Notice of Meeting and Agenda

Audit Committee

Venue: **Council Chambers,**
Midlothian House, Dalkeith, EH22 1DN

Date: **Tuesday, 28 January 2020**

Time: **11:00**

Executive Director : Place

Contact:

Clerk Name: Janet Ritchie
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Further Information:

This is a meeting which is open to members of the public.

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1 Welcome, Introductions and Apologies

2 Order of Business

Including notice of new business submitted as urgent for consideration at the end of the meeting.

3 Declaration of Interest

Members should declare any financial and non-financial interests they have in the items of business for consideration, identifying the relevant agenda item and the nature of their interest.

4 Minute of Previous Meeting

4.1	Minute of the meeting of 3 December 2019 submitted for approval	3 - 10
4.2	Action Log	11 - 12

5 Public Reports

5.1	Treasury Management and Investment Strategy 202021 & Prudential Indicators - Report by Chief Officer Corporate Solutions	13 - 42
5.2	Internal Audit Work to December 2019 - Report by Chief Internal Auditor	43 - 54
5.3	Audit Scotland Report Local Government in Scotland Financial Overview 2018-19 (December 2019) - Report by Chief Officer Corporate Solutions	55 - 62

6 Private Reports

No items for discussion

7 Date of Next Meeting

The next meeting will be held on Tuesday 10 March at 11 am

Minute of Meeting

Audit Committee
Tuesday 28 January 2020
Item No: 4.1

Midlothian

Audit Committee

Date	Time	Venue
Tuesday 3 December 2019	11.00am	Council Chambers, Midlothian House, Dalkeith, EH22 1DN

Present:

Mike Ramsay (Independent Chair)
Councillor Hardie
Councillor Milligan
Councillor Muirhead
Councillor Smaill
Councillor Alexander (Substitute)
Councillor Cassidy (Substitute)

In attendance:

Grace Vickers	Chief Executive
Kevin Anderson	Executive Director Place
Joan Tranent	Chief Officer, Children's Services, Partnerships and Communities
Alison White	Head of Adult Health and Social Care
Gary Fairley	Head of Finance and Integrated Service Support
Alan Turpie	Legal Services Manager/Monitoring Officer
Grace Scanlin	External Auditor, EY
Jill Stacey	Chief Internal Auditor
Chris Lawson	Waste, Risk and Resilience Manager
Janet R Ritchie	Democratic Services Officer

1. Welcome and Apologies

The Chair, Mike Ramsay welcomed everyone to the meeting, following which there was a round of introductions.

Apologies were received from Councillor Baird, Councillor Parry and the Independent Member, Peter de Vink.

2. Order of Business

The order of business was confirmed as that outlined in the agenda with an additional item to be added under A.O.B with regards to the Chair's absence at the January meeting.

3. Declarations of interest

No declarations of interest were received.

4. Minutes of Previous Meetings

4.1 The minute of the meeting of 24 June 2019 was submitted and approved as a correct record having been proposed by Councillor Muirhead, seconded by Councillor Hardie.

4.2 The Action log was submitted and the following agreed:

1) 'Treasury Management Training Session' - This training Session took place on Tuesday 5 November 2019 – closed.

2) 'Report on "Where does a Councillor go if they lose faith in Senior Officers?" – The Legal Services Manager provided an update on this item and after a lengthy discussion it was acknowledged the Chief Executive would follow up with informal discussions with COSLA. It was agreed that this item would now be closed to this committee. – closed.

3) 'Lothian Buses Pension Fund' The Risk Manager advised that after discussion with the Head of Finance and Integrated Service Support it would be included in the Q3 Risk Management update. - closed.

4) Proposed Change to the Scheduled Meeting dates from December 2019 – December 2020 – This was approved at Council on 12 November 2019 – closed.

5. Public Reports

Report No.	Report Title	Presented by:
5.1	Internal Audit Mid-Term Performance Report 2019/20	Jill Stacey, Chief Internal Auditor
Outline of report and summary of discussion		
The Chief Internal Auditor presented this report advising that the purpose of this report was to inform the Audit Committee of the progress Internal Audit has made,		

in the first 6 months of the year to 30 September 2019, towards completing the Internal Audit Annual Plan 2019/20. It also summarises the statutory obligations for Internal Audit and requirements of the Public Sector Internal Audit Standards. She highlighted that Appendix 1 to this report provides details of the half yearly progress by Internal Audit with its programme of work and explained the impact the fraud investigation had during the first half of the year on staff resources. Details of the most significant variations from the Plan to 30 September 2019 are detailed within the report and the Chief Internal Auditor explained that the remaining planned audit work will require additional Internal Audit resources within this period to deliver the Internal Audit Plan 2019/20 in full.
Decision
The Audit Committee: a) Noted the progress Internal Audit has made with activity in the Internal Audit Annual Plan 2019/20 by the mid-year point; and b) Acknowledged the additional auditor resources for the second half of the year to enable full delivery of the approved Internal Audit Annual Plan 2019/20.

Report No.	Report Title	Presented by:
5.2	Internal Audit Work to October 2019	Jill Stacey, Chief Internal Auditor
Outline of report and summary of discussion		
The Chief Internal Auditor presented this report advising that the purpose of this report was to provide members of the Audit Committee with details of the recent work carried out by Internal Audit and the findings and recommended audit actions agreed by Management to improve internal controls and governance arrangements. The Chief Internal Auditor highlighted the main sections of the report and updated the Committee on the Final Internal Audit Report on EU Funded Programme Tyne Esk LEADER (arising from the legislative and other compliance audit), including audit objective, findings, audit opinion on the compliance with the Service Level Agreement and the recommendations which are detailed in Appendix 1.		
Decision		
The Audit Committee: a) Noted the Final Internal Audit Report issued in the period from 1 September to 1 November 2019 associated with the delivery of the approved Internal Audit Annual Plan 2019/20. b) Noted the Internal Audit Assurance work in progress and Internal Audit Consultancy and Other Work carried out in accordance with the Internal Audit Charter, Strategy and Plan. c) Acknowledged the assurance provided on internal controls and governance arrangements in place for the areas covered by this Internal Audit work.		

Report No.	Report Title	Presented by:
5.3	Internal Audit Recommendations Progress Report 2019	Jill Stacey, Chief Internal Auditor

Outline of presentation and summary of discussion

The Chief Internal Auditor presented this report to the Committee explaining that the purpose of this report was to inform the Audit Committee of the number of recommendations raised by Internal Audit over the last 4 years and the Council's performance in addressing these issues by the agreed implementation dates. The report focusses on actions still open and the Chief Internal Auditor highlighted that this year was very positive in comparison to previous years with 9 actions (2%) which are detailed in Appendix 1 to the report.

She further advised that discussion had taken place with regards to the overdue Internal Audit recommendations and the reasons why they were not completed on the original due date and the risk mitigations in place in the interim and in accordance with the new Protocol, revised due dates for completion of these have been proposed by relevant Management, discussed at CMT and agreed by Internal Audit based on the further work required to implement.

Thereafter Officers provided assurances when responding to questions and comments raised by members of the Committee with regards to the overdue recommendations. It was also noted that on a request from Councillor Hardie a breakdown of staff debt would be provided as an appendix to the minute.

Decision

The Audit Committee:

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

b) Noted that Internal Audit will continue to monitor for completion the outstanding recommendations and will provide update reports to the Audit Committee.

Action

Executive Director Place
Chief Internal Auditor

Report No.	Report Title	Presented by:
5.4	Risk Management Q2 Update for 1 July 2019 – 30 September 2019	Chris Lawson, Waste, Risk and Resilience Manager

Outline of presentation and summary of discussion

The Risk Manager presented a report dated 15 November 2019 providing the Audit Committee with the 2019/20 quarter 2 strategic risk management update, covering the period 1 July 2019 to 30 September 2019. The Audit Committee had previously requested regular reports on the Council's Strategic Risks.

The Strategic Risk Profile sought to provide a strategic look at the current issues and future risks and opportunities facing the Council. The Risk Manager highlighted the main sections contained within the report and members of the committee raised questions and comments with regards to the Strategic Risks for the Council summarised in table 2 within the report. In a response to a questions raised by Councillor Muirhead, Joan Tranent confirmed that within table 2, Scottish Abuse Inquiry and Historic Abuse Claims project were two different things and she provided an explanation on both of these, she also confirmed that he was correct that Historic should be removed from the Abuse Claims project and this would be amended. In response to questions raised with regards to Climate Change the Risk Manager highlighted that work was underway on the consultation of a new Climate Strategy and this would be presented to Council in due course. The Chief Executive also highlighted that at the Community Planning Partnership development day the key theme was Climate emergency and sustainability and this will also be reported back to Council on how this influences the Single Midlothian Plan in the year ahead.
Decision
Audit Committee noted the quarter 2 2019/20 Strategic Risk Profile report and considered the current response to the issues, risks and opportunities highlighted.

Report No.	Report Title	Presented by:
5.5	Treasury Management Mid-Year Review 2019 – 20	Gary Fairley, Head of Finance and Integrated Service Support
Outline of presentation and summary of discussion		
The Head of Finance and Integrated Service Support presented this report to inform members of the Treasury Management activity undertaken during the first half of 2019/20, an update to the Treasury and Prudential Indicators for 2019/20 and the link across to the Council's Capital Investment Strategy. He then explained that this report ideally should have been presented to the Audit Committee prior to being presented to Council but due to timing of meetings it was presented to Council on 12 November 2019 prior to this meeting. He provided a summary of the contents of the report and highlighted the recommendations in section 9 of the report. Thereafter he responded to questions and comments raised by members of the Committee and confirmed that with regards to the information Councillor Smaill had previously requested from Alan George from Link he would follow this up.		

Decision
The Audit Committee; a) Noted that this report had been presented to Council on 12 November 2019 and that the recommendations contained within the report had been agreed. b) To otherwise note the report.

6. Private Reports

No private reports were submitted.

7. Date of Next Meeting

The next meeting will be held on Tuesday 28 January 2020 at 11 am

A.O.B:

The Independent Chair, Mike Ramsay highlighted to the Audit Committee that he would not be present at the next meeting in January and it was agreed by the Committee to nominate a Chair for this meeting.

