Agenda

Audit Committee

Date:	Thursday, 20 November 2014 at 6:15 pm
Venue:	Town Hall, St Annes, FY8 1LW
Committee members:	Councillor John Singleton JP (Chairman) Councillor Brenda Ackers (Vice-Chairman) Councillors Ben Aitken, Christine Akeroyd, Leonard Davies, Howard Henshaw, Ken Hopwood, Linda Nulty, Louis Rigby

Contact: Katharine McDonnell – Telephone: (01253) 658423 – Email: katharine.mcdonnell@fylde.gov.uk

The code of conduct for members can be found in the council's constitution at www.fylde.gov.uk/council-and-democracy/constitution

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Minutes

Audit Committee

Date:	Thursday, 25 September 2014
Venue:	Town Hall, St Annes
Committee members:	Councillor John Singleton JP (Chairman) Councillors Brenda Ackers, Ben Aitken, Leonard Davies, Tony Ford, Ken Hopwood, Linda Nulty and Louis Rigby
Officers:	Tracy Morrison, Paul Swindells, Savile Sykes, Andrew Wilsdon and Katharine McDonnell

1. Declarations of interest

Members were reminded that any disclosable pecuniary interests should be declared as required by the Localism Act 2011 and any personal or prejudicial interests should be declared as required by the Council's Code of Conduct for Members. There were none on this occasion.

2. Confirmation of minutes

RESOLVED: To approve the minutes of the Audit Committee meeting held on 26 June 2014 as a correct record for signature by the Chairman.

3. Substitute members

The following substitution was reported under Council procedure rule 23(c):

Councillor Tony Ford for Councillor Howard Henshaw.

4. Annual Statement of Accounts

Paul Swindells (Deputy Section 151 Officer) presented the Annual Statement of Accounts for 2013/2014.

Mr Swindells advised that the item before the Committee was the post audit statement of accounts, which had a number of changes from the document that members had looked at in detail at the workshop in July. The changes were presentational in nature and did not affect the financial position of the Council.

He drew members' attention to the Explanatory Foreword section of the Statement of Accounts and in particular to the level of non-earmarked General Fund Reserves as at 31 March 2014 of £5.089m as shown in table 6 of that section. He referred to the key revenue risks to the Council's finances, an analysis of which was included as part of each Financial Forecast update, and to the Section 151

Officer's certification that the Council's finances remain robust despite constant pressure. Mr Swindells concluded by drawing the Committee's attention to the unqualified opinion offered by the Council's external auditors, KPMG, and recommended the statement of accounts to the Committee.

In response to a question from Committee regarding a deficit from car park enforcement, Mr Swindells undertook to get a response regarding arrangements for car park enforcement from Mr Loynd (Principal Car Parking and Energy Officer).

Members of the Committee commented on the usefulness of the workshop arranged by the Section 151 Officer, which enabled the Committee to go through the Statement of Accounts in detail and have their many questions answered.

It was RESOLVED

1. To approve the Statement of Accounts for 2013/2014, and
2. That the Audit Committee, on behalf of the Council, thanked the Finance team for all their hard work in the production of a timely and robust set of accounts that provided an accurate and true position of the Council's finances.

5. Report to those Charged with Governance (ISA 260) 2013/2014

Keith Illingworth (KPMG) presented the annual Report to those Charged with Governance (ISA260) 2013/2014. He explained that it summarised the key issues identified during the audit of the Council's financial statements and KPMG's assessment of the Council's arrangements to secure value for money in its use of resources.

Mr Illingworth explained that KPMG provided an unqualified opinion that the Council had secured economy, efficiency and effectiveness, and had complied with all legal and regulatory frameworks in regard to its accounting arrangements.

The Committee asked a number of questions regarding a misstatement on the statement of accounts and IT audit. Mr Illingworth advised that the misstatement was a presentational error that had been corrected on the final statement of accounts and had a nil effect on the budget. In regards to the questions regarding IT, Mr Illingworth advised that the requirements of the audit had changed and there was no longer a requirement to audit the wider IT provisions, but merely those IT systems necessary for financial processes. He advised that those systems had an unqualified opinion.

It was therefore RESOLVED

1. To note the Report to those Charged with Governance (ISA) 260 for 2013/2014
2. To thank the external auditors, KPMG, for their work, and
3. To note the work of the Council over 2013/2014 which had resulted in a positive audit opinion of the Council's effectiveness.

6. Management Representation Letter 2013/2014

Paul Swindells (Deputy Section 151 Officer) presented the management response letter. Mr Swindells explained that the Council was required to make a formal statement to the external auditors (KPMG) confirming that the Council had acted properly, with due regard to all regulations and guidance in the preparation of the accounts.

He advised that the statement was for Committee's approval and for the signature of the Chairman.

It was RESOLVED to agree that the Management Representation Letter be signed by the Chief Financial Officer and the Chairman of the Audit Committee, and then be provided to KPMG.

7. <u>Review of the Effectiveness of Internal Audit</u>

Savile Sykes (Head of Internal Audit) presented a report of the findings of a self-assessment exercise conducted by the Head of Internal Audit and endorsed by the Section 151 Officer, regarding the effectiveness of Internal Audit and the compliance with Public Sector Internal Audit Standards (PSIAS).

He advised that the purpose of the self-assessment was to ensure that the opinion of the Head of Internal Audit issued for the annual audit report could be relied upon as a source of evidence for the Annual Governance Statement.

Arising from the self-assessment were a small number of actions, Mr Sykes advised that an Improvement Action Plan had been drawn up to ensure these were attended to in a timely manner.

