Public Document Pack

A meeting of the

WECA Audit Committee

will be held on

Date: Thursday, 21 February 2019

Time: 10.00 am

Place: The Board Room, WECA Offices, 3 Rivergate, Temple Quay, Bristol BS1 6ER

Notice of this meeting is given to members of the West of England Audit Committee as follows

Cllr Geoff Gollop, Bristol City Council
Cllr Will Sandry, Bath & North-East Somerset Council
Cllr Brian Simmons, Bath & North-East Somerset Council
Cllr Brenda Massey, Bristol City Council
Cllr Donald Alexander, Bristol City Council
Cllr Harriet Bradley, Bristol City Council
Cllr Charlie Bolton, Bristol City Council
Cllr Liz Radford, Bristol City Council
Cllr John Ashe, South Gloucestershire Council
Cllr John O'Neill, South Gloucestershire Council
Cllr Roger Avenin, South Gloucestershire Council

Enquiries to:
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West of England Combined Authority Committee Agenda

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Guidance for press and public attending this meeting

The Openness of Local Government Bodies Regulations 2014 mean that any member of the public or press attending this meeting may take photographs, film or audio record proceedings and may report on the meeting including by use of social media (oral commentary is not permitted during the meeting as it would be disruptive). This will apply to the whole of the meeting except where there are confidential or exempt items, which may need to be considered in the absence of the press or public.

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1. EVACUATION PROCEDURE

In the event of a fire, please await direction from the West of England Combined Authority staff who will help assist with the evacuation. Please do not return to the building until instructed to do so by the fire warden(s).

2. APOLOGIES FOR ABSENCE

To receive any apologies for absence from Members.

3. DECLARATIONS OF INTEREST UNDER THE LOCALISM ACT 2011

Members who consider that they have an interest to declare are asked to: a) state the item number in which they have an interest; b) the nature of the interest;
c) whether the interest is a disclosable pecuniary interest, non-disclosable pecuniary interest or non-pecuniary interest. Any Member who is unsure about the above should seek advice from the Monitoring Officer prior to the meeting in order to expedite matters at the meeting itself.

4. MINUTES OF THE PREVIOUS MEETING 7 - 10

To approve the minutes of the meeting of the West of England Combined Authority Audit Committee held on 8 November 2018 as a correct record.

5. ITEMS FROM THE PUBLIC (PETITIONS; STATEMENTS; QUESTIONS)

If you wish to present a petition or make a statement, you are required to submit this by 12 noon on the working day before the meeting by e-mail to democratic.services@westofengland-ca.gov.uk For this meeting, this means that your submission must be received in this office by **12 noon on Wednesday 20 February 2019**.

If you wish to ask a question at the meeting, you are required to submit the question in writing to democratic.services@westofengland-ca.gov.uk no later than 3 working days before the meeting**.** For this meeting, this means that your question(s) must be received in this office by the end of **Friday 15 February 2019**.

In presenting any statements at the meeting, members of the public can speak for up to 3 minutes each. The total time for this session is 30 minutes so speaking time may be reduced if more than 10 people wish to speak. All statements will be circulated in advance of the meeting to the committee members.

6. INTERNAL AUDIT UPDATE 11 - 26

To update the Committee on Internal Audit work in 2018/2019 and present the latest position on the Reasonable Assurance Model

7. EXTERNAL AUDIT PLAN FOR THE YEAR ENDING 31 MARCH 2019 27 - 42

To consider the External Audit Plan for the year ending 31 March 2019

8. EXTERNAL AUDIT PROGRESS REPORT AND SECTOR UPDATE 2018/19 43 - 56

To consider the External Audit Progress Report and Sector update

9. WECA TREASURY MANAGEMENT MID-YEAR REVIEW 2018/19 57 - 72

To review the mid-year report for Treasury Management performance for 2018/19

10. WECA TREASURY MANAGEMENT STRATEGY 2019/20 73 - 92

To consider the Treasury Management Strategy for 2019/20

Next meeting: Thursday, 11 April 2019

West of England Combined Authority
WECA Audit Committee

Thursday, 8 November 2018, Meeting commenced at 10:30am.
3 Rivergate - Board Room
3 Rivergate, Bristol BS1 6ER

Present:
Cllr Will Sandry, Bath & North-East Somerset Council
Cllr Brian Simmons, Bath & North-East Somerset Council
Cllr Donald Alexander, Bristol City Council
Cllr Charlie Bolton, Bristol City Council
Cllr John Ashe, South Gloucestershire Council
Cllr Liz Radford, Bristol City Council
Cllr Roger Avenin, South Gloucestershire Council

Officers In Attendance:
Malcolm Coe, Director of Finance, WECA
Jeff Wring, Bath & North East Somerset

Also in Attendance:
Michelle Burge, Grant Thornton

Apologies:
Cllr Geoff Gollop, Bristol City Council
Cllr Brenda Massey, Bristol City Council
Cllr Harriet Bradley, Bristol City Council
Cllr John O'Neill, South Gloucestershire Council

Minutes

1	**EVACUATION PROCEDURE** The clerk set out the evacuation procedure.
2	**APOLOGIES FOR ABSENCE** Apologies for absence were received from Councillors Geoff Gollop (Bristol City Council), Brenda Massey (Bristol City Council), Harriet Bradley (Bristol City Council) and John O'Neill (South Gloucestershire Council).
3	**DECLARATIONS OF INTEREST UNDER THE LOCALISM ACT 2011** There were no declarations of interest declared under the Localism Act 2011.
4	**MINUTES OF PREVIOUS MEETING** The Minutes of the meeting held on 12 July 2018 were agreed as a correct record and signed by the Chair.
5	**SUBMISSIONS FROM THE PUBLIC (PETITIONS; STATEMENTS; QUESTIONS)** There were no members of the public present at the meeting and there had been no petitions, statements or questions submitted to the meeting prior to the deadline.
6	**INTERNAL AUDIT UPDATE**

	The Committee considered an update on the Internal Audit work in 2018/19. The Committee had been presented with the proposed Audit Plan at its meeting in April 2018. This approach involved a mixture of formal audit work along with an assessment of the internal control framework to inform the plan for future years using the Combined Authority's reasonable assurance model. A table set out in Section 4.5 of the report summarised the status of the work as either complete, planned or work in progress (WIP). There were currently no issues or areas of concern to raise with the Committee. Any exceptions would be reported including any areas of concern that arise. Although only one review area was 100% complete, Jeff Wring stated he was very comfortable with the progress being made and that everything was currently on track. A further update would be brought to the next meeting on the work undertaken on the eight themes in the Combined Authority's "Reasonable Assurance Model". An outline of this was contained within the Audit Plan document attached at Appendix 1. The Plan would continue to remain 'fluid' to the end of the year to enable the service to respond to the Combined Authority's changing risk environment. The Committee would continue to receive updates through its normal meeting cycle. **Resolved**: That the report be noted.
7	**EXTERNAL AUDIT - ANNUAL AUDIT LETTER FOR YEAR ENDING 31 MARCH 2018** The Director of Investment and Corporate Services submitted a report asking the Committee to consider the External Auditor's Annual Audit Letter for the year ending 31 March 2018. The letter was appended to the report. Michelle Burge from Grant Thornton, the Combined Authority's external auditors, was present at the meeting to answer queries from the Committee members. Michelle explained that there were a couple of typographical errors in the letter that would be corrected including references to 'Council' to be corrected to read 'Authority'. The Financial Statements opinion of the External Auditors was that they gave an 'unqualified' opinion on the Authority's statements on 13 July 2018. Cllr Bolton stated that he felt that while he welcomed the good opinion from the Auditors he asked that some of the terminology should be explained in more layman's terms. **Resolved**: That the Annual Audit Letter and the updates from the Combined Authority's External Auditor be noted.
8	**EXTERNAL AUDIT PROGRESS REPORT AND SECTOR UPDATE 2018-19** The Director of Investment and Corporate Services submitted a report requesting that the Committee consider the External Audit Progress Report and Sector Update which had been appended to the report. Michelle Burge from Grant Thornton, the Combined Authority's external auditors, was present at the meeting to answer queries from the Committee members and summarised the main issues therein. **Resolved**:

	That the Progress Report and Sector Update be noted and welcomed.
9	**WECA RISK MANAGEMENT FRAMEWORK** The Head of Performance, Planning and Projects introduced a report providing a draft Risk Management Framework for the Combined Authority. Comments were sought from the Committee prior to finalisation of the framework. The Risk Management Framework was attached as appendix 1 and the draft Corporate Risk Register was attached as appendix 2. The Monitoring & Evaluation framework aimed to bring together all of the Combined Authority's reporting requirements into one place and to provide a clear structure for reporting focussed on three levels: • Delivery of the Annual Business Plan; • Project and Programme delivery; • Longer term organisational impact. The detailed appendices to the Monitoring and Evaluation Framework were currently being updated following a meeting with the Department for Business, Energy & Industrial Strategy (BEIS) on 24 October 2018. The monitoring and evaluation of the Combined Authority was an essential part of the governance framework for the Authority. The report set out how this would be evidenced in the future. The following comments were made: • The basic outline for the Framework had been based on that used by Unitary Authorities,. It was stated that the document was still work in progress; • It was also stated that there could be an impression that the Authority was waiting for the government to offer money rather than proactively bidding for funding. It was noted that the Authority had to bid for much of the funding; • It was queried whether collapse of local government/Brexit should be listed as risks in their own right. Lynda Bird replied that there was a danger of straying into 'political' ground but a risk of 'changing national priorities' had been listed; • Cllr Radford queried why the matrix was different to that had previously been used in the Audit report. It was stated that this was because different frameworks had been used; • In response to a query around the level of detail in the framework it was requested that a more detailed report be brought back to a future meeting. **Resolved**: (1) That the comments on the framework received at the meeting be noted. (2) That a more detailed report be brought to a future meeting.
10	**WECA MONITORING AND EVALUATION FRAMEWORK** The Head of Performance, Planning and Projects submitted a report providing an updated Monitoring and Evaluation Framework for the Combined Authority. The Senior Economic Intelligence Officer was also in attendance to answer any queries. A presentation was circulated at the meeting and copies of the slides were made available on the Authority's website following the meeting. The Framework contained reporting mechanisms for each project and was the basis for the

	annual update to government. It was explained that the plan was to bring the Monitoring and Evaluation Frameworks together in one document. The strategic aim was that sometime towards the end of 2020/ beginning of 2021 there would be a need to demonstrate the Authority's progress to government. A definite list of aims and objectives were set out in the Business Plan. The following comments were made: • The aim was to have costs and include how each aim was linked to regional priorities. One possibility was to have a system of "traffic lights" to show how close each priority was to each aim, although it was noted that the business plan report was a fairly high level report and nothing would be showing particularly 'red' or 'green' on such a system; • It was planned that regular updates be brought to both the Authority's Audit Committee and the Authority's Overview & Scrutiny Committee. **Resolved**: That the feedback received on the Monitoring and Evaluation Framework be taken in consideration in future versions of the document.
	The next meeting was scheduled for Thursday, 24 January 2019, 10.00 am. The Venue would be confirmed.

ITEM: 6

REPORT TO: **WEST OF ENGLAND COMBINED AUTHORITY AUDIT COMMITTEE**

DATE: **21 FEBRUARY 2019**

REPORT TITLE: INTERNAL AUDIT UPDATE

AUTHOR: **JEFF WRING – AUDIT WEST (INTERNAL AUDIT)**

Purpose of Report

1. To update the Committee on Internal Audit work in 2018/19 and present latest position on the Reasonable Assurance Model.

Issues for Consideration

2. To note the areas under review and progress against the plan. These are in the context of WECA being a relatively new organisation and the assurances it requires from its audit function on its core systems and governance framework.

3. To ensure that the Audit Committee can rely on the independent assurance given by its Internal Auditor's.

Report Narrative / Main Content

4.1 The Committee was presented with the proposed Audit Plan at its meeting in April 2018 (Appendix 1). This approach involved a mixture of formal audit work along with an assessment of the internal control framework to inform the plan for future years using our reasonable assurance model.

4.2 The table in section 4.5 summarises the status of work as either complete, planned or work in progress and currently there are no areas or issues of concern to raise with the Committee.

4.3 As this is the second year of the organisation and there are still limited transactions to examine it is important that there is flexibility in our approach so work will involve a mixture of risk based audit reviews, key controls testing and compliance reviews.

4.4 At the meeting we will update the Committee as we did last year on the work undertaken on the eight themes in our 'Reasonable Assurance Model' an outline of which you can see in our Audit Plan document (**Appendix 1**).

4.5 **Summary of Audit Work & Status – 2018/19**

Area Under Review	Status	Opinion
Adult Education	WIP	-
Future Bright	Draft Report	-
Risk Management	Draft Report	-
Control A/C Reconciliation	Complete	Level 4 - Good
Bank A/C Reconciliation	WIP	-
Counter Fraud Arrangements	WIP	-
WOE/LEP Local Growth Fund	Complete	Level 4 - Good
Follow-Up – Treasury Management	WIP	-
Follow-Up – IBB Procurement	WIP	-
Follow-Up – Local Growth Fund	Complete	100% Implementation
Follow-Up – Accounts Payable	Complete	71% Implementation
Follow-Up – Accounts Receivable	Complete	75% Implementation
Follow-Up – Payroll	Complete	75% Implementation
Annual Governance Review	WIP	-
Reasonable Assurance Model – Corporate Governance	WIP	-
Reasonable Assurance Model – Financial Management	WIP	-
Reasonable Assurance Model – Risk Management	WIP	-
Reasonable Assurance Model – Performance Management	WIP	-
Reasonable Assurance Model – Procurement	WIP	-
Reasonable Assurance Model – Programme & Project Management	WIP	-
Reasonable Assurance Model – Information Management	WIP	-
Reasonable Assurance Model – Asset Management	WIP	-

4.7 The Plan will continue to remain fluid to the end of the year to enable the service to respond to WECA's changing risk environment and the Committee will continue to receive updates through its normal meeting cycle.

Consultation:

5. Report and work undertaken is consulted with the Director of Investment and Corporate Services and relevant Senior Management.

Public Sector Equality Duties:

6. No direct implications

Economic Impact Assessment:

7. No direct implications.

Finance Implications:

8. No direct implications, cost of service within existing budgets

Legal Implications:

9. No direct implications

Land/Property Implications;

10. No direct implications.

Human Resources Implications:

11. No direct implications

Recommendation:

12. To note the report.

Report Author: Jeff Wring – Audit West (Internal Audit)

West of England Combined Authority Contact: Malcolm Coe – Director of Investment & Corporate Services

West of England Combined Authority Contact:
Any person seeking background information relating to this item should seek the assistance of the contact officer for the meeting who is Ian Hird / Tim Milgate on 0117 332 1486; or by writing to West of England Combined Authority, 3 Rivergate, Temple Way, Bristol BS1 6ER; email: democratic.services@westofengland-ca.gov.uk

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WEST OF ENGLAND
Combined Authority

Audit West

Appendix 1 – Internal Audit Plan 2018/19

Delivering Independent Assurance to the Public Sector

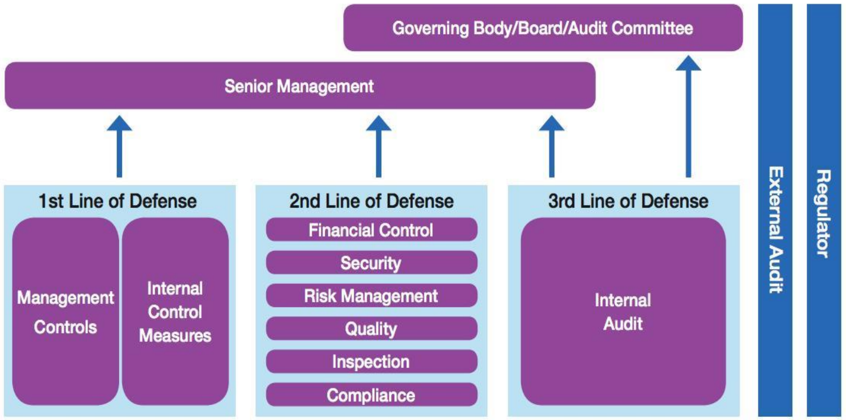
1. Our Role

Introduction

The West of England Combined Authority is striving to be a beacon of growth and innovation where everyone has an opportunity to reach their potential and where prosperity delivers for everybody. The Authority has also recognised through its first year the importance of excellence in resource management and sound governance as fundamental to achieving its priorities and is putting those key building blocks in place.

