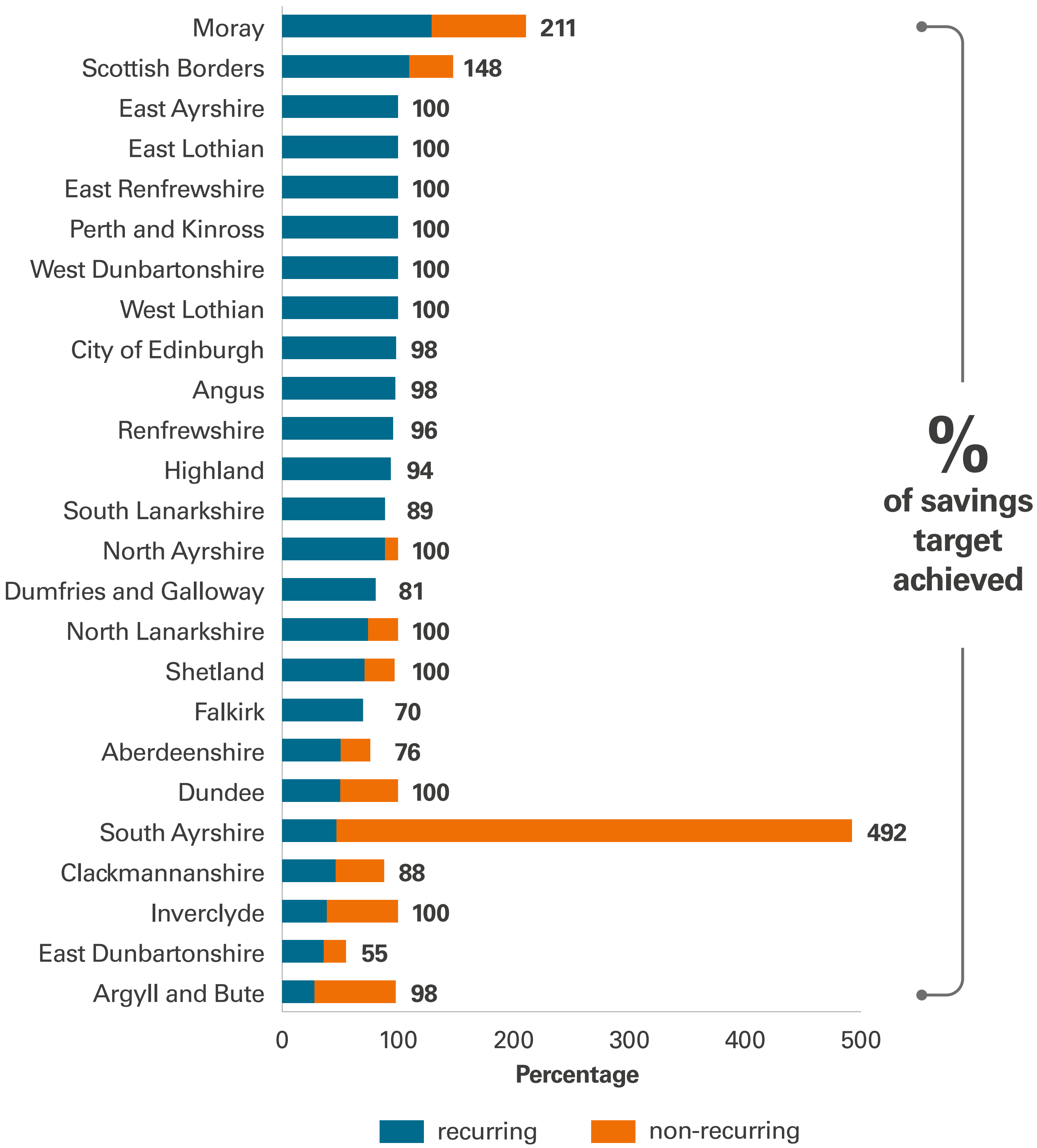
29. Where we have a breakdown of how savings were achieved, 82 per cent (£126 million), were achieved on a recurring basis, which is higher than the 76 per cent achieved across all councils in 2021/22.

Recommendation

Councils should prioritise the achievement of recurring savings and avoid reliance on non-recurring savings to enhance longer-term financial sustainability.

[1] This savings target does not match the planned savings (recurring and non-recurring combined) identified as bridging actions in Exhibit 6. Savings identified during budget setting may be further revised before a savings target is agreed.

Exhibit 7.
Percentage of savings target achieved, split by recurring and non-recurring, 2022/23



Note: Information on the split of savings achieved was not available for Dundee. South Ayrshire's savings performance was 492% due to a large (non-recurring) underspend. Five councils within the sample are not included in the chart: Midlothian, Orkney and Stirling did not have a savings target in place for 2022/23. Information on savings performance was not available for Glasgow and Aberdeen.

Source: Auditor data returns (30 councils in the sample

30. A review of councils' management commentaries identified that 66 per cent of council accounts provided no or insufficient commentary on performance against savings targets. Further detail on the transparency of management commentaries is included at paragraphs 44–46).

Over half of councils used financial flexibilities in 2022/23

31. In recent years, the Scottish Government has introduced a number of financial flexibilities to help alleviate ongoing financial and funding pressures.

32. The three main flexibilities available are:

- The use of capital receipts for revenue costs.
- The ability to apply for revised loans repayments.
- Changes to service concession arrangements which allow councils to write off the debt costs associated with these schemes over the expected lives of the respective assets rather than over the contract period of each arrangement.

33. Of our sample of 30 councils, 18 (60 per cent) reported that they used some of the financial flexibilities allowed by the Scottish Government in 2022/23.

34. Using flexibilities to meet immediate spending pressures may help councils to balance their budgets, but it defers costs to later years and does not tackle the underlying challenges to financial sustainability.

Capital funding and expenditure

Increases in capital expenditure were driven by increased borrowing

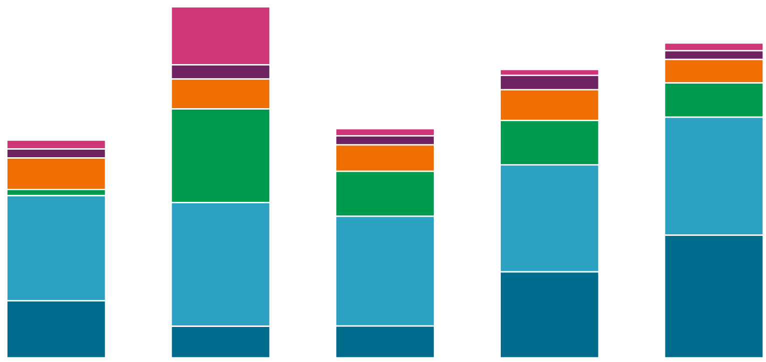
35. Councils' **capital expenditure** in 2022/23 was £3.6 billion. This is a 16 per cent (£0.5 billion) increase in cash terms compared to 2021/22.