Councillor Smaill was nominated by Councillor Hardie and seconded by Councillor Cassidy as Chair for the Audit Committee meeting scheduled for 28 January 2020.

The meeting terminated at 12.15 pm

Appendix to Minute with reference to Item 5.3

Table 1 below summarises the current debt position

Table 1

	No of Employees	Debt currently outstanding (£)
Direct payroll deductions in place	103	£485,863.85
Other payment arrangements in place, including Sherriff Officers	60	£72,861.62
Arrangements yet to be secured	27	£198,330.26
The Total	190	£757,055.73

The original data match in March 2014 identified employee debt at £898,766.66. New start debt checks since then has identified debt for new employees joining the Council of £1,266,316.81. Accordingly the total employee debt identified through the original data match and for new recruits since April 2015 if no action was taken amount to £2,165,083.48

Note that where debt is identified for potential new starts it does not prohibit their recruitment but there is a requirement for a payment arrangement to be put in place before they join the Council. Our employee code of conduct states makes it clear that failure to make and keep to an arrangement for the repayment of monies due to the Council would be considered to be breach of the code and so dealt with as a disciplinary matter.

As table 1 identifies the current debt outstanding stands at £757,055.73 which represents a reduction of £1,408,027.75 or 65% over the period since March 2014. This comes from £846,023.56 collected on mandate and £562,004.19 paid direct to the Council/Sheriff Officer etc

It should be noted that the debts reported includes all debt types, although mainly Council Tax. Analysis highlights that the vast majority of the debt is due by employees who are at the lower end of our pay and grading structure (grade 4 or less) and or part time staff. As such earnings can be too low to attract any or sufficient deductions from an earnings arrestment. When discussing a payment arrangement with a new staff member with an earnings arrestment in place with Walker Love, we would normally cancel it and replace with our own staff mandate.

There are currently 27 cases with an average debt of £7,345.57 where further action is being investigated.

I hope this additional information provides greater clarity on the action which has and continues to be taken in respect of employees who also debtors to the Council. “

Actions Log

Midlothian

No	Subject	Date	Action	Action Owner	Expected completion date	Comments
1	**Internal Audit Recommendations**	03/12/2019	Internal Audit will continue to monitor for completion the outstanding recommendations and will provide update reports to the Audit Committee.	Chief Internal Auditor	June 2020	Two follow-up reports per year to Audit Committee as per approved Internal Audit Annual Plan
2						
3						
4						

Treasury Management and Investment Strategy 2020/21 & Prudential Indicators

Report by Gary Fairley, Chief Officer Corporate Solutions

1 Purpose of Report

In accordance with the 2017 Treasury Management Code of Practice, the annual Treasury Management & Investment Strategy & Prudential Indicators report is required to be adequately scrutinised before being recommended to the Council. For Midlothian, this role is undertaken by the Audit Committee, with this report being presented to Audit Committee on 28 January 2020 prior to consideration by Council on 11 February 2020.

The purpose of the report to Council will be to seek the agreement of Council to the Treasury Management and Annual Investment Strategies for 2020/21, the Prudential and Treasury indicators contained therein, and the approach to the statutory repayment of loans fund advances.

This report is currently in draft as we do not yet have our capital grant settlement figure and are unable to finalise our budget position at this time. Nonetheless the scrutiny on the key areas/principles can still be carried out by Audit Committee as follows:-

- Borrowing strategy (Section 2.3);
- Investment Strategy & Permitted investments (Section 2.4 / Appendix 2);
- The draft Capital Financial Requirement/Authorised Limit (Section 3), noting that this reflects the capital plans to be considered by Council and could fluctuate markedly following the grant settlement;
- Changes in accounting policy in respect of the statutory repayment of loans fund advances (Section 4);

2 Treasury Management & Investment Strategy 2020/21

2.1 Current Loan and Investment Portfolio

The Council’s current loan and investment portfolio, as at 10 January 2020, is shown in tables 1 and 2 below:-

Table 1: Current Loan Portfolio as at 10 January 2020

Loan Type	Principal Outstanding £000's	Weighted Average Rate
PWLB Annuity	637	8.90%
PWLB Maturity	198,824	3.39%
LOBO	20,000	4.51%
Market Loans	18,831	2.68%
Salix Loans	803	0.00%
Total Loans	**239,096**	**3.43%**

Table 2: Current Investment Portfolio as at 10 January 2020

Investment Type	Principal Outstanding £000's	Weighted Average Rate
Bank Call Accounts	0	n/a
Money Market Funds	22,134	0.72%
Bank Notice Accounts	49,985	1.20%
Other Local Authorities	15,000	1.58%
Total Investments	**85,182**	**1.14%**

2.2 Borrowing Requirement 2019/20 to 2023/24

The Council's capital plans contain projections of capital expenditure and income over the forthcoming financial years. Any expenditure not financed directly by income, requires funding through borrowing.

The projected borrowing requirement arising from the Council's Capital Plans, and the maturing long-term loans that require to be refinanced, over the period 2019/20 to 2023/24 is shown in table 3 below:-

Table 3: Total Borrowing Requirement over the period 2019/20 to 2023/24

	2019/20 £000's	2020/21 £000's	2021/22 £000's	2022/23 £000's	2023/24 £000's	Total £000's
Capital Expenditure						
General Services	36,896	61,305	70,331	52,577	28,483	**249,592**
HRA	29,915	81,128	64,175	25,423	14,593	**215,234**
Total Capital Expenditure	**66,811**	**142,433**	**134,506**	**78,000**	**43,076**	**464,826**
Total Available Financing	-33,370	-46,792	-41,349	-19,098	-13,064	**-153,673**
Principal Debt Repayments	-8,563	-9,305	-11,096	-12,912	-13,376	**-55,252**
Capital Expenditure less available Financing	**24,878**	**86,336**	**82,061**	**45,990**	**16,636**	**255,901**
Maturing Long-term Loans	9,219	9,230	1,471	1,465	830	**22,215**
Total Borrowing Requirement	**34,097**	**95,566**	**83,532**	**47,455**	**17,466**	**278,116**
Borrowing secured	-20,000	0	0	0	0	**-20,000**
Total Remaining Borrowing Requirement	**14,097**	**95,566**	**83,532**	**47,455**	**17,466**	**258,116**

Note these are draft, awaiting an update post grant settlement.

The total level of borrowing noted above is required to meet the capital investment previously approved by Council for both the General Fund and HRA Capital Plans.

2.3 Borrowing Strategy for remainder of 2019/20 and 2020/21

Long-term borrowing rates from the Debt Management Office's (DMO) Public Works Loans Board (PWLB) were subject to a 100bps increase applied across the tenor curve by the UK's Debt Management Office in October 2019. Despite this, medium-long term borrowing rates from both the PWLB and other market providers are currently still sitting just above historical lows and significantly below historical averages. Whilst the Council has already secured long-term borrowing for financial year 2019/20, as can been noted from Table 3 above the Council has a significant borrowing requirement across the forthcoming 4 financial years (2020/21 to 2023/24).

The current low Bank of England base rate level of 0.75% and the expectation that any base rate rises will follow a shallow upward trajectory in the short-medium term, means that continued utilisation of temporary borrowing within the Council's overall loan portfolio would continue to provide a cost-effective solution to the Council. The quantum of this will continue to be assessed against the backdrop of potential long term costs if the opportunity is missed to take PWLB or other market loans at low medium-long term rates, particularly given the projected gradual rise in PWLB rates.

Part of the Council's borrowing requirement over the current and forthcoming four financial years has already been secured through the drawdown of two £10 million maturity loans from the PWLB in September 2019, prior to the 100bps increase applied by the DMO.

It is expected that the majority of the remaining borrowing requirement to fund capital expenditure incurred in the remainder of 2019/20 and through to 2023/24 shall be sourced from a blend of internal borrowing, further temporary borrowing and by locking in to longer term PWLB borrowing to manage longer term cost and risk for the loan portfolio. However, the opportunity continues to exist to consider further loans on a 'forward dealing' basis, and officers will continue to explore the viability of these loans throughout the remainder of 2019/20 and into 2020/21.

The projected under-borrowing position as at 31 March 2020 is £40.402 million. This means that the Council have funded an equivalent amount of capital expenditure on new assets through internal resources / working capital, and have not committed to fixed long term borrowing to fund this capital expenditure through loans from external counterparties. Other options available to the Council would be to borrow a further £40.402 million from external loan providers to fully finance the capital investment which would result in an additional cost to the revenue budget; or to mature the existing £69.985 million of deposits that are cash backing the Council's reserves and defer equivalent long term borrowing over the current and forthcoming financial years, until the reserves are utilised.

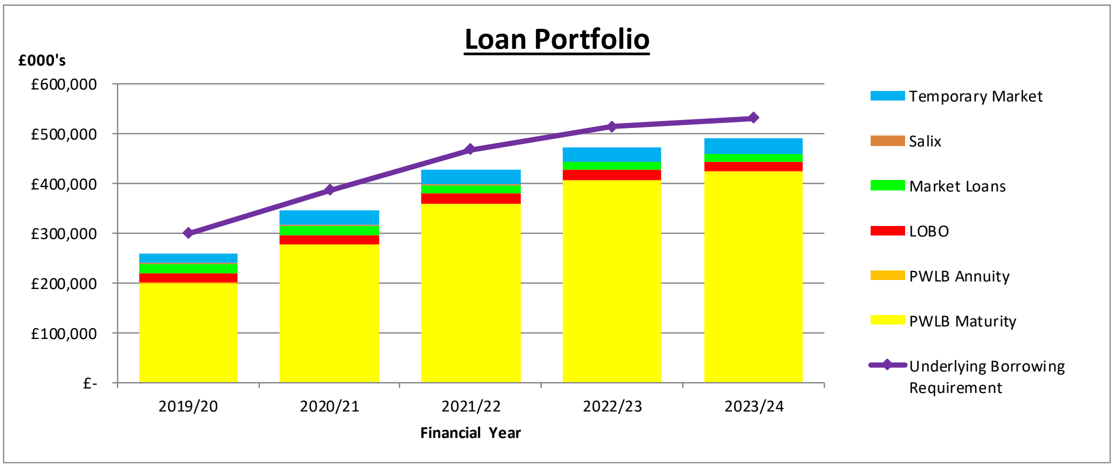
Whilst this may result in savings against the Council's current loan charges in the short term it will expose the Council to a significant risk in the medium to long term by having over £100 million exposure to interest rate and refinancing risk.