Audit West fully recognizes its need to be flexible and agile in the face of the significant changes affecting the whole of the public sector and meet the needs of its stakeholders. Independent assurance which is strong but supportive can provide a helpful and positive role not just to services but to elected Members and the Community at large by demonstrating that the Authority is operating effectively and protecting its assets and resources for the benefit of all its stakeholders.

Three Lines of Defence Model



By being independent of management Audit West maintain the third line of defence and we continue to do this effectively by working with all our stakeholders - especially the Audit Committee, Statutory Officers and Senior Management – to improve the service we offer but also to provide an independent voice in supporting service change and transformation.

We also aim to offer continued value to all our clients based on the following key priorities –

- Use of our Reasonable Assurance Model

- Maximising Use of Technology

- Investment in Skills

- Offering complimentary assurance services

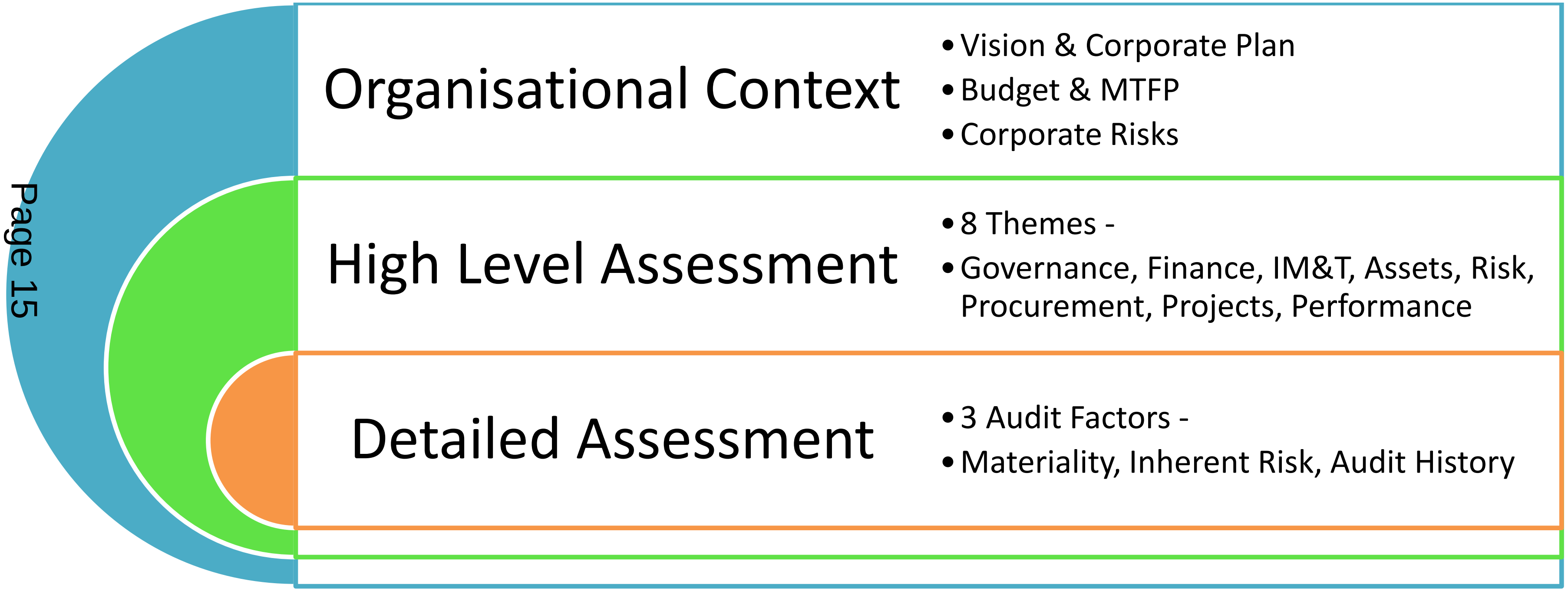
- Providing Value for Money

The remainder of this document outlines our approach and also the indicative areas for our audit and assurance plan for 2018/19.

2. Reasonable Assurance Model – Producing the Audit Plan

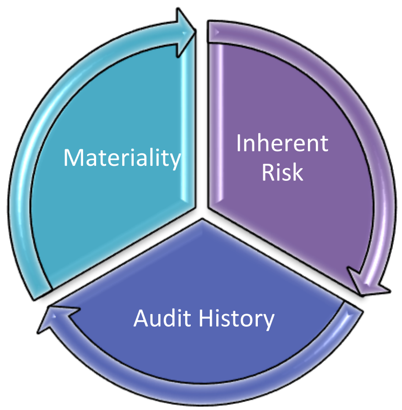
The model is based on the fundamental requirement that the audit plan proposed will deliver sufficient work to enable the Head of Audit to independently assess the internal control framework and give a reasonable assurance opinion at the end of each year.

This involves considering current context of the Authority, what a 'healthy organisation' requires to operate effectively and then assessing independently against this in a staged process as follows –

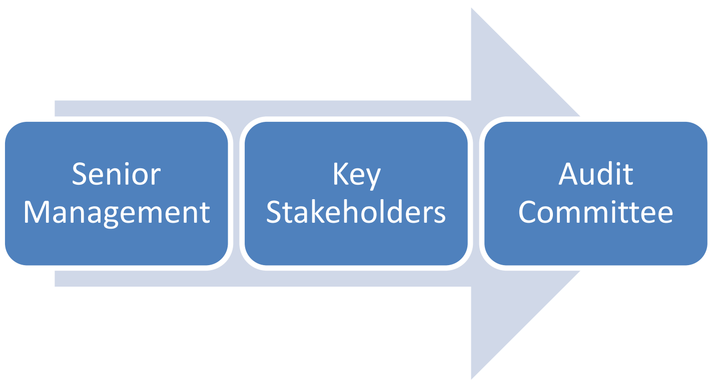


HIGH LEVEL ASSESSMENT AREAS – REASONABLE ASSURANCE

DETAILED CRITERIA – AUDIT PLAN LISTING



CONSULTATION & APPROVAL



Results of our Reasonable Assurance Model Risk Assessment –

LEVEL OF RISK	HIGH (Level of Assurance)				LOW (Level of Assurance)
HIGH					
		CORPORATE GOVERNANCE	FINANCIAL MANAGEMENT		
		PROGRAMME & PROJECT MANAGEMENT		PERFORMANCE MANAGEMENT	RISK MANAGEMENT
			INFORMATION MANAGEMENT	PROCUREMENT	
LOW				ASSET MANAGEMENT	

HIGH LEVEL OF ASSURANCE LOW

3 Areas for Review – 2018/19

Internal Audit Areas	Reasonable Assurance Theme
Core Systems	
Accounting Ledger – Control A/C Reconciliation	Financial Management
Bank Account Reconciliation	Financial Management
Financial Management	
Risk Management	Risk Management
Counter Fraud Arrangements	Risk Management
Corporate Governance	
Annual Governance Review (AGS)	Corporate Governance
Reasonable Assurance Model – Corporate Governance	Corporate Governance
Reasonable Assurance Model – Financial Management	Financial Management
Reasonable Assurance Model – Performance Management	Performance Management
Reasonable Assurance Model – Risk Management	Risk Management
Reasonable Assurance Model – Programme & Project Management	Programme & Project Management
Reasonable Assurance Model – Procurement	Procurement
Reasonable Assurance Model – Information Management	Information Management & Technology
Reasonable Assurance Model – Asset Management	Asset Management
Accountable Body Functions	
Adult Education	Risk & Performance Management
Future Bright	Risk & Performance Management
WOE Office (Accountable Body Status)	
Grant Funding (i.e. Local Growth Fund)	Financial Management
Follow-Up Reviews	Corporate Governance

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4 Methodology, Approach & Standards

Introduction:

Internal Audit is an assurance function that provides an independent and objective opinion to the Authority on its control environment. Scope of Internal Audit activity is not limited to the Authority's financial systems and records, but extends to all its functions.

Internal Audit is required to compile each year a Plan of its intended activity for approval by the Audit Committee and to be compliant with the Public Sector Internal Audit Standards and designs its methodologies to ensure it meets these standards.

Independence:

A critical element of the performance of Internal Audit is independence from the activities audited. This enables the function to form impartial and effective judgment for the opinions and recommendations made.

To help ensure independence, Internal Audit is delivered through a contractual arrangement with Bath & North East Somerset Council and so is not fettered by any management reporting line restrictions. It also has unrestricted access to Senior Management & Members, particularly, the Mayor, Chair of the Audit Committee, the Chief Executive, Directors, the Council's s151 Officer and Monitoring Officer. Additionally, the Head of Audit West reports in his own name and acts as Chief Audit Executive for the Combined Authority.

Relationship with the Authority's External Auditor:

As part of their audit of the financial statements, the external auditor has a dedicated plan from which they carry out specific reviews of the Authority's activities. The External Auditors carry out their own risk assessment methodology to assist in agreeing their work plan.

The working relationship between Internal Audit and the External Auditors carrying out their respective functions is important and must take account of their differing roles. The External Auditor has a statutory responsibility to express an opinion on the financial statements, whilst the Internal Audit function is responsible for assessing the adequacy and effectiveness of the internal controls and advising Management accordingly.

The External Auditors whilst not formally required to seek reliance on the work of Internal Audit take into account the outcomes of all audit activity and consider their approach and plans to maximise their effectiveness and there is therefore regular contact between them.

Performance Management

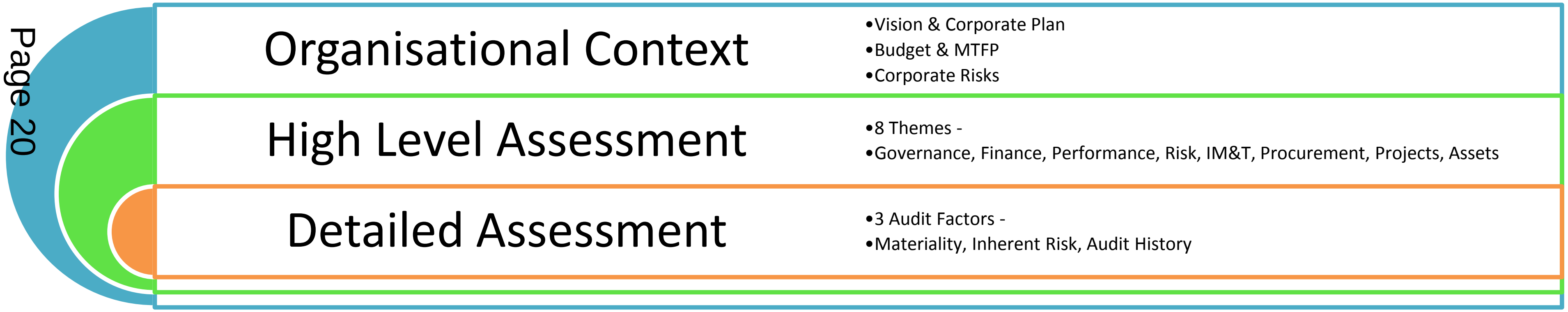
The function recognises the importance of regular and effective performance management to ensure an effective service is being operated. A performance dashboard is produced and reported as necessary to each of the key stakeholders.

Performance Indicators and Measures are set in the following areas –

Completion of the Plan
Audit Recommendations Implemented
Assurance Levels Provided
Productivity
Customer Satisfaction
Numbers of Investigations
Unplanned Work

Preparation of the Annual Plan: Reasonable Assurance Model

Internal Audit has adopted a risk based approach in determining its Annual Plan using the reasonable assurance model.



Unplanned Work

The plan also allows for a contingency for any unplanned work. Unplanned work consists of the investigation of irregularities and prioritised ‘consultancy’ work. If this contingency number of days is fully utilised and further unplanned work is required it is the intention that planned audit reviews, with the lowest risk rating, will be replaced by the unplanned work activity.

In view of the ever changing environment in which Local Government exists the Plan will be reconsidered at regular intervals to confirm that the remaining work planned is still appropriate. This process will be carried out in consultation with Senior Management and in particular the S151 Officer who acts as the principal client for the function.

Methodology:

Individual Audit Reviews:

At the commencement of each Audit Review, an Audit Brief (**Annex A**) will be prepared and issued to the relevant Head of Service/Director and responsible Manager. This Brief will identify the objectives of the review and areas to be covered.

At the conclusion of each review, an end of review meeting will be held with the Client to discuss the matters arising. Following the conclusion of the audit review work a ‘draft’ audit report will be issued to Management. The report will provide a graded ‘Assurance Level’ (see ANNEX B); a summary of identified strengths & weaknesses; and a detailed action plan recording weaknesses & recommendations.

The nominated responsible Manager is required to respond to the audit findings and recommendations and prepare an action implementation plan recording responsible officers and timescale for implementation. The management comments and implementation plan are compiled into a ‘final’ version of the report. The relevant Director, Chief Executive and the Audit Committee will be informed of the outcome of any work which receives a level 1 rating.

Audit Review ‘Follow-Ups’:

Internal Audit recommendations are subject to “follow-up” to ensure actions are implemented within the agreed timescales. The process is dependent on the risk classification and for all ‘High’ risk recommendations Internal Audit will carry out testing to confirm implementation and report its back to the Client. Where an area has a level 1 rating this may be reported to the Audit Committee.

Investigation of Fraud & Corruption:

Senior Management have the primary responsibility for the prevention and detection of fraud and other financial irregularities. Internal Audit will however ensure it provides a lead in supporting management in this area, including design of appropriate strategies, policies and levels of control and will be alert in all their work to the possibility of theft, fraud, corruption and bribery.

Professional Standards

All Internal Audit functions are required to comply the professional standards set out by the Chartered Institute of Internal Auditors and endorsed by CIPFA. Evidence of this compliance is through a formal external assessment every 5 years and annual self-assessments.

Audit West received a formal external self-assessment in March 2018 and it was confirmed that it was confirming with the standards. Updates will be provided to the Audit Committee of areas for improvement on an annual basis.

AUDIT BRIEF

Title	**{Title}**	
Purpose of Review	To review the risks and internal controls related to the scope of the audit (detailed below) and provide management with an opinion on the adequacy of the framework of internal control.	
Scope of Review	The audit will review the following key risks/control objectives: • Ensure…… • Ensure…… • Ensure……	
Key Stages of Review Process		
Timeframe	**Fieldwork Starts:** {Date}	**Draft Report:** {Date}
Key Contacts	**Lead Auditor:** {Name}	**Lead Client:** {Name}
Service Charter & Professional Standards	Our customer service charter outlines what you can expect from us and what in turn we need from you to complete this audit. All audit work is reported to and monitored by the Audit Committee. All audit work complies with Public Sector Internal Audit Standards.	

AUDIT OPINIONS

Assurance Level 5 **(Excellent)**

The systems of internal control are excellent with a number of strengths and reasonable assurance can be provided over all the areas detailed in the Assurance Summary.

- ***Assurance Level 4*** **(Good)**

The systems of internal control are good and reasonable assurance can be provided. Only minor weaknesses have been identified over the areas detailed in the Assurance Summary.

- ***Assurance Level 3*** **– (Satisfactory)**

The systems of internal control are satisfactory and reasonable assurance can be provided. However, there are a number of areas detailed in the Assurance Summary which require improvement and specific recommendations are detailed in the Action Plan.

- ***Assurance Level 2*** **– (Weak)**

The systems of internal control are weak and reasonable assurance could not be provided over a number of areas detailed in the Assurance Summary. Prompt action is necessary to improve the current situation and reduce risk exposure.

- ***Assurance Level 1*** **– (Poor)**

The systems of internal control are poor and there are fundamental weaknesses in the areas detailed in the Assurance Summary. Urgent action is necessary to reduce the high levels of risk exposure and the issues will be escalated to your Director and the Audit Committee.