36. The increase in capital expenditure in 2022/23 was driven by a 52 per cent increase in borrowing. At £1.41 billion, this was the largest source of capital financing, surpassing government grants which accounted for £1.35 billion of capital expenditure. The higher costs associated with borrowing place further pressure on revenue budgets over the longer term (Exhibit 8, page 16).

37. Twenty-two councils reported higher capital expenditure than in 2021/22. At a council level, year-on-year movement ranged from a £207 million increase (Glasgow) to a £54 million decrease (Angus).

Capital expenditure is the money spent by councils to maintain or improve their assets, for example school buildings and roads. It cannot be used on day-to-day running costs.

Exhibit 8.
Capital expenditure split by sources of finance in cash terms, 2018/19 to 2022/23 (£ billion)



2018/19	2019/20	2020/21	2021/22	2022/23	
0.09	0.60	0.07	0.06	0.09	Capital receipts
0.09	0.15	0.09	0.15	0.10	Other contributions and Public Private Partnership (PPP)
0.32	0.31	0.28	0.33	0.27	Capital Funded from Current Revenue (CFCR)
0.06	0.96	0.47	0.48	0.39	Internal loans fund repayments available to reinvest
1.06	1.27	1.15	1.15	1.35	Government grants
0.57	0.32	0.33	0.92	1.41	An increase in borrowing
2.18	**3.61**	**2.41**	**3.10**	**3.61**	**Total expenditure (£ billion)**

Source: Councils' annual accounts 2018/19 to 2022/23 (audited and unaudited)

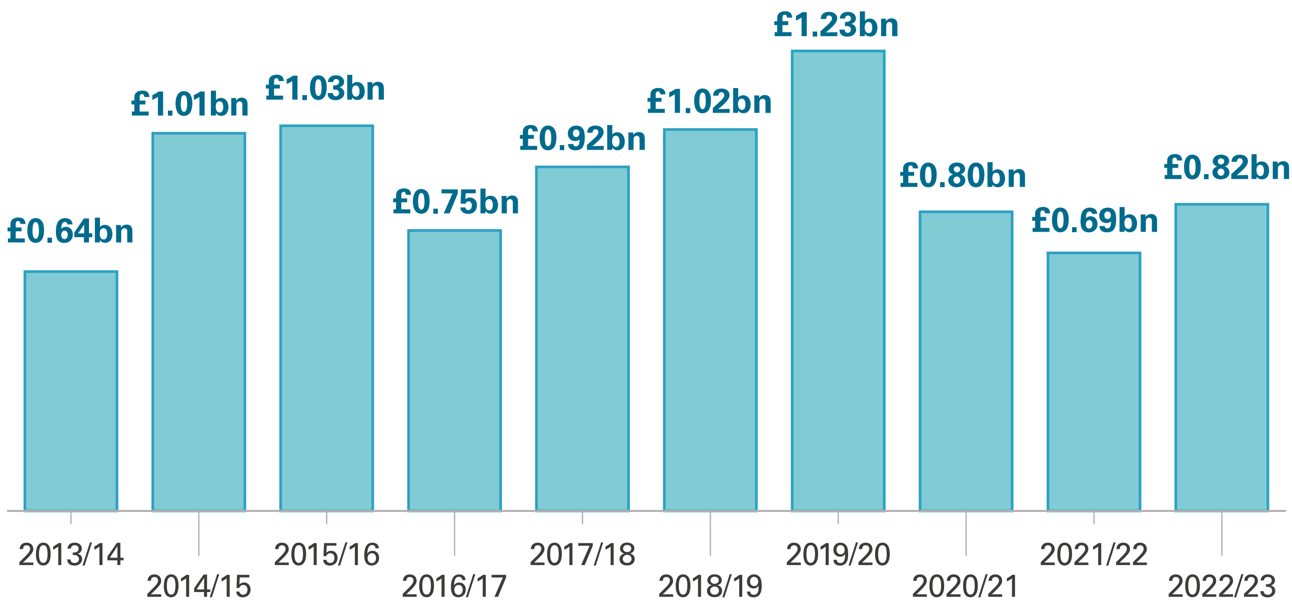
38. Slippage against capital projects was noted by auditors in some Annual Audit Reports for 2022/23. Factors included higher costs for goods and services including utilities, fuel and labour; and wider economic circumstances including inflation, war, Covid-19, interest rates and pay awards.

Capital funding from the Scottish Government rose in 2022/23 but remains lower than before the pandemic

39. Councils receive capital funding from the Scottish Government in the form of the capital grant, distributed by means of a funding formula based largely on population and road-length.

40. In 2022/23 capital funding from the Scottish Government rose by 19 per cent in real terms to £0.82 billion compared to 2021/22. However, it remains lower than many of the years leading up to the Covid-19 pandemic (Exhibit 9).

Exhibit 9.
Scottish Government capital funding to local government 2013/14 to 2022/23, real terms



Source: Scottish Government budget documents (spring revision)

41. Some capital funding is directed towards specific policies. For example, in 2022/23 around £120 million was allocated to support the local government pay deal in 2022/23 and £30 million to fund expansion of free school meals.

42. Scottish Government capital funding is volatile. Some of the more significant movements can also be attributed partly to reallocation of capital funding payments from one financial year to another, as agreed between the Scottish Government and COSLA. For example, the 2016/17 figure excludes £150 million that was reallocated and included in the 2019/20 capital settlement.

Reporting on financial outturn in management commentaries

Councils could improve the transparency of their reporting on financial outturn and progress against savings plans

43. A management commentary is a report by the council, set out within its annual accounts. It should provide information on the council's strategic priorities and key risks, as well as a balanced analysis of the financial and wider performance of the council over the year.

We undertook a review of councils' management commentaries to assess the transparency of their reporting against three elements that the Accounts Commission has previously recommended should be included:

- Is the outturn against budget position for the year clearly shown with the reasons for significant variances obvious?
- Is the outturn reported in the narrative reconciled to the movement in the general fund contained in the financial statements and major differences explained?
- Is progress against agreed savings reported?

44. Twenty councils included commentary related to outturn against budget including the main reasons for the variances. Of the remaining, nine provided insufficient detail or no commentary on variances and three lacked clarity on the outturn against budget.

45. Half of councils provided a table within the management commentary which showed the reconciliation of outturn to the movement on the general fund. Of the remaining, 12 did not provide sufficient detail within the management commentary to demonstrate a reconciliation of the general fund against reserves and four did not provide any information.

46. Eleven councils outlined progress against savings targets to some extent, with some providing a table of savings performance trends and/or links to other documents. Of the remaining, 12 provided generic statements or insufficient detail, seven provided no information and two referred only to previous or future savings plans.