In the current climate, Council officers have assessed that the current under-borrowed position is a prudent approach which balances (a) the short-medium term cashflow benefit and saving to the revenue budget of using internal resources / working capital at a lower cost against (b) the longer-term risk of not locking into longer-term borrowing at still historically low longer term borrowing rates, particularly against the backdrop of the recent 100bps increase in PWLB rates applied by the DMO without any prior notice.

Officers will ensure that any loans taken are drawn to match the existing maturity and projected capital expenditure profiles as closely as possible, that proposed interest rates continue to sit below forward interest rate projections, and that the overall borrowing remains within the Authorised Limit proposed below.

Any other borrowing undertaken in advance of need would be supported by a business case which will appraise the anticipated savings in borrowing costs (from expected increases in rates later in the year / in forthcoming years) against the carrying cost associated with borrowing in advance of need.

The Council's projected loan portfolio over the period 2019/20 to 2023/24 is shown in graphical format below.



2.4 Investment Strategy

The position on potential investment opportunities remains broadly as reported to Council in the Treasury Management Mid-Year Update report on 12 November 2019.

The investment environment within which the Council seeks to invest its cash reserves remains challenging, with the continued scrutiny over the creditworthiness of counterparties resulting in an ever tighter counterparty list. At the same time, the low 0.75% Bank of England base rate dictates low returns of typically c. 1% for a 12 month fixed term deposit.

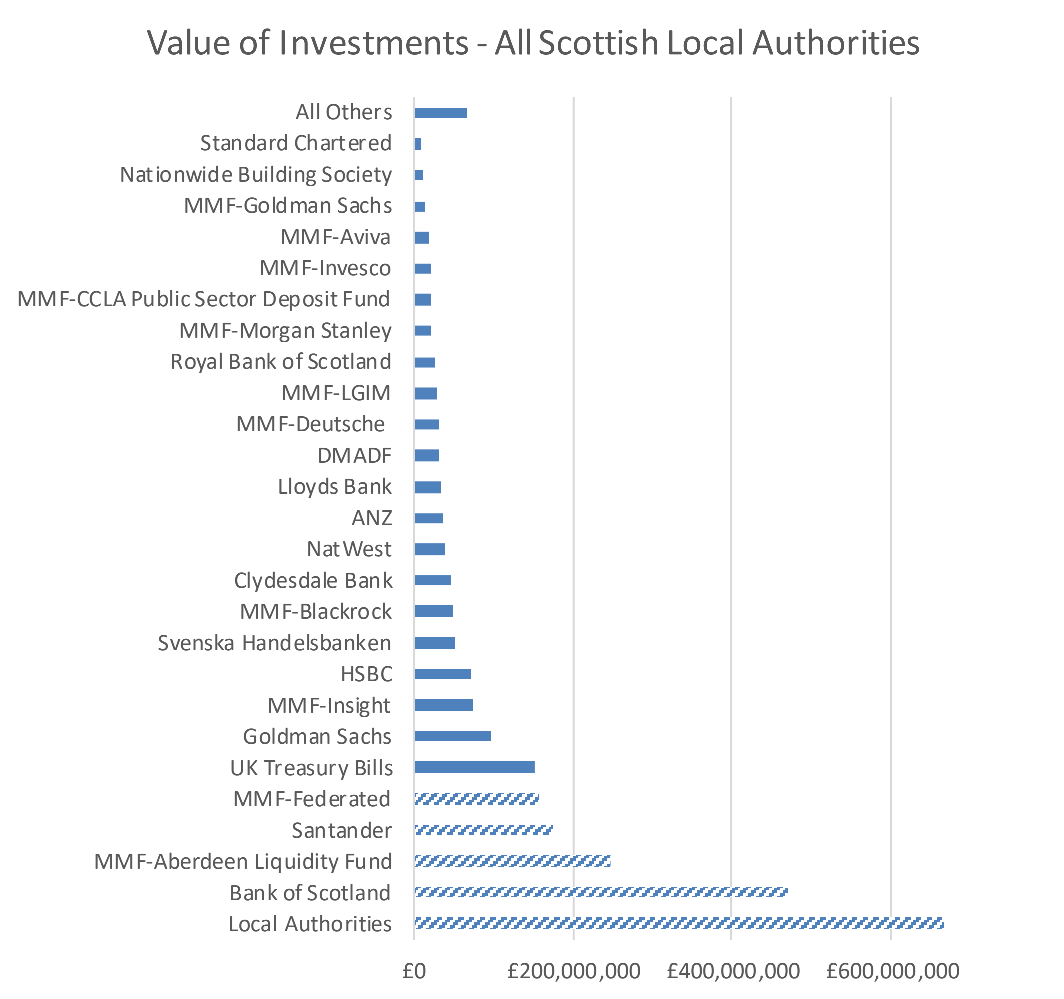
The Council currently has £69.985 million of short-term investments which have the primary aim of cash backing the Council's reserves. These are detailed in Appendix 1.

In addition, the Council currently holds £22.134 million in instant access accounts with Money Market Funds, earning a return as at the date of writing of 0.72%. These investments have the primary purpose of ensuring short-term liquidity for the Council in order to manage its day-to-day cashflow needs.

The amount held in Money Market Funds broadly reflects the Council's level of working capital and fluctuates throughout the year due to a number of factors, including cashflow fluctuations throughout the month (e.g. payrolls/council tax receipts), receipt of Scottish Government general capital (for example, £6.928 million Early Years Revenue grant funding from Scottish Government on 1 August 2019, £6.300 million Early Years Capital Grant funding from Scottish Government on 30 August 2019 and £2.042 million for new social housing 10 January 2020), general revenue and specific grants, grants from other external parties, receipt of developer contributions, and the impact of borrowing to finance the Council's capital plans and any subsequent rephasing of expenditure within these plans. The amount held in Money Market Funds throughout the current financial year is shown in Table 4 below:-

Month	Minimum £000's	Average £000's	Maximum £000's
April	5,276	10,252	18,353
May	9,985	16,590	26,742
June	8,973	23,142	30,089
July	5,516	12,056	17,947
August	6,569	18,422	27,218
September	5,743	11,620	26,218
October	23,712	29,267	36,998
November	21,608	29,055	32,731
December	6,890	18,067	27,158

Attached below is a graph showing the total level of investments held by 31 of the 32 Local Authorities in Scotland. Counterparties that the Council currently have investments with are shown as a hatched bar.



Council officers, in conjunction with Link Asset Services will continue to review the range of investment options available to the Council, within the proposed Permitted Investments included as Appendix 2, in order to select only the most creditworthy counterparties to ensure the security of Council funds, and from that list select the range of investment products that offer best value to the Council's investment portfolio.

An alternative investment strategy would be to deposit funds directly with the UK Government's Debt Management Account Deposit Facility (DMADF). All deposits with the UK DMADF would be guaranteed by HM Government and therefore have a direct claim on HM Government / the equivalent of a sovereign double-A credit rating.

Rates payable by the DMADF range from 0.50% for an overnight deposit to 0.51% for a 6 month deposit.

Were the Council to switch the entirety of its £69.985 million deposits that are currently invested with other counterparties into DMADF 6 month deposits, this would result in a loss of income to the Council of £0.490 million per annum.

3 Prudential Indicators

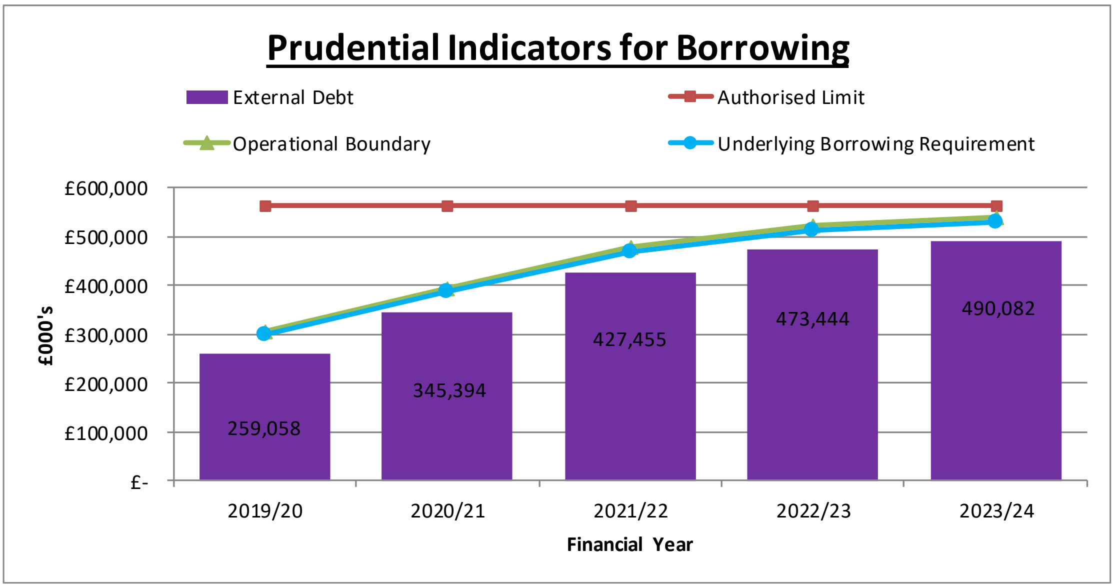
Prudential Code for Capital Finance in Local Authorities

The Prudential Code for Capital Finance in Local Authorities requires that Councils can demonstrate that their Capital Plans are affordable, prudent and sustainable, taking into account the financial provisions made in current and future revenue budgets; and that Treasury Management decisions are taken in accordance with good practice.

The Prudential Indicators that Councils need to consider relate to both actual, historic outcomes, and future estimated outcomes (covering the same period as the Council's Capital Plans), as follows:-

- Original indicators and actual outcomes for 2018/19;
- Revised estimates of the 2019/20 indicators; and
- Estimates of indicators for 2020/21 to 2023/24.