It was RESOVLED

1. To note the findings of the review on the effectiveness of internal audit and to confirm the conclusion of the Head of Internal Audit that there was substantial compliance with the Public Sector Internal Audit Standards, and
2. To approve enhancements to internal audit arrangements, as outlined in the Improvement Plan, and
3. To bring an update of the Improvement Action Plan to a future meeting of the Audit Committee, for review.

8. <u>Quality Assurance and Improvement Programme</u>

Savile Sykes (Head of Internal Audit) presented an explanation of the Quality Assurance and Improvement Programme (QAIP). He explained that the QAIP was to provide assurance that Internal Audit was performing in accordance with its Charter, was operating consistently and effectively with the Public Sector Internal Audit Standards (PSIAS). He further explained that the QAIP assessments were both ongoing and periodic. In addition an external assessment must be undertaken by external assessor every five years.

Mr Sykes advised that results of the QAIP assessments would be communicated to the Audit Committee on a regular basis.

Following discussion the committee RESOLVED to note that the Quality Assurance and Improvement Programme (QAIP) covered all aspects of internal audit activity.

9. <u>Risk Management Update Report</u>

Andrew Wilsdon (Risk and Emergency Planning Officer) presented updates on the current position regarding the Local Plan Risk Action Plan, and progress on the implementation of the recommendations of the internal audit action plan on Business Continuity

Mr Wilsdon advised that the Risk Action Plan for the Local Plan had not been produced. He explained that following the release of new population data from the Office for National Statistics, the Department of Communities and Local Government was anticipated to revise household projections. These new figures and expected household revisions would impact on the Strategic Housing Market Assessment (SHMA). In preparation for the anticipated revision, Blackpool, Fylde and Wyre Councils had re-engaged the consultants who had undertaken the SHMA initially. This work was expected to be concluded by the end of September 2014.

He further explained that the SHMA was fundamental to a sound Local Plan, and until the work was complete, work on a preferred option could not proceed.

In regards to the Risk Management Action Plan concerned with business continuity, Mr Wilsdon provided an update on the current position. He advised that the seven medium priority tasks scheduled to be completed by the end of July 2014 had been successfully completed. One of two high priority actions due to be completed by the end of September, had been completed, the remaining action was on target for completion at the end of the month. In addition, he advised there were no actions overdue and work was underway to ensure that the two high, five medium and two low priority actions, due for completion by the end of December 2014, would be completed on time.

Following discussion it was RESOLVED

(1) To note the latest position regarding the Local Plan; and

(2) To note the update on the audit action plan for Business Continuity.

10. Regulation of Investigatory Powers Act 2000: Authorisations

The Committee was presented with the quarterly report on the Regulation of Investigatory Powers Act 2000: Authorisations. It was noted that for the quarter to June-September 2014, there were no authorised operations.

It was RESOLVED that the Committee note the information in the report.

11. Protocol for Members on Outside Bodies

Tracy Morrison (Director of Resources) presented an overview of the effectiveness of, and compliance with, the Protocol for Members serving on Outside Bodies.

Ms Morrison spoke briefly regarding the Protocol, its guidance for members and the reporting mechanism for those serving on outside bodies. She advised that the reporting had been undertaken in the early part of 2014, with the complete set of reports emailed to all councillors for information at the beginning of July 2014.

The Committee discussed the reports, the reporting form and the information shared on the reporting forms. Members of the Committee expressed concern that the reports were not returned in a timely manner and that the information shared was inconsistent.

Some members of the Committee, who also served on Outside Bodies, commented that the reporting form was difficult to complete and could perhaps be reviewed to ensure that better quality information was captured.

After a detailed discussion, it was RESOLVED

1. To note the report
2. That the concerns of Audit Committee regarding the robustness, timeliness and quality of the reports, submitted by the Council's representatives on outside bodies, be formally brought to the attention of their respective group leaders at the earliest opportunity, and
3. That the Group leaders be asked to consider forming a working group comprising of members on outside bodies, to review the reporting form, with a view to making the reports more robust and the form easier to complete.

REPORT

REPORT OF	MEETING	DATE
FINANCE	AUDIT COMMITTEE	20 NOVEMBER 2014

ANNUAL AUDIT LETTER 2013/14

PUBLIC ITEM

This item is for consideration in the public part of the meeting.

SUMMARY

The Committee is requested to consider the contents of the Annual Audit Letter issued by the Council's external auditors, KPMG for the financial year 2013/14. The Audit Letter details the auditor's opinion on the Council's performance and financial management. The opinion of KPMG is also provided on the Council's preparation of its financial statements. The report will be presented by KPMG.

RECOMMENDATIONS

The Audit Committee is asked to note the content of the Annual Audit Letter and are invited to make any comments.

CABINET PORTFOLIO

This item falls within the following cabinet portfolio(s):

Finance and Resources - Councillor Karen Buckley

SUMMARY OF PREVIOUS DECISIONS

The Annual Audit Letter from the Council's external auditors is considered each year by Audit Committee.

REPORT

1.1 The Audit letter is produced each year by the Council's external auditors upon conclusion of the audit in respect of the prior financial year. The judgements contained within the Audit Letter are based upon inspection activity which has been undertaken as part of the audit.

1.2 Commentary is provided within the letter about the external auditor's opinion on the Council's financial statements and arrangements for securing value for money. In arriving at their conclusions, the auditors considered financial governance, financial planning and control processes, and how the Council is prioritising resources and seeking to improve efficiency and productivity.