Recommendation

Councils should ensure that management commentaries are open and transparent, include a clear link between budget outturn and the financial performance in the accounts and report on the achievement of planned savings targets.

2. Councils' financial position and outlook

2022/23 financial position

In 2022/23, councils increased their total usable reserves by £0.31 billion to £4.46 billion

47. Reserves play an important role in good financial management of councils. They may be used to invest in a major project, transform services or respond to unexpected events. Reserves are a one-off resource, so councils need to plan carefully for their use. In doing so, they should consider the strategic, operational, and financial risks facing the council.

48. In 2022/23, councils increase their total usable reserves by £0.31 billion, from £4.15 billion to £4.46 billion (Exhibit 10, page 20).

49. Revenue reserves increased by 2.2 per cent (£80 million) and capital reserves increased by 40 per cent (£232 million). The increase in capital reserves may be linked to slippage against capital projects (paragraph 38).

50. Half of councils increased their usable reserves in 2022/23. A review of management commentaries for those councils with the greatest increases found these were largely attributable to accounting adjustments related to the permitted use of financial flexibilities for the repayment of longer-term debt. Some councils are also committing reserves to contingency or financial sustainability funds to cushion the impact of known financial challenges in the years ahead or to help fund transformation, potential workforce reconfiguration or pay settlements.

The level of reserves as a proportion of total net revenue expenditure is higher in 2022/23 than before the pandemic

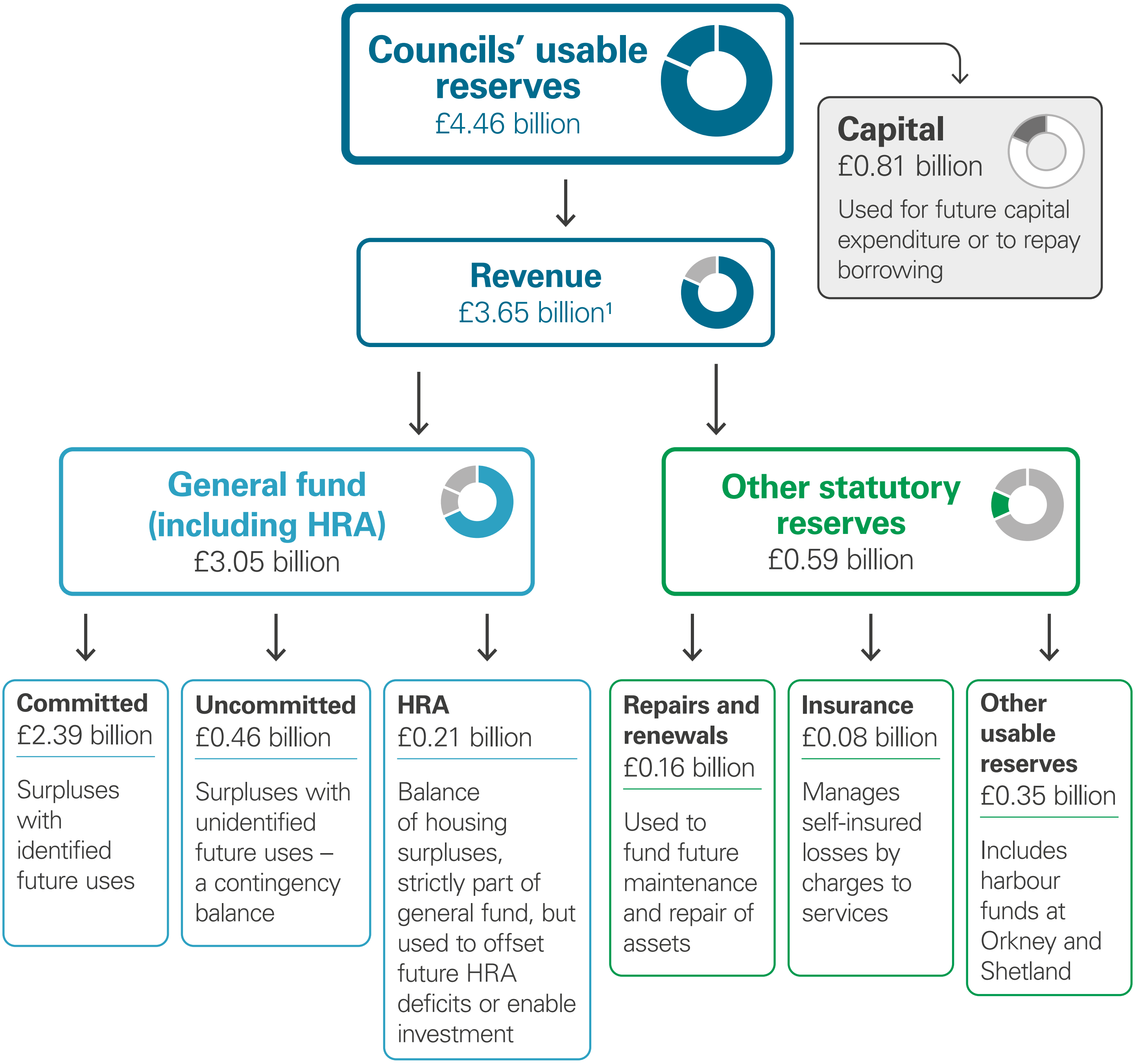
51. In 2022/23, the total usable reserves across all councils as a proportion of total net revenue expenditure was 27.3 per cent compared to 20.4 per cent in 2019/20 before the pandemic (Exhibit 11, page 21).

52. In 2022/23, no council had usable reserves that were less than ten per cent of net revenue expenditure compared to four councils in 2019/20. Twenty councils had reserves that were over 20 per cent of net revenue expenditure, compared to nine in 2019/20.

£/£

Looking at the level of **reserves as a proportion of total net revenue expenditure** is one way of assessing financial sustainability. A low figure may suggest that a council will struggle financially if it experiences a financial shock or is unable to deliver a budget where income matches expenditure.