The Prudential Indicators required by the Code are listed individually in Appendix 3. The key indicators relating to external borrowing are shown in graphical format below.



The **Capital Financing Requirement (CFR)** denotes the Council's underlying need to borrow for capital purposes. The CFR includes borrowing arising as a result of the Council's Capital Plans, plus the long-term liability arising from the Council's two PPP contracts. The **Underlying Borrowing Requirement** strips out the latter of these (long-term liability arising from the two PPP contracts) from the CFR.

The **Authorised Limit for Borrowing** represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It is the expected maximum borrowing need with some headroom for unexpected movements.

The Authorised Limit for Borrowing has been calculated by taking the maximum value of the CFR over this year and the next 4 financial years (2020/21 to 2023/24), with the total forecast level of capital receipts and developer contributions added back to this figure (given the inherent uncertainty regarding the timing and value of these receipts/contributions). This is shown in table 5 below.

Table 5: Authorised Limit for Borrowing: Calculation

Authorised Limit	**Amount £000's**
CFR – General Services (31 March 2024)	211,281
CFR – HRA (31 March 2024)	319,202
Unrealised Capital Receipts/Developer Contributions 19/20	1,591
Forecast Capital Receipts & Developer Contributions 20/21-23/24	30,277
Proposed Authorised Limit	**562,351**

Council will therefore be asked to approve an adjustment to the authorised limit for borrowing to £562.351 million, if market conditions support this action. This would have the effect of securing lower costs for future years but care would be taken to ensure that the cost of carry from borrowing early is minimised and that the maturity structure of all debt is sufficiently robust to ensure that the CFR at 31 March 2024 remains achievable.

The authorised limit therefore reflects a level of borrowing which, while not desired, could be afforded but is not sustainable.

4 Statutory repayment of loans fund advances

Under the Local Government Finance Circular 7/2016, Council is now required to set out its policy for the statutory repayment of loans fund advances prior to the start of each financial year. The repayment of loans fund advances ensures that the Council makes a prudent provision each year to pay off an element of the accumulated loans fund advances made in previous financial years.

Audit Committee is therefore asked to scrutinise the approach and methodology to the statutory repayment of loans fund advances and the accounting policies that dovetail together with this, prior to these being proposed and presented to Council on 11 February 2020.

4.1 New Assets

In accordance with Finance Circular 7/2016, for all advances made in relation to the provision of a new asset, the policy will be to defer the commencement of the first principal repayment of the loans fund advance until the financial year following the one in which the asset is first available for use.

4.2 Loans Fund Review: Options for Prudent Repayment

Finance Circular 7/2016 then provides a variety of options to Councils for the profiling of the repayment of each loans fund advance, so long as the principle of prudence is maintained. There are 4 options available: (a) Asset Life method; (b) Statutory method; (c) Depreciation method; and (d) Funding/income profile method.

The guidance states that Councils should be consistent when applying options; however Councils do not need to select one single option and may select different options for different capital schemes/asset classes.

(a) Asset Life method

Council officers, in conjunction with Link Asset Services, have therefore undertaken a comprehensive review of the Loans Fund accounting arrangements to assess the approach to how Loans Fund advances should prudently be repaid.

As a result of this, for those asset classes outlined in table 6 below, the Asset Life method is proposed to be adopted for the repayment of General Fund loans fund advances from 2020/21. This ensures that the repayment of the loans fund advance is reasonably commensurate with the period and pattern over which the capital expenditure provides benefits to the community and reflecting the economic benefit of assets that are now lasting longer than originally assumed, and that the period of the repayment of the loans fund advance is the same as the useful life recognised for that asset component in the Council's statutory Annual Accounts.

Table 6: Asset Classes to adopt the "Asset Life" method

Infrastructure	**Current Loans Fund Advance Period***	**Proposed Loans Fund Advance Period**
New Primary Schools/Extensions	50	60
New Leisure Centres	39	60
New Offices	25	60
Road Upgrades	29	50
Street Lighting Columns	26	50
Structures/Bridges	26	50
Footway/Cyclepaths	30	50
Town Centre Environmental Improvements	20	50
New Care Homes	33	45
Children's Play Equipment	9	20

* *Average loans fund advance length*

As part of the Loans Fund Review, historic debt repayments were also reviewed to assess whether the repayment methodology applied to historic loans fund advances was still the most prudent option. As a result of this review, officers are recommending that the historic General Fund loans fund advances for the asset classes as noted in Table 6 above should also be repaid using the Asset Life method, to ensure that in line with future loans fund advances, the payments made to date can be assessed as prudent and to ensure that the repayments reasonably reflect the period over which the community receives the economic benefit of assets that are now lasting longer than originally assumed. This also ensures that the Council is not charging the borrowing cost associated with the provision of new assets to the revenue account too early (which would reduce the level of revenue budget available to support service provision).

The annual repayments under the "Asset Life" method for those asset classes as noted above will be calculated using the asset lives and will use the annuity method, to ensure consistency of approach with the Statutory method for all other asset classes (see 4.2(b) below). The annuity interest rate that will be used to calculate loans fund principal repayments under the "Asset Life" method will be the in-year loans fund rate, which for 2019/20 is currently estimated to be 3.10%.

(b) Statutory method

For all other asset classes, the policy will be to maintain the practice of previous years and apply what is termed "the Statutory Method" – following the principles of Schedule 3 of the Local Government (Scotland) Act 1975 – with all loans fund advances being repaid by the annuity method. The annuity rate that is proposed to be applied to the loans fund repayments varies will be the in-year loans fund rate, reflecting the Council's current loan and investment portfolio. The loans fund rate for 2019/20 is forecast to be 3.10%

(c) Depreciation method

Whilst this method is not currently proposed, Council officers will continue to monitor whether it is appropriate to use this for future capital projects.

(d) Funding/income profile method

Whilst this method is not currently proposed, Council officers will continue to monitor whether it is appropriate to use this for future capital projects.

4.3 Outcome of Review

Applying the Asset Life method as outlined in Section 4.2(a) above results in a reduction in loans fund principal repayments over the life of the medium term financial strategy which can help support higher levels of capital expenditure at a time where resources are stretched significantly and the Council is experiencing an unprecedented level of demographic growth with resultant capital investment requirements, in particular through the evolving Learning Estate Strategy requirements.

In addition, the prior year overprovision of £7.022 million can be used to further reduce the level of loans fund advances and therefore limit the increase the Council would need to make in the revenue budget to support borrowing. In other words the current or a smaller revenue budget for loan charges can support an increase in the level of capital expenditure that can be funded. Final decision on the profile of the prior year overprovision will be made as part of finalising the 2020/21 budget, once the Capital Strategy is updated and the grant settlement is known.

The Asset Life method is the approach that the majority of councils are migrating towards for the statutory repayment of loans fund advances, with these Councils achieving similar outcomes to those set out in this paper.

5 Other issues

5.1 Treasury Management Practices

The Chief Officer Corporate Solutions is responsible for updating Treasury Management Practices. These are reviewed on a regular basis and were reported as part of the Treasury Management Mid-Year Review Report 2017/18 presented to Council on 07 November 2018.

5.2 Performance Indicators 2018/19 – comparison with other Scottish Local Authorities

The Treasury Management Forum collates performance indicators for all Scottish Local Authorities. The indicators relating to financial year 2018/19 have been published and once again demonstrate the continuing effectiveness of the Treasury function in maximising efficiency in Treasury Management activity, with the Council continuing to have one of the lowest weighted average borrowing & investment (loans fund) rate across all Scottish mainland authorities for the sixth year out of the last eight financial years. Appendix 4 outlines the loans fund rate for each Scottish Local Authority in 2018/19.

Were the internal loans fund rate to have equated to the Scottish weighted average of 3.83%, this would have generated loan charges in 2018/19 of £18.5m. The Council's actual 2018/19 loan charges for General Services and HRA were £16.5m, representing a cash saving (compared to the Scotland average) of £2.0m in 2018/19.

6. Report Implications

6.1 Resources

There are no direct resource implications arising from this report.

6.2 Risk

The strategies outlined in this report are designed to maintain the effectiveness of the overall risk management arrangements for Treasury activity. Providing the limits outlined in the strategies are observed they will support the controls already in place in the Treasury Management Practices within which the treasury function operates.

The Prudential Indicators contained in Appendix 3 maintain the effectiveness of the overall risk management of Capital Investment and Treasury Management.

6.3 Single Midlothian Plan and Business Transformation

Themes addressed in this report:

☐ Community safety
☐ Adult health, care and housing
☐ Getting it right for every Midlothian child
☐ Improving opportunities in Midlothian
☐ Sustainable growth
☐ Business transformation and Best Value
☒ None of the above

6.4 Impact on Performance and Outcomes

The strategies to be adopted are an integral part of the corporate aim to achieve Best Value as they seek to minimise the cost of borrowing by exercising prudent debt management and investment. This in turn helps to ensure that the Council's capital expenditure is sustainable in revenue terms.

6.5 Adopting a Preventative Approach

The proposals in this report do not directly impact on the adoption of a preventative approach.

6.6 Involving Communities and Other Stakeholders

Although no external consultation has taken place, cognisance has been taken of professional advice obtained from Link Asset Services, the Council's appointed Treasury Consultants.

6.7 Ensuring Equalities

There are no equality issues arising from this report.

6.8 Supporting Sustainable Development

There are no sustainability issues arising from this report.

6.9 Digital Issues

There are no IT issues arising from this report.

7 Summary

The Treasury Management and Investment Strategies outlined in this document, and in the detailed document that has been placed in the Member's Library / uploaded to the Council's Committee Management System, have been formulated to comply with the revised Codes of Practice and relevant Regulations and provide the framework for achieving best value in the management of the Council's borrowing and investment portfolios.