1.3 A copy of the Annual Audit Letter for 2013/14 is attached.

CONCLUSION

1.4 The Audit Committee is asked to note the content of the Annual Audit and are invited to make any comments for referral to, and consideration by, Cabinet.

IMPLICATIONS	
Finance	Implications are detailed within the body of the Audit Letter.
Legal	Implications are detailed within the body of the Audit Letter.
Community Safety	None arising from this report
Human Rights and Equalities	None arising from this report
Sustainability and Environmental Impact	None arising from this report
Health & Safety and Risk Management	None arising from this report

REPORT AUTHOR	TEL	DATE	DOC ID
Paul O'Donoghue Section 151 Officer	01253 658566	October 2014	

LIST OF BACKGROUND PAPERS		
Name of document	Date	Where available for inspection
None		

Attached documents

1. Annual Audit Letter 2013/14

KPMG

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Annual Audit Letter 2013/14

Fylde Borough Council

October 2014

Contents

The contacts at KPMG in connection with this report are:

Tim Cutler
Partner
KPMG LLP (UK)

Tel: 0161 2464774
tim.cutler@kpmg.co.uk

Jillian Burrows
Senior Manager
KPMG LLP (UK)

Tel: 0161 2464705
jillian.burrows@kpmg.co.uk

Keith Illingworth
Assistant Manager
KPMG LLP (UK)

Tel: 0113 231
keith.illingworth@kpmg.co.uk

This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission has issued a document entitled *Statement of Responsibilities of Auditors and Audited Bodies*. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw your attention to this document which is available on the Audit Commission's website at www.auditcommission.gov.uk.

External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Tim Cutler, the appointed engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees on 0161 246 4000, or by email to trevor.rees@kpmg.co.uk, who is the national contact partner for all of KPMG's work with the Audit Commission. After this, if you are still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure. Put your complaint in writing to the Complaints Unit Manager, Audit Commission, 3rd Floor, Fry Building, 2 Marsham Street, London, SW1P 4DF or by email to complaints@audit-commission.gsi.gov.uk. Their telephone number is 0303 4448 330.

Headlines

This report summarises the key findings from our 2013/14 audit of Fylde Borough Council (the Authority).

Although this letter is addressed to the Members of the Authority, it is also intended to communicate these issues to key external stakeholders, including members of the public.

Our audit covers the audit of the Authority's 2013/14 financial statements and the 2013/14 VFM conclusion.

VFM conclusion	We issued an unqualified conclusion on the Authority's arrangements to secure value for money (VFM conclusion) for 2013/14 on 29 September 2014. This means we are satisfied that you have proper arrangements for securing financial resilience and challenging how you secure economy, efficiency and effectiveness. To arrive at our conclusion we looked at your financial governance, financial planning and financial control processes, as well as how you are prioritising resources and improving efficiency and productivity.
Audit opinion	We issued an unqualified opinion on your financial statements on 29 September 2014. This means that we believe the financial statements give a true and fair view of the financial position of the Authority and of its expenditure and income for the year.
Financial statements audit	As a result of our audit work, we identified one material misstatement. This was due to the NNDR tariff (the tariff being the sum that the Authority pays over to Central Government from it's share of retained business rates) being shown gross on the face of the Comprehensive Income and Expenditure Statement, when it should be shown net. The effect of this misstatement was to overstate both income and expenditure by £7.9m, so the net impact on total comprehensive income and expenditure is nil. All of the non-material audit differences we identified were also adjusted by management. The most significant of these was the NNDR appeals provision for £486k which had been incorrectly included within the short term debtors balance on the balance sheet instead of provisions. Two audit issues were identified which have been communicated to management. One of these was medium priority and the other was low priority, and are as follows: ■ The Authority used an expert to estimate the level of it's NNDR appeals provision. Where such experts are used, the Authority should ensure that the methodology is fully understood and that it can obtain sufficient evidence to support the balance. ■ Due to the small accountancy team at the Authority, there was a lack of segregation of duties in the raising and approval of journals. The Authority has put new arrangements in place to ensure all journals are reviewed at weekly and monthly intervals by more senior officers.
Annual Governance Statement	We reviewed your *Annual Governance Statement* and concluded that it was consistent with our understanding.

Headlines (continued)

All the issues in this letter have been previously reported. The detailed findings are contained in the reports we have listed in Appendix 1.

Whole of Government Accounts	We reviewed the consolidation pack which the Authority prepared to support the production of Whole of Government Accounts by HM Treasury. As the Authority is below the audit threshold, we are not required to undertake a full review of the consolidation pack, but we do confirm that the pension liabilities and property, plant and equipment disclosures within the Authority's pack are consistent with the audited financial statements .
High priority recommendations	We raised no high priority recommendations as a result of our 2013/14 audit work. The medium priority recommendation and low priority recommendation we made have been outlined on page 2.
Certificate	We issued our certificate on 29 September 2014. The certificate confirms that we have concluded the audit for 2013/14 in accordance with the requirements of the *Audit Commission Act 1998* and the Audit Commission's *Code of Audit Practice*.
Audit fee	Our fee for 2013/14 was £63,600, excluding VAT. This is £900 more than the planned fee for the year. Further detail is contained in Appendix 2.

Appendix 1: Summary of reports issued

This appendix summarises the reports we issued since our last *Annual Audit Letter*.

2014

January

February

March

April

May

June

July

August

September

October

November

External Audit Plan (January 2014)

The *External Audit Plan* set out our approach to the audit of the Authority's financial statements and to work to support the VFM conclusion.

Certification of Grants and Returns (4 February 2014)

This report summarised the outcome of our certification work on the Authority's 2012/13 grants and returns.

Audit Fee Letter (April 2014)

The *Audit Fee Letter* set out the proposed audit work and draft fee for the 2014/15 financial year.

Report to Those Charged with Governance (25 September 2014)

The *Report to Those Charged with Governance* summarised the results of our audit work for 2013/14 including key issues and recommendations raised as a result of our observations.

We also provided the mandatory declarations required under auditing standards as part of this report.

Auditor's Report (29 September 2014)

The *Auditor's Report* included our audit opinion on the financial statements, our VFM conclusion and our certificate.

Annual Audit Letter (October 2014)

This *Annual Audit Letter* provides a summary of the results of our audit for 2013/14.

Appendix 2: Audit fees

This appendix provides information on our final fees for 2013/14.

To ensure openness between KPMG and your Audit Committee about the extent of our fee relationship with you, we have summarised the outturn against the 2013/14 planned audit fee.

External audit

Our final fee for the 2013/14 audit of the Authority was £63,600. This compares to a planned fee of £62,700. The reasons for this variance are:

- an increased fee for the audit of the financial statements reflecting additional costs incurred in carrying out the final accounts audit of £900 over and above our initial estimate as at April 2013. This is due to additional work we needed to undertake in relation to the collection fund balances because we are no longer required to certify the NNDR return. This is a national issue which is currently being considered as part of the 2014/15 fee consultation.

Our fees are still subject to final determination by the Audit Commission.

Certification of grants and returns

Our grants work is still ongoing and the fee will be confirmed through our report on the *Certification of Grants and Returns 2013/14* which we are due to issue in January 2015.

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REPORT

REPORT OF	MEETING	DATE
FINANCE	AUDIT COMMITTEE	20 NOVEMBER 2014

MID YEAR PRUDENTIAL INDICATORS AND TREASURY MANAGEMENT MONITORING REPORT 2014/15

PUBLIC ITEM

This item is for consideration in the public part of the meeting.

SUMMARY

This report is a mid-year Prudential Indicators and Treasury Management monitoring report for Audit Committee to scrutinise in line with the recommendations of CIPFA (Chartered Institute of Public Finance Accountants) Code of Practice on Treasury Management 2011.

RECOMMENDATIONS

1. The Audit Committee is recommended to scrutinise the Mid-Year Prudential Indicators and Treasury Management monitoring report and;

2. To recommend the following changes to Council:-
   - That the revised Investment Strategy, including the amendment to the Strategy to allow investment in banks and building societies rated BBB+ or above for short periods of time as described at section 5 of this report, be approved;
   - That the revised Prudential Indicators and Limits in Appendix B of this report be approved.

CABINET PORTFOLIO

This item falls within the following cabinet portfolio:

Finance and Resources - Councillor Karen Buckley.

SUMMARY OF PREVIOUS DECISIONS

Council approved the 2014-15 to 2016-17 Treasury Management Strategy & Prudential Indicators at its meeting of 3rd March 2014.

REPORT

1. Introduction

The Code of Practice on Treasury Management requires the Council to receive a Mid-Year Treasury Review report in addition to the forward-looking Annual Treasury Strategy and the backward-looking Annual Treasury Report.

The Mid-Year Treasury Review report has been prepared in compliance with the Code of Practice. The Code of Practice requires Members to receive reports and scrutinise the Treasury Management function.

In order to assist with the terminology and explanations that are included within this report Appendix A sets out a Glossary of Treasury Terms and a number of Treasury Management and Prudential Indicators Frequently Asked Questions.

2. Economic Update

2.1 Economic Background

The UK economic recovery has continued and appears to be sustainable. Gross Domestic Product (GDP) has grown by an average of 0.8% since the middle of 2013. The recovery is still largely driven by household consumption, but the continued rise in employment makes this position less of a concern in the short term. Business investment is recovering and should support continued GDP growth.

Inflationary pressure is currently low and is likely to remain so in the short-term. The annual rate of CPI (Consumer Prices Index) inflation fell to 1.2% in the 12 months to September 2014.

There was no change to UK monetary policy with official interest rates being maintained at 0.5%. The Monetary Policy Committee (MPC) remains concerned about the sensitivity of the UK economy to a rise in Bank Rate. The MPC's focus is on the amount of spare capacity in the economy.

The Bank of England announced a range of measure to cool the UK's housing market including tighter stress testing of mortgage applications and a cap on the number of mortgages at more than 4.5 times the borrower's income.

Eurozone inflation continued to fall towards zero and the limited recovery is losing pace. The EU unemployment rate is high at 11.5%. This compares to an unemployment rate for the UK as at July 2014 of 6.2%, the lowest level since the 2008 financial crisis. The European Central Bank has lowered its interest rate from 0.15% to 0.05%. The Bank of England Monetary Policy Committee noted that weakness in the euro area could lead to uncertainty, damage confidence and disrupt financial markets.

2.2 Economic Outlook for 2014/15

The growth in the level of consumer spending is expected to slow later this year, alongside a softening of housing market activity. The first rise in Bank Rate is forecast to be in the quarter July to September 2015, with the pace of any further increases being slow and gradual.

2.3 Interest Rate Forecast

The latest forecast for interest rates from the Council's Treasury Advisors, Arlingclose, is shown in table 1 below.