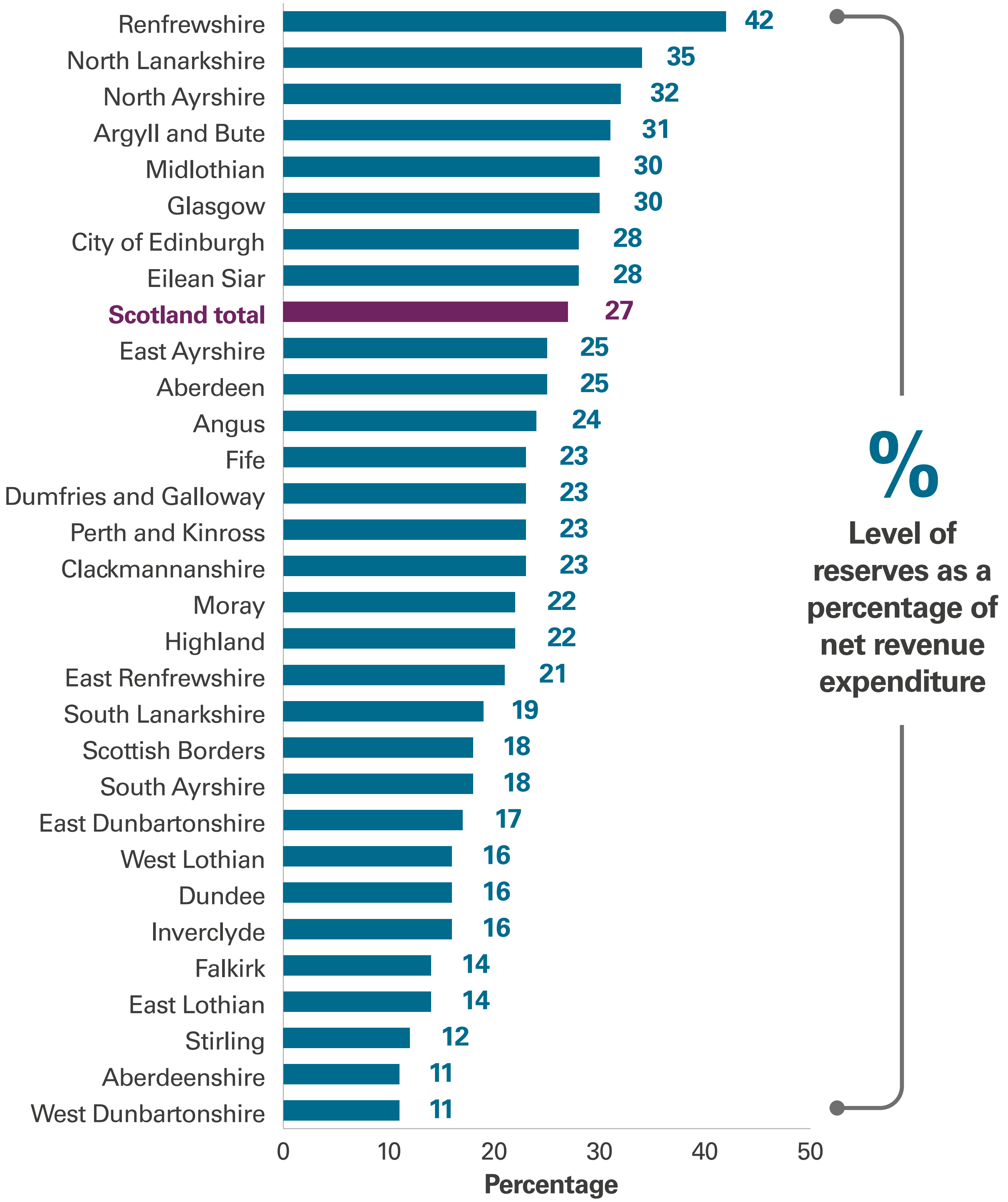
Exhibit 10.
The nature and value of councils combined usable reserves, 2022/23



Note 1. Total figure doesn't match subtotals due to rounding.

Source: Councils' annual accounts 2022/23 (audited and unaudited)

Exhibit 11.
Level of usable reserves as a proportion of net revenue expenditure, split by council, 2022/23



Note: Orkney and Shetland are excluded from this chart as both hold large reserves (over 200 per cent of net cost of services) related to oil, gas and harbour related activities.

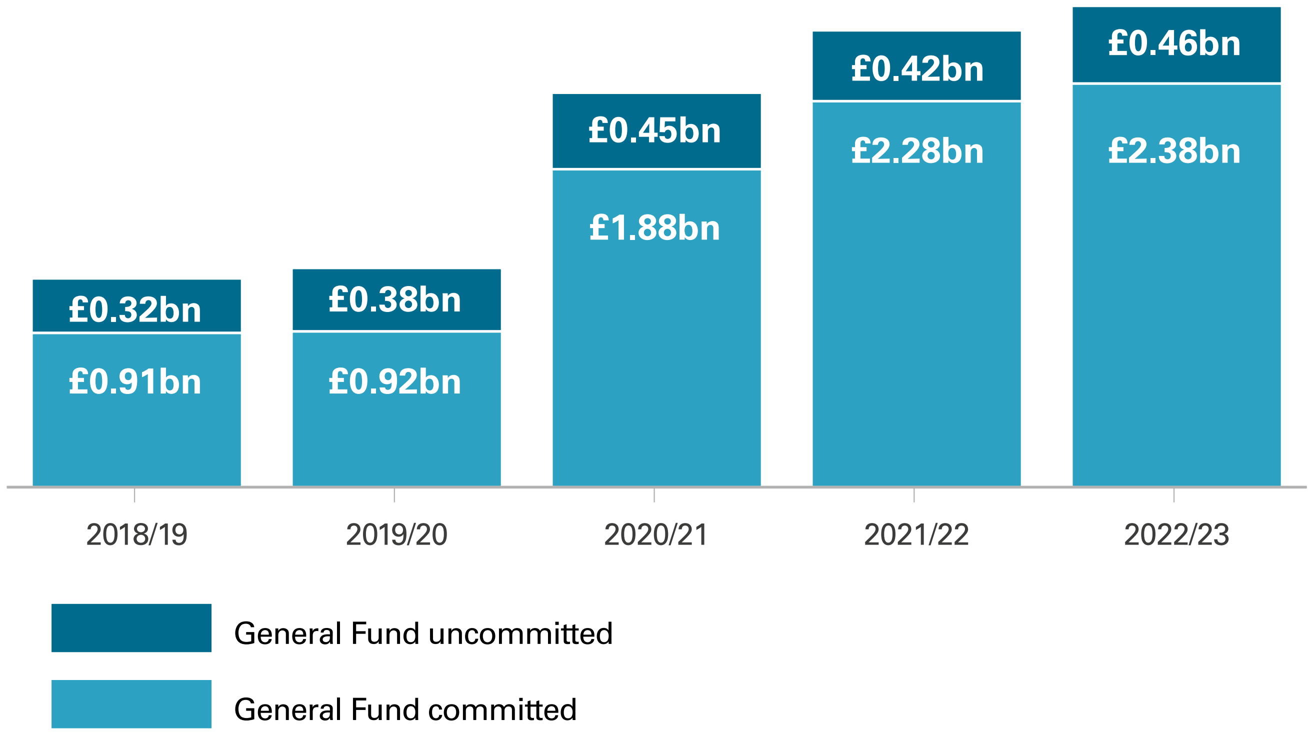
Source: Councils' annual accounts 2022/23 (audited and unaudited)

Councils increased their general fund reserves, but this is driven by growth in committed funds

53. In 2022/23, councils increased their total General Fund reserves (excluding any HRA element which not all councils have) by £0.1 billion (4.8 per cent) to £2.84 billion compared to 2021/22.