8 Recommendations

The Audit Committee is invited to comment on this report before the final report is presented to Council. In particular, the following recommendations which are proposed to be put to Council on 11 February 2020:-

a) Approve the Treasury Management and Investment Strategy for the 2020/21 financial year, as detailed in Section 2 of this report;
b) Approve the list of Permitted Investments outlined in Appendix 2;
c) Adopt the Prudential Indicators contained in Appendix 3 of this report;
d) Approve an adjustment to the Authorised Limit for Borrowing to £562.351 million (as shown in Section 3) if market conditions indicate that this is prudent;
e) Note that the policy to repay loans fund advances for those asset classes outlined in Table 5 in Section 4.2(a) will be to use the “Asset Life” method, using an annuity approach with an interest rate equating to the in-year loans fund rate;
f) Note that the policy to repay loans fund advances as outlined in Section 4.2(a) will be applied both prospectively and retrospectively to all loans fund advances made since 31 March 1998;
g) Note that the policy to repay loans fund advances for all other asset classes will be the “Statutory method” as outlined in Section 4.2(b), using an annuity approach with an interest rate equating to the in-year loans fund rate;

Date:- 16 January 2020

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Background Papers:-
Appendix 1: Current Short-term Investment Portfolio
Appendix 2:- Permitted Investments
Appendix 3:- Prudential Indicators
Appendix 4: Performance Indicators 2018/19
Appendix 5:- Treasury Management & Annual Investment Strategy Statement – 2020/21 Detailed – uploaded to Members Library on the Committee Management System

Appendix 1: Current Short-term Investment Portfolio

Counterparty	Amount £000's	Product	Security *Long/Short Term Rating** *(Colour)***	Liquidity	Yield
Bank of Scotland PLC	30,000	Fixed term deposit	A+/F1 (*Orange*)	Start: 26/06/19 Maturity: 26/06/19	1.25%
Santander UK plc	14,985	Notice account	A+/F1 (*Red*)	180 days' notice	1.10%
Warrington Borough Council	10,000	Fixed term deposit	AA (Yellow)	Start: 21/03/18 Maturity 23/03/20	1.00% Year 1 / 1.70% Year 2
Plymouth City Council	5,000	Fixed term deposit	AA (Yellow)	Start: 28/03/18 Maturity 30/03/20	1.00% Year 1 / 1.70% Year 2
Rushmoor Borough Council	10,000	Fixed term deposit	AA (Yellow)	Start: 22/07/19 Maturity 22/01/21	1.15%
Total	**69,985**				**1.20%**

** Credit Rating from Fitch*

*** Colour represents maximum recommended duration for investment per Link Asset Services, Treasury Solutions Credit Scoring methodology – see Appendix 2.*

Permitted Investments Appendix 2

The Council uses the Link creditworthiness service. This utilises credit ratings from the three main credit rating agencies – Fitch, Moody's and Standard & Poors, along with credit watches, outlooks, CDS spreads and country sovereign ratings in a weighted scoring system with an end product of a series of colour coded bands which indicate the relative creditworthiness of counterparties for investment.

These colour codes are used by the Council to determine the maximum suggested duration for investment with that counterparty. These are as follows:-

Link Asset Services Colour Code	Maximum Suggested Duration for Investment
Yellow	6 years*
Dark Pink	6 years**
Light Pink	6 years**
Purple	3 years
Blue	2 years***
Orange	2 years
Red	8 months
Green	120 days
No colour	Not to be used

* *Note the yellow colour category is for:- UK Government Debt, or its equivalent, Money Market Funds (MMF's), and collateralised deposits where the collateral is UK Government Debt*

** *Dark Pink for Ultra Short Dated Bond Funds with a credit score of 1.25; Light Pink for Ultra Short Dated Bond Funds with a credit score of 1.5*

*** *Only applies to nationalised or semi-nationalised UK banks*

Note that the maximum suggested durations listed above have been extended by 1 year (when compared to the suggested maximum durations provided by Link) for the Yellow, Dark Pink, Light Pink, Purple, Blue and Orange categories, to allow flexibility around these durations on the margins e.g. the placement of a 13 month fixed term deposit for a counterparty rated Orange or Blue. Equally, the maximum suggested duration for the Red category has been extended by a month to 8 months, and the maximum duration for the Green category has been extended by 20 days to 120 days, on the same basis. A thorough appraisal of the additional risk involved in extending the duration of any deposit (marginally) beyond the maximum suggested by Link, against any enhanced value to the portfolio, will be undertaken prior to the placement of any deposit.

1.1 Deposits

Investment Category	Minimum Credit Criteria	Liquidity risk	Market risk	Max %/£m of total investments	Max. maturity period
Debt Management Agency Deposit Facility	--	Term	No	**100%**	**6 months**
Term deposits – local authorities	--	Term	No	**100%**	**5 years**
Call accounts – banks and building societies	Green	Instant	No	**100%**	**1 day**
Term deposits / Notice Accounts – banks and building societies	Yellow Purple Blue Orange Red Green No Colour	Term	No	**100%**	**Up to 6 yrs** **Up to 3 yrs** **Up to 2 yrs** **Up to 2 yrs** **Up to 8 mths** **Up to 120 days** **Not for use**
Fixed term deposits with variable rate and variable maturities: - Structured deposits	Yellow Purple Blue Orange Red Green No Colour	Term	No	**100%**	**Up to 6 yrs** **Up to 3 yrs** **Up to 2 yrs** **Up to 2 yrs** **Up to 8 mths** **Up to 120 days** **Not for use**

1.2 Deposits with counterparties currently in receipt of government support / ownership

Investment Category	Minimum Credit Criteria	Liquidity risk	Market risk	Max %/£m of total investments	Max. maturity period
UK nationalised banks – Call accounts	Blue	Instant	No	**100%**	**1 day**
UK nationalised banks – Term Deposits / Notice Accounts	Blue	Term	No	**100%**	**2 years**
UK nationalised banks – Fixed term deposits with variable rate and variable maturities: - Structured deposits	Blue	Term	No	**100%**	**2 years**
Non-UK(high sovereign rated country) nationalised banks – Call accounts	Green	Instant	No	**100%**	**1 day**
Non-UK (high sovereign rated country) nationalised banks:- Term Deposits / Notice Accounts	Yellow Purple Blue Orange Red Green No Colour	Term	No	**100%**	**Up to 6 yrs** **Up to 3 yrs** **Up to 2 yrs** **Up to 2 yrs** **Up to 8 mths** **Up to 120 days** **Not for use**
Non-UK (high sovereign rated country) nationalised banks:- Fixed term deposits with variable rate and variable maturities: - Structured deposits	Yellow Purple Blue Orange Red Green No Colour	Term	No	**100%**	**Up to 6 yrs** **Up to 3 yrs** **Up to 2 yrs** **Up to 2 yrs** **Up to 8 mths** **Up to 120 days** **Not for use**

If forward deposits are made, the forward period plus the deal period equate to the maximum maturity period.

1.3 Collective investment schemes structured as Open Ended Investment Companies (OEICs)

Investment Category	Minimum Credit Criteria	Liquidity risk	Market risk	Max %/£m of total investments	Max. maturity period
Government Liquidity Funds	AAA	Instant	No	**100%**	**1 day**
Money Market Funds CNAV	AAA	Instant	No	**100%**	**1 day**
Money Market Funds LVNAV	AAA	Instant	No	**100%**	**1 day**
Money Market Funds VNAV	AAA	Instant	No	**100%**	**1 day**
Ultra Short Dated Bond Funds with a credit score of 1.25	AAA	T+1 to T+5	Yes	**100%**	**5 days**
Ultra Short Dated Bond Funds with a credit score of 1.5	AAA	T+1 to T+5	Yes	**100%**	**1 week**
Bond Funds	AAA	T+2 or longer	Yes	**50%**	**2 days**
Gilt Funds	AAA	T+2 or longer	Yes	**50%**	**2 days**

1.4 Securities issued or guaranteed by governments

Investment Category	* Minimum Credit Criteria	Liquidity risk	Market risk	Max %?£m of total investments	Max. maturity period
Treasury Bills	UK sovereign rating	Sale T+1	Yes	**100%**	**50 years**
UK Government Gilts	UK sovereign rating	Sale T+1	Yes	**100%**	**50 years**
Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government e.g. National Rail	UK sovereign rating	Sale T+3	Yes	**100%**	**50 years**
Sovereign bond issues (other than the UK govt)	AAA (or state your criteria if different)	Sale T+1	Yes	**100%**	**50 years**
Bonds issued by multilateral development banks	AAA (or state your criteria if different)	Sale T+1	Yes	**100%**	**50 years**

1.5 Securities issued by corporate organisations

Investment Category	* Minimum Credit Criteria	Liquidity risk	Market risk	Max % of total investments	Max. maturity period
Certificates of deposit issued by banks and building societies	Yellow Purple Blue Orange Red Green No Colour	Sale T+0	Yes	**100%**	**Up to 6 yrs Up to 3 yrs Up to 2 yrs Up to 2 yrs Up to 8 mths Up to 100 days Not for use**
Commercial paper other	Yellow Purple Blue Orange Red Green No Colour	Sale T+0	Yes	**100%**	**Up to 6 yrs Up to 3 yrs Up to 2 yrs Up to 2 yrs Up to 8 mths Up to 100 days Not for use**
Floating rate notes	Yellow Purple Blue Orange Red Green No Colour	Sale T+2	Yes	**100%**	**Up to 6 yrs Up to 3 yrs Up to 2 yrs Up to 2 yrs Up to 8 mths Up to 100 days Not for use**
Corporate Bonds other	Yellow Purple Blue Orange Red Green No Colour	Sale T+2	Yes	**100%**	**Up to 6 yrs Up to 3 yrs Up to 2 yrs Up to 2 yrs Up to 8 mths Up to 100 days Not for use**

1.6 Other

Investment Category	Minimum Credit Criteria	Liquidity risk	Market risk	Max %/£m of total investments	Max. maturity period
Local authority mortgage guarantee scheme.	Blue	Term	No	**50%**	**5 years**
Loans to Third Parties	n/a	Term	No	**£25m**	**25 years**
Subordinated Debt Subscription to Newbattle Centre SPV	n/a	Term	No	**£0.333m**	**25 years**
Property Funds	n/a	T+4	Yes	**50%**	**15 years**

Prudential Indicators Appendix 3

1. Prudential Indicators for Affordability

These indicators provide an indication of the impact of the capital investment plans on the Council's overall finances.

1.1 Estimates of Ratio of Financing Costs to Net Revenue Stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

Ratio of Financing Costs to Net Revenue Stream						
%	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
	Actual	Estimate	Estimate	Estimate	Estimate	Estimate
General Services	3.07%	2.99%	3.19%	3.37%	3.53%	3.77%
HRA	36.90%	34.89%	35.17%	39.78%	40.77%	42.67%

The figures above are based on the latest Capital Plans presented to Council.

1.2 HRA Ratios

The following indicator identifies the ratio of overall debt on the HRA account compared to annual house rent revenue.

HRA Debt as a % of Gross Revenue						
	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
	Actual	Estimate	Estimate	Estimate	Estimate	Estimate
HRA debt £000's	£ 163,303	£ 178,072	£ 248,241	£ 301,323	£ 313,191	£ 319,202
HRA revenues £000's	£ 29,397	£ 30,248	£ 32,790	£ 34,723	£ 35,621	£ 35,512
Ratio of debt to revenues %	556%	589%	757%	868%	879%	899%

The following indicator identifies the ratio of overall debt on the HRA account per HRA dwelling.

HRA Debt per Dwelling						
	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
	Actual	Estimate	Estimate	Estimate	Estimate	Estimate
HRA debt £000's	£ 163,303	£ 178,072	£ 248,241	£ 301,323	£ 313,191	£ 319,202
Number of HRA dwellings	6,927	6,972	7,088	7,403	7,793	£ 7,985
Debt per dwelling £	£ 23,575	£ 25,541	£ 35,023	£ 40,703	£ 40,189	£ 39,975

2. Prudential Indicators for Capital Expenditure

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

2.1 Estimated Capital Expenditure

This indicator shows the gross capital spend included in the relevant capital plans.

Capital Expenditure	2018/19 Actual £000's	2019/20 Estimate £000's	2020/21 Estimate £000's	2021/22 Estimate £000's	2022/23 Estimate £000's	2023/24 Estimate £000's
General Services						
Resources	£ 10,326	£ 10,027	£ 25,041	£ 22,448	£ 23,045	£ 9,585
Education, Community & Economy	£ 7,327	£ 25,904	£ 30,811	£ 31,529	£ 24,258	£ 19,874
Health & Social Care	£ 558	£ 963	£ 1,214	£ 7,473	£ 1,724	£ 338
Business Transformation	£ (2)	£ 2	£ 5,161	£ 10,414	£ 5,308	£ -
Provision for Return of Contingencies	£ -	£ -	£ (922)	£ (1,533)	£ (1,758)	£ (1,314)
Total General Services	**£ 18,209**	**£ 36,896**	**£ 61,305**	**£ 70,331**	**£ 52,577**	**£ 28,483**
Total HRA	**£ 14,718**	**£ 29,915**	**£ 81,128**	**£ 64,175**	**£ 25,423**	**£ 14,593**
Combined Total	**£ 32,927**	**£ 66,811**	**£ 142,433**	**£ 134,506**	**£ 78,000**	**£ 43,076**

2.2 Financing of Capital Expenditure

This indicator shows how the Capital Expenditure forecasts are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Capital Expenditure and Available Financing	2018/19 Actual £000's	2019/20 Estimate £000's	2020/21 Estimate £000's	2021/22 Estimate £000's	2022/23 Estimate £000's	2023/24 Estimate £000's
Capital Expenditure						
General Services	£ 18,209	£ 36,896	£ 61,305	£ 70,331	£ 52,577	£ 28,483
HRA	£ 14,718	£ 29,915	£ 81,128	£ 64,175	£ 25,423	£ 14,593
Total	**£ 32,927**	**£ 66,811**	**£ 142,433**	**£ 134,506**	**£ 78,000**	**£ 43,076**
Financed by:						
Capital receipts	£ 3,304	£ -	£ 2,120	£ -	£ -	£ -
Capital grants	£ 23,329	£ 24,271	£ 27,355	£ 25,227	£ 13,928	£ 8,366
Capital reserves	£ -	£ 2,437	£ 2,000	£ 10,694	£ 2,000	£ -
Developer/Other Contributions	£ 2,498	£ 6,662	£ 15,317	£ 5,428	£ 3,170	£ 4,698
Net financing need for the year	**£ 3,796**	**£ 33,441**	**£ 95,641**	**£ 93,157**	**£ 58,902**	**£ 30,012**

2.3 Estimated Capital Financing Requirement

This indicator measures the Council's maximum underlying need to borrow for capital purposes and other long term liabilities over the next three years.

Capital Financing Requirement (CFR)						
	2018/19 Actual £000's	2019/20 Estimate £000's	2020/21 Estimate £000's	2021/22 Estimate £000's	2022/23 Estimate £000's	2023/24 Estimate £000's
Capital Financing Requirement						
CFR – General Services	£ 111,279	£ 121,388	£ 137,555	£ 166,534	£ 200,656	£ 211,281
CFR – HRA	£ 163,303	£ 178,072	£ 248,241	£ 301,323	£ 313,191	£ 319,202
CFR – PFI Schemes	£ 85,135	£ 82,832	£ 80,359	£ 77,703	£ 74,849	£ 71,782
Total CFR	**£ 359,717**	**£ 382,292**	**£ 466,155**	**£ 545,560**	**£ 588,696**	**£ 602,265**
Movement in CFR	**£ 25,963**	**£ 22,575**	**£ 83,863**	**£ 79,405**	**£ 43,136**	**£ 13,569**
Movement in CFR represented by						
Net financing need for the year (previous table)	£ 3,796	£ 33,441	£ 95,641	£ 93,157	£ 58,902	£ 30,012
Less Scheduled Debt Amortisation	£ (8,369)	£ (8,563)	£ (9,305)	£ (11,096)	£ (12,912)	£ (13,376)
Less PFI Finance Lease Principal Payments	£ 30,163	£ (2,303)	£ (2,473)	£ (2,656)	£ (2,854)	£ (3,067)
Movement in CFR	**£ 25,590**	**£ 22,575**	**£ 83,863**	**£ 79,405**	**£ 43,136**	**£ 13,569**

3. Prudential Indicators for Prudence

3.1 Net Borrowing Requirement

This indicator shows the amount of external borrowing required to finance the current debt outstanding on capital projects.

Net Borrowing Requirement						
	2018/19 Actual £000's	2019/20 Estimate £000's	2020/21 Estimate £000's	2021/22 Estimate £000's	2022/23 Estimate £000's	2023/24 Estimate £000's
External Debt						
Debt at 1 April	£ 257,302	£ 241,031	£ 251,279	£ 318,732	£ 360,154	£ 424,571
Actual/Expected change in Debt	£ (16,271)	£ 10,248	£ 67,453	£ 41,422	£ 29,101	£ 23,053
Other long-term liabilities (OLTL)	£ 54,972	£ 85,135	£ 82,832	£ 80,359	£ 77,703	£ 74,849
Actual/Expected change in OLTL	£ 30,163	£ (2,303)	£ (2,473)	£ (2,656)	£ (1,832)	£ (1,831)
Actual/Expected Gross Debt at 31 March	**£ 326,166**	**£ 334,111**	**£ 399,091**	**£ 437,857**	**£ 465,126**	**£ 520,642**
The Capital Financing Requirement	**£ 359,717**	**£ 382,292**	**£ 466,155**	**£ 545,560**	**£ 588,696**	**£ 602,265**
Under / (over) borrowing	**£ 33,551**	**£ 48,181**	**£ 67,064**	**£ 107,703**	**£ 123,570**	**£ 81,623**
Investments						
Cash & Cash Equivalents	£ 10,000	£ 10,000	£ 10,000	£ 10,000	£ 10,000	£ 10,000
Short-Term Investments	£ 69,985	£ 69,985	£ 69,985	£ 69,985	£ 69,985	£ 69,985
Total Investments	**£ 79,985**	**£ 79,985**	**£ 79,985**	**£ 79,985**	**£ 79,985**	**£ 79,985**

4. Prudential Indicators for External Debt

4.1 Operational Boundary

This is the limit beyond which external debt is not normally expected to exceed and will be the focus of day to day treasury management. Typically, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

For this Council:-

- the Operational Boundary for Borrowing has been calculated to equate directly to the value of the CFR for General Services and HRA combined, over the current financial year and the following 4 financial years (2018/19 to 2022/23); and
- the Operational Boundary for Other Long-Term Liabilities has been calculated to equate directly to the in-year CFR for Other Long-Term Liabilities, given the known contractual provisions for the repayment of debt within the Council's two PPP agreements.

Operational Boundary						
	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
	Actual	Estimate	Estimate	Estimate	Estimate	Estimate
	£000's	£000's	£000's	£000's	£000's	£000's
Operational Boundary - Borrowing	£274,582	£299,460	£385,796	£ 467,857	£ 513,847	£ 530,483
Operational Boundary - Other long term liabilities	£ 85,135	£ 82,832	£ 80,359	£ 77,703	£ 74,849	£ 71,782
Total	**£359,717**	**£382,292**	**£466,155**	**£ 545,560**	**£ 588,696**	**£ 602,265**

Should the Operational Boundary be breached, for example as a result of a decision taken to borrow in advance (should market conditions indicate that it is prudent to do so), this will be reported to Council at the next available opportunity.

4.2 Authorised Limit of Total External Debt

This indicator sets the limit for total external debt.

In an active Treasury Management policy it is sometimes prudent to borrow in advance of need if interest rates are expected to rise.

In order to continue to service the ongoing external debt and finance the current capital programmes the Council needs to increase its external borrowing to £523.188 million by 31 March 2023. Within the Capital Plans, there are assumptions regarding capital receipts and developer contributions which when applied to the Council's capital plans reduce the Council's borrowing requirements. However, the realisation of these capital receipts and developer contributions carry inherent uncertainty around both the timing and value of each receipt/contribution, given that they are largely dependent upon economic and market activity which are outwith the Council's control. Therefore, in order to calculate the Authorised Limit for Borrowing, these capital receipts and developer contributions have been added to the Capital Financing Requirement, to give the Council flexibility to fully borrow in advance of need (if market conditions support this action) should these receipts and contributions be unable to be realised in the short term. This therefore reflects a level of borrowing which, while not desired, could be afforded but is not sustainable.

Council is therefore asked to approve that, rather than restrict borrowing to £284.963 million for 2018/19, £346.056 million for 2019/20, £443.098 million for 2020/21, £487.488 million for 2021/22 and £497.965 million for 2022/23, that permission be granted to borrow up to the 2022/23 Authorised Limit for borrowing of £524.349 million as shown in the table below), if market conditions support this action.

Adopting this approach will secure lower costs for future years but care will be taken to ensure that the cost of carry is minimised and that the maturity structure of all debt is sufficiently robust to ensure that the Capital Financing Requirement at 31 March 2023 remains achievable.

Authorised Limit						
	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
	Actual	Estimate	Estimate	Estimate	Estimate	Estimate
	£000's	£000's	£000's	£000's	£000's	£000's
Authorised Limit - Borrowing	£ 562,351	£ 562,351	£ 562,351	£ 562,351	£ 562,351	£ 562,351
Authorised Limit - Other long term liabilities	£ 85,135	£ 82,832	£ 80,359	£ 77,703	£ 74,849	£ 71,782
Total Debt	**£ 647,486**	**£ 645,183**	**£ 642,710**	**£ 640,054**	**£ 637,200**	**£ 634,133**

Reconciliation of calculation of Authorised Limit for borrowing:-

Reconciliation of Authorised Limit for Borrowing	
	£000's
CFR - General Services at 31 March 2024	£ 211,281
CFR - HRA at 31 March 2024	£ 319,202
Capital Receipts 2019/20 unrealised to date	£ 385
Capital Receipts 2020/21 to 2023/24	£ 2,000
Developer/Other Contributions 2019/20 Unrealised to date	£ 1,206
Developer/Other Contributions 2020/21 to 2023/24	£ 28,277
Authorised Limit for Borrowing	**£ 562,351**

5. Prudential Indicators for Treasury Management

5.1 Upper limits on Fixed and Variable Interest Rates

This indicator limits the amount of external debt that may be held at fixed or variable rates. These limits are proposed to be as follows:-

Upper Limits on Exposure to Fixed and Variable Interest Rates 2019/20	
Interest rate exposures	**Upper Limit**
Limits on fixed interest rates based on gross debt	100.00%
Limits on variable interest rates based on gross debt	30.00%
Limits on fixed interest rates based on investments	100.00%
Limits on variable interest rates based on investments	100.00%

5.2 Maturity Structure of Borrowing

This indicator sets the upper and lower limits of the time scales within which external debt may be held.

The Treasury Management Code of Practice now requires that LOBO's with a call date in the next 12 months are classified as short-term borrowing rather than longer-term (10 year+) borrowing.

In addition, the Code also recommends that where an authority's debt is typically very long term (i.e. for a period of greater than 10 years), that authorities should break down the period in excess of 10 years into several ranges, for example 10 to 20 years, 20 to 30 years, etc.

With the above in mind, the proposed upper and lower limits for each maturity band are shown below, with the overall aim to ensure a spreading approach to avoid a cluster of high value loans maturing/requiring refinancing within a short period of time.

Maturity Structure of Borrowing 2020/21		
Maturity structure of fixed interest rate borrowing 2020/21	**Lower**	**Upper**
Under 12 months	0.00%	50.00%
12 months to 2 years	0.00%	50.00%
2 years to 5 years	0.00%	50.00%
5 years to 10 years	0.00%	50.00%
10 years to 20 years	0.00%	50.00%
20 years to 30 years	0.00%	50.00%
30 years to 40 years	0.00%	50.00%
40 years to 50 years	0.00%	50.00%
50 years and above	0.00%	50.00%
Maturity structure of variable interest rate borrowing 2020/21	**Lower**	**Upper**
Under 12 months	0.00%	30.00%
12 months to 2 years	0.00%	30.00%
2 years to 5 years	0.00%	30.00%
5 years to 10 years	0.00%	30.00%
10 years to 20 years	0.00%	30.00%
20 years to 30 years	0.00%	30.00%
30 years to 40 years	0.00%	30.00%
40 years to 50 years	0.00%	30.00%
50 years and above	0.00%	30.00%

5.4 Total Principal Sums Invested for Periods Longer than 365 Days

This indicator relates to the total level of investments held for periods longer than 365 days.

Principal Sums Invested for > 365 Days		
Limit		£70m

The current strategy as outlined in the body of these reports is to cash-back the Council's balance sheet reserves. It is expected that the majority of this will be in the form of 12 month fixed term deposits and/or certificates of deposit; however the Council currently have two fixed term deposits with other Local Authorities, with an original maturity period of 2 years, which offer security of funds along with a higher yield as a result of longer duration. With this in mind, the limit for prinicipal sums invested for > 365 days has therefore been set at £70m to give the Council flexibility to extend the duration of deposits that are cash-backing the Council's reserves.

Appendix 4: Loans Fund Rate 2018/19

Authority	Interest	Expenses	Loans Fund
West Dunbartonshire	2.683%	0.094%	2.770%
Dumfries & Galloway	3.000%	0.045%	3.050%
Perth & Kinross	3.006%	0.049%	3.055%
Midlothian	3.090%	0.030%	3.120%
Aberdeenshire	3.240%	0.030%	3.270%
East Lothian	3.230%	0.040%	3.270%
North Lanarkshire	3.490%	0.050%	3.540%
Inverclyde	3.610%	0.040%	3.650%
Fife	3.620%	0.050%	3.670%
Dundee City	3.660%	0.035%	3.695%
East Dunbartonshire	3.670%	0.050%	3.720%
Falkirk	3.650%	0.090%	3.740%
Argyll & Bute	3.715%	0.078%	3.800%
Aberdeen City	3.800%	0.020%	3.820%
West Lothian	3.800%	0.060%	3.860%
East Renfrewshire	3.700%	0.180%	3.880%
South Lanarkshire	3.870%	0.070%	3.940%
Glasgow City	3.970%	0.030%	4.000%
Highland	3.970%	0.040%	4.010%
South Ayrshire	3.890%	0.120%	4.010%
North Ayrshire	4.003%	0.089%	4.090%
Scottish Borders	4.070%	0.030%	4.100%
Renfrewshire	4.030%	0.080%	4.110%
East Ayrshire	4.070%	0.080%	4.150%
Stirling	4.060%	0.100%	4.160%
Moray	3.990%	0.200%	4.190%
Angus	4.28%	0.070%	4.350%
Edinburgh City	4.625%	0.030%	4.660%
Clackmannanshire	4.818%	0.097%	4.915%

Internal Audit Work to December 2019
Report by Chief Internal Auditor

1. Purpose of the Report

The purpose of this report is to provide members of the Audit Committee with details of the recent work carried out by Internal Audit and the findings and recommended audit actions agreed by Management to improve internal controls and governance arrangements.

2. Progress Report

2.1 The Internal Audit Annual Plan 2019/20 was approved by the Audit Committee on 12 March 2019. Internal Audit has carried out the following work in the period from 2 November to 31 December 2019 associated with the delivery of the Plan to meet its objective of providing an opinion on the efficacy of the Council's risk management, internal control and governance.

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

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

- Social Care Income Charging, Billing and Collection
- Commercial Rents
- Environmental Health
- Electronic Payment Systems

2.4 An Executive Summary of the final Internal Audit assurance report issued, including audit objective, findings, good practice and recommendations (where appropriate), and the Chief Internal Auditor's independent and objective opinion on the adequacy of the control environment and governance arrangements within each audit area, is shown in Appendix 1.

The definitions for Internal Audit assurance categories are as follows:

Level	Definition
Comprehensive assurance	Sound risk, control, and governance systems are in place. These should be effective in mitigating risks to the achievement of objectives. Some improvements in a few, relatively minor, areas may be required.
Substantial assurance	Largely satisfactory risk, control, and governance systems are in place. There is, however, some scope for improvement as current arrangements could undermine the achievement of objectives or leave them vulnerable to error or misuse.
Limited assurance	Risk, control, and governance systems have some satisfactory aspects. There are, however, some significant weaknesses likely to undermine the achievement of objectives and leave them vulnerable to an unacceptable risk of error or misuse.
No assurance	The systems for risk, control, and governance are ineffectively designed and operated. Objectives are not being achieved and the risk of serious error or misuse is unacceptable. Significant improvements are required.

Current Internal Audit Assurance Work in Progress

2.5 Internal Audit assurance work in progress to deliver the Internal Audit Annual Plan 2019/20 consists of the following:

Audit Area	Audit Stage
Procurement and Management of Contracts	Drafting the Report
Change and Transformation Programme	Drafting the Report
Business Planning, Budget Setting and Monitoring	Drafting the Report
ICT Operational Processes	Testing Underway
Community Empowerment	Planning underway
Leisure Management Booking System	Planning underway

Internal Audit Consultancy and Other Work

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

a) In its critical friend role provided an independent view and challenge at various forums including Business Transformation Board, Capital Planning and Asset Management Board, Learning Estate Strategy Board, Information Management Group, and Early Learning and Childcare Expansion Working Group.
b) Monitored publication of Audit Scotland reports and co-ordinated submission by Management of Audit Scotland Reports to the Audit Committee or other Committee as relevant.
c) Attended and provided support for the Serious and Organised Crime Group (Principal Internal Auditor).
d) Attended the SLACIAG quarterly meeting (Chief Internal Auditor), 2-day CIIA Conference (Principal Internal Auditor), Cyber Security Conference (Internal Auditor) and SLACIAG Computer Audit Sub-Group quarterly meeting (Internal Auditor) for personal learning and development.

Recommendations

2.6 Recommendations in reports are suggested changes to existing procedures or processes to improve the controls or to introduce controls where none exist. The grading of each recommendation reflects the risk assessment of non-implementation, being the product of the likelihood of the risk materialising and its impact:

High: Significant weaknesses in existing controls, leaving the Council or Service open to error, fraud, financial loss or reputational damage, where the risk is sufficiently high to require immediate action within one month of formally raising the issue. Added to the relevant Risk Register and included in the relevant Assurance Statement.
Medium: Substantial weaknesses in existing controls, leaving the Council or Service open to medium risk of error, fraud, financial loss or reputational damage requiring reasonably urgent action within three months of formally raising the issue.
Low: Moderate weaknesses in existing controls, leaving the Council or Service open to low risk of error, fraud, financial loss or reputational damage requiring action within six months of formally raising the issue to improve efficiency, effectiveness and economy of operations or which otherwise require to be brought to attention of senior management.
Outwith the report, Internal Audit informs operational managers about other matters as part of continuous improvement.

2.7 The table below summarises the number of Internal Audit recommendations made during 2019/20:

	2019/20 Number of Recs
High	0
Medium	5
Low	13
Sub-total reported this period	**18**
Previously reported	15
Total	**33**

Recommendations agreed with action plan	33
Not agreed; risk accepted	0
Total	**33**

3. Report Implications

3.1 Resource

Resource implications of implementing Internal Audit recommendations are considered as part of the audit process to ensure these are reasonable and proportionate to the risks.

3.2 Risk

The PSIAS require Internal Audit to evaluate the effectiveness of the Council's Risk Management arrangements and contribute to improvements in the process. At the start of each audit engagement, to capture potential areas of risk and uncertainty more fully, key stakeholders have been consulted and risk registers have been considered. During each audit engagement the management of risk has been tested.

It is anticipated that improvements in the management and mitigation of risks will arise as a direct result of Management implementing the Internal Audit recommendations made. If audit recommendations are not implemented, there is a greater risk of financial loss and/or reduced operational efficiency and effectiveness, and Management may not be able to demonstrate improvement in internal control and governance arrangements, and effective management of risks.

3.3 Single Midlothian Plan

Themes addressed in this report:

- ☒ Community safety
- ☒ Adult health, care and housing
- ☒ Getting it right for every Midlothian child
- ☒ Improving opportunities in Midlothian
- ☒ Sustainable growth
- ☒ Business transformation and Best Value
- ☐ None of the above

3.4 **Key Priorities within the Single Midlothian Plan**

Midlothian Council and its Community Planning Partners include the following areas as key priorities under the Single Midlothian Plan:

- Reducing the gap in learning outcomes
- Reducing the gap in health outcomes
- Reducing the gap in economic circumstances

3.5 **Impact on Performance and Outcomes**

The Findings and Recommendations from Internal Audit work during the year assists the Council in improving its performance and outcomes.

3.6 **Adopting a Preventative Approach**

Internal Audit assurance work includes assessments on when a preventative approach can be adopted.

3.7 **Involving Communities and Other Stakeholders**

This report has been presented to the Corporate Management Team on 15 January 2020 (as part of BTB) to outline the key messages of assurance and areas of improvement. Executive Directors, Chief Officers/Heads of Service and Service Managers relevant to the area audited have agreed the final Internal Audit reports as set out in the relevant Executive Summary within Appendix 1.

3.8 **Ensuring Equalities**

There are no equalities issues with regard to this report.

3.9 **Supporting Sustainable Development**

There are no sustainability issues with regard to this report.

3.10 **IT Issues**

There are no IT issues with regard to this report.

4. Recommendations

The Audit Committee is asked to:

a) Note the final assurance reports issued in the period from 2 November to 31 December 2019 associated with the delivery of the approved Internal Audit Annual Plan 2019/20; and

b) Acknowledge the assurance provided on internal controls and governance arrangements in place for the areas covered by this Internal Audit work.

Date: **09 January 2020**
Report Authors: **Jill Stacey, Chief Internal Auditor**
E-Mail: **Jill.Stacey@midlothian.gov.uk**

Report	Summary of key findings and recommendations	Recommendations H	Recommendations M	Recommendations L	Status
Subject: Social Care Income Charging, Billing and Collection Category: Assurance - Cyclical Date issued: 18 November 2019 Draft; 12 December 2019 Final Level of Assurance: Substantial	The purpose of this assurance audit was to assess the mechanisms in place to raise charges for Social Care clients in a timely manner and the process of collection and recovery of those charges, including the reliance upon various elements, namely: Care Plan, Funding, Contract and Financial Assessment. The integration of health and social care services is required, under statute, to provide care and support services to those who are assessed as being in need. When a referral for support is received, a Social Worker from the Council undertakes an assessment to determine the level of care and support required and submits an application to the Resource Panel to agree the care package. A charging policy is in place based on the ability of the service user to pay, as determined by a financial assessment of their income, capital and specified outgoings. The Operational Support team within Finance and Integrated Service Support are responsible for undertaking the financial assessments for service users and has a close working relationship with staff within Adult Services. When requested, they also submit financial information to the Resource Panel. The Operational Support team are also responsible for making payments to external providers and billing service users for services provided by Midlothian Council. A social work case management and finance system (Mosaic) is used within the service to record details of all service users. There is an automated interface enabling authorised payments from Mosaic to be downloaded into Integra (the Council's finance system). All payments to external care home and care at home suppliers are made through the Purchase Ledger of the Integra system. Integra is also used to collect income from service users. Internal Audit testing was performed on a judgemental sample basis and focused on 5 residential cases (older people) and 5 non-residential cases (all ages) assessed in the financial year 2019/20. The Corporate Fraud team also undertook additional checks against the Open Revenues system and other data sources.	0	0	3	Management have agreed the factual accuracy of the report, accepted the report findings and agreed the implementation of the Internal Audit recommendations by June 2020.

Report	Summary of key findings and recommendations	Recommendations			Status
		H	M	L	
Subject: Social Care Income Charging, Billing and Collection (cont'd)	Internal Audit considers that the level of assurance we are able to give is Substantial Assurance. Largely satisfactory risk, control, and governance systems are in place to undertake financial assessments, arrange billing, make payments to suppliers; and update service charges and benefit rates each year. There is a segregation of duty between the staff processing and authorising the financial assessment information on Mosaic system. The financial assessment forms that were tested were fully completed and comprehensive procedures are available for staff undertaking financial assessments. We made the following recommendations: • Financial assessment forms and the Health and Social Care Charging Policy and Guidance should be updated so they are compliant with the relevant legislative changes, and these should be published on the Council's website. (Low) • As part of improving the financial assessment process, the Operational Support Team Leader should make use of the Council's Open Revenue System and should inform any concerns of fraudulent activities to the Corporate Fraud team who can undertake additional checks. (Low) • The Individual service and financial (Care Home) contract should be signed by the Head of Service or alternatively, the Head of Service should consider updating the authorisation required for this process on the authorised signatory database and delegate this to the appropriate officers. (Low)				

Report	Summary of key findings and recommendations	Recommendations			Status
		H	M	L	
Subject: Commercial Rents Category: Assurance – Brought Forward 2018/19 Date issued: 21 November 2019 Draft; 5 December 2019 Final Level of Assurance: Substantial (tenant billing, arrears collection, and performance reporting); and Limited (tenant vetting, property rental database, rent reviews, inspections, control of service charge accounts, void timescales, and the long term plan.	The purpose of this assurance audit was to review the controls and governance arrangements surrounding the renting of Council owned commercial property. Midlothian Council currently controls 155 properties and ground leases which are managed through the Property Investment Account (PIA). The properties are rented out to generate income for the Council and to help encourage economic growth in Midlothian. For 2018/19, £764,895 of income was generated in respect of the PIA properties through the renting of these properties. The budgeted income for 2019/20 is £765,715. Our audit identified that a high level procedure is in place for the PIA account, there is satisfactory performance reporting, and appropriate arrangements are in place for tenant billing and pursuit of rent arrears. The most significant improvement that is required is to have an asset management plan and associated investment plan for the PIA assets. Internal Audit will review other classes of assets in the forthcoming audit of Capital Investment. Internal Audit considers that the levels of assurance we are able to give is: Substantial Assurance in terms of tenant vetting, tenant billing, arrears collection, and performance reporting; and Limited Assurance in terms of the property rental database, rent reviews (as it relies on an accurate property database), inspections, control of service charge accounts, void timescales and the long term plan for improving property condition in response to the external surveyor's report.	0	2	6	Management have agreed the factual accuracy of the report, accepted the report findings and agreed the implementation of the Internal Audit recommendations.

Report	Summary of key findings and recommendations	Recommendations			Status
		H	M	L	
Subject: Commercial Rents (cont'd)	We made the following recommendations: • A formal Property Asset Management Plan for the PIA assets needs to be developed, which should include property repairs required on the units and the criticality of these. (Medium) • A suitable system / database should be in place for the Council's PIA properties and this should be complete and regularly updated. Management need to ensure sufficient staff are trained to use key property asset systems. The audit trail of rent reviews should be improved. (Medium) • Tenancy identity verification records should be retained as per the Council's retention policy and tenants' ID should be re-confirmed on lease renewal. A formal record of the review of vetting information should be documented. (Low) • A formal programme of periodic property inspections should be carried out and evidence of these should be recorded. (Low) • The one instance of non-compliance with the lease terms should be addressed. (Low) • Property Assets should liaise with the Voids team to explore ways to reduce the length of time taken to undertake repairs to void properties. (Low) • Monitoring and review of the PIA control accounts should be carried out to ensure accuracy with the support from Financial Services, and the two large credit and one large debit balances should be addressed. (Low) • The local PIA procedures should be reviewed and updated. (Low)				

Report	Summary of key findings and recommendations	Recommendations H	Recommendations M	Recommendations L	Status
Subject: Electronic Payments Category: Assurance – Brought Forward from 2018/19 Date issued: 13 December 2019 Draft; 09 January 2020 Final Level of Assurance: Substantial	The purpose of this assurance audit was to review the security and authorisation controls, including segregation of duties, over the Council's electronic payment systems. The audit included a review of the Council's response to the Audit Scotland Report: Report on a Significant Fraud- Dundee City Council (Audit Scotland, March 2018). BACS payments are generated by a number of different Services within the Council. The payments file is generated by an application held by the Service and is passed to Treasury within Financial Services to release the file for payment via the BACS payment system. Bankline payments are made using the Council's online banking system and separate system-enforced segregation of duties and authorisation processes have been established for this. The total processed via BACS in 2018/19 was £281.65m, and the total processed via Bankline was £435.54m. The high level process for payments is set out in Financial Regulations, supplemented by Payment Guidelines issued by Financial Services, to assist Services in ensuring that proper procedures are in place to ensure that all payments made by the Council are valid and the risk of fraud has been mitigated as far as possible. The audit identