Supplementary Committee Agenda

Epping Forest District Council

Audit & Governance Committee
Monday, 25th November, 2019

Place:	Council Chamber, Civic Offices, High Street, Epping
Time:	7.00 pm
Democratic Services:	Gary Woodhall Tel: 01992 564243 Email: democraticservices@eppingforestdc.gov.uk

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10.a TREASURY MANAGEMENT & PRUDENTIAL INDICATORS - MID-YEAR REPORT 2019/20 (Pages 129 - 142)

(Interim Strategic Director) To consider the attached report (AGC-011-2019/20).

10.b FINAL ACCOUNTS IMPROVEMENT PLAN (Pages 143 - 158)

(Interim Strategic Director) To consider the attached report (AGC-012-2019/20).

10.c UPDATE FROM THE EXTERNAL AUDITOR

(External Auditor) To receive a verbal update from the External Auditor on outstanding issues.

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Report to: Audit and Governance Committee

Report reference: AGC-011-2019/20
Date of meeting: 25 November 2019

Epping Forest District Council

Portfolio: **Business Services**

Subject: **Mid-Year Report on Treasury Management and Prudential Indicators 2018/19**

Responsible Officer: **Martin Hone (01992 562295).**

Democratic Services Officer: **Gary Woodhall (01992 564470).**

Recommendations/Decisions Required:

(1) To note how the risks associated with Treasury Management have been dealt with in the first half of 2019/20; and

(2) To make any comments or suggestions that Members feel necessary to the Finance and Performance Management Cabinet Committee.

Executive Summary:

The mid-year treasury report is a requirement of the CIPFA Code of Practice on Treasury Management. It covers the treasury activity for the first half of the financial year 2019/20.

During the first half of the year: the Council has continued to finance all capital expenditure from within internal resources; the average net investment position has been approximately £11.75m and there have been no breaches on any of the prudential indicators.

Reasons for Proposed Decision:

To inform the Committee about the risks associated with Treasury Management and how the Council has sought to manage these risks.

To comply with the Committee's role and responsibilities, which include being responsible for the scrutiny of the Council's Treasury Management Strategy, including consideration of mid financial year and outturn reports.

Other Options for Action:

Members could ask for additional information about the CIPFA Codes or the Prudential Indicators.

Report:

Introduction

1. The Council's treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management), which

includes the requirement for determining a treasury strategy on the likely financing and investment activity for the current year. The updated code in November 2011 also recommended that Members are informed of Treasury Management activities at least twice a year. This report therefore ensures this authority is embracing Best Practice in accordance with CIPFA's recommendations.

2. The report attached at appendix 1 shows the mid-year position of the treasury function in accordance with the revised CIPFA Treasury Management Code and the revised Prudential Code.

Capital activity for the year and how it will be financed

3. The Council undertakes capital expenditure on long-term assets. These activities may either be financed immediately through capital receipts, grants etc; or through borrowing.

4. The Council does plan to borrow in order to carry out its capital programme. The original estimate, along with the spend to 30 September 2018 is shown below in the table.

Financial Year 2019/20		
Capital Expenditure	**Estimated £m**	**to month 6 £m**
Non-HRA capital expenditure	3.328	0.498
HRA capital expenditure	16.807	5.331
Capital loans	0.120	0
REFCUS	0.562	0
Total Capital expenditure	**20.817**	**5.829**
Financed by:		
Capital grants	0.085	
Capital receipts	3.608	
Internal Borrowing	2.267	
Revenue	14.857	
Total resources applied	**20.817**	

5. The revised capital programme is currently being worked on and will be going to Cabinet for approval in December.

6. There is a financial risk involved in reducing the balance of usable capital receipts over the next five years. This risk has the following potential consequences; loss of interest; loss of cover for contingencies; service reductions required; and Council Tax increases required.

7. This prudential indicator assists the Council in controlling and monitoring the level of usable capital receipts that will be available at the end of a five-year period. The forecast Capital Programme for the five years to 2022/23 totals £97m and was partly funded by £8m borrowing. It was predicted that at the end of this period there would still be £3.9m available in Capital Receipts and £0.5m in the Major Repairs Reserve. These figures will be revised as part of the update to the Capital Programme.

The impact on the Council's indebtedness for capital purposes

8. The Council's underlying need to borrow is called the Capital Financing Requirement (CFR). This figure is a gauge for the Council's debt position. The Council now has an overall positive CFR (HRA and Non-HRA) following the borrowing in relation to the HRA self-

financing and will need to borrow for capital purpose as highlighted in the previous section.

	Financial year 2019/20		
CFR	**Estimated £m**	**Revised £m**	**to month 6 £m**
Non-HRA	61.0	61.0	61.0
HRA	154.4	154.4	154.4
Total Capital expenditure	**215.4**	**215.4**	**215,4**

9. The Chief Financial Officer confirms that there were no breaches of the Authorised Limit (£270m), the Operational Boundary (£260m) and the Maturity Structure of Fixed Rate Borrowing during the period to 30 September 2019.

10. The risks for Councils are associated with affordability, interest rates and refinancing – the affordability risk is whether the Council can afford to service the loan, this has been evidenced through the Council producing a viable thirty-year financial plan for the HRA. This plan is reviewed quarterly by officers and half yearly reports are presented to Communities Select Committee. The interest rate risk is whether a change in interest rate could have an impact on the viability of the financial plan. The Council received advice from our treasury advisors before undertaking the borrowing. Only 17% of the amount borrowed was at a variable rate, the remainder was fixed. Any upward movement in interest rates would be 'hedged', in part, by a corresponding increase in interest earned on Council investments. The refinancing risk is that maturing borrowings cannot be refinanced on suitable terms. Within the original capital programme, it was anticipated that all borrowing would be repaid on maturity and the capital programme would be financed through internal resources. The Council does though intend to borrow later in 2019-20 in order to finance approved capital projects e.g. Qualis Group Ltd.

11. These prudential indicators assist the Council in controlling the level of debt the Council may need to finance over the coming years and ensure where debt is owed it is managed, such that the Council would not be left in a situation where it finds itself having to refinance on unsuitable terms.

<u>The Council's overall treasury position</u>

12. During the first half of 2018/19 the average investment position for the first half of the year was £19.75m. The table below shows the treasury position as at 30 September 2018.

Treasury position	**31/03/2019 £m**	**30/09/2019 £m**
Total external borrowing	**(185.5)**	**(185.5)**
Short term investment		
▪ Fixed investment	8.0	1.0
▪ Cash and Cash Equivalents	8.5	17.3
Total investments	**16.5**	**18.3**

13. It is important that the cash flow of the Council is carefully monitored and controlled to ensure enough funds are available each day to cover its outgoings. This will become more difficult as the Council uses up capital receipts and reduces investment balances.

14. The Chief Financial Officer confirms that there have been no breaches of:

(a) The Upper Limit for Fixed Rate Exposure (100%) and Upper Limit for Variable Rate Exposure (75%) on investment during the period. At the end of September 2019

neither upper limit was breached.

(b) The limit set for investment over 364 days (£30m). The Council made no investments over 364 days.

(c) The limit set for investment in non UK Country (30%).

15. The risks associated with this section are as follows:

(a) Credit and Counterparty Risk – the risk of failure by a third party to meet its contractual obligations to the Council, i.e. goes into liquidation. The Council's counter-party lists and limits reflect a prudent attitude towards organisations with which funds may be deposited and these are regularly updated by our treasury management advisors (Arlingclose).

(b) Liquidity Risk – the risk that cash will not be available when it is needed, incurring additional unbudgeted costs for short-term loans. The Director of Resources has monthly meetings with treasury staff, to go through the cash flow for the coming month. A number of instant access accounts are used to ensure adequate cash remains available.

(c) Interest Rate Risk – the risk of fluctuations in interest rates. The Council has short term investments at variable rates pending the loan to Qualis Group in November 2019 . This allows the Council to receive reasonable rates, whilst at the same time, gives the Council flexibility to take advantage of any changes in interest rates. The view of the Council's treasury advisors is that interest rates are unlikely to change significantly in the short term.

16. The prudential indicators within this section assist the Council to reduce the risk of:

(a) Counterparties going into liquidation by ensuring only highly rated institutions are used when investing the Council's money.

(b) The Council incurring unbudgeted short-term loans, to pay unexpected expenditure items through ensuring adequate amounts of money are available immediately through instant access accounts.

(c) Potentially losing out on investment income when interest rates start to increase by ensuring that most deposits are kept within one year.

Resource Implications:

The continued low interest rate was reflected in estimated investment income to the Council of £90,000 in 2019/20.

Legal and Governance Implications:

The Council's treasury management activities are regulated by a variety of professional codes, statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken;

- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the ODPM (now MHCLG) has issued Investment Guidance to structure and regulate the Council's investment activities.
- Under section 21(1) AB of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8 November 2007.

Safer, Cleaner and Greener Implications:

None.

Consultation Undertaken:

The Council's external treasury management advisors provided the framework for this report and have confirmed that the content satisfies all regulatory requirements.

Background Papers:

The report on the Council's Prudential Indicators for 2019/20 to 2021/22 and the Treasury Management Strategy for 2019/20 to 2021/22 went to Council on 21 February 2019.

Risk Management
As detailed in the report, a risk averse position is adopted to minimise the chance of any loss of the capital invested by the Council. The specific risks associated with the different aspects of the treasury management function have been outlined within the main report.

Due Regard Record

This page shows **which groups of people are affected** by the subject of this report. It sets out **how they are affected** and how any **unlawful discrimination** they experience can be eliminated. It also includes information about how **access to the service(s)** subject to this report can be improved for the different groups of people; and how they can be assisted to **understand each other better** as a result of the subject of this report.

S149 Equality Act 2010 requires that due regard must be paid to this information when considering the subject of this report.

No groups of people are affected by this report which is not directly service related.

Treasury Management Mid-term Report H1 2019/20

Introduction

In April 2002 the Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice* (the CIPFA Code) which requires the Authority to approve treasury management semi-annual and annual reports.

The Authority's treasury management strategy for 2019/20 was approved at a meeting on 21 February 2019. The Authority has borrowed and invested the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk remains central to the Authority's treasury management strategy.

The 2017 Prudential Code includes a requirement for local authorities to provide a Capital Strategy, a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Authority's Capital Strategy, complying with CIPFA's requirement, was approved by full Council on 21 February 2019.

External Context

Economic background: UK Consumer Price Inflation (CPIH) fell to 1.7% year/year in August 2019 from 2.0% in July, weaker than the consensus forecast of 1.9% and below the Bank of England's target. The most recent labour market data for the three months to July 2019 showed the unemployment rate edged back down to 3.8% while the employment rate remained at 76.1%, the joint highest since records began in 1971. Nominal annual wage growth measured by the 3-month average excluding bonuses was 3.8% and 4.0% including bonuses. Adjusting for inflation, real wages were up 1.9% excluding bonuses and 2.1% including.

The Quarterly National Accounts for Q2 GDP confirmed the UK economy contracted by 0.2% following the 0.5% gain in Q1 which was distorted by stockpiling ahead of Brexit. Only the services sector registered an increase in growth, a very modest 0.1%, with both production and construction falling and the former registering its largest drop since Q4 2012. Business investment fell by 0.4% (revised from -0.5% in the first estimate) as Brexit uncertainties impacted on business planning and decision-making.

Politics, both home and abroad, continued to be a big driver of financial markets over the last quarter. Boris Johnson won the Conservative Party leadership contest and has committed to leaving the EU on 31st October regardless of whether a deal is reached with the EU. Mr Johnson prorogued Parliament which led some MPs to put forward a bill requiring him to seek a Brexit extension if no deal is in place by 19th October. The move was successful and, having been approved by the House of Lords, was passed into law. The Supreme Court subsequently ruled Mr Johnson's suspension of Parliament unlawful.

Tensions continued between the US and China with no trade agreement in sight and both countries imposing further tariffs on each other's goods. The US Federal Reserve cut its target Federal Funds rates by 0.25% in September to a range of 1.75% - 2%, a pre-emptive move to maintain economic growth amid escalating concerns over the trade war and a weaker economic environment leading to more pronounced global slowdown. The euro area Purchasing Manager Indices (PMIs) pointed to a deepening slowdown in the Eurozone. These elevated concerns have caused key government yield curves to invert, something seen by many commentators as a predictor of a global recession. Market expectations are for further interest rate cuts from the Fed and in September the European

Central Bank reduced its deposit rate to -0.5% and announced the recommencement of quantitative easing from 1st November.

The Bank of England maintained Bank Rate at 0.75% and in its August Inflation Report noted the deterioration in global activity and sentiment and confirmed that monetary policy decisions related to Brexit could be in either direction depending on whether a deal is ultimately reached by 31st October.

Financial markets: After rallying early in 2019, financial markets have been adopting a more risk-off approach in the following period as equities saw greater volatility and bonds rallied (prices up, yields down) in a flight to quality and anticipation of more monetary stimulus from central banks. The Dow Jones, FTSE 100 and FTSE 250 are broadly back at the same levels seen in March/April.

Gilt yields remained volatile over the period on the back of ongoing economic and political uncertainty. From a yield of 0.63% at the end of June, the 5-year benchmark gilt yield fell to 0.32% by the end of September. There were falls in the 10-year and 20-year gilts over the same period, with the former dropping from 0.83% to 0.55% and the latter falling from 1.35% to 0.88%. 1-month, 3-month and 12-month LIBID (London Interbank Bid) rates averaged 0.65%, 0.75% and 1.00% respectively over the period.

Recent activity in the bond markets and PWLB interest rates highlight that weaker economic growth remains a global risk. The US yield curve remains inverted with 10-year Treasury yields lower than US 3-month bills. History has shown that a recession hasn't been far behind a yield curve inversion. Following the sale of 10-year Bunds at -0.24% in June, yields on German government securities continue to remain negative in the secondary market with 2 and 5-year securities currently both trading around -0.77%.

Credit background: Credit Default Swap (CDS) spreads rose and then fell again during the quarter, continuing to remain low in historical terms. After rising to almost 120bps in May, the spread on non-ringfenced bank NatWest Markets plc fell back to around 80bps by the end of September, while for the ringfenced entity, National Westminster Bank plc, the spread remained around 40bps. The other main UK banks, as yet not separated into ringfenced and non-ringfenced from a CDS perspective, traded between 34 and 76bps at the end of the period.

There were minimal credit rating changes during the period. Moody's upgraded The Co-operative Bank's long-term rating to B3 and Fitch upgraded Clydesdale Bank and Virgin Money to A-.

Local Context

On 31st March 2019, the Authority had net borrowing of £157.9m arising from its revenue and capital income and expenditure. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. These factors are summarised in Table 1 below.

Table 1: Balance Sheet Summary

	31.3.19 Actual £m
General Fund CFR	58.7
HRA CFR	154.4
Total CFR	**213.1**

Internal borrowing	-28.1
Less: Usable reserves	-34.8
Less: Working capital	-1.5
Net Worth	**148.7**

The treasury management position at 30th September 2019 and the change during the year is shown in Table 2 below.

Table 2: Treasury Management Summary

	31.3.19 Balance £m	**Movement £m**	**30.9.19 Balance £m**	**30.9.19 Rate %**
Long-term borrowing	185.5	0	185.5	2.97
Total borrowing	**185.5**	**0**	**185.5**	
Long-term investments	0	0	0	0
Short-term investments	8.0	-8.0	0	0.46
Cash and cash equivalents	8.6	8.0	16.6	0.01
Total investments	**16.6**	**0.0**	**16.6**	
Net Borrowing	**168.9**	**0.0**	**168.9**	

Borrowing Strategy during the period

At 30th September 2019 the Authority held £185.5m of loans, a similar position to 31st March 2019, as part of its strategy for funding previous and current years' capital programmes. Outstanding loans on 30th September are summarised in Table 3 below.

Table 3: Borrowing Position

	31.3.19 Balance £m	**Net Movement £m**	**30.9.19 Balance £m**	**30.9.19 Weighted Average Rate %**	**30.9.19 Weighted Average Maturity (years)**
Public Works Loan Board	185.5	0	185.5	2.97	17.47
Total borrowing	**185.5**	**0**	**185.5**	**2.97**	**17.47**

The Authority's chief objective when borrowing has been to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required, with flexibility to renegotiate loans should the Authority's long-term plans change being a secondary objective.

Treasury Investment Activity

The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held and money borrowed in advance of need. During the year, the Authority's investment balances remained at about £16.6 million. The investment position is shown in table 4 below.

Table 4: Treasury Investment Position

	31.3.19 Balance £m	Net Movement £m	30.9.19 Balance £m	30.9.19 Income Return %	30.9.19 Weighted Average Maturity days
Banks & building societies (unsecured)	0.6	8.0	8.6	0.01	3
Government (incl. local authorities)	8.0	-8.0	0.0	0.00	0
Money Market Funds	8.0	0.0	8.0	0.72	1
Total investments	**16.6**	**0.0**	**16.6**		

Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

The progression of risk and return metrics are shown in the extracts from Arlingclose's quarterly investment benchmarking in Table 5 below.

Table 5: Investment Benchmarking – Treasury investments managed in-house

	Credit Score	Credit Rating	Bail-in Exposure	Weighted Average Maturity (days)	Rate of Return %
31.03.2019	4.05	AA-	50%	71	0.87
30.09.2019	4.29	AA-	50%	1	0.70%
Similar LAs	**4.12**	**AA-**	**61%**	**98**	**0.70%**
All LAs					

The Council's investment funds have intentionally been held as liquid as possible pending the transfer of funds to the development company in November 2019.

Treasury Performance

The Authority measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in table 6 below.

Table 6: Performance

	Actual £m	Budget £m	Over/ under	Actual %	Benchmark %	Over/ under
Total borrowing	**-185.5**	**-185.5**	**0**	**2.97%**	**2.97%**	**0**
Banks UK Local Authorities Money Market Funds	8.6 0.0 8.0	Per TM Strategy Statement agreed at Council 21/2/19	N/A	0.01 0.00 0.72	0.01 0.00 0.86	0 N/A -0.14
Total treasury investments	**16.6**	**16.6**	**0**	**0.70**	**0.87**	**-0.17**

Compliance

The Chief Finance Officer reports that all treasury management activities undertaken during the quarter complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy. Compliance with specific investment limits is demonstrated in table 7 below.

Compliance with the authorised limit and operational boundary for external debt is demonstrated in table 8 below.

Table 7: Debt Limits

	H1 Maximum	30.9.19 Actual	2019/20 Operational Boundary	2019/20 Authorised Limit	Complied? Yes/No
Borrowing	187.3	185.5	260.00	270.0	Yes

Table 8: Investment Limits

	H1 Maximum	30.9.19 Actual	2019/20 Limit	Complied? Yes/No
Any single organisation, except the UK Government	£3m	£3m	£3m each	Yes
Any group of organisations under the same ownership	£3m	£3m	£3m per group	Yes
Any group of pooled funds under the same management	0	0	£5m per manager	Yes
Negotiable instruments held in a broker's nominee account	0	0	£2m per broker	Yes

Limit per non-UK country	0	0	£3m per country	Yes
Registered providers and registered social landlords	0	0	£3m in total	Yes
Unsecured investments with building societies	0	0	£2m in total	Yes
Loans to unrated corporates	0	0	£2m in total	Yes
Money Market Funds	£15m	£8.0m	£15m in total	Yes
Real Estate Investment Trusts	0	0	£5m in total	Yes

Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	30.9.19 Actual	**2019/20 Target**	**Complied?**
Portfolio average credit rating	AA-	AA-	Yes

Liquidity: The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing.

	30.9.19 Actual	**2019/20 Target**	**Complied?**
Total cash available within 3 months	£16.6m	£16.6m	Yes

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on the one-year revenue impact of a 1% rise or fall in interests was:

Interest rate risk indicator	**30.9.19 Actual**	**2019/20 Limit**	**Complied?**
Upper limit on one-year revenue impact of a 1% rise in interest rates	£318,000	£318,000	Yes
Upper limit on one-year revenue impact of a 1% fall in interest rates	£100,000	£100,000	Yes

The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at current rates.

Maturity Structure of Borrowing: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of all borrowing were:

	30.9.19 Actual	Upper Limit	Lower Limit	Complied?
Under 12 months	0	100%	0%	Yes
12 months and within 24 months	0	100%	0%	Yes
24 months and within 5 years	0	100%	0%	Yes
5 years and within 10 years	0	100%	0%	Yes
10 years and above	0	100%	0%	Yes

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal Sums Invested for Periods Longer than a year: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

	2019/20	2020/21	2021/22
Actual principal invested beyond year end	0	0	0
Limit on principal invested beyond year end	£3m	£1m	£0m
Complied?	Yes	Yes	Yes

Outlook for the remainder of 2019/20

The global economy is entering a period of slower growth in response to political issues, primarily the trade policy stance of the US. The UK economy has displayed a marked slowdown in growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations have eased dramatically.

There appears no near-term resolution to the trade dispute between China and the US, a dispute that the US appears comfortable exacerbating further. With the 2020 presidential election a year away, Donald Trump is unlikely to change his stance.

Parliament appears to have frustrated UK Prime Minister Boris Johnson's desire to exit the EU on 31st October. The probability of a no-deal EU exit in the immediate term has decreased, although a no-deal Brexit cannot be entirely ruled out for 2019 and the risk of this event remains for 2020. The risk of a general election in the near term has, however, increased.

Central bank actions and geopolitical risks will continue to produce significant volatility in financial markets, including bond markets.

Our treasury advisor Arlingclose expects Bank Rate to remain at 0.75% for the foreseeable future but there remain substantial risks to this forecast, dependant on Brexit outcomes and the evolution of the global economy. Arlingclose also expects gilt yields to remain at low levels for the foreseeable future and judge the risks to be weighted to the downside and that volatility will

continue to offer longer-term borrowing opportunities

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Cas	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside risk	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75

Report to the Audit and Governance Committee

Epping Forest District Council

Report reference: ***AGC-012-2019/20***
Date of meeting: ***25 November 2019***

Portfolio: **Business Services**

Subject: **Final Accounts Improvement Plan**

Responsible Officer: **Nick Dawe** **(01992 564000 Ext 2541).**

Democratic Services: **Gary Woodhall** **(01992 564470).**

Recommendations/Decisions Required:

(1) To note the contents and approach set out in the attached improvement plan which provides an overview of key areas of improvement and the approach being taken to deliver the improvement;

(2) To note to date that all improvement actions are to timetable and are associated with resolving issues in respect of the 2018/19 accounts and preparing for future final accounts;

(3) To note the significant contribution made by the lead technical team leader in both completing the accounts and authoring and delivering the improvement plan;

(4) To note the improvements are being delivered within current establishment, by an officer who is an interim; and

(5) To note that the planned improvements are well documented and that a planned exchange of knowledge and procedures will occur in respect of existing and new permanent staff.

Epping Forest District Council

Final Accounts Improvement Plan (for 2018/19 and subsequent years)

Updated for Audit and Performance Committee, 23rd November 2019

Introduction

The conditional report issued by our external Auditors, Deloitte, on 6 September 2019 highlighted several weaknesses in arrangements for the preparation of the statement of accounts and supporting work papers. Although at that time there was yet to be found any significant misstatement in the accounts, a final view could not begiven by the External Auditor until all matters had been resolved.

These weaknesses were due to many factors that have since been immediately resolved as part of on-going improvement programme by the Finance Department. There are proposals to further improve the process of Final Account preparation for 2019/20 and in subsequent years.

This report seeks to assure the Audit committee about measures that have been taken to address these weaknesses and to share with the committee what improvement measures are in place to ensure that these weaknesses are managed to the extent that they do not occur again.

The loss of key officers at a crucial time during the Account closure cycle was very disruptive to the closing exercise. It meant that supporting papers were not completed before the departure of these key officers. Source document could not be traced in their absence to allow figures in the statement of accounts to be verified.

New staff who were drafted in to help complete the Statement of accounts found that there were no dedicated folders for the year end working papers. Most information was saved in individual folders, making it difficult or impossible to retrieve, especially in the absence of the key officers.

In most cases it was easier to start afresh in the production of working papers, than to try and understand or second guess the assumptions made by staff who had already left.

These and other factors led to significant delays in delivery of supporting working papers for audit from management and delays in receiving information and explanations in response to subsequent audit queries.

Together with significant issues in the classification of transactions and balances within the financial statements, presented a worse than the actual weaknesses in our organisation of and processes around year end activities

In the pages that follow, we will discuss the weaknesses and control deficiencies identified by our external auditors, and the measures in place to mitigate them, going forward.

1. Quality of Draft Financial Statement	The initial draft financial statements which were published for public inspection and presented for audit were not of the expected standard. Issues noted included: • Findings regarding the compliance of the narrative report, financial statements and annual governance statement with the CIPFA code; • Inconsistencies between notes in the financial statements; • Accounting policies not updated for the adoption of IFRS 9 and IFRS 15; • Accounts disclosures not updated for the adoption of IFRS 9; • Accounts disclosures not updated for the adoption of IFRS 15; • Differences between primary statements and notes; • Differences noted during our call and cast process; • Incorrect classification of transactions and balances; • Numerous differences noted between the financial statements and supporting working papers and/or an absence of suitable supporting working papers; and • A lack of knowledge about key balances due to a significant loss of corporate knowledge following the departure of a number of members of the finance team which was exacerbated by a lack of documented processes.
Improvement Measures	Together these indicate weaknesses in the financial reporting and close process. • The Finance team will from now on work to a documented timetable that includes detailed guidance on processes and controls. This will be co-ordinated by a dedicated Finance staff to ensure compliance and to improve the quality of audit papers. • A skeleton draft of the financial statements will be prepared at the end of quarter three, ahead of year end, reviewed against the Statement of Recommended Practice (SORP) for any changes in the year and for the disclosure requirements for any new or changed activities of the Council • All judgments made in respect of materiality of disclosure requirements in preparing the accounts documented and quantified appropriately • The completed CIPFA disclosure checklist will be reviewed in tandem with the Statement of Account to ensure compliance • Internal checks will be conducted and documented to ensure consistency of approach • The CIPFA “pre-audit checks on draft year end accounts” checklist will be conducted to ensure compliance. • Supporting working papers will be documented and reviewed internally to tie back and referenced to the draft financial statements.
Target Dates	For 2018/19 Account Improvements, October 2019. ● Further improvements are planned for the 2019/20 final account processes.

2. Preparation of accounting papers **Improvement Measures** **Target Date**	Accounting papers were not prepared to explain and support key judgements and estimates, including the ongoing pertinence of judgements made in previous years, or were not sufficiently detailed to explain and support those judgements and estimates. It is good practice (and the expectation of the Financial Reporting Council) for organisations to prepare accounting papers in respect of key matters in the application of accounting standards, in particular, for matters of judgement or of estimation complexity. Typically, these would include consideration of the relevant requirements of the accounting standards and the Code, the fact pattern (including details of relevant terms of contracts etc.), an assessment of how the standards apply in this context, consideration of potential alternative treatments, the proposed approach to measurement/calculation of accounting entries required, and the required disclosures. The preparation of accounting papers supports accurate financial reporting, including facilitating both internal and external review and challenge, and provides a resource to ensure institutional knowledge is retained in the organisation. The Council will adopt an approach of preparing papers for any key accounting judgements or issues arising. Accounting papers will be presented to the same meeting of the Committee at which the draft statement of accounts are approved (if not earlier) for scrutiny and to help the Committee in their approval of the draft statement of accounts. For 2018/19 Account Improvements, October 2019. ● Further improvements are planned for the 2019/20 final account processes.
3. Documentation of controls and process **Improvement Measures** **Target Date**	There were significant delays in the completion of the audit process and provision of key information due to significant turnover in the finance team of key staff and the subsequent loss of corporate knowledge. This has been exacerbated by the lack of documented processes and routines, therefore restricting the level of knowledge and continuity. A succession plan, based on knowledge share is being introduced across the finance department. This will ensure wider knowledge across the team. A cultural shift towards documentation of processes and procedures is also being introduced. This will ensure continuity within the finance team and minimise disruption should a member of staff leave us. For 2018/19 Account Improvements, October 2019. ●

4. Review and approval of workings papers **Improvement Measures** **Target Date:**	A number of key working papers and reconciliations provided by management in the first instance were inadequate as they did not reconcile to the trial balance or contain the required level of detail. For example, the profit on disposal amount included in the accounts was misstated by £700k, with the workings provided to corroborate the amount containing a number of incorrect calculations. Whilst we note that in most instances subsequent workings have been provided by management which are correct, we recommend that a process of review and approval of all key working papers is embedded in the year end process to implement an appropriate level of quality control. This was a direct consequence of staff leaving midway through the closing process. Incomplete working papers and outstanding journals contributed largely to this error. Measures are now in place to ensure that only completed working papers and statements will be submitted for audit. The New staff structure will be resilient to the effects of unexpected staff departure For 2018/19 Account Improvements, October 2019. ●
5. Controls of cash accounts **Improvement Measures** **Target Date**	We have identified a number of bank accounts which are held by the council but are not recorded within the general ledger. Whilst the amounts held within these accounts are not material, there is an increased risk of error in reporting cash if the accounts are not correctly recorded. The SIBA Account which is an investment Account, will not be in our ledger and will continue to be maintained for our financial investment activities. All other Accounts that are not in our ledger will is being closed. December 2019
6. Maintenance of contact information and mandates with third parties **Improvement Measures** **Target Date**	We have noted through our audit procedures that incorrect information is held with key third parties. For example, the bank mandates have not been updated to reflect turnover in key members of staff, and incorrect contact information is documented with the investment managers. This increases the risk of accounts being accessed by members of staff who have left, or the council being unable execute banking or investment changes without an individual with the required authority. A regular review of this information will be conducted by the council to ensure that the relevant changes are updated on a timely basis. On-going

7. Evidence of 'rents to mortgages' scheme	The council holds charges of £2.1m over properties sold by the council through a historic 'rents to mortgages' scheme. The council has been unable to provide the relevant supporting documentation to corroborate the charges held over the properties, and is therefore unable support the amounts recorded within the financial statements.
Improvement Measures	This information had previously never been compiled by Legal Services. Finance are working with Legal Services to put in place a process that will compile and update a register of all properties that have charges against them. This will specify the percentage of ownership by the tenant.
Target Date	March 2020
8. Disposal processes	Through our testing we have identified a number of assets which are still owned by the Council but are no longer in use. These have been incorrectly treated as disposals and have been removed from the fixed asset register. We have also identified £163k of costs relating to the demolition of garages which have incorrectly been capitalised in the year. Furthermore, we note there is no formal process of review and approval of disposals.
Improvement Measures	Disposal either through sales or demolition are reviewed and actioned on the Council's Asset register regularly.
Target Date	March 2020
9. Depreciation policy	The council has an accounting policy to apply a full year of depreciation in the year of disposal and no depreciation in the year of acquisition, primarily for the reason that the fixed asset register is only updated at the end of year. This practice is not uncommon in the sector and does not have a significant impact on the carrying amount of assets where assets are acquired and disposed relatively evenly across the year. Management have prepared a high-level calculation to assess the impact of this, which has been reviewed by the audit team This assessment outlined the total net impact on depreciation as £64k, which is trivial.
Improvement Measures	Our depreciation policy is in line with the SORP and is the norm across Local authorities. There is no significant implication to the carrying value of the Assets. If the Council chooses to change its accounting policy on Depreciation, this will be disclosed in the financial statement in the year of change.
Target Date	December 2019

10. Production of debtor & creditors listings **Improvement Measures** **Target Date**	The councils accounting system can only produce debtors & creditors listings on the date they are requested, and is therefore unable to provide retrospective listings. These listings were not produced the March 2019 year end and as a result, full listings were not provided. Whilst management have been able to produce an alternative summary, this has been a time-consuming task and has resulted in significant delays. We recommend the council ensures the production of these reports are embedded in the year end processes which is not disrupted by a loss of continuity in the finance team. A monthly download of all NDR and Council Tax debtors report will be maintained throughout the year, to ensure that the month end reports are available for year-end accounting. January 2020 (retrospective till April 2019)
11. Elimination of internal recharges **Improvement Measures** **Target Date**	Internal recharges should be eliminated from the presentation of income and expenditure in the Comprehensive Income and Expenditure Statement. £3.6m of expenditure has been identified which was incorrectly recorded within the financial statements. Recharges are netted off by the income to the initiating department. It should therefore not be accounted for in the Statement of Account as it has no effect on the bottom line. March 2020
12. Retention of signed employee contracts **Improvement Measures** **Target Date**	We have identified that the council does not retain signed employment contracts for a number of employees. The HR department retains copies of employee contract on file and in archives. This will be checked post the current establishment review. March 2020

13. New accounting standards IFRS 9 and 15 **Improvement Measures** **Target Date**	Whilst we understand that officers discussed the impact of adoption of the new standards during the closure process, they did not prepare accounting papers on the transition to IFRS 9 and 15. The initial draft accounts were not updated for changes in disclosure requirements from IFRS 9 and 15. We are yet to receive management's assessment of these standards, which we will then assess to determine if the correct treatment has been applied. We also observe that because the new standards have been discussed as a one-off exercise, new requirements will not have been embedded in the Council's underlying systems, processes and controls. This presents a risk that new contracts or transaction may give rise to unanticipated impacts in future, or not be detected. The impact of changes to Accounting standards are assessed each year to ensure that the financial statement reflect the new standard. The introduction of IFRS 9 and 15 has no implication to Epping Forest District Council. We will continue to monitor all future contract transactions to ensure that Epping Forest District council is compliant. October 2019 initial view ●
14. Preparation for IFRS 16 **Improvement Measures** **Target Date**	The implementation of IFRS 16, Leases, for 2020/21 is expected to have a greater and more complex impact upon most Councils than the adoption of IFRS 9 and 15. The scope and potential complexity of work required, which may require system or process changes to underpin correct accounting under the standard, will require work to be completed at a significantly earlier stage than has been the case for IFRS 9 and 15 to allow for financial reporting timetables to be met. An IFRS 16 impact analysis will be conducted during 2019/20, and to calculate an adjusted opening balance sheet position for audit following the 31 March 2020 audit. An accounting paper will be prepared for the purposes of 2019/20 audit as part of the impact assessment that will be done. February 2020
15. Preparation of cash forecasts **Improvement Measures** **Target Date**	We note that the council does not prepare detailed cash flow forecasts. This restricts the council's ability to manage its working capital effectively and inform medium and long-term finance strategy and planning, including its capital expenditure programme and financing requirements. A cash forecast for 2019/20 has been produced and updated to the end of period 7. This will be monitored and updated accordingly at each month end. December 202

Summary

The conditional report issued by our external Auditors, Deloitte, on 6 September Significant improvements have already been made and no planned improvement action is either late or incomplete (at this stage).

Further improvements are planned around conducting a dummy account closure exercise in January (for nine months of 2019/20).

Additional improvements will also take place before the end of the financial year.

These activities are taking place as part of a continuous improvement approach in consultation with our External Auditors.

The resources to undertake this work fall mainly to:

The Technical Accounting Team Leader (interim and the author of this report).

The Accounting Team Manager (interim).

Appropriate measures are in place to ensure all procedure and approaches are well understood by other permanent members of the accounting team, and when appointed permanent post holders for the Technical Accounting Team Leader and the Accounting Team Manager.

Deloitte.

Epping Forest District Council

Epping Forest District Council

Update on the audit and analysis of additional costs relating to the 2018/19 audit

Update to the Audit & Risk Committee

Conclusion on our Audit

When we presented our report to the Audit and Risk Committee on 12 September 2019, we identified that there were a number of matters outstanding. No new matters have arisen since that date. This report provides an update on those matters. To date, no further adjustments, disclosure deficiencies or control recommendations have been identified in addition to the ones reported to you within our previous report.

In terms of outstanding items, the below remain key outstanding deliverables –

Property Valuation – We are awaiting managements detailed assessment to support the judgement that a number of operational properties were not revalued at the year end on the basis that they had not moved materially in value. Once received, our valuation experts will review this information.

We have also raised queries on the valuation amounts used when recording the properties which received a full valuation, as it varies from the valuation presented in the valuation reports.

Recharges Adjustment – As communicated in our previous paper, an adjustment was identified in regards to expenditure being double counted through the expenditure recharges mechanism. We have received managements workings in regards to this, but have outstanding queries in regards to the completeness of the amounts identified.

Cash – There is 1 bank account whereby we have requested a breakdown of the reconciling items in order to reconcile the amounts recorded in the ledger, this is outstanding.

Adoption of IFRS 9 & IFRS 15 – We are yet to receive managements assessment of these new accounting standards introduced in the year.

CIES Mapping – We are yet to receive a breakdown which reconciles the account codes in the trial balance to the *'income and expenditure by nature'* note. Until we receive this, we are unable to finalise our testing of the income statement.

Grant Income – We have been unable to reconcile the DWP income and balance sheet position to the grant form and bank statements provided by management. We have raised this query with management.

Financial statements – We await the finalised financial statements updated for the adjustments identified, including the prior year misstatements which are currently not reflected in the prior year.

Please note the above is a summary of the key items outstanding but is not an exhaustive list. In particular, we would highlight that all remaining procedures will be subject to our internal quality control and review processes.

Our additional costs and fee proposal

As we outlined in our final report to the Audit & Risk Committee in September 2019, additional cost was incurred in the performance of the audit of the 2018/19 financial year. Per below, these hours have been applied against the rates outlined in the PSAA terms of appointment to provide a cost of £51,930. We are proposing additional billings of £40,000.

The additional time reflects the significant delays in completing the audit process, which is a result of a number of factors, including, but not limited to:

- Delays in the delivery of supporting working papers for the financial statements from management.
- Delays in receiving initial information and schedules, as well as responses to subsequent audit queries, resulting in significant delays in progressing the audit. This has been driven primarily by weaknesses in arrangements for the preparation of the statement of accounts and supporting work papers and the loss of key members of staff within the finance team.
- Significant amount of control deficiencies and errors identified, including two errors requiring a restatement of the prior year financial statement balances.
- Financial statements received were substantially incomplete and were not, in material respects, compliant with the requirements of the CIPFA code.
- The audit team, at the request of management, being asked to leave site and return at a later date once adequate arrangements have been put in place to complete the audit. This occurred multiple times, despite the original timeline for completion being agreed in advance of the year end process.

Additional hours incurred to date has been 700 hours, whilst we anticipate another 150 hours are required to complete the audit upon receipt of the remaining outstanding information. The total additional hours will therefore be 850.

Additional Hours Incurred:	Additional hours:	PSAA rate per hour:	Calculated cost:	Actual additional fee:
Partner	40	£132	£5,280	-
Senior Manager / Manager	330	£73	£24,090	-
Senior Auditor	480	£47	£22,560	-
Total:	**850**	**-**	**£51,930**	**£40,000**

Responsibility statement

This report should be read in conjunction with the "Final Report to the Audit Committee" circulated to you for the audit and governance committee meeting on the 12th September 2019 and sets out an update on those audit matters of governance interest which came to our attention during the audit and were outstanding at the time of our final report or have arisen since that date. Our audit was not designed to identify all matters that may be relevant to the board and this report is not necessarily a comprehensive statement of all deficiencies which may exist in internal control or of all improvements which may be made.

This report has been prepared for the Audit & Governance committee, as a body, and we therefore accept responsibility to you alone for its contents. We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose. It should not be made available to any other parties without our prior written consent.

Deloitte LLP

15 October 2019

Deloitte.

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