54. Committed funds have increased by £0.1 billion (4.6 per cent) since 2021/22 and by £1.47 billion (159 per cent) since 2019/20 (Exhibit 12).

Exhibit 12.
National General Fund balance, 2018/19 to 2022/23, cash terms



Note: This chart excludes HRA.

Source: Councils' annual accounts (audited and unaudited)

55. Paragraph 50 outlines some of the reasons for growth in committed funds in the past year. Based on data extracted from 2022/23 accounts, we calculate that remaining Covid-19 funding makes up around nine per cent of the total committed General Fund balance, but it is difficult to provide an exact figure for this and it may actually be higher. The continued lack of consistent transparency and detail in annual accounts around what and when reserves are committed for, and their associated spending plans, makes conclusions in this area difficult to draw.

Recommendation

Councils should provide clear statements about reserves policy and explicitly set out the purpose of committed reserves within their annual accounts. This will enhance the level of assurance that councils can provide regarding their ongoing financial sustainability.

Some councils hold very low levels of uncommitted reserves but have specific reserves earmarked for contingency instead

56. Councils have reserves policies in place that set out the rationale for the minimum reserves levels set by the council. Most councils plan to maintain uncommitted reserves at around 2 to 4 per cent of net budgeted expenditure as a contingency to respond to unforeseen events and associated cost pressures.

57. In 2022/23, five councils had an uncommitted reserve balance below two per cent of net budgeted expenditure. Low levels of uncommitted reserves present a risk as it limits a council's ability to cushion the impact of uneven cash flows, unexpected events or emergencies. However, a review of 2022/23 annual accounts for those with the lowest uncommitted balances found that these were planned decisions with specific reserve funds earmarked for contingency.

Councils' total net debt increased by £1 billion (six per cent) between 2021/22 and 2022/23

58. Total net debt (total debt less cash and investments) increased by £1 billion from £16.4 billion in 2021/22 to £17.4 billion in 2022/23 (Exhibit 13, page 24).

59. At a council level, net debt increased in 24 councils between 2021/22 and 2022/23. This compares to an increase in net debt in 15 councils in 2021/22, and eight in 2020/21.

Exhibit 13.
Councils' total net debt, 2018/19 to 2022/23

	2018/19	2019/20	2020/21	2021/22	2022/23
Net debt (£ billion)	15.7	17.1	16.2	16.4	17.4
Year-on-year % change		9.1%	-5.3%	1.4%	5.8%

Note: Orkney is excluded from the total net debt analysis as it has net investments.

Source: Councils' annual accounts (audited and unaudited)

60. There is significant variation between councils. Some councils have experienced very large increases in their net debt, with the highest increases being in South Ayrshire (29 per cent) and East Dunbartonshire (21 per cent). Both these councils were also among those with the highest increases in the previous year. West Dunbartonshire saw the largest decrease between these years, at seven per cent.

61. Glasgow City Council had the highest net debt at £2.1 billion, which represents a 10 per cent increase on the previous year. Shetland had the lowest net debt, but this had increased by 14 per cent compared to the previous year.

Councils' borrowing costs have reduced over the past nine years. However, decisions to reschedule debt repayment in recent years may create financial pressure in the longer-term

62. LGBF financial sustainability data for 2022/23 shows that the proportion of councils' general fund revenue budget being used to service debt has fallen from 8.4 per cent in 2013/14 to 5.4 per cent in 2022/23.

63. A key contributory factor to this has been the decision by councils to re-profile principal repayments over a longer period, in line with 2016 Loans Fund regulations. Some councils also used the financial flexibility afforded by the Scottish Government that permitted a reduction in the statutory repayment of debt in 2020/21, 2021/22 and 2022/23.

64. Although borrowing costs have reduced, the long-term affordability of these payments is an important element of councils' financial sustainability. There is a risk that decisions to reschedule debt repayments may add pressure on future budgets as it defers costs to later years and does not tackle the underlying challenges to financial sustainability.

Financial sustainability indicators included within the Local Government Benchmarking Framework (LGBF) consider the affordability of councils' borrowing costs. The ratio of borrowing costs to net revenue budget highlights the revenue implications of existing and proposed capital expenditure. The indicator included in the LGBF identifies the proportion of the general fund revenue budget that is required to meet the cost of borrowing.

Scottish Government funding for 2023/24

Revenue funding to local government from the Scottish Government in 2023/24 saw a cash and real-terms increase on 2022/23

65. The initial core revenue funding settlement for local government in 2023/24 was £10.9 billion. At the 2023/24 autumn revision, an additional £1.5 billion in general revenue grant funding increased total funding to £12.5 billion. This is a 13.5 per cent increase in cash terms and a 7.0 per cent increase in real terms (in 2022/23 prices) on the 2022/23 position. Almost £1 billion was transferred from health to support social care and integration, over £0.25 billion was additional funding for school staff pay and £0.2 billion was transferred from education. (Exhibit 14).

Exhibit 14.
Scottish Government revenue funding (autumn budget revision), 2023/24 compared to 2022/23, in real terms

	Cash terms			Real terms		
Scottish Government revenue funding	2022/23 £ million	2023/24 £ million	change %	2022/23 £ million	2023/24 £ million	change %
Core revenue	**10,999**	**12,482**	**13.5%**	**10,999**	**11,765**	**7.0%**
General revenue grant	7,458	8,683	16.4%	7,458	8,184	9.7%
Non-domestic rates	2,766	3,047	10.2%	2,766	2,872	3.8%
Specific revenue grants	775	752	-3.0%	775	709	-8.5%

Note: Real terms calculation uses 2022/23 as base year.

Source: Scottish Government budget documents (autumn revision)

66. Over the past decade, the total value of specific revenue grants has steadily increased – see Exhibit 16 (page 28) for further details. However, at the latest 2023/24 budget revision (autumn) it decreased in both cash terms and real terms.

Councils' capital funding allocation for 2023/24 represents a real-terms decrease on 2022/23

67. The initial capital funding settlement for local government in 2023/24 was £747 million. At the autumn revision, capital funding was increased to £767 million. This represents a 2.6 per cent fall in cash terms and an 8.2 per cent fall in real terms compared to the same position in 2022/23.

68. Some capital funding is directed for specific policies. For example, £50 million capital to help with the expansion of the Free School Meals policy.

69. The capital funding outlook for the whole Scottish public sector is challenging and the Scottish Government is currently undertaking a programme of reprioritisation of capital projects. The continued pressure on capital budgets presents risks to local government capital programmes, many of which impact on key services (eg, schools, libraries, roads, etc). However, councils did increase their capital reserves by 40 per cent in 2022/23.