CONTACT DETAILS

Engagement Lead –	Jeff Wring 01225 477323 jeff_wring@bathnes.gov.uk
Audit Team Leader -	Mark Wheeler 01225 477286 Mark_wheeler@bathnes.gov.uk
Address	Audit West Resources The Guildhall High Street BATH, BA1 5AW

ITEM: 7

REPORT TO: WEST OF ENGLAND COMBINED AUTHORITY AUDIT COMMITTEE

DATE: 21 FEBRUARY 2019

REPORT TITLE: EXTERNAL AUDIT PLAN

AUTHOR: MALCOLM COE – DIRECTOR OF INVESTMENT AND CORPORATE SERVICES (S151 OFFICER)

Purpose of Report

1. To consider the External Audit Plan for the year ending 31 March 2019.

Issues for Consideration

2. The External Auditor has provided the External Audit Plan for 2018/19 for consideration by the Committee (**Appendix 1**).

3. The External Auditor will provide a full briefing on the plan at the meeting.

Report Narrative / Main Content

4. The External Audit Plan provides an overview of the planned scope and timing of the statutory audit of the West of England Combined Authority for consideration by the Audit Committee. The Plan sets out the Audit approach in relation to significant risks, materiality, value for money arrangements, audit logistics and independence.

Consultation:

5. The plan has been produced in consultation with the WECA s151 Officer and the appointed Internal Audit provider (Audit West).

Public Sector Equality Duties:

6. No direct implications

Economic Impact Assessment:

7. No direct implications.

Finance Implications:

8. The External Audit Plan supports the statutory audit requirements for the Annual Accounts and the fee for this work is agreed by Public Sector Auditor Appointments Ltd.

Legal Implications:

9. The work that the External Auditors carry out on the 2018/19 accounts is completed based on the requirements set out in the Local Audit and Accountability Act 2014 and under the Code of Audit Practice published by the National Audit Office.

Land/Property Implications;

10. No direct implications.

Human Resources Implications:

11. No direct implications.

Recommendation:

12. To note the External Audit Plan for 2018/19.

Report Author: Malcolm Coe – Director of Investment & Corporate Services

West of England Combined Authority Contact: Malcolm Coe – Director of Investment & Corporate Services

West of England Combined Authority Contact:
Any person seeking background information relating to this item should seek the assistance of the contact officer for the meeting who is Ian Hird / Tim Milgate on 0117 332 1486; or by writing to West of England Combined Authority, 3 Rivergate, Temple Way, Bristol BS1 6ER; email: democratic.services@westofengland-ca.gov.uk

APPENDIX 1

Grant Thornton

External Audit Plan

Year ending 31 March 2019

West of England Combined Authority

8 February 2019

Contents

Your key Grant Thornton team members are:

Barrie Morris

Director

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Michelle Burge

Manager

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Executive

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The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our audit planning process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect the Authority or all weaknesses in your internal controls. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

Introduction & headlines

Purpose

This document provides an overview of the planned scope and timing of the statutory audit of West of England Combined Authority ('the Authority') for those charged with governance.

Respective responsibilities

The National Audit Office ('the NAO') has issued a document entitled Code of Audit Practice ('the Code'). This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. Our respective responsibilities are also set out in the Terms of Appointment and Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA), the body responsible for appointing us as auditor of West of England Combined Authority. We draw your attention to both of these documents on the PSAA website.

Scope of our audit

The scope of our audit is set in accordance with the Code and International Standards on Auditing (ISAs) (UK). We are responsible for forming and expressing an opinion on the :

- Authority financial statements that have been prepared by management with the oversight of those charged with governance (the Audit committee); and
- Value for Money arrangements in place at the Authority for securing economy, efficiency and effectiveness in your use of resources.

The audit of the financial statements does not relieve management or the Audit Committee of your responsibilities. It is the responsibility of the Authority to ensure that proper arrangements are in place for the conduct of its business, and that public money is safeguarded and properly accounted for. We have considered how the Authority is fulfilling these responsibilities.

Our audit approach is based on a thorough understanding of the Authority's business and is risk based. We will be using our new audit methodology and tool, LEAP, for the 2018/19 audit. It will enable us to be more responsive to changes that may occur in your organisation.

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Significant risks	Those risks requiring special audit consideration and procedures to address the likelihood of a material financial statement error have been identified as: • Management override of controls • Valuation of net pension liability We will communicate significant findings on these areas as well as any other significant matters arising from the audit to you in our Audit Findings (ISA 260) Report.
Materiality	We have determined planning materiality to be £0.99m (PY £0.43m), which equates to 2% (PY £1%) of your forecast gross expenditure for the year. We are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. Clearly trivial has been set at £49k (PY £21k).
Value for Money arrangements	Our risk assessment regarding your arrangements to secure value for money have identified the following VFM significant risks: • Development of detailed Medium Term Financial Plan to support the Combined Authority's strategic objectives • Development of performance management framework against which the Authority can measure its impact and effectiveness and be accountable to stakeholders and tax payers.
Audit logistics	Our interim visit will take place in March 2019 and our final visit will take place in July 2019. Our key deliverables are this Audit Plan and our Audit Findings Report. Our audit approach is detailed in Appendix A. Our fee for the audit will be £18,634 (PY: £24,200) for the Authority, subject to the Authority meeting our requirements set out on page 10.
Independence	We have complied with the Financial Reporting Council's Ethical Standard and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements..

Key matters impacting our audit

Factors

The wider economy and political uncertainty

Local Government funding continues to be stretched with increasing cost pressures and demand. For the West of England Combined Authority discussions are ongoing with HMRC and Treasury in relation to future funding. The medium term financial plan will be updated and more detail included, as far as practicable, forming part of the 2019/20 budget process.

At a national level, the government continues its negotiation with the EU over Brexit, and future arrangements remain clouded in uncertainty. The Authority will need to ensure that it is prepared for all outcomes, including in terms of any impact on contracts, funding and it's longer term strategy.

Governance arrangements

2018/19 is the second full year of operation for the Combined Authority. The Authority's governance framework continues to evolve:

- Key personnel appointments, including statutory roles are now in place
- A operating framework and business Plan has been developed to support the delivery of the Authority's objectives.
- A risk management and performance management framework is now in place.
- Plans are being put in place to delegate central government budgets for transport, adult education and economic regeneration to the Combined Authority during 2019.

Changes to the CIPFA 2018/19 Accounting Code

The most significant changes relate to the adoption of:

- IFRS 9 Financial Instruments which impacts on the classification and measurement of financial assets and introduces a new impairment model.
- IFRS 15 Revenue from Contracts with Customers which introduces a five step approach to revenue recognition.

Our response

- We will consider your arrangements for managing and reporting your financial resources as part of our work in reaching our Value for Money conclusion.
- We will consider whether your financial position leads to material uncertainty about the going concern of the Authority and will review related disclosures in the financial statements.
- In the second full year of operation for the Combined Authority, we will consider the progress made against previously agreed recommendations arising from our 2017/18 VFM work in relation to the Authority's Medium Term Financial Plan (MTFP), Risk Management and Performance Management arrangements.

- We will keep you informed of changes to the financial reporting requirements for 2018/19 through on-going discussions and invitations to our technical update workshops.
- As part of our opinion on your financial statements, we will consider whether your financial statements reflect the financial reporting changes in the 2018/19 CIPFA Code.

Significant risks identified

Significant risks are defined by ISAs (UK) as risks that, in the judgement of the auditor, require special audit consideration. In identifying risks, audit teams consider the nature of the risk, the potential magnitude of misstatement, and its likelihood. Significant risks are those risks that have a higher risk of material misstatement.

Risk	Reason for risk identification	Key aspects of our proposed response to the risk
The revenue cycle includes fraudulent transactions (rebutted)	Under ISA (UK) 240 there is a rebuttable presumed risk that revenue may be misstated due to the improper recognition of revenue. This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition. Having considered the risk factors set out in ISA240 and the nature of the revenue streams at the Authority, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because: • there is little incentive to manipulate revenue recognition • opportunities to manipulate revenue recognition are very limited • the culture and ethical frameworks of combined authorities, including West of England Combined Authority mean that all forms of fraud are seen as unacceptable	Therefore we do not consider this to be a significant risk for West of England Combined Authority.
Management over-ride of controls	Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities. We therefore identified management override of control, in particular journals, management estimates and transactions outside the course of business as a significant risk, which was one of the most significant assessed risks of material misstatement.	We will: • evaluate the design effectiveness of management controls over journals • analyse the journals listing and determine the criteria for selecting high risk unusual journals • test unusual journals recorded during the year and after the draft accounts stage for appropriateness and corroboration • gain an understanding of the accounting estimates and critical judgements applied made by management and consider their reasonableness with regard to corroborative evidence • evaluate the rationale for any changes in accounting policies, estimates or significant unusual transactions.

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Significant risks identified

Risk	Reason for risk identification	Key aspects of our proposed response to the risk
Valuation of the pension fund net liability	The Authority's pension fund net liability, as reflected in its balance sheet as the net defined benefit liability, represents a significant estimate in the financial statements. The pension fund net liability is considered a significant estimate due to the size of the numbers involved (£1.7 million in the Authority's balance sheet) and the sensitivity of the estimate to changes in key assumptions. We therefore identified valuation of the Authority's pension fund net liability as a significant risk, which was one of the most significant assessed risks of material misstatement	We will: • update our understanding of the processes and controls put in place by management to ensure that the Authority's pension fund net liability is not materially misstated and evaluate the design of the associated controls; • evaluate the instructions issued by management to their management expert (an actuary) for this estimate and the scope of the actuary's work; • assess the competence, capabilities and objectivity of the actuary who carried out the Authority's pension fund valuation; • assess the accuracy and completeness of the information provided by the Authority to the actuary to estimate the liability; • test the consistency of the pension fund asset and liability and disclosures in the notes to the core financial statements with the actuarial report from the actuary; • undertake procedures to confirm the reasonableness of the actuarial assumptions made by reviewing the report of the consulting actuary (as auditor's expert) and performing any additional procedures suggested within the report; and • obtain assurances from the auditor of Avon Pension Fund as to the controls surrounding the validity and accuracy of membership data; contributions data and benefits data sent to the actuary by the pension fund and the fund assets valuation in the pension fund financial statements.

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We will communicate significant findings on these areas as well as any other significant matters arising from the audit to you in our Audit Findings Report in July 2019.

Other matters

Other work

In addition to our responsibilities under the Code of Practice, we have a number of other audit responsibilities, as follows:

- We read your Narrative Report and Annual Governance Statement to check that they are consistent with the financial statements on which we give an opinion and consistent with our knowledge of the Authority.
- We carry out work to satisfy ourselves that disclosures made in your Annual Governance Statement are in line with the guidance issued by CIPFA.
- We carry out work on your consolidation schedules for the Whole of Government Accounts process in accordance with NAO group audit instructions.
- We consider our other duties under legislation and the Code, as and when required, including:
  - Giving electors the opportunity to raise questions about your 2018/19 financial statements, consider and decide upon any objections received in relation to the 2018/19 financial statements;
  - issue of a report in the public interest or written recommendations to the Authority under section 24 of the Act, copied to the Secretary of State.
  - Application to the court for a declaration that an item of account is contrary to law under Section 28 or for a judicial review under Section 31 of the Act; or
  - Issuing an advisory notice under Section 29 of the Act.
- We certify completion of our audit.

Other material balances and transactions

Under International Standards on Auditing, "irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance and disclosure". All other material balances and transaction streams will therefore be audited. However, the procedures will not be as extensive as the procedures adopted for the risks identified in this report.

Going concern

As auditors, we are required to “obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about the Authority's ability to continue as a going concern” (ISA (UK) 570). We will review management's assessment of the going concern assumption and evaluate the disclosures in the financial statements.

Materiality

The concept of materiality

The concept of materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to the monetary misstatements but also to disclosure requirements and adherence to acceptable accounting practice and applicable law. Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Materiality for planning purposes

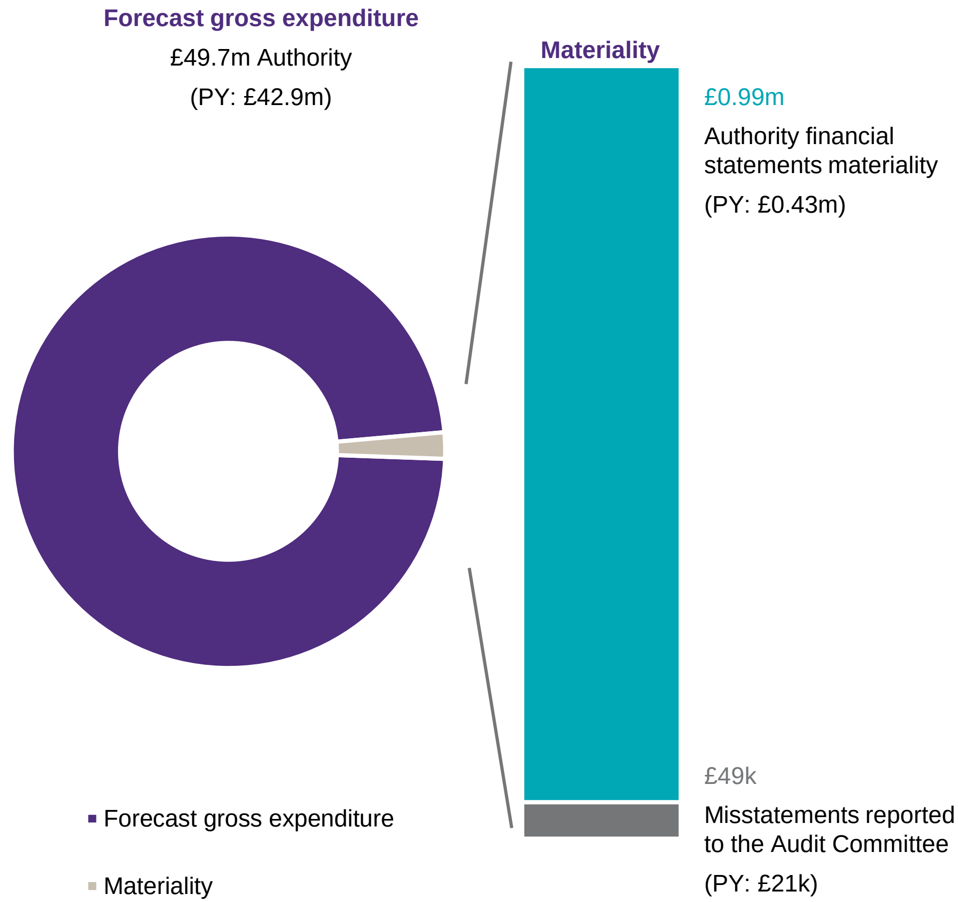
We have determined financial statement materiality based on a proportion of the gross expenditure of the Authority for the financial year. In the prior year we used the same benchmark. Materiality at the planning stage of our audit is £0.99m (PY £0.43m), which equates to 2% of your forecast gross expenditure for the year. We design our procedures to detect errors in specific accounts at a lower level of precision which we have determined to be £20k for Senior officer remuneration.

We reconsider planning materiality if, during the course of our audit engagement, we become aware of facts and circumstances that would have caused us to make a different determination of planning materiality.

Matters we will report to the Audit Committee

Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Audit Committee any unadjusted misstatements of lesser amounts to the extent that these are identified by our audit work. Under ISA 260 (UK) ‘Communication with those charged with governance’, we are obliged to report uncorrected omissions or misstatements other than those which are ‘clearly trivial’ to those charged with governance. ISA 260 (UK) defines ‘clearly trivial’ as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria. In the context of the Authority, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £49k (PY £21k).

If management have corrected material misstatements identified during the course of the audit, we will consider whether those corrections should be communicated to the Audit Committee to assist it in fulfilling its governance responsibilities.



Value for Money arrangements

Background to our VFM approach

The NAO issued its guidance for auditors on Value for Money work in November 2017. The guidance states that for Local Government bodies, auditors are required to give a conclusion on whether the Authority has proper arrangements in place to secure value for money.

The guidance identifies one single criterion for auditors to evaluate:

"In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people."