Table 1: Interest Rate Forecast from Arlingclose

Quarter Ending	Bank Rate %	Investment Rates		Borrowing Rates		
		3 month %	1 year	5 year	20 year	50 year
Dec 2014	0.50	0.55	0.95	2.50	3.70	3.80
Mar 2015	0.50	0.60	1.00	2.55	3.75	3.85
Jun 2015	0.50	0.65	1.05	2.70	3.85	3.90
Sep 2015	0.75	0.85	1.20	2.80	3.90	3.95
Dec 2015	0.75	1.00	1.35	2.90	3.95	4.00
Mar 2016	1.00	1.15	1.50	3.00	4.00	4.05
Jun 2016	1.00	1.30	1.65	3.10	4.05	4.10
Sep 2016	1.25	1.45	1.80	3.20	4.10	4.15
Dec 2016	1.25	1.60	1.95	3.30	4.15	4.20
Mar 2017	1.50	1.75	2.10	3.40	4.20	4.25
Jun 2017	1.50	1.85	2.20	3.50	4.25	4.30

3. Debt Management

The Council currently has long-term debt of £3.8M at an average rate of 2.856%. No additional external borrowing has taken place during the current financial year.

The Council has a requirement to fund a further £3.0M in 2014/15 (the £6.8M Capital Financing Requirement, or CFR, less £3.8M already borrowed) based on Prudential Borrowing that has been approved as part of the Capital Programme. The CFR of £6.8M (See Appendix B Table 2) includes this Prudential Borrowing. Currently this is being funded by the Council's cash flow, i.e. internal borrowing, and it is expected that internal borrowing will continue to be used for the rest of the financial year in line with advice from the Council's Treasury Advisors.

On 14th December 2014 £1.5M of external debt (PWLB loan) will be repaid, reducing the total level of external borrowing from £3.8M to £2.3M.

The use of internal resources in lieu of borrowing, i.e. internal borrowing, has continued to be the most cost effective means of funding capital expenditure. Following the repayment of £1.5M of debt on 14th December 2014, internal borrowing of £4.5M will be used to fund the Capital Programme in 2014/15. Using internal borrowing lowers the overall treasury risk by reducing both external debt and temporary investments. However, this position will not be sustainable over the medium term. Consequently, external borrowing options and the timing of such borrowing will continue to be assessed in conjunction with the Council's Treasury Advisors.

The Council has recently been advised that it has qualified for borrowing at the 'Certainty Rate' (0.20% below the PWLB standard rate) for a further 12 month period (from 1st November 2014) having earlier qualified for the period from November 2013 to October 2014.

4. Investment Activity

The guidance on Local Government Investments in England give priority to security and liquidity and the Council's aim is to achieve a yield commensurate with these principles.

The security of capital has remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in the Investment Strategy for 2014/15 approved by Council on 3rd March 2014.

The Council held £15.9M of investments as at 30th September 2014. These investments represent the Council's surplus cash flow at the mid-year point. The balance of cash is likely to reduce during the remainder of the financial year.

The UK Bank Rate has been maintained at 0.5% since March 2009 and it is not expected to rise until 2015/16. Short-term money market rates have remained at very low levels. Deposits have been made at an average rate of 0.35% in line with the benchmark return of 0.35%. The Council's budgeted investment return for 2014/15 is £0.026m, and performance for the first half of the year is in line with the revised budget.

5. Banking Reform Legislation and Revised Investment Strategy

In April 2014 the European Parliament adopted the Bank Recovery and Resolution Directive which sets out new rules for all Member States and puts an end to bank bail-outs. The Directive will be introduced on the 1st January 2015 and aims to ensure that a failing bank or financial institution can be rescued quickly with minimal risk to wider financial stability. The shareholders and creditors of a failing bank will bear the cost of the bank's failure rather than taxpayers.

The European Parliament has also approved a revised Deposit Guarantee Schemes Directive in April 2014 which will affect the UK's Financial Service's Compensation Scheme from July 2015. At present, individuals with investments of up to £85,000 are protected from loss. This protection is being extended to include all non-financial private sector organisations. This change affects how Local Authorities are ranked as creditors in the event of a banking failure. The legislation states that central, regional, local governments and money market funds are not protected from bail-in as it is expected that Public Authorities have much better access to credit than citizens. Many depositors (such as corporate and retail customers) will rank above the Council in the event of a bail-in (A bail-in takes place before bankruptcy and under current proposals, certain types of depositors would suffer a reduction in the amount of their deposit that would be returned to them whilst other classes of investor would not). This will mean that the Council's deposits are at risk of a larger loss if bailed-in when a bank fails as illustrated in Appendix C. **The risk of a bank failing remains unchanged, but the amount of loss that the Council would incur increases as a consequence of these revised arrangements.**

In preparation for the implementation of the new Directive, credit rating agencies have stated that they plan to review the credit ratings of EU banks in this financial year. At present, the ratings of many UK banks are uplifted by the credit rating agencies to allow for potential government support in the event of a banking failure. Treasury Advisor's Arlingclose consider that there is a realistic risk that some major UK banks may have their credit ratings downgraded from A- to BBB. The Council's existing approved Investment Strategy permits investments to financial institutions with a credit rating of A- or above.

To respond to the risk that the Council's investment counterparties may have their credit ratings downgraded, the Council is asked to approve the following amendments to the Investment Strategy:

- Amend the Investment Strategy by adding authorisation to invest in BBB+ rated banks and building societies for short periods of time (see Table 2 below).

Table 2: Approved Investment Counterparties

Counterparty	Credit Rating	Time Limit	Cash Limit
Banks and other organisations and securities whose lowest published long-term credit rating from Fitch, Moody's and Standard & Poor's is:	BBB+	1 month	£1M per counterparty subject to a maximum of £3M in total to BBB+ rated institutions

The counterparty limit for banks and building societies that have a credit rating of A- and above will continue to be £2M per counterparty in line with the existing approved Investment Strategy.

The Council will always aim to invest in the highest-rated institutions as is possible.

6. Compliance with Prudential Indicators

The Council has complied with its Prudential Indicators for 2014/15, which were approved on 3rd March 2014 as part of the Council's Medium Term Financial Strategy Update, Including General Fund, Capital Programme and Treasury Management for 2014/15 to 2016/17.

Details of the Prudential Indicators can be found in Appendix B. As changes arise during the year some of the Prudential Indicators and Limits need to be revised.

7. Risk Assessment

Scrutiny of the revised Prudential Indicators and Limits and the subsequent recommendation of approval to the revisions by Audit Committee to Council helps to protect the Council from the risk of not having adequate liquidity or funding for the Council's capital plans.

Additionally, if this scrutiny process were absent the Council would not be compliant with the Council's approved Treasury Management Practices (as detailed in the Council Constitution) or CIPFA's Code of Practice on Treasury Management.

8. Conclusion

In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of the treasury management activity during the first half of 2014/15. As indicated in this report, none of the Prudential Indicators have been breached and a prudent approach has been taking in relation to investment activity with priority being given to security and liquidity over yield.

IMPLICATIONS	
Finance	Financial implications are contained within the body of the report.
Legal	This report secures the continued compliance with the Council's approved Treasury Management Practices (as detailed in the Council Constitution) and CIPFA's Code of Practice on Treasury Management.
Community Safety	None

Human Rights and Equalities	None
Sustainability and Environmental Impact	None
Health & Safety and Risk Management	None

REPORT AUTHOR	TEL	DATE	DOC ID
Paul O'Donoghue (Section 151 Officer)	(01253) 658566	October 2014	

LIST OF BACKGROUND PAPERS		
Name of document	Date	Where available for inspection
Medium Term Financial Strategy Update Including General Fund, Capital Programme & Treasury Management for 2013/14 – 2017/18	Council meeting 3rd March 2014	www.fylde.gov.uk

Attached documents

1. Appendix A – Glossary of Treasury Terms and Treasury Management and Prudential Indicators Frequently Asked Questions
2. Appendix B – Prudential Indicators
3. Appendix C – Impact of Banking Reform Changes

Appendix A

Glossary of Treasury Terms

Term	Description
Counterparty	Another party to an agreement.
Credit rating	A measure of the credit worthiness of an institution, corporation, or a country. Credit ratings are calculated from financial history and current assets and liabilities. Typically, a credit rating tells a lender or investor the probability of the counterparty being able to pay back a loan.
Liquidity	As assessment of how readily available an investment is. It is safer to invest in liquid assets because it is easier for an investor to get their money out of the investment.
Minimum Revenue Provision (MRP)	The minimum amount that the Council must charge to the accounts each year in order to meet the costs of repaying amounts borrowed.
Public Works Loan Board (PWLB)	PWLB is part of HM Treasury and lends money to local authorities.
Security	As assessment of the creditworthiness of a counterparty.
Treasury adviser	External consultancy firms that provide information to local authorities, including information regarding counterparty creditworthiness.
Bail-in	A bail-in takes place before bankruptcy and under current proposals, certain types of depositors would suffer a reduction in the amount of their deposit that would be returned to them whilst other classes of investor would not.

Treasury Management and Prudential Indicators Frequently Asked Questions

1. What is the difference between capital expenditure and capital financing requirement?

Capital Expenditure is defined as expenditure on the acquisition, creation or enhancement of tangible fixed assets, subject to a de minimis level of £10,000. It includes expenditure on land, buildings and vehicles.

The Capital Financing Requirement (CFR) is the level of total funding that is required to fund the capital programme. The actual level of external borrowing may be lower than the CFR as a consequence of the use of internal borrowing. Internal Borrowing occurs when the Council temporarily uses it's own cash resources to finance capital expenditure rather than arranging new external borrowing. This is a prudent approach when investment returns are low and counterparty risk is high.

2. What does the term 'financing' mean?

The term 'financing' does not refer to the payment of cash but the resources that will be applied to ensure that the capital payment amount is dealt with over the longer term. A number of financing options are available to Councils:-

- capital receipts (eg. sale of land or buildings)
- contribution from revenue expenditure
- capital grant
- contribution from a third party
- borrowing
- contribution from earmarked reserves

3. Does the Council link long term loans to particular capital assets/projects?

The Council does not directly associate loans with particular capital assets/projects, as it is not best practice. The Council will, at any point in time, have a number of cash flows both positive and negative and will be managing its position in terms of its borrowings and investments in accordance with its treasury management strategy and practices. This is best practice in line with the CIPFA Prudential Code.

4. What does the term 'net borrowing should not exceed the total of the CFR' mean?

Net borrowing will remain below the CFR to ensure that the Council is only borrowing for a capital purpose. The Council is permitted to borrow in advance for a capital purpose over the medium term. The term 'total of the CFR' is the CFR of the current year plus increases in the CFR of the previous financial year and next two financial years. In other words, the total of the Council's existing assets, plus additions to assets resulting from forecast Capital Programme expenditure, e.g. vehicles. This gives the Council some headroom to borrow early for a capital purpose in order to secure low interest rates.

5. Is the cash that is being managed in-house revenue or capital?

The short term surplus cash that is managed during the year in house may be revenue or capital, e.g. the Council may receive a capital receipt in April but capital expenditure is incurred throughout the year which gives rise to increased cash balances in the early part of the financial year which is invested short term by the in house treasury team. The Council receives Council Tax which is classed as revenue income. Council Tax income is typically received in the months of April to January as Council Tax payers make 10 instalments. Therefore, the Council has less cash in the months of February and March and may need to borrow cash short-term in line with the cash flow forecast.

6. What does the Council invest in?

The Council is restricted in where it can invest its surplus funds. The restrictions are prescribed by statute (Local Government Act 2003 section 15(1) (a)). Councils are also required to have regard to supplementary investment guidance provided by the Communities and Local Government.

The Council's investments are typically short term, i.e. less than a year, and are made in sterling with institutions with high credit ratings. Which is in accordance with the Treasury Management Strategy approved on the 3rd March 2014.

7. What is the role of internal and external auditors in respect of treasury management?

The focus of external auditors work is a Council's annual accounts and the financial management systems and processes that underpin them. The external audit will enquire as to whether the Treasury Management Code has been adopted and whether its principles and recommendations have been implemented and adhered to. External auditors cannot comment or advise on Council's treasury management strategy or policies

Through a process of review, the role of Internal Audit is to provide an opinion of the adequacy, application and reliability of the key internal controls put in place by management to ensure that the identified risks are sufficiently mitigated. This will assist Treasury Management in meeting its desired objectives and help to ensure that the risk of fraud and/or error is minimised. Internal Audit will also look to identify other areas of potential risk which could usefully be included as well as any inefficiencies in existing processes and procedures where improvements can be made. Treasury Management is one of the core financial systems and as such is audited on a cyclical basis.

8. What are the qualifications of Council staff involved in treasury management practices?

Staff are either working towards or have achieved professional accountancy qualifications from CIPFA (Charted Institute of Public Finance Accountants), ACCA (Association of Chartered Certified Accountants) or CIMA (Chartered Institute of Management Accountants). Staff work closely with Treasury Management Advisors and attend treasury training and updates provided by the Treasury Management Advisor

Appendix B

Prudential Indicators

1.1 Capital Expenditure

Table 1 shows the revised forecast capital expenditure as reported in the Quarter 2 Capital Programme Update as compared to the capital expenditure originally approved by Council.

Table 1 Forecast Capital Expenditure

Forecast Capital Expenditure	2014/15 Original Indicator £M	2014/15 Latest Estimate £M
Total	4.1	4.0

The above table shows the forecast capital expenditure on new projects. The minor reduction in the latest estimate is a consequence of re-phasing the accommodation project and slippage from 2013/14 into 2014/15.

1.2 Capital Financing Requirement (CFR)

Table 2 shows the CFR which is the total of all of the Council's capital assets (existing and planned) less all of the Council's capital reserves. This is the amount of capital expenditure that the Council has still to finance. The CFR is normally funded by external borrowing. The Council has borrowed £3.8M and will repay £1.5M of this debt on 14th December 2014 (see section 3 of report). After the £1.5M of debt has been repaid, there is a requirement to finance £4.5M from internal cash resources.

Table 2 Capital Financing Requirement (CFR)

	2014/15 Original Indicator £M	2014/15 Revised Indicator £M
Total CFR	6.8	6.8

The latest estimate of the CFR is in line with the original approved indicator.

1.3 Gross Borrowing

The Council needs to ensure that its total capital borrowing does not, except in the short term, exceed the total of the CFR. Table 3 below shows that the Council will be able to comply with this requirement.

There are no difficulties anticipated in keeping the long term capital borrowing below the CFR. Revenue borrowing may be incurred for short periods in line with cash flow requirements.

Table 3 Gross Borrowing

	2014/15 Original Indicator £M	2014/15 Revised Indicator £M
Gross Borrowing Indicator	6.8	3.8
Short Term Borrowing (Revenue)	0	0
Gross Borrowing (Capital)	**6.8**	**3.8**
CFR	**6.8**	**6.8**
Under Borrowing (Capital)	**0**	**3.0**

The Gross Borrowing Indicator has decreased as the Council is forecast to be able to fund the capital borrowing requirement with internal borrowing and does not expect to require new external borrowing during 2014/15, in line with advice from Treasury Advisors. The Under Borrowing (Capital) amount of £3.0M will increase to £4.5M after the repayment of £1.5M of debt on 14th December 2014.

1.4 Operational Boundary and Authorised Limit for External Debt

The Operational Boundary is based on the maximum external debt during the course of the year. It is not a limit and therefore may be exceeded on occasion.

The Authorised Limit for external debt represents the limit beyond which borrowing is prohibited, and is set and revised by Council. It reflects the level of borrowing which, in extreme circumstances, could be afforded in the short term. This is a statutory limit which should not be breached.

There were no breaches to the Authorised Limit and the Operational Boundary to 30th September 2014.

Table 4 Operational Boundary and Authorised Limit for External Debt

	2014/15 Original Indicator £M	2014/15 Revised Indicator £M	Note
Existing Capital Borrowing	6.8	3.8	1
Gross Borrowing Indicator	**6.8**	**3.8**	
Operational Boundary	**6.8**	**3.8**	1
Contingency	6.1	6.1	2
Authorised Limit	**12.9**	**9.9**	

Note

1. The Gross Borrowing Indicator and Operational Boundary have decreased as the Council is able to fund the capital borrowing requirement with internal borrowing and does not

expect to request new external borrowing during 2014/15, in line with advice from Treasury Advisors.

2. The Authorised Limit includes £6.1M for 'contingency' which is an amount that has been estimated to provide scope to undertake short-term borrowing in the event of a service delivery failure or emergency, e.g. a failure to collect council tax income.

1.5 Forecast Treasury Position

Table 5 shows the expected balances for investments and debt at 31st March 2015.

Table 5 Forecast Treasury Position

At 31st March	2014/15 Estimate £M	2014/15 Revised £M
Debt (Long-Term External Borrowing)	6.8	2.3
Investments	0	4.0

The Council has not undertaken any new external long-term borrowing as it is funding capital expenditure with internal borrowing (see Section 3 of the report).

1.6 Forecast Interest

Table 6 shows the impact on the revenue budget of interest payable and investment income.

Table 6 Forecast Interest

Revenue Budget	2014/15 Estimate £M	2014/15 Revised £M
Interest payable on Borrowing	0.22	0.10
Investment Income	0.03	0.04

The interest payable budget has been revised to incorporate the savings generated by using internal borrowing to fund capital expenditure.

1.7 Adoption of the CIPFA Treasury Management Code

The Council approved the adoption of the CIPFA Treasury Management Code at its meeting on 1st December 2003, and adopted the revised Code on 1st March 2010.

1.8 Limits on Interest Rate Exposure

These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates.

Table 7 Interest Rate Exposures

	2014/15 Original Indicator £M	2014/15 Revised Indicator £M
Limits on fixed rate debt	6.8	3.8
Limit on variable rate debt (50% of total debt)	3.4	1.9

The limits have decreased as the Council is able to fund the capital borrowing requirement with internal borrowing and does not expect to request new external borrowing during 2014/15.

1.9 Ratio of Financing Costs to Net Revenue Stream

This indicator identifies the trend in the financing cost (interest payable less interest receivable) as a percentage of the net revenue stream as shown in Table 8.

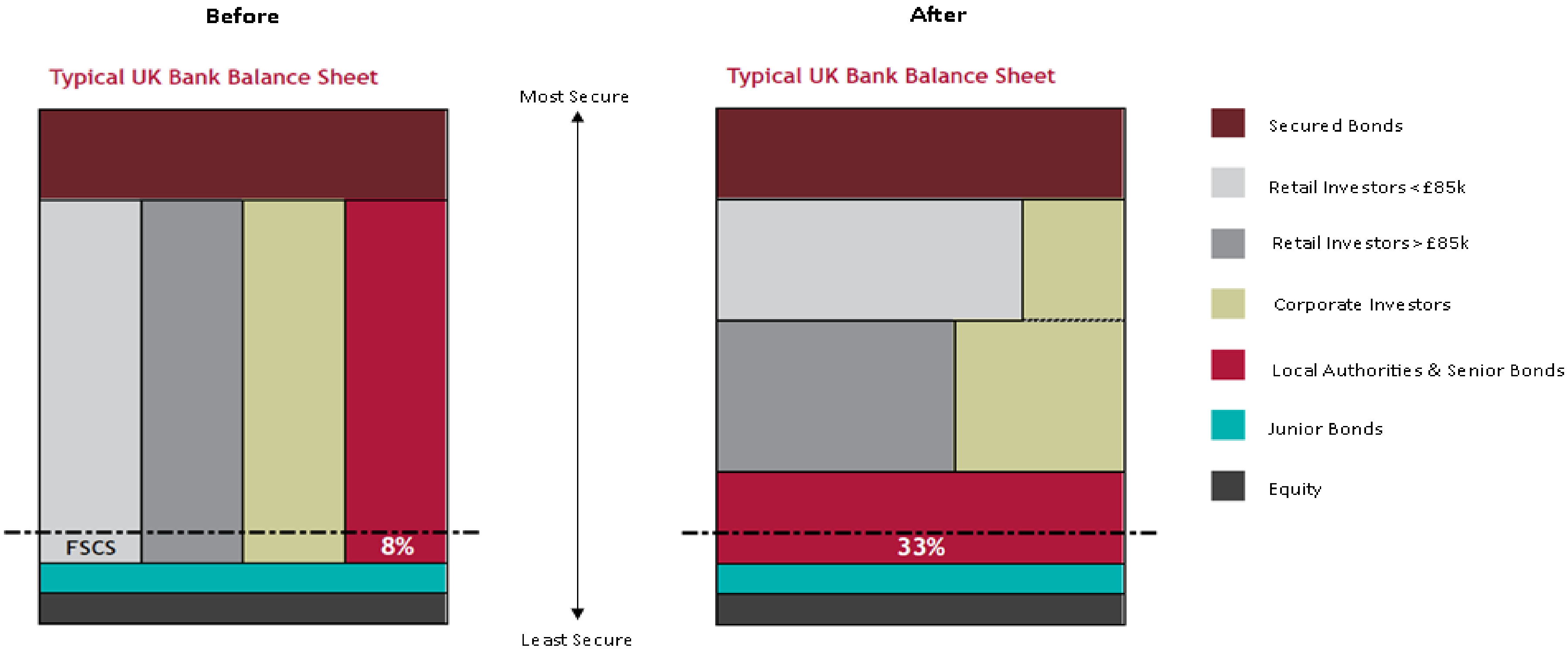
Table 8 Ratio of Financing Costs to Net Revenue Stream

	2014/15 Original Indicator	2014/15 Revised Indicator
Ratio	8.8%	7.5%

Financing costs are based on the amount of interest payable and receivable as a percentage of the total net revenue stream of the Council. The latest estimate is lower than the original estimate due to the current treasury strategy of internal borrowing rather than long-term external borrowing, which has reduced estimated debt interest charges.

Appendix C

Impact of Changes to the Banking Reform Legislation



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