Councils' budget-setting for 2023/24

Councils' budget gaps increased significantly in 2023/24 compared to 2022/23

70. At the time of budgeting, from our sample of 30 councils, a total budget gap of £725 million was identified for councils' 2023/24 budgets, a significant increase on the £476 million identified in 2022/23. This represents 4.2 per cent of the net cost of services (in real terms) compared to 2.9 per cent in 2022/23.

71. All but three councils (East Lothian, Dundee and Highland) in the sample reported a higher budget gap in 2023/24 than 2022/23. The budget gaps for 2023/24 ranged from £5 million in Highland (0.6 per cent of net cost of services) to £77 million in South Lanarkshire (7.8 per cent of net cost of services). The wide range may be in part due to different approaches to budgeting rather than significant differences in cost and service pressures.

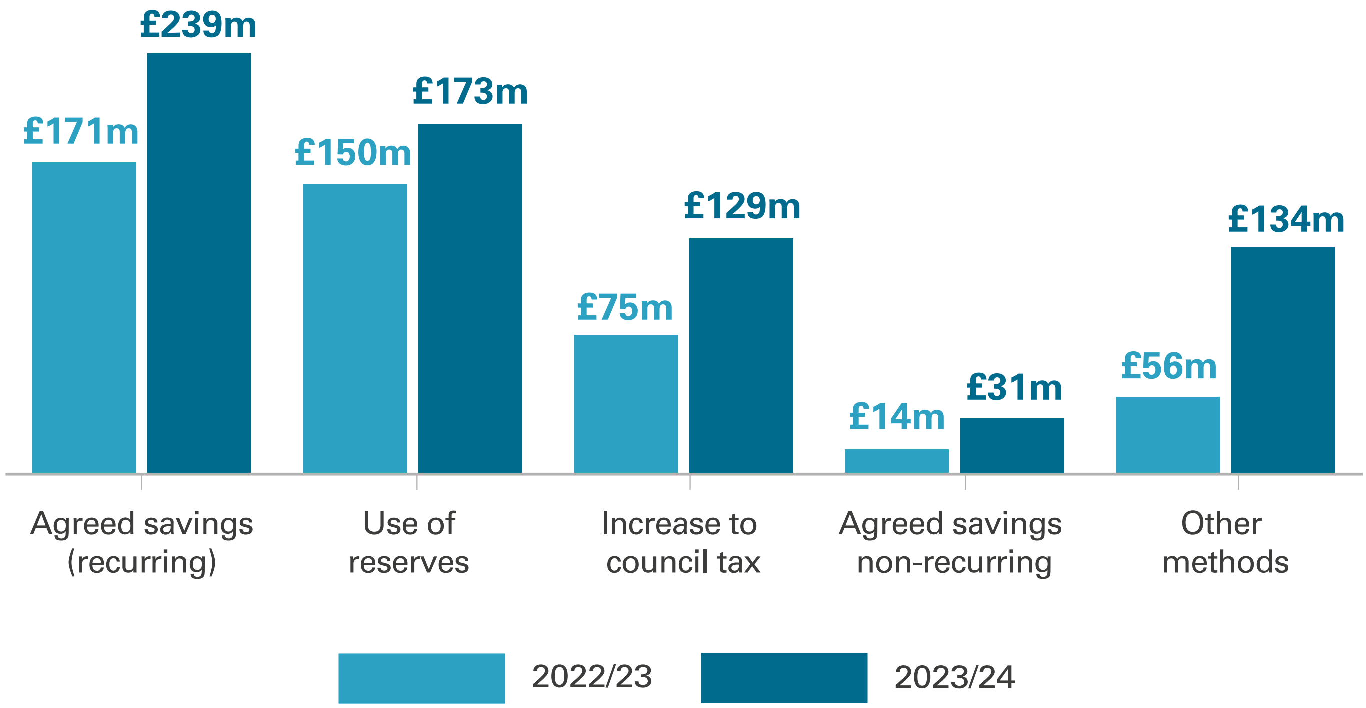
72. The most common bridging actions taken to set balanced budgets in 2023/24 were recurring savings (33 per cent), the use of reserves (27 per cent) and increases to council tax (18 per cent) (Exhibit 15, page 27).

73. Some councils have already taken difficult decisions to address budget gaps through implementation of recurring savings options. However, in the face of public opposition, some councils have reversed decisions that related to the reduction or cessation of services as part of savings put forward for 2024/25. This illustrates the increasing challenges that councils are facing in delivering balanced budgets and highlights the need for proper and timely consultation over budget proposals.

Recommendation

Councils should ensure effective and timely consultation and engagement with communities on the options that must be considered to achieve a balanced budget.

Exhibit 15.
Councils' bridging actions to set their 2023/24 budget compared to 2022/23



Note: The chart elements for 2023/24 add up to £733 million which is higher than the total anticipated budget gap for 2023/24. This is because Dundee and North Lanarkshire reported bridging actions of greater value than their budget gap.

Source: Auditor data returns (30 councils in the sample)

Financial sustainability

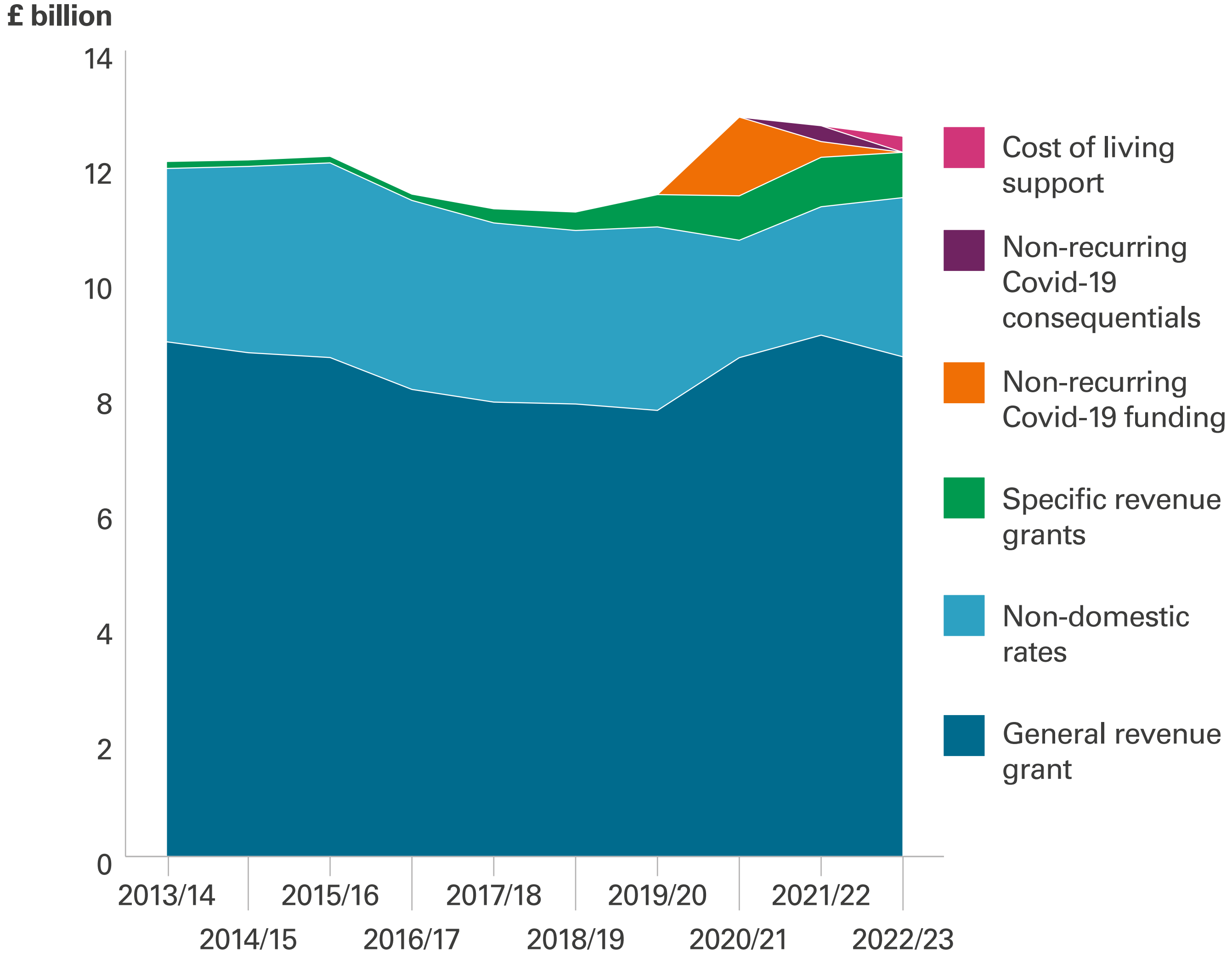
In real terms, councils' core revenue funding is similar to levels a decade ago. However, over that time, councils' have experienced periods of reduced budgets and increasingly ring-fenced funding

74. The £12.2 billion core allocation received by councils in 2022/23 compares to a real-terms value of £12.1 billion in 2013/14, a 1.3 per cent increase (Exhibit 16, page 28).

75. Over this period, in real terms the general revenue grant decreased year-on-year until 2020/21 and non-domestic rates also fell over the same period. During the pandemic, councils received additional core and specific non-recurring Covid-19 funding.

76. In real terms, the general revenue grant in 2022/23 is 2.9 per cent (£262 million) lower than in 2013/14 and income from non-domestic rates is 8.1 per cent (£244 million) lower.

Exhibit 16.
Scottish Government revenue funding to local government, real terms, 2013/14 to 2022/23



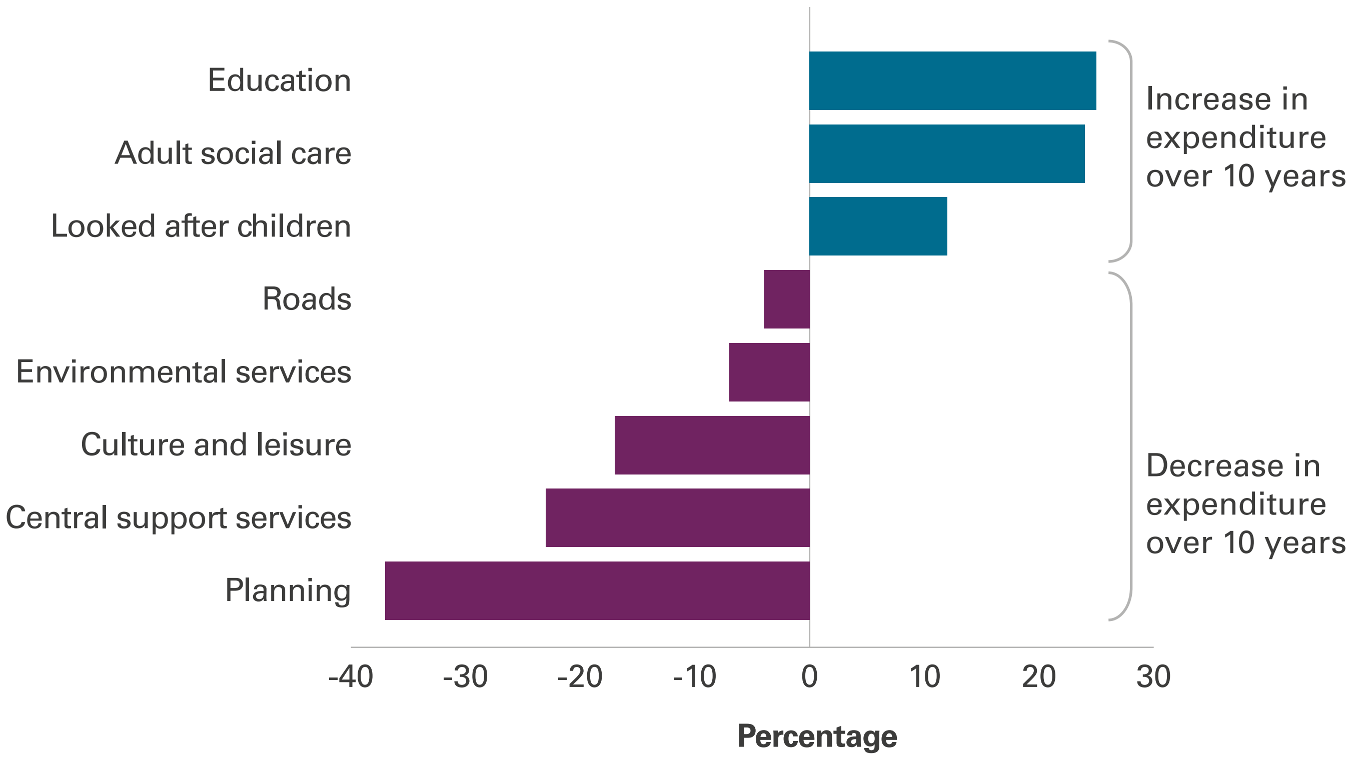
Source: Scottish Government budget documents (spring revision) for 2014/15 to 2022/23 and actual figures for 2013/14 (from 02/2014 circular) as budget documents were not available

77. Specific revenue grants have increased by over 500 per cent (£663 million) across the same period in real terms (although there was a reduction in 2022/23). This significant increase has been a key contributory factor in keeping the overall local government budget at a similar level. These grants are to support the delivery of specific national policies, for example the expansion of early learning and childcare, rather than provision of flexible funding for councils to use at their discretion.

As demand for council services continues to rise, councils have reduced spending on 'unprotected' services to balance budgets

78. As we reported in our Local government in Scotland: Overview 2023 report in May 2023, over the last decade, there is a clear divergent pattern of spending on council services. Spending on children's services (education and looked after children) and adult social care has been protected and increased because of increased demand and national policy directives. This means that the remaining 'unprotected' services have borne a disproportionate level of spending reductions (Exhibit 17).

Exhibit 17.
Percentage change in expenditure (in real terms) over ten years, 2012/13 to 2021/22



Source: Improvement Service

Councils' medium- and longer-term financial plans demonstrate a clear recognition of the significant financial challenges that lie ahead

79. Councils' medium- and longer-term financial plans provide a clear picture of the challenging and volatile financial landscape that they face. Significant pressures resulting from increased demand for services, inflation, and legislative reform, as well as the continuing financial impacts of the Covid-19 pandemic and cost of living crisis, feature strongly.

80. Generally, these plans also set out projected budget gaps over the medium and longer term, highlighting the scale of the challenge and the level of savings required to continue to deliver balanced budgets in the years ahead.

81. As the whole public sector faces the most difficult financial outlook seen for many years, councils are having to make increasingly difficult choices about their spending priorities and need to balance short-term pressures with robust planning for long-term financial sustainability.

Some councils use indicators to assess their financial resilience but the extent to which they are used and their effectiveness varies

82. From a sample of 30 councils, an assessment of financial resilience arrangements found all but five use the **financial sustainability indicators** from the local government benchmarking framework (LGBF) in local reporting. Of the same sample, only six use the CIPFA Resilience Index. The extent of this reporting also varies. Some councils provide regular reports to elected members, while others include detail on a less frequent basis in other documents, such as service plans or strategies.

83. Auditor returns indicated that in some cases, financial resilience indicators are not used to any great extent by councils on a regular basis. Financial resilience is instead built into day-to-day financial processes and strategies. In other cases, auditors highlighted the use of key financial ratios recommended by CIPFA Directors of Finance within the management commentary of the accounts or reporting upon financial resilience monitoring in their medium-term financial plans.

Financial sustainability indicators are a helpful tool for councils to measure performance and resilience on an ongoing basis. Councils have adopted different approaches to how they use indicators to monitor financial resilience.

Recommendation

Given the scale of the challenges, councils should strengthen their monitoring and reporting of financial resilience including clearer and more public-facing use of performance against financial resilience indicators and measures. Financial resilience indicators should be a component of councils' medium- and longer-term financial plans to provide assurance that they are balancing short-term pressures with robust planning for long-term financial sustainability.

The pensions' triennial funding valuation as at 31 March 2023 is not yet complete, but preliminary results suggest a potential positive impact on finances at some councils in the short term

84. The most recent triennial funding valuation took place across Local Government Pension Scheme pension funds at 31 March 2023. The main purpose of the valuation is to review the financial position of each fund and to set appropriate contribution rates for each employer for the upcoming three-year period as part of the fund's overall funding strategy.

85. Preliminary results across some pension funds show an improved funding position. An improved funding position may allow the fund to retain a surplus, change the investment strategy, take less funding risks, or reduce employer contributions.

86. Reducing employer contributions has the potential to create a 'windfall' effect for some councils, thus potentially reducing some of the cost pressures likely to be faced in 2023/24. This may allow councils some additional flexibility to manage immediate financial pressures while taking steps to enhance financial sustainability over the longer term. This will however require careful consideration at a local level. It is likely that auditors will monitor this closely as part of 2023/24 audits.

The Verity House Agreement and looking to the future

87. In June 2023, a new partnership agreement, the Verity House Agreement, was agreed between the Scottish Government and COSLA.

88. The partnership committed to:

- **From June 2023, a default position of no ring-fencing or direction of funding unless there is a mutual understanding of the reasons for a ring-fenced funding arrangement.** A reduction in the level of ring-fencing is likely to have a positive impact on the efficient and effective use of resources at a local level. Councils will experience increased local flexibility, providing greater scope to respond well to local needs in a targeted manner. However, good accountability for the use of public funds remains crucial. It is important therefore that the Scottish Government and COSLA work together to establish the right balance between direction and flexibility.
- **By the end of October 2023, undertake a joint review of specific grants and in-year transfers to local government.** The purpose of the review is to identify what funding can be baselined into the General Revenue Grant or General Capital Grant from the 2024/25 financial year to create more flexibility for councils in terms of their spending.
- **By the end of September 2023, agree a new fiscal framework which will govern the allocation of funding for local authorities and provide councils with increased control over their budget-setting processes. This includes multi-year settlements wherever possible to support strategic planning and investment.** The Accounts Commission has previously highlighted the importance of longer-term certainty in funding for councils, and the ongoing need for effective and robust financial management. This commitment in the Verity House Agreement is a welcome development.

89. Work in these areas remains ongoing, although at mid-December 2023 these milestones had not been met.

Recommendation

Councils should work with the Scottish Government to build momentum and accelerate progress in the development of a fiscal framework for local government to enhance the clarity and certainty of budgets for councils in future years.

90. In October 2023, the First Minister unexpectedly announced a council tax freeze for 2024/25 and the postponement of Scottish Government proposals to increase the council tax multipliers for properties in bands E to H, by 7.5 per cent, 12.5 per cent, 17.5 per cent and 22.5 per cent. This was done without consultation with COSLA. Following greater reliance on increasing council tax to help deliver a balanced budget over the past two years, indications were that many councils were planning to increase council tax again for 2024/25.

91. The Fraser of Allander Institute modelled that 'if councils were planning increases that mirrored last year's (5.4 per cent), fully funding the freeze and cancellation of the multipliers would cost £329 million – £148 million for the former and £182 million for the latter'.

92. In the Scottish Budget on 19 December 2023, £144 million was allocated to 'fully fund' the council tax freeze, with the Scottish Government stating this is equivalent to a five per cent increase. Details on what this means for individual councils were not available at this time.

93. The impact of the freeze on councils' financial sustainability is not yet known and we will monitor this in our future audit work. However, even when 'fully funded' a council tax freeze suppresses the growth of the council tax base over that period and the income generated when the freeze is lifted is potentially lower than if councils were able to make tax raising decisions at a local level. The latest council tax freeze follows decisions by the Scottish Government to freeze council tax between 2008/09 and 2016/17 and in 2021/22, as well as cap increases at three per cent in 2017/18 and 2018/19.

94. The Scottish Government published their single year 2024/25 budget on 19 December 2023. The 2024/25 initial core revenue and capital settlement for local government is £12.3 billion which is a 1.7 per cent cash increase on the 2023/24 initial settlement. An additional £144 million has been allocated to fund the council tax freeze. A number of elements that were previously specific grants have been baselined into the general revenue grant including early learning and childcare expansion and the Living Wage funding. We will examine the implications of the Scottish Budget for councils' own budget setting in a budget briefing in spring 2024.

Local government in Scotland

Financial bulletin 2022/23

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