This is supported by three sub-criteria, as set out below:

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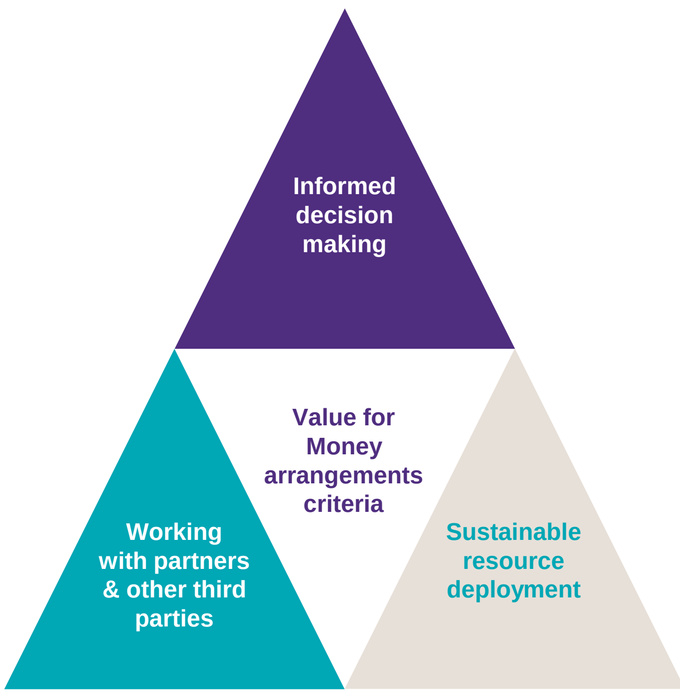


Significant VFM risks

Those risks requiring audit consideration and procedures to address the likelihood that proper arrangements are not in place at the Authority to deliver value for money.

Medium Term Financial Plan (MTFP)

The Combined Authority is an evolving organisation taking on more responsibilities as it becomes more established and new opportunities arise. Consequently there are a number of emerging factors which will have an impact on it's financial sustainability and medium term financial plan.

It is important to ensure that any new funding responsibilities are aligned to sustainable funding streams and that a more detailed MTFP, supported by appropriate financial information, is developed once funding streams are confirmed. The Plan will need to remain flexible as the new opportunities for projects and funding are identified.

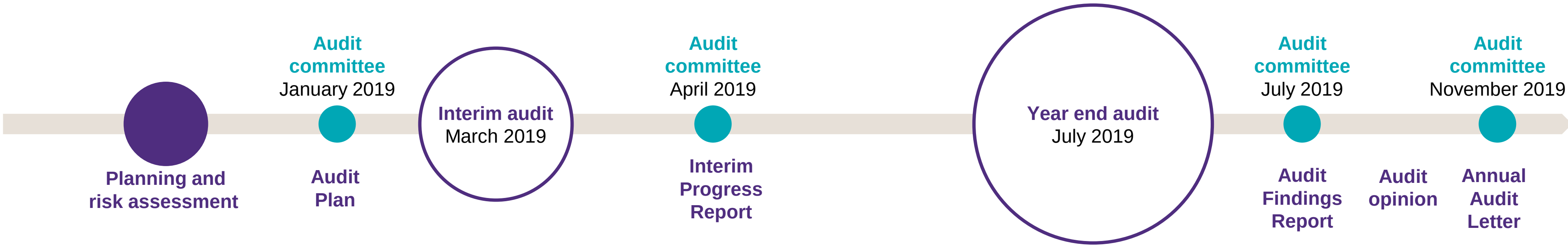
We will review the revised MTFP prepared as part of the 2019/20 budget process to assess the clarity of the information provided and the factors used to inform the assumptions that underpin the strategy.

Measuring and Monitoring Performance

Recognising 2017/18 was the first full year of operation, good progress was made to develop priorities, objectives and tasks from which the performance of the Combined Authority can be measured in future years. The Authority should ensure that it monitors the performance of the Combined Authority through the performance management framework. The performance management framework should ensure that all objectives have measurable metrics, either based on inputs, outputs or outcomes, against which the Authority can measure its impact and effectiveness and be accountable to stakeholders and tax payers.

We will review progress made in developing and monitoring performance metrics to measure and monitor the performance of the Combined Authority.

Audit logistics, team & fees



Barrie Morris, Engagement Lead

Barrie leads our relationship with you and is a key contact for the Chief Executive, Director of Investment and Corporate Services and Audit Committee. Barrie takes overall responsibility for the delivery of a high quality audit, meeting the highest professional standards and adding value to the Combined Authority.

Michelle Burge, Audit Manager

Michelle's role involves overseeing the day to day planning and execution of the audit, ensuring the audit requirements are fully complied with and producing reports for the Audit Committee. She will respond to ad-hoc queries whenever raised and meet regularly with the Director of Investment and Corporate Services and members of the finance team.

Rob Patterson, Audit Incharge

Rob's role is to co-ordinate the on-site delivery of audit tasks through his own work and that of junior team members. He liaises with the finance team throughout audit visits and will keep them up to date on progress and any issues arising throughout the year.

Audit fees

The planned audit fees are £18,634 (PY: £24,200) for the financial statements audit completed under the Code, which are inline with the scale fee published by PSAA. There is no non-Code (as defined by PSAA) work planned. In setting your fee, we have assumed that the scope of the audit, and the Authority and its activities, do not significantly change.

Our requirements

To ensure the audit is delivered on time and to avoid any additional fees, we have detailed our expectations and requirements in the following section 'Early Close'. If the requirements detailed overleaf are not met, we reserve the right to postpone our audit visit and charge fees to reimburse us for any additional costs incurred.

Early close

Meeting the 31 July audit timeframe

In the prior year, the statutory date for publication of audited local government accounts was brought forward to 31 July, across the whole sector. This was a significant challenge for local authorities and auditors alike. For authorities, the time available to prepare the accounts was curtailed, while, as auditors we had a shorter period to complete our work and faced an even more significant peak in our workload than previously.

In 2017/18 the Authority presented us with draft accounts in accordance with the national deadline, and provided a good set of working papers to support them. We gave an unqualified opinion on the Authority's financial statements on 13 July 2018, 18 days in advance of the national deadline.

We have carefully planned how we can make the best use of the resources available to us during the final accounts period. As well as increasing the overall level of resources available to deliver audits, we have focused on:

- bringing forward as much work as possible to interim audits
- starting work on final accounts audits as early as possible, by agreeing which authorities will have accounts prepared significantly before the end of May
- seeking further efficiencies in the way we carry out our audits
- working with you to agree detailed plans to make the audits run smoothly, including early agreement of audit dates, working paper and data requirements and early discussions on potentially contentious items.

We are satisfied that, if all these plans are implemented, we will be able to complete your audit and those of our other local government clients in sufficient time to meet the earlier deadline.

Client responsibilities

Where individual clients do not deliver to the timetable agreed, we need to ensure that this does not impact on audit quality or absorb a disproportionate amount of time, thereby disadvantaging other clients. We will therefore conduct audits in line with the timetable set out in audit plans (as detailed on page 10). Where the elapsed time to complete an audit exceeds that agreed due to a client not meetings its obligations we will not be able to maintain a team on site. Similarly, where additional resources are needed to complete the audit due to a client not meeting their obligations we are not able to guarantee the delivery of the audit by the statutory deadline. Such audits are unlikely to be re-started until very close to, or after the statutory deadline. In addition, it is highly likely that these audits will incur additional audit fees.

Our requirements

To minimise the risk of a delayed audit or additional audit fees being incurred, you need to ensure that you:

- produce draft financial statements of good quality by the deadline you have agreed with us, including all notes, the narrative report and the Annual Governance Statement
- ensure that good quality working papers are available at the start of the audit, in accordance with the working paper requirements schedule that we have shared with you
- ensure that the agreed data reports are available to us at the start of the audit and are reconciled to the values in the accounts, in order to facilitate our selection of samples
- ensure that all appropriate staff are available on site throughout (or as otherwise agreed) the planned period of the audit
- respond promptly and adequately to audit queries.

In return, we will ensure that:

- the audit runs smoothly with the minimum disruption to your staff
- you are kept informed of progress through the use of an issues tracker and weekly meetings during the audit
- we are available to discuss issues with you prior to and during your preparation of the financial statements.

Independence & non-audit services

Auditor independence

Ethical Standards and ISA (UK) 260 require us to give you timely disclosure of all significant facts and matters that may bear upon the integrity, objectivity and independence of the firm or covered persons relating to our independence. We encourage you to contact us to discuss these or any other independence issues with us. We will also discuss with you if we make additional significant judgements surrounding independence matters.

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Financial Reporting Council's Ethical Standard and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements.

We confirm that we have implemented policies and procedures to meet the requirements of the Financial Reporting Council's Ethical Standard and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements. Further, we have complied with the requirements of the National Audit Office's Auditor Guidance Note 01 issued in December 2017 and PSAA's Terms of Appointment which set out supplementary guidance on ethical requirements for auditors of local public bodies.

Other services provided by Grant Thornton

For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Authority. No other services were identified.

The amounts detailed are fees agreed to-date for audit related and non-audit services to be undertaken by Grant Thornton UK LLP in the current financial year. All services have been approved by the Audit Committee. Any changes and full details of all fees charged for audit related and non-audit related services by Grant Thornton UK LLP and by Grant Thornton International Limited network member Firms will be included in our Audit Findings report at the conclusion of the audit.

grantthornton.co.uk

ITEM: 8

REPORT TO: **WEST OF ENGLAND COMBINED AUTHORITY AUDIT COMMITTEE**

DATE: **21 FEBRUARY 2019**

REPORT TITLE: **EXTERNAL AUDIT PROGRESS REPORT AND SECTOR UPDATE 2018/19**

AUTHOR: **MALCOLM COE – DIRECTOR OF INVESTMENT AND CORPORATE SERVICES (S151 OFFICER)**

Purpose of Report

1. To consider the External Audit Progress Report and Sector Update attached to this cover report.

Issues for Consideration

2. The External Auditor will provide a general update to the Committee on their work.

3. **Appendix 1** provides an update on the External Auditors work for the West of England Combined Authority, along with references to a number of national initiatives, announcements and publications of potential interest to the Committee.

4. The External Auditor will provide a fuller verbal briefing on these areas at the meeting.

Consultation:

5. Consultation has been carried out with the WECA s151 Officer and the appointed Internal Audit provider (Audit West).

Public Sector Equality Duties:

6. No direct implications.

Economic Impact Assessment:

7. No direct implications.

Finance Implications:

8. The External Audit Plan supports the statutory audit requirements for the Annual Accounts and the fee for this work is agreed by Public Sector Auditor Appointments Ltd. The financial implications of the Audit Fee are already contained within existing corporate budgets.

Legal Implications:

9. The work that the External Auditors carry out on the 2018/19 accounts is completed based on the requirements set out in the Local Audit and Accountability Act 2014 and under the Code of Audit Practice published by the National Audit Office.

Land/Property Implications;

10. No direct implications.

Human Resources Implications:

11. No direct implications

Recommendation:

12. The Audit Committee is asked to note the Progress Report and Sector Update.

Report Author: Malcolm Coe – Director of Investment & Corporate Services

West of England Combined Authority Contact: Malcolm Coe – Director of Investment & Corporate Services

West of England Combined Authority Contact:
Any person seeking background information relating to this item should seek the assistance of the contact officer for the meeting who is Ian Hird / Tim Milgate on 0117 332 1486; or by writing to West of England Combined Authority, 3 Rivergate, Temple Way, Bristol BS1 6ER; email: democratic.services@westofengland-ca.gov.uk

APPENDIX 1

Audit Progress Report and Sector Update

West of England Combined Authority
Year ending 31 March 2019

8 February 2019

Contents

Introduction

Barrie Morris

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Michelle Burge

Engagement Manager

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This paper provides the Audit Committee with a report on progress in delivering our responsibilities as your external auditors.

The paper also includes:

- a summary of emerging national issues and developments that may be relevant to you as a combined authority; and
- includes a number of challenge questions in respect of these emerging issues which the Committee may wish to consider (these are a tool to use, if helpful, rather than formal questions requiring responses for audit purposes)

Members of the Audit Committee can find further useful material on our website, where we have a section dedicated to our work in the public sector. Here you can download copies of our publications www.grantthornton.co.uk ..

If you would like further information on any items in this briefing, or would like to register with Grant Thornton to receive regular email updates on issues that are of interest to you, please contact either your Engagement Lead or Engagement Manager.

Progress at February 2019

Financial Statements Audit

We have started planning for the 2018/19 financial statements audit and have issued a detailed audit plan, setting out our proposed approach to the audit of the Authority's 2018/19 financial statements.

We are due to commence our interim audit in March 2019. Our interim fieldwork visit will include:

- Updated review of the Authority's control environment
- Updated understanding of financial systems
- Review of Internal Audit reports on core financial systems
- Early work on emerging accounting issues
- Early substantive testing

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We will report any findings from the interim audit to you in our Progress Report at the April Audit committee.

The statutory deadline for the issue of the 2018/19 opinion is 31 July 2019. We will discuss our plan and timetable with officers.

The final accounts audit is due to begin in July with findings reported to you in the Audit Findings Report by the deadline of 31 July 2019.

Value for Money

The scope of our work is set out in the guidance issued by the National Audit Office. The Code requires auditors to satisfy themselves that; "the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources".

The guidance confirmed the overall criterion as: "in all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people".

The three sub criteria for assessment to be able to give a conclusion overall are:

•Informed decision making

•Sustainable resource deployment

•Working with partners and other third parties

Details of our initial risk assessment to determine our approach are included in our Audit Plan. This is included as a separate agenda item.

We will report our work in the Audit Findings Report and give our Value For Money Conclusion by the deadline in July 2019.

Other areas

Meetings

We met with the Director of Investment and Corporate Services in January as part of our quarterly liaison meetings and continue to be in discussions with finance staff regarding emerging developments and to ensure the audit process is smooth and effective.

Events

We provide a range of workshops, along with network events for members and publications to support the Combined Authority.

Our annual accounts workshop is to take place in February 2019 and we have invited key members of your finance team to this.

Further details of the publications that may be of interest to the Combined Authority are set out in our Sector Update section of this report.

Audit Deliverables

2018/19 Deliverables	Planned Date	Status
Fee Letter Confirming audit fee for 2018/19.	April 2018	Complete
Accounts Audit Plan We are required to issue a detailed accounts audit plan to the Audit Committee setting out our proposed approach in order to give an opinion on the Combined Auhority's 2018-19 financial statements.	January 2019	Presented as separate item
Interim Audit Findings We will report to you the findings from our interim audit and our initial value for money risk assessment within our Progress Report.	April 2019	Not yet due
Audit Findings Report The Audit Findings Report will be reported to the July Audit Committee.	July 2019	Not yet due
Auditors Report This is the opinion on your financial statement, annual governance statement and value for money conclusion.	July 2019	Not yet due
Annual Audit Letter This letter communicates the key issues arising from our work.	August 2019	Not yet due

Sector Update

Local government bodies are tackling a continuing drive to achieve greater efficiency in the delivery of public services, whilst facing the challenges to address rising demand, ongoing budget pressures and social inequality.

Our sector update provides you with an up to date summary of emerging national issues and developments to support you. We cover areas which may have an impact on your organisation, the wider Local Government and the public sector as a whole. Links are provided to the detailed report/briefing to allow you to delve further and find out more.

Our public sector team at Grant Thornton also undertake research on service and technical issues. We will bring you the latest research publications in this update. We also include areas of potential interest to start conversations within the organisation and with audit committee members, as well as any accounting and regulatory updates.

- **Insights from local government sector specialists**
- **Reports of interest**
- **Accounting and regulatory updates**

More information can be found on our dedicated public sector and local government sections on the Grant Thornton website by clicking on the logos below:

Public Sector

Local government

Public Sector Audit Appointments – Report on the results of auditors' work 2017/18

This is the fourth report published by Public Sector Audit Appointments (PSAA) and summarises the results of auditors' work at 495 principal local government and police bodies for 2017/18. This will be the final report under the statutory functions from the Audit Commission Act 1998 that were delegated to PSAA on a transitional basis.

The report covers the timeliness and quality of financial reporting, auditors' local value for money work, and the extent to which auditors used their statutory reporting powers.

For 2017/18, the statutory accounts publication deadline came forward by two months to 31 July 2018. This was challenging for bodies and auditors and it is encouraging that 431 (87 per cent) audited bodies received an audit opinion by the new deadline.

The most common reasons for delays in issuing the opinion on the 2017/18 accounts were:

- technical accounting/audit issues;
- various errors identified during the audit;
- insufficient availability of staff at the audited body to support the audit;
- problems with the quality of supporting working papers; and
- draft accounts submitted late for audit.

All the opinions issued to date in relation to bodies' financial statements are unqualified, as was the case for the 2016/17 accounts. Auditors have made statutory recommendations to three bodies, compared to two such cases in respect of 2016/17, and issued an advisory notice to one body.

The number of qualified conclusions on value for money arrangements looks set to remain relatively constant. It currently stands at 7 per cent (32 councils, 1 fire and rescue authority, 1 police body and 2 other local government bodies) compared to 8 per cent for 2016/17, with a further 30 conclusions for 2017/18 still to be issued.

The most common reasons for auditors issuing qualified VFM conclusions for 2017/18 were:

- the impact of issues identified in the reports of statutory inspectorates, for example Ofsted;
- corporate governance issues;
- financial sustainability concerns; and
- procurement/contract management issues.

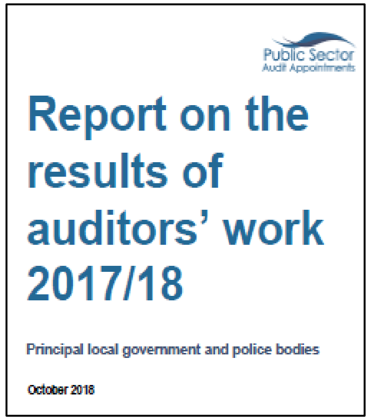
The report is available on the PSAA website:

https://www.psaa.co.uk/audit-quality/reports-on-the-results-of-auditors-work/

PSAA Report

Challenge question:

Has your Authority identified improvements to be made to the 2018/19 financial statements audit and Value for Money Conclusion?



National Audit Office – Local auditor reporting in England 2018

The report describes the roles and responsibilities of local auditors and relevant national bodies in relation to the local audit framework and summarises the main findings reported by local auditors in 2017-18. It also considers how the quantity and nature of the issues reported have changed since the Comptroller & Auditor General (C&AG) took up his new responsibilities in 2015, and highlights differences between the local government and NHS sectors.

Given increasing financial and demand pressures on local bodies, they need strong arrangements to manage finances and secure value for money. External auditors have a key role in determining whether these arrangements are strong enough. The fact that only three of the bodies (5%) the NAO contacted in connection with this study were able to confirm that they had fully implemented their plans to address the weaknesses reported suggests that while auditors are increasingly raising red flags, some of these are met with inadequate or complacent responses.

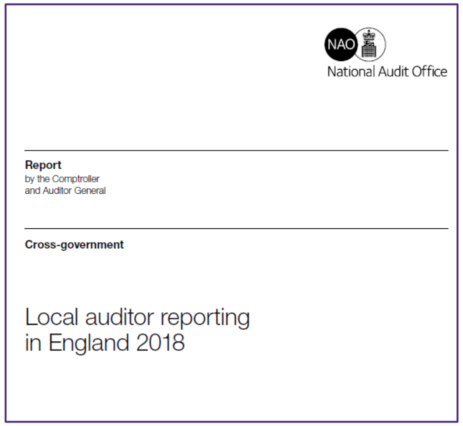
Qualified conclusions on arrangements to secure value for money locally are both unacceptably high and increasing. Auditors qualified their conclusions on arrangements to secure value for money at an increasing number of local public bodies: up from 170 (18%) in 2015-16 to 208 (22%) in 2017-18. As at 17 December 2018, auditors have yet to issue 20 conclusions on arrangements to secure value for money, so this number may increase further for 2017-18.

The proportion of local public bodies whose plans for keeping spending within budget are not fit-for-purpose, or who have significant weaknesses in their governance, is too high. This is a risk to public money and undermines confidence in how well local services are managed. Local bodies need to demonstrate to the wider public that they are managing their organisations effectively, and take local auditor reports seriously. Those charged with governance need to hold their executives to account for taking prompt and effective action. Local public bodies need to do more to strengthen their arrangements and improve their performance.

Local auditors need to exercise the full range of their additional reporting powers, where this is the most effective way of highlighting concerns, especially where they consider that local bodies are not taking sufficient action. Departments need to continue monitoring the level and nature of non-standard reporting, and formalise their processes where informal arrangements are in place. The current situation is serious, with trend lines pointing downwards.

The report is available on the NAO website:

https://www.nao.org.uk/report/local-auditor-reporting-in-england-2018/


NAO National Audit Office

Report
by the Comptroller
and Auditor General

Cross-government

Local auditor reporting
in England 2018

NAO Report

Challenge question:

Has your Authority responded appropriately to any concerns or issued raised in the External Auditor's report for 2017/18?

National Audit Office – Local authority governance

The report examines whether local governance arrangements provide local taxpayers and Parliament with assurance that local authority spending achieves value for money and that authorities are financially sustainable.

Local government has faced considerable funding and demand challenges since 2010-11. This raises questions as to whether the local government governance system remains effective. As demonstrated by Northamptonshire County Council, poor governance can make the difference between coping and not coping with financial and service pressures. The Department (Ministry of Housing, Communities and Local Government) places great weight on local arrangements in relation to value for money and financial sustainability, with limited engagement expected from government. For this to be effective, the Department needs to know that the governance arrangements that support local decision-making function as intended. In order to mitigate the growing risks to value for money in the sector the Department needs to improve its system-wide oversight, be more transparent in its engagement with the sector, and adopt a stronger leadership role across the governance network

Not only are the risks from poor governance greater in the current context as the stakes are higher, but the process of governance itself is more challenging and complex. Governance arrangements have to be effective in a riskier, more time-pressured and less well-resourced context. For instance, authorities need to:

• maintain tight budgetary control and scrutiny to ensure overall financial sustainability at a time when potentially contentious savings decisions have to be taken and resources for corporate support are more limited; and

• ensure that they have robust risk management arrangements in place when making commercial investments to generate new income, and that oversight and accountability is clear when entering into shared service or outsourced arrangements in order to deliver savings.

Risk profiles have increased in many local authorities as they have reduced spending and sought to generate new income in response to funding and demand pressures. Local authorities have seen a real-terms reduction in spending power (government grant and council tax) of 28.6% between 2010-11 and 2017-18. Demand in key service areas has also increased, including a 15.1% increase in the number of looked after children from 2010-11 to 2017-18. These pressures create risks to authorities' core objectives of remaining financially sustainable and meeting statutory service obligations. Furthermore, to mitigate these fundamental risks, many authorities have pursued strategies such as large-scale transformations or commercial investments that in themselves carry a risk of failure or under-performance.

The report is available on the NAO website:

https://www.nao.org.uk/report/local-authority-governance-2/

NAO Report

Challenge question:

Has your Authority got appropriate governance and risk management arrangements in place to address the risks and challenges identified in the NAO report?


NAO National Audit Office

Report
by the Comptroller
and Auditor General

Ministry of Housing, Communities & Local Government

Local authority governance

ICEAW Report: expectations gap

The Institute of Chartered Accountants in England and Wales (ICEAW) has published a paper on the 'expectation gap' in the external audit of public bodies.

Context:

The expectation gap is the difference between what an auditor actually does, and what stakeholders and commentators think the auditors obligations might be and what they might do. Greater debate being whether greater education and communication between auditors and stakeholders should occur rather than substantial changes in role and remit of audit.

What's the problem?

- **Short-term solvency vs. Longer-term value:**
  - LG & NHS: Facing financial pressures, oversight & governance pressures
- **Limited usefulness of auditors reports**: 'The VFM conclusion is helpful, but it is more about the system/arrangements in place rather than the actual effectiveness of value for money'
- **Other powers and duties**: implementing public interest reports in addition to VFM
- **Restricted role of questions and objections**: Misunderstanding over any objections/and or question should be resolved by the local public auditor. Lack of understanding that auditors have discretion in the use of their powers.
- **Audit qualification not always acted on by those charged with governance**: 'if independent public audit is to have the impact that it needs, it has to be taken seriously by those charged with governance'
- **Audit committees not consistently effective**: Local government struggles to recruit external members for their audit committees, they do not always have the required competencies and independence.
- **Decreased audit fees**: firms choose not to participate because considered that the margins were too tight to enable them to carry out a sufficient amount of work within the fee scales.
- **Impact of audit independence rules**: new independence rules don't allow for external auditors to take on additional work that could compromise their external audit role
- **Other stakeholders expectations not aligned with audit standards**
- **Increased auditor liability**: an auditor considering reporting outside of the main audit engagement would need to bill their client separately and expect the client to pay.

Future financial viability of local public bodies

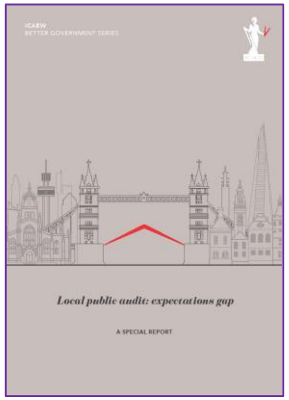
Local public bodies are being asked to deliver more with less and be more innovative and commercial. CFOs are, of course, nervous at taking risks in the current environment and therefore would like more involvement by their auditors. They want auditors to challenge their forward-looking plans and assumptions and comment on the financial resilience of the organisation..

The ICAEW puts forward two solutions:

Solution a) If CFO's want additional advisory work, rather than just the audit, they can separately hire consultants (either accountancy firms not providing the statutory audit or other business advisory organisations with the required competencies) to work alongside them in their financial resilience work and challenging budget assumptions.

Solution b) Wider profession (IFAC,IAASB, accountancy bodies) should consider whether audit, in its current form, is sustainable and fit for purpose. Stakeholders want greater assurance, through greater depth of testing, analysis and more detailed reporting of financial matters. It is perhaps, time to look at the wider scope of audit. For example, could there be more value in auditors providing assurance reports on key risk indicators which have a greater future-looking focus, albeit focused on historic data?

More information can be found in the link below (click on the cover page)



The expectations gap

Challenge question:

How effectively is the audit meeting client expectations?

Links

Grant Thornton website links

https://www.grantthornton.co.uk/

http://www.grantthornton.co.uk/industries/publicsector

National Audit Office link

https://www.nao.org.uk/report/local-auditor-reporting-in-england-2018/

https://www.nao.org.uk/report/local-authority-governance-2/

Public Sector Audit Appointments

https://www.psaa.co.uk/audit-quality/reports-on-the-results-of-auditors-work/

ITEM: 9

REPORT TO: **WEST OF ENGLAND COMBINED AUTHORITY AUDIT COMMITTEE**

DATE: **21 FEBRUARY 2019**

REPORT TITLE: **WECA TREASURY MANAGEMENT MID-YEAR REVIEW 2018/19**

AUTHOR: **MALCOLM COE – DIRECTOR OF INVESTMENT AND CORPORATE SERVICES (S151 OFFICER)**

Purpose of Report

1. To review the mid-year report for Treasury Management performance for 2018/19.

1.1 The CIPFA Treasury Management in the Public Services: Code of Practice requires the authority to approve a Treasury Management Strategy before the start of each financial year, review performance during the year, and approve an annual report after the end of each financial year. This report provides a review of performance to 30th September 2018.

Background / Issues for Consideration

2 **Summary**

2.1 The average rate of investment return for 2018/19 is 0.80%, which is 0.32% above the benchmark rate.

2.2 The Authority's Prudential Indicators for 2018/19 were agreed by the Authority at its meeting on 2nd February 2018 and performance against the key indicators is shown in **Appendix 1**. All indicators are within target levels.

Summary of Returns

2.3 The Authority's investment position as at 30th September 2018 is given in **Appendix 2**. This shows a change in Investment Balances to £198.2m at 30th September 2018 from £203.3m at 30th June 2018, which reflects net payments made.

2.4 The Authority's Prudential Indicators for 2018/19 were agreed by the Authority at its meeting on 2nd February 2018 and performance against the key indicators is shown in **Appendix 1**. All indicators are within target levels.

2.5 The Authority is the Accountable Body for the West of England Revolving Investment Fund (RIF) a role previously undertaken by B&NES who received grant funding of £57 million at the end of the 2011/12 financial year. The balances at 30th September 2018 was £19.5m and this sum, prior to distribution, is being invested in line with the Authority's overall Treasury Management Strategy, with the interest earmarked to the RIF.

2.6 The Authority also acts as Accountable Body for the West of England Local Enterprise Partnership (WoE LEP). In 2018/19 £45.4m of Local Growth Fund (LGF) grant was received from Central Government, along with the remaining sums gave a balance at 30th September 2018 of £80.4m. This sum, prior to distribution, is being invested in line with the Authority's overall Treasury Management Strategy and with interest earmarked to fund associated operating and governance costs.

2.7 Gross interest earned on all investments for April to September 2018 is estimated at £786k. Interest earned for RIF and LGF is ringfenced to those funds, giving rise to a forecast income outturn of £1.004m for the WECA fund, mainly arising from Investment Fund balances. **Appendix 3** details the investment performance, showing the average rate of interest earned over this period was 0.80%, which was 0.32% above the benchmark rate of average 7 day LIBID +0.05% (0.48%). This arises from the longer investment duration arising on the funds as investment periods range from an on-call basis out to 24 months.

Summary of Borrowings

2.8 The Authority's currently has no external borrowing. Any future borrowing requirement would be subject to the Authority's decision making process and the HM Treasury cap. For reference only, the statutory framework for Borrowing is set out in **Appendix 1.**

Strategic and Tactical Decisions

2.9 As shown in the charts at **Appendix 2**, the investment portfolio has been diversified across UK Banks and Building Societies and Local Authorities, which totalled £161m. The Authority also uses AAA rated Money Market funds to maintain very short-term liquidity with £27.3m invested in Money Market Funds as at 30th September 2018.

2.10 The Authority retains units in the CCLA Property Fund with an investment of £10.0m. This investment seeks to enhance yields, provide diversification and is intended to be held for higher return over a long period of time.

2.11 The Authority does not hold any direct investments with banks in countries within the Eurozone reflecting both on the underlying debt issues in some Eurozone countries and the low levels of interest rates. The Authority's investment counterparty list does not currently include any banks from Portugal, Ireland, Greece, Spain and Italy.

Future Strategic and Tactical Issues

2.12 The Authority's treasury management advisors have provided an economic and market review for 2018/19 – attached at **Appendix 5**.

2.13 The rebound in quarterly GDP growth in Q2 to 0.4% appeared to overturn the weakness in Q1 which was largely due to weather-related factors. However, the detail showed much of Q2 GDP growth was attributed to an increase in inventories. Year/year GDP growth at 1.2% also remains below trend. The Bank of England Monetary Policy Committee (MPC) made a unanimous decision for a rate rise of 0.25% in August 2018, taking Bank Rate to 0.75%, but maintains expectations of a slow rise in interest rates over the forecast horizon.

Consultation:

3. Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Director of Investment and Corporate Services and designated staff, who must act in line with the treasury management strategy. Reports on treasury management activity are presented to the WECA Committee, with the Audit Committee being responsible for scrutinising treasury management decisions.

Public Sector Equality Duties:

4. No direct implications.

Economic Impact Assessment:

5. As set out in the attached report.

Finance Implications:

6. A breakdown of the revenue budget for interest and the year-end outturn position is included in **Appendix 6.**

Legal Implications:

7. The Prudential Code and CIPFA's Code of Practice on Treasury Management requires regular monitoring and reporting of Treasury Management activities.

Land/Property Implications;

8. There are no Land/property implications arising as a result of this report.

Human Resources Implications:

9. There are no Human Resources implications arising as a result of this report.

Recommendation:

10. **The Audit Committee is recommended to;**

    - **Note the Treasury Management Report to 30th September 2018, prepared in accordance with the CIPFA Treasury Code of Practice.**
    - **Note the Treasury Management Indicators to 30th September 2018.**

Report Author: Malcolm Coe – Director of Investment & Corporate Services

West of England Combined Authority Contact: Malcolm Coe – Director of Investment & Corporate Services

West of England Combined Authority Contact:
Any person seeking background information relating to this item should seek the assistance of the contact officer for the meeting who is Ian Hird / Tim Milgate on 0117 332 1486; or by writing to West of England Combined Authority, 3 Rivergate, Temple Way, Bristol BS1 6ER; email: democratic.services@westofengland-ca.gov.uk

Appendices & Background Papers:

Treasury Management Strategy Statement & Investment Strategy 2018/19 – As reported to WECA Committee on 2nd February 2018.

Appendix 1 – Performance Against Prudential Indicators
Appendix 2 – The Authority's Investment Position at 30 September 2018
Appendix 3 – Average monthly rate of return for 2018/19
Appendix 4 – The Authority's External Borrowing Position at 30 September 2018
Appendix 5 – Arlingclose's Economic & Market Review for Q2 2018/19
Appendix 6 – Interest & Capital Financing Budget Monitoring 2018/19
Appendix 7 – Summary Guide to Credit Ratings

West of England Combined Authority Contact:
Any person seeking background information relating to this item should seek the assistance of the contact officer for the meeting who is Ian Hird / Tim Milgate on 0117 332 1486; or by writing to West of England Combined Authority, 3 Rivergate, Temple Way, Bristol BS1 6ER; email: democratic.services@westofengland-ca.gov.uk

APPENDIX 1

Performance against Treasury Management Indicators agreed in Treasury Management Strategy Statement

1. Authorised limit for external debt

These limits include current commitments and proposals in the budget report for capital expenditure, plus additional headroom over & above the operational limit for unusual cash movements.

	2018/19 Prudential Indicator	Actual as at 30th September 2018
	£'000	£'000
Borrowing	0	0
Other long term liabilities	0	0
Cumulative Total	**0**	**0**

2. Operational limit for external debt

The operational boundary for external debt is based on the same estimates as the authorised limit but without the additional headroom for unusual cash movements.

	2018/19 Prudential Indicator	Actual as at 30th September 2018
	£'000	£'000
Borrowing	0	0
Other long term liabilities	0	0
Cumulative Total	**0**	**0**

3. Upper limit for fixed interest rate exposure

This is the maximum amount of total borrowing which can be at fixed interest rate, less any investments for a period greater than 12 months which has a fixed interest rate.

	2018/19 Prudential Indicator	Actual as at 30th September 2018
	%	%
Fixed interest rate exposure	**100**	**0**

4. Upper limit for variable interest rate exposure

While fixed rate borrowing contributes significantly to reducing uncertainty surrounding interest rate changes, the pursuit of optimum performance levels may justify keeping flexibility through the use of variable interest rates. This is the maximum amount of total borrowing which can be at variable interest rates.

	2018/19 Prudential Indicator	Actual as at 30th September 2018
	%	%
Variable interest rate exposure	**10%**	**0%**

5. Upper limit for total principal sums invested for over 364 days

This is the maximum amount of total investments which can be over 364 days. 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.

	2018/19 Prudential Indicator	**Actual as at 30th September 2018**
	%	%
Investments over 364 days	**30**	**16.6**

6. Maturity Structure of borrowing
This indicator is set to control the Authority's exposure to refinancing risk.

	Upper Limit	**Lower Limit**	**Actual as at 30th September 2018**
	%	%	%
Under 12 months	50	Nil	0
12 months and within 24 months	75	Nil	0
24 months and within 5 years	75	Nil	0
5 years and within 10 years	100	Nil	0
10 years and above	100	Nil	0

7. Average Credit Rating
The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the weighted average credit rating of its investment portfolio. A summary guide to credit ratings is set out at **Appendix 7**. The figure excludes the Property Fund Investment.

	2018/19 Prudential Indicator	**Actual as at 30th September 2018**
	Rating	Rating
Minimum Portfolio Average Credit Rating	**A-**	**AAA-**

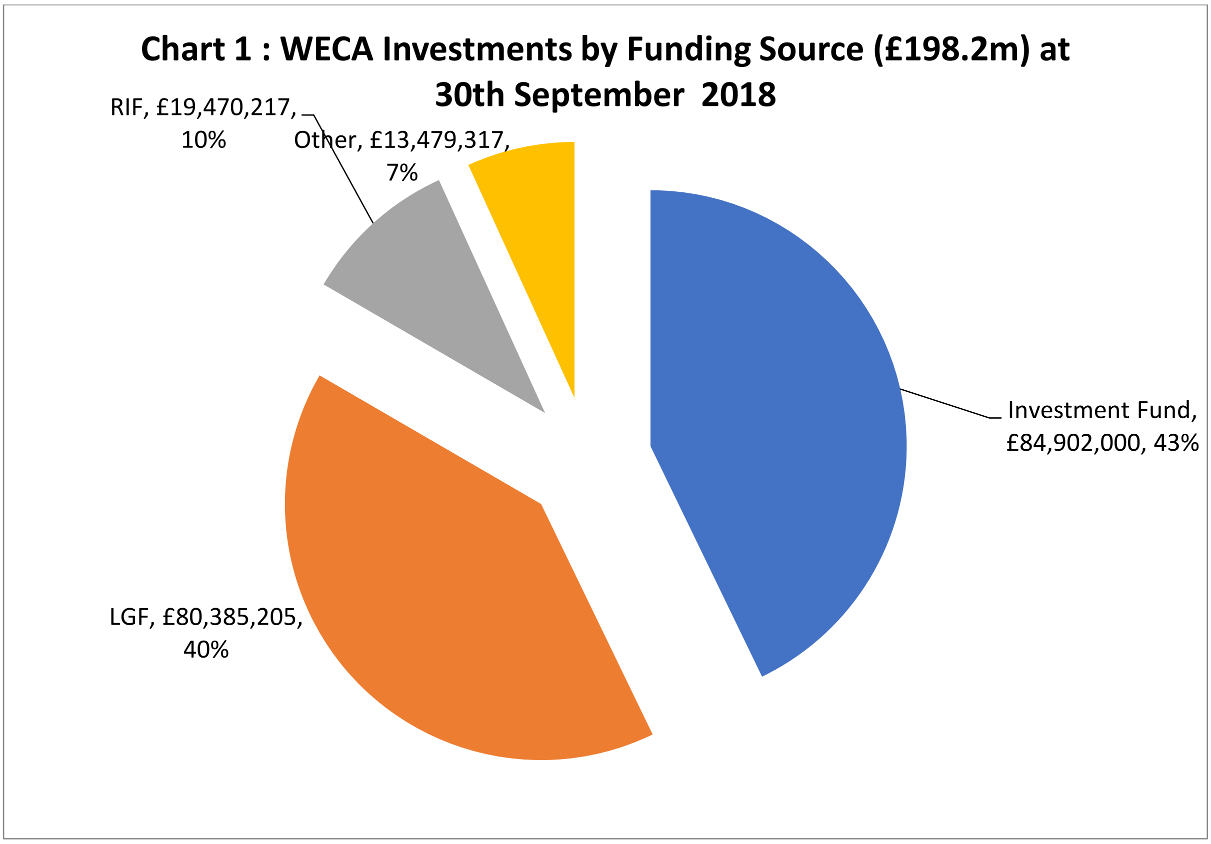
APPENDIX 2

The Authority's Investment position at 30th September 2018

The term of investments, from the original date of the deal, are as follows:

	Balance at 30th September 2018 (Duration from Original date of Deal) £000
Notice (instant access funds)	27,280
Up to 1 month	0
1 month to 3 months	25,000
4 to 6 months	5,000
6 to 12 months	98,000
More than 12 months	33,000
Property Fund	9,957
Total	**198,237**

The Authority had a total average net positive balance of £195.3m during the period April to September 2018.



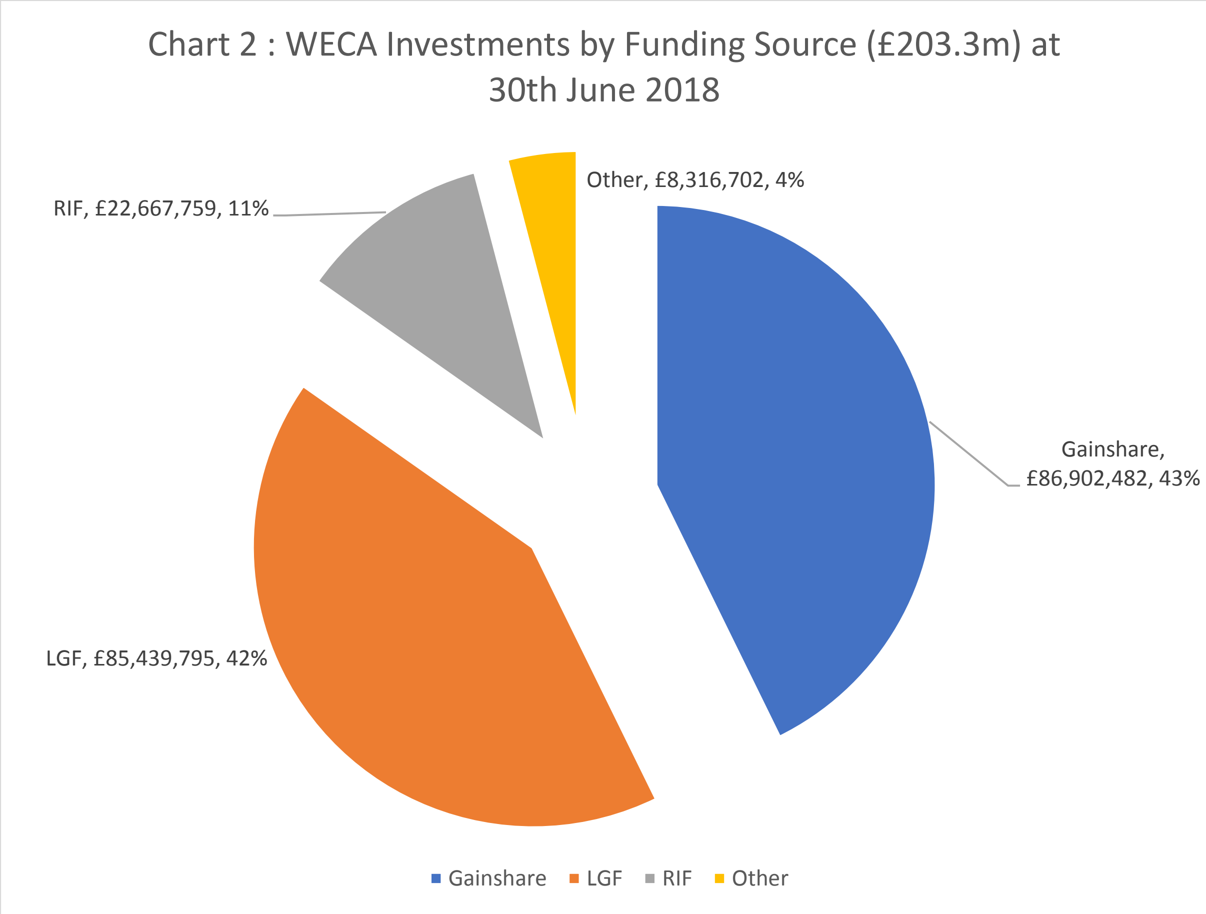


Chart 2 : WECA Investments by Funding Source (£203.3m) at 30th June 2018
Other, £8,316,702, 4%
RIF, £22,667,759, 11%
Gainshare, £86,902,482, 43%
LGF, £85,439,795, 42%
Gainshare
LGF
RIF
Other

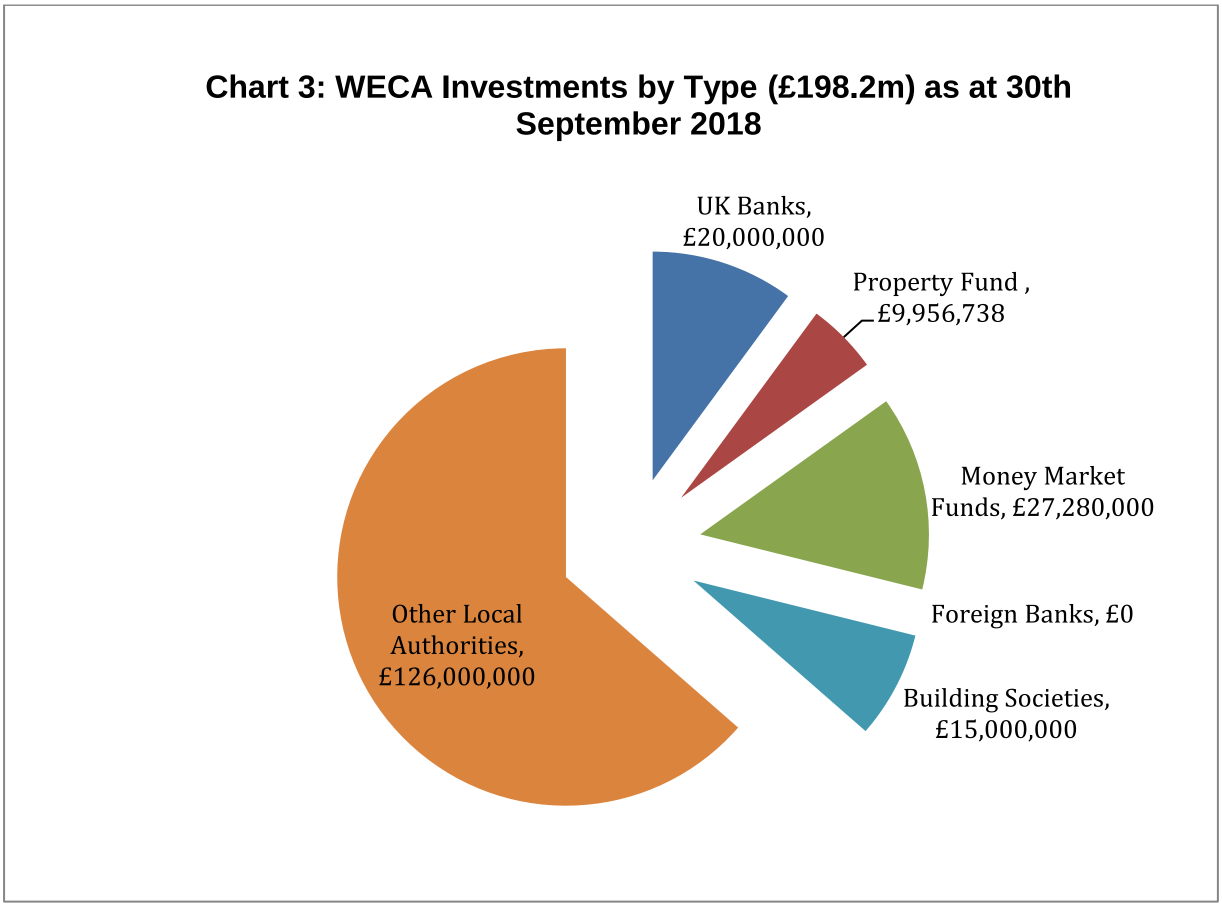


Chart 3: WECA Investments by Type (£198.2m) as at 30th September 2018
UK Banks, £20,000,000
Property Fund , £9,956,738
Money Market Funds, £27,280,000
Foreign Banks, £0
Building Societies, £15,000,000
Other Local Authorities, £126,000,000

Chart 4: WECA Investments by Type (£203.3m) as at 30th June 2018

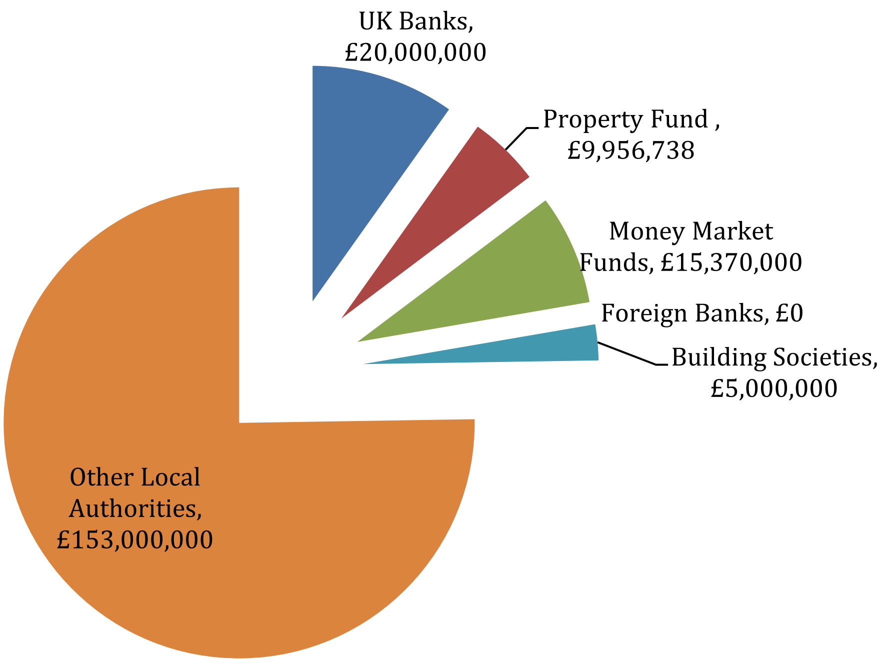


Chart 5: WECA Investments per lowest equivalent Long Term credit rating (£198.2m) at 30th September 2018

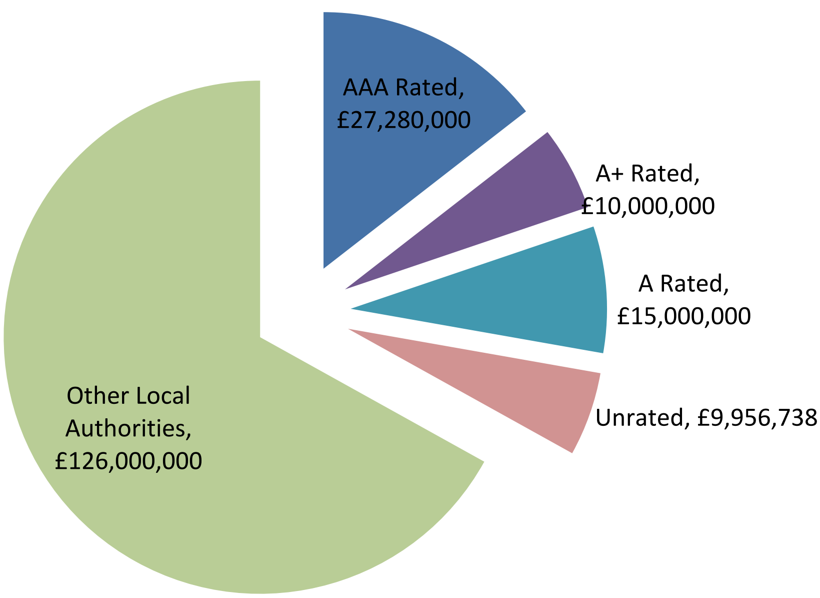
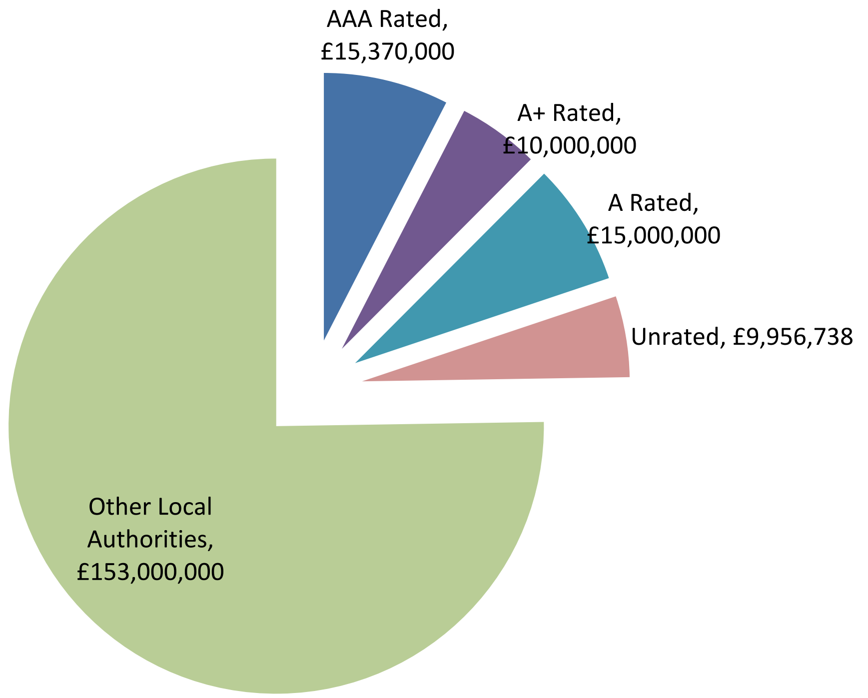


Chart 6: WECA Investments per lowest equivalent Long Term credit rating (£203.3m) at 30th June 2018



APPENDIX 3

Average rate of return on investments for 2018/19

	April %	May %	June %	July	Aug	Sept	Average %
Average rate of interest earned	0.77	0.79	0.78	0.82	0.82	0.84	0.80
Benchmark = Average 7 Day LIBID rate +0.05% (source: Arlingclose)	0.41	0.41	0.41	0.41	0.63	0.64	0.48
Difference from Benchmark %	+0.36	+0.38	+0.37	+0.41	+0.19	+0.20	+0.32

APPENDIX 4

Authorities External Borrowing at 30th September 2018

*There is no current borrowing.

APPENDIX 5

Economic and market review for April to September 2018

Economic background: Oil prices rose by 23% over the six months to around $82/barrel. UK Consumer Price Inflation (CPI) for August rose to 2.7% year/year, above the consensus forecast and that of the Bank of England's in its August Inflation Report, as the effects of sterling's large depreciation in 2016 began to fade. The most recent labour market data for July 2018 showed the unemployment rate at 4%, its lowest since 1975. The 3-month average annual growth rate for regular pay, i.e. excluding bonuses, was 2.9% providing some evidence that a shortage of workers is providing support to wages. However real wages (i.e. adjusted for inflation) grew only by 0.2%, a marginal increase unlikely to have had much effect on households.

The rebound in quarterly GDP growth in Q2 to 0.4% appeared to overturn the weakness in Q1 which was largely due to weather-related factors. However, the detail showed much of Q2 GDP growth was attributed to an increase in inventories. Year/year GDP growth at 1.2% also remains below trend. The Bank of England made no change to monetary policy at its meetings in May and June, however hawkish minutes and a 6-3 vote to maintain rates was followed by a unanimous decision for a rate rise of 0.25% in August, taking Bank Rate to 0.75%.

Having raised rates in March, the US Federal Reserve again increased its target range of official interest rates in each of June and September by 0.25% to the current 2%-2.25%. Markets now expect one further rise in 2018.

The escalating trade war between the US and China as tariffs announced by the Trump administration appeared to become an entrenched dispute, damaging not just to China but also other Asian economies in the supply chain. The fallout, combined with tighter monetary policy, risks contributing to a slowdown in global economic activity and growth in 2019.

The EU Withdrawal Bill, which repeals the European Communities Act 1972 that took the UK into the EU and enables EU law to be transferred into UK law, narrowly made it through Parliament. With just six months to go when Article 50 expires on 29th March 2019, neither the Withdrawal Agreement between the UK and the EU which will be legally binding on separation issues and the financial settlement, nor its annex which will outline the shape of their future relationship, have been finalised, extending the period of economic uncertainty.

Financial markets: Gilt yields displayed marked volatility during the period, particularly following Italy's political crisis in late May when government bond yields saw sharp moves akin to those at the height of the European financial crisis with falls in yield in safe-haven UK, German and US government bonds. Over the period, despite the volatility, the net change in gilt yields was small. The 5-year benchmark gilt only rose marginally from 1.13% to 1.16%. There was a larger increase in 10-year gilt yields from 1.37% to 1.57% and in the 20-year gilt yield from 1.74% to 1.89%. The increase in Bank Rate resulted in higher in money markets rates. 1-month, 3-month and 12-month LIBID rates averaged 0.56%, 0.70% and 0.95% respectively over the period.

Credit background: Reflecting its perceived higher risk, the Credit Default Swap (CDS) spread for non-ringfenced bank NatWest Markets plc rose relatively sharply over the period to around 96bps. The CDS for the ringfenced entity, National Westminster Bank plc, has held steady below 40bps. Although the CDS of other UK banks rose marginally over the period, they continue to remain low compared to historic averages.
The ringfencing of the big four UK banks - Barclays, Bank of Scotland/Lloyds, HSBC and RBS/Natwest Bank plc – is complete, the transfer of their business lines into retail (ringfenced)

and investment banking (non-ringfenced) is progressing and will need to be completed by the end of 2018.

There were a few credit rating changes during the period. Moody's downgraded Barclays Bank plc's long-term rating to A2 from A1 and NatWest Markets plc to Baa2 from A3 on its view of the credit metrics of the entities post ringfencing. Upgrades to long-term ratings included those for Royal Bank of Scotland plc, NatWest Bank and Ulster Bank to A2 from A3 by Moody's and to A- from BBB+ by both Fitch and Standard & Poor's (S&P). Lloyds Bank plc and Bank of Scotland plc were upgraded to A+ from A by S&P and to Aa3 from A1 by Moody's.

Our treasury advisor Arlingclose will henceforth provide ratings which are specific to wholesale deposits including certificates of deposit, rather than provide general issuer credit ratings. Non-preferred senior unsecured debt and senior bonds are at higher risk of bail-in than deposit products, either through contractual terms, national law, or resolution authorities' flexibility during bail-in. Arlingclose's creditworthiness advice will continue to include unsecured bank deposits and CDs but not senior unsecured bonds issued by commercial banks.

Technical Update Following consultation in 2017, CIPFA published new versions of the Prudential Code for Capital Finance in Local Authorities (Prudential Code) and the Treasury Management Code of Practice but has yet to publish the local authority specific Guidance Notes to the latter. In England, MHCLG published its revised Investment Guidance which came into effect from April 2018. The updated Prudential Code includes a new requirement for local authorities to provide a Capital Strategy, which is to be a summary document approved by the Authority covering capital expenditure and financing, treasury management and non-treasury investments. The Authority will be producing its Capital Strategy later in 2018-19.

APPENDIX 6

Interest & Capital Financing Costs – Budget Monitoring 2018/19

April to September 2018	YEAR END FORECAST			
	Budgeted (Income) £'000	Forecast (Income) £'000	Forecast over or (under) spend £'000	ADV/FAV
Interest & Capital Financing				
- Debt Costs	0	0	0	
- Interest on Balances	(520)	(1,004)	(484)	FAV
Sub Total - Capital Financing	**(520)**	**(1,004)**	**(484)**	**FAV**

APPENDIX 7

Summary Guide to Credit Ratings

Rating	**Details**
AAA	Highest credit quality – lowest expectation of default, which is unlikely to be adversely affected by foreseeable events.
AA	Very high credit quality - expectation of very low default risk, which is not likely to be significantly vulnerable to foreseeable events.
A	High credit quality - expectations of low default risk which may be more vulnerable to adverse business or economic conditions than is the case for higher ratings.
BBB	Good credit quality - expectations of default risk are currently low but adverse business or economic conditions are more likely to impair this capacity.
BB	Speculative - indicates an elevated vulnerability to default risk, particularly in the event of adverse changes in business or economic conditions over time.
B	Highly speculative - indicates that material default risk is present, but a limited margin of safety remains. Capacity for continued payment is vulnerable to deterioration in the business and economic environment.
CCC	Substantial credit risk - default is a real possibility.
CC	Very high levels of credit risk - default of some kind appears probable.
C	Exceptionally high levels of credit risk - default is imminent or inevitable.
RD	Restricted default - indicates an issuer that has experienced payment default on a bond, loan or other material financial obligation but which has not entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, and which has not otherwise ceased operating.
D	Default - indicate san issuer that has entered into bankruptcy filings, administration, receivership, liquidation or other formal winding-up procedure, or which has otherwise ceased business.

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ITEM: 10

REPORT TO: **WEST OF ENGLAND COMBINED AUTHORITY AUDIT COMMITTEE**

DATE: **21 FEBRUARY 2019**

REPORT TITLE: **WECA TREASURY MANAGEMENT STRATEGY 2019/20**

AUTHOR: **MALCOLM COE – DIRECTOR OF INVESTMENT AND CORPORATE SERVICES (S151 OFFICER)**

Purpose of Report

1. To consider the Treasury Management Strategy for 2019/20.

Issues for Consideration

2. The West of England Combined Authority is required each year to approve a Treasury Management Strategy in accordance with the CIPFA Treasury Management in Public Services Code of Practice 2011.

3. The Treasury Management Strategy for 2019/20 is attached to this report at **Appendix 1**, for consideration and comment as appropriate, by the Audit Committee.

Consultation:

4. Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Director of Investment and Corporate Services and designated staff, who must act in line with the treasury management strategy. Reports on treasury management activity are presented to the WECA Committee, with the Audit Committee being responsible for scrutinising treasury management decisions.

Public Sector Equality Duties:

5. No direct implications.

Economic Impact Assessment:

6. As set out in the attached report.

Finance Implications:

7. As set out in the attached report.

Legal Implications:

8. The report fulfils the WECA's legal obligations under the Local Government Act 2003 to have regard to both the CIPFA Code and government guidance.

Land/Property Implications;

9. No direct implications.

Human Resources Implications:

10. As set out in the attached report.

Recommendation:

11. To endorse the 2019/20 WECA Treasury Management Strategy Statement.

Report Author: Malcolm Coe – Director of Investment & Corporate Services

West of England Combined Authority Contact: Malcolm Coe – Director of Investment & Corporate Services

West of England Combined Authority Contact:
Any person seeking background information relating to this item should seek the assistance of the contact officer for the meeting who is Ian Hird / Tim Milgate on 0117 332 1486; or by writing to West of England Combined Authority, 3 Rivergate, Temple Way, Bristol BS1 6ER; email: democratic.services@westofengland-ca.gov.uk

ITEM 10 APPENDIX 1

West of England Combined Authority

Treasury Management Strategy Statement 2019/20

1. Introduction

1.1 Treasury management is the management of the Authority's cash flows, borrowing and investments, and the associated risks. The Authority has substantial sums of money invested and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Authority's prudent financial management.

1.2 Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code.

2. External Context

2.1 **Economic background:** The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2019/20.

2.2 UK Consumer Price Inflation (CPI) for October was up 2.4% year/year, slightly below the consensus forecast and broadly in line with the Bank of England's November Inflation Report. The most recent labour market data for October 2018 showed the unemployment rate edged up slightly to 4.1% while the employment rate of 75.7% was the joint highest on record. The 3-month average annual growth rate for pay excluding bonuses was 3.3% as wages continue to rise steadily and provide some pull on general inflation. Adjusted for inflation, real wages grew by 1.0%, a level still likely to have little effect on consumer spending.

2.3 The rise in quarterly GDP growth to 0.6% in Q3 from 0.4% in the previous quarter was due to weather-related factors boosting overall household consumption and construction activity over the summer following the weather-related weakness in Q1. At 1.5%, annual GDP growth continues to remain below trend. Looking ahead, the BoE, in its November Inflation Report, expects GDP growth to average around 1.75% over the forecast horizon, providing the UK's exit from the EU is relatively smooth.

2.4 Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy has been made since. However, the Bank expects that should the economy continue to evolve in line with its November forecast, further increases in Bank Rate will be required to return inflation to the 2% target. The Monetary Policy Committee continues to reiterate that any further increases will be at a gradual pace and limited in extent.

2.5 While US growth has slowed over 2018, the economy continues to perform robustly. The US Federal Reserve continued its tightening bias throughout 2018, pushing rates to the current 2%-2.25% in September. Markets continue to expect one more rate rise in December, but expectations are fading that the further hikes previously expected in 2019 will materialise as concerns over trade wars drag on economic activity.

2.6 **Credit outlook:** The big four UK banking groups have now divided their retail and investment banking divisions into separate legal entities under ringfencing legislation. Bank of Scotland, Barclays Bank UK, HSBC UK Bank, Lloyds Bank, National Westminster Bank, Royal Bank of Scotland and Ulster Bank are the ringfenced banks that now only conduct lower risk retail banking activities. Barclays Bank, HSBC Bank, Lloyds Bank Corporate Markets and NatWest Markets are the investment banks. Credit rating agencies have adjusted the ratings of some of these banks with the ringfenced banks generally being better rated than their non-ringfenced counterparts.

2.7 The Bank of England released its latest report on bank stress testing, illustrating that all entities included in the analysis were deemed to have passed the test once the levels of capital and potential mitigating actions presumed to be taken by management were factored in. The BoE did not require any bank to raise additional capital.

2.8 European banks are considering their approach to Brexit, with some looking to create new UK subsidiaries to ensure they can continue trading here. The credit strength of these new banks remains unknown, although the chance of parental support is assumed to be very high if ever needed. The uncertainty caused by protracted negotiations between the UK and EU is weighing on the creditworthiness of both UK and European banks with substantial operations in both jurisdictions.

2.9 **Interest rate forecast:** Following the increase in Bank Rate to 0.75% in August 2018, the Authority's treasury management adviser Arlingclose is forecasting two more 0.25% increases during 2019 to take official UK interest rates to 1.25%. The Bank of England's MPC has maintained expectations for slow and steady rate rises over the forecast horizon. The MPC continues to have a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. Arlingclose believes that MPC members consider both that ultra-low interest rates result in other economic problems, and that higher Bank Rate will be a more effective policy weapon should downside Brexit risks crystallise when rate cuts will be required.

2.10 The UK economic environment remains relatively soft, despite seemingly strong labour market data. Arlingclose's view is that the economy still faces a challenging outlook as it exits the European Union and Eurozone growth softens. While assumptions are that a Brexit deal is struck and some agreement reached on transition and future trading arrangements before the UK leaves the EU, the possibility of a "no deal" Brexit still hangs over economic activity *(at the time of writing).* As such, the risks to the interest rate forecast are considered firmly to the downside.

2.11 Gilt yields and hence long-term borrowing rates have remained at low levels but some upward movement from current levels is expected based on Arlingclose's interest rate projections, due to the strength of the US economy and the ECB's forward guidance on higher rates. 10-year and 20-year gilt yields are forecast to remain around 1.7% and 2.2% respectively over the interest rate forecast horizon, however volatility arising from both economic and political events are likely to continue to offer borrowing opportunities.

2.12 A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix A.

2.13 For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 1.3% for WECA balances, and 0.9% for LGF and RIF balances.

3. Local Context

3.1 On 31st December 2018, the Authority held £188m of investments and no borrowing. This is set out in further detail at **Appendix B**.

3.2 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.

3.3 The Authority is currently debt free and its capital expenditure plans do not currently imply any need to borrow over the forecast period. Investments are forecast to fall to £133m by the end of 2019/20 as capital grants are used to finance capital expenditure and reserves are used to finance the revenue budget.

4. Investment Strategy

4.1 The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. Since 1 April 2018, the Authority's investment balance has ranged between £123m and £210m, and similarly for 2019/20 the balances are expected to range between £120m and £198m (slightly lower due to capital grants and reserves being used to finance spend).

4.2 As well as holding investments in its own right, the Authority also acts as Accountable Body for the West of England Revolving Investment Fund (RIF) and Local Growth Fund (LGF), holding Government Grants until they are ready to be distributed to Local Authorities and other organisations for infrastructure works over the coming years.

4.3 The funds are invested in line with the WECA strategy primarily to protect the capital and in order to achieve this high level of capital security, investments are made predominantly with Central Government, Local Authorities and Banks.

4.4 Interest earned on RIF investments is re-invested into the Fund. LGF investment returns are earmarked to fund the corporate support and governance costs that come with performing the Accountable Body function for the Local Enterprise Partnership (LEP).

4.5 **Objectives:** The CIPFA Code requires the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest 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. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested. Given the current level of CPI at 2.2% this will be difficult to achieve with fixed term deposits alone. However, the intention is to consider further longer term investments such as pooled funds, which will achieve a higher rate of return. Any temporary liquidity issues that may arise can then be dealt with by short term borrowing.

4.6 **Negative interest rates:** If the UK enters into a recession in 2019/20, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

4.7 **Strategy:** Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority aims to further diversify into more secure and/or higher yielding asset classes during 2019/20. This is especially the case for the estimated £20m that is available for longer-term investment. A dwindling proportion of the Authority's surplus cash remains invested in short-term unsecured bank deposits and money market funds. This diversification will represent a continuation of the strategy adopted in 2018/19. The strategy of this policy is to set outer limits for treasury management operations. In the case of exceptional market uncertainty, WECA officers will operate in a more restrictive manner than the policy allows.

4.8 **Business models:** Under the new IFRS 9 standard, the accounting for certain investments depends on the Authority's "business model" for managing them. The Authority aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

4.9 **Approved counterparties:** The Authority may invest its surplus funds with any of the counterparty types in table 1 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 1: Approved investment counterparties and limits

Credit rating	Banks unsecured	Banks secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£10m 5 years	£15m 20 years	£10m 50 years	£10m 20 years	£5m 20 years
AA+	£10m 5 years	£15m 10 years	£15m 25 years	£5m 10 years	£5m 10 years
AA	£10m 4 years	£15m 5 years	£15m 15 years	£5m 5 years	£5m 10 years
AA-	£10m 3 years	£15m 4 years	£10m 10 years	£5m 4 years	£5m 10 years
A+	£10m 2 years	£15m 3 years	£10m 5 years	£5m 3 years	£5m 5 years
A	£10m 13 months	£10m 2 years	£10m 5 years	£5m 2 years	£5m 5 years
A-	£10m 6 months	£10m 13 months	£10m 5 years	£5m 13 months	£5m 5 years
None	£1m 6 months	n/a	£10m 25 years	£50,000 5 years	£3m 5 years
Pooled funds and real estate investment trusts		£10m per fund or trust			

This table must be read in conjunction with the notes below

a) **Credit rating:** Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

b) **Banks unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

c) **Banks secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

d) **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

e) **Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment or to a maximum of £50,000 per company as part of a diversified pool in order to spread the risk widely.

f) **Registered providers:** Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

g) **Pooled funds:** Shares or units in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

The Authority may consider further investment in Pooled Funds during 2019/20 with a view to providing further diversification and the potential for earning a higher investment yield on long-term investment balances. Cash that is not required to meet any short or medium-term liquidity need can be invested for the longer term with a greater emphasis on achieving returns that will support spending on local WECA services.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

h) **Real estate investment trusts:** Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

i) **Operational bank accounts:** The Authority may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £100,000 per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.

j) **Risk assessment and credit ratings**: Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

k) **Other information on the security of investments**: The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Authority's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

l) **Investment limits**: The Authority's revenue reserves available to cover investment losses are forecast to be £0.5 million on 31st March 2019. This low level of reserves means that in the event of a single default loss, WECA will have limited resources to cover such a loss. The revenue budget report elsewhere on this agenda recommends a small increase in general reserves. With this in mind, the maximum that will be lent to any one organisation (other than the UK Government) will be £10 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 4: Investment limits

	Cash limit
Any single organisation, except the UK Central Government	£10m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£10m per group
Any group of pooled funds under the same management	£10m per manager
Negotiable instruments held in a broker's nominee account	£10m per broker
Foreign countries	£15m per country (AAA sovereign rating) £10m per country (AA+ sovereign rating)
Registered providers and registered social landlords	£50m in total
Unsecured investments with building societies	£20m in total
Loans to unrated corporates	£20m in total
Money market funds	£100m in total
Real estate investment trusts	£50m in total

m) **Liquidity management**: The Authority uses cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium-term financial plan and cash flow forecast. The intention is to invest a limited amount of funds on a longer term basis to secure higher returns, and based on cashflow forecasts. This may result in a temporary liquidity issue, which will be dealt with via short term borrowing – as a proactive treasury tool.

5. Borrowing Strategy

5.1 The Authority currently holds no borrowing. The balance sheet forecast shows that the Authority does not expect to need to borrow in 2019/20.

5.2 **Objectives:** The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Authority's long-term plans change is a secondary objective.

5.3 **Strategy:** The Authority does not currently have any underlying need to borrow long-term to fund capital expenditure. WECA holds no long-term loans and no long-term borrowing is anticipated during 2019/20. Therefore, a debt-free strategy will be maintained until such time as the Authority determines that its capital strategy and prioritised programme of investment requires consideration of any borrowing decision.

5.4 As part of its approach to liquidity management, the Authority may borrow short-term loans to cover any unplanned cash flow shortages as they arise. Rather than always keeping cash on instant access for unplanned cash flows (where security and liquidity will mean yields will be low) the Authority will retain the option of short-term borrowing at current low rates to enable it to explore increasing investments in longer-term and more diversified assets. The Authority will test access to borrowing occasionally even where this is not required to ensure liquidity is available.

5.5 **Sources of borrowing:** The approved sources of short-term borrowing are:

- Public Works Loan Board (PWLB) and any successor body
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except Avon Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

5.6 **Other sources of debt finance:** In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback

5.7 **Short-term and variable rate loans**: These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below.

6. Treasury Management Indicators

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

6.2 **Security:** The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating 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.

Credit risk indicator	**Target**
Minimum portfolio average credit rating	A-

6.3 **Liquidity:** The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount it can borrow each quarter without giving prior notice.

Liquidity risk indicator	**Target**
Total sum borrowed in past 3 months without prior notice	£30m

6.4 **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 interest rates will be:

Interest rate risk indicator	**Limit**
Upper limit on one-year revenue impact of a 1% fall in interest rates	£570k

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

6.5 **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 will be:

Price risk indicator	2019/20	2020/21	2021/22
Limit on principal invested beyond year end	£100m	£75m	£50m

7. Related Matters

The CIPFA Code requires the Authority to include the following in its treasury management strategy.

7.1 **Financial Derivatives:** In the absence of any explicit legal power to do so, the Authority will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivatives embedded into loans and investments, including pooled funds and forward starting transactions, may be used, and the risks that they present will be managed in line with the overall treasury risk management strategy.

7.2 **Markets in Financial Instruments Directive (MiFID II)**: As a result of the directive, Local Authorities will be treated as retail clients, but can opt up to professional client status, providing that they meet certain criteria which includes having an investment balance of at least £10m and the persons authorised to make investment decisions on behalf of WECA having at least a year's relevant professional experience. In addition, the regulated financial services firms to whom this directive applies must assess that these persons have the expertise, experience and knowledge to make investment decisions and understand the risks involved.

The Authority has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

8. Financial Implications

8.1 The budget for WECA investment income in 2019/20 is £0.82 million, based on an average investment portfolio of £71 million at an interest rate of 1.3% and making an allowance for impairment as required. In addition, the budget for the LEP investment income in 2019/20 is £0.5 million, based on an average investment of £60 million at an interest rate of 0.9% and making an allowance for impairment. The differing levels of interest expected to be achieved reflect the ability to invest the funds for longer terms and hence achieve a higher return. Longer term investment of LEP funds is limited as LGF grant will all be spent within the next 2 years. If actual levels of investments, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

9. Other Options Considered

9.1 The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer, having consulted the West of England Mayor and Chief Executive, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller

Appendix A – Arlingclose Economic & Interest Rate Forecast December 2018

Underlying assumptions:

- Our central interest rate forecasts are predicated on there being a transitionary period following the UK's official exit from the EU.
- The MPC has a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. We believe that MPC members consider that: 1) tight labour markets will prompt inflationary pressure in the future, 2) ultra-low interest rates result in other economic problems, and 3) higher Bank Rate will be a more effective policy weapon if downside risks to growth crystallise.
- Both our projected outlook and the increase in the magnitude of political and economic risks facing the UK economy means we maintain the significant downside risks to our forecasts, despite the potential for slightly stronger growth next year as business investment rebounds should the EU Withdrawal Agreement be approved. The potential for severe economic outcomes has increased following the poor reception of the Withdrawal Agreement by MPs. We expect the Bank of England to hold at or reduce interest rates from current levels if Brexit risks materialise.
- The UK economic environment is relatively soft, despite seemingly strong labour market data. GDP growth recovered somewhat in the middle quarters of 2018, but more recent data suggests the economy slowed markedly in Q4. Our view is that the UK economy still faces a challenging outlook as the country exits the European Union and Eurozone economic growth softens.
- Cost pressures are easing but inflation is forecast to remain above the Bank's 2% target through most of the forecast period. Lower oil prices have reduced inflationary pressure, but the tight labour market and decline in the value of sterling means inflation may remain above target for longer than expected.
- Global economic growth is slowing. Despite slower growth, the European Central Bank is conditioning markets for the end of QE, the timing of the first rate hike (2019) and their path thereafter. More recent US data has placed pressure on the Federal Reserve to reduce the pace of monetary tightening – previous hikes and heightened expectations will, however, slow economic growth.
- Central bank actions and geopolitical risks have and will continue to produce significant volatility in financial markets, including bond markets.

Forecast:

- The MPC has maintained expectations of a slow rise in interest rates over the forecast horizon, but recent events around Brexit have dampened interest rate expectations. Our central case is for Bank Rate to rise twice in 2019, after the UK exits the EU. The risks are weighted to the downside.

- Gilt yields have remained at low levels. We expect some upward movement from current levels based on our central case that the UK will enter a transitionary period following its EU exit in March 2019. However, our projected weak economic outlook and volatility arising from both economic and political events will continue to offer borrowing opportunities.

	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.17**
Arlingclose Central Case	**0.75**	**0.75**	**1.00**	**1.00**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	1.13
Downside risk	0.00	-0.50	-0.75	-0.75	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	-1.00	**-0.85**
3-mth money market rate														
Upside risk	0.10	0.10	0.10	0.10	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	**0.17**
Arlingclose Central Case	**0.90**	**0.95**	**1.10**	**1.30**	**1.40**	**1.40**	**1.40**	**1.35**	**1.35**	**1.35**	**1.35**	**1.35**	**1.35**	1.27
Downside risk	-0.20	-0.45	-0.60	-0.80	-0.90	-0.90	-0.90	-0.85	-0.85	-0.85	-0.85	-0.85	-0.85	**-0.76**
1-yr money market rate														
Upside risk	0.20	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	**0.33**
Arlingclose Central Case	**1.15**	**1.25**	**1.35**	**1.50**	**1.70**	**1.60**	**1.50**	**1.40**	**1.35**	**1.35**	**1.35**	**1.35**	**1.35**	1.40
Downside risk	-0.35	-0.50	-0.60	-0.80	-0.90	-0.90	-0.90	-0.85	-0.85	-0.85	-0.85	-0.85	-0.85	**-0.77**
5-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.37**
Arlingclose Central Case	**1.15**	**1.25**	**1.35**	**1.50**	**1.50**	**1.40**	**1.35**	**1.35**	**1.30**	**1.30**	**1.30**	**1.30**	**1.30**	1.33
Downside risk	-0.50	-0.60	-0.65	-0.80	-0.80	-0.70	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	**-0.66**
10-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.37**
Arlingclose Central Case	**1.50**	**1.65**	**1.70**	**1.80**	**1.80**	**1.75**	**1.75**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	1.70
Downside risk	-0.55	-0.70	-0.70	-0.80	-0.80	-0.75	-0.75	-0.70	-0.70	-0.70	-0.70	-0.70	-0.70	**-0.71**
20-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.37**
Arlingclose Central Case	**2.00**	**2.10**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	**2.20**	2.18
Downside risk	-0.60	-0.70	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.73**
50-yr gilt yield														
Upside risk	0.25	0.30	0.30	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.37**
Arlingclose Central Case	**1.90**	**1.95**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	1.99
Downside risk	-0.60	-0.70	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	**-0.73**

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
PWLB Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Appendix B – Existing Investment & Debt Portfolio Position

	31 Dec 2018 Actual Portfolio £m	31 Dec 2018 Average Rate %
External borrowing:	**0**	**0**
Other long-term liabilities:	**0**	**0**
Total gross external debt	**0**	**0**
Treasury investments:		
Banks & building societies (unsecured)	30	0.85
Covered bonds & repo (secured)	0	0
Government (incl. local authorities)	124	0.93
Corporate bonds and loans	0	0
Money Market Funds	24	0.74
Other pooled funds (CCLA Property Fund)	10	4.05
Real estate investment trusts	0	0
Total treasury investments	188	0.90
Net debt	0	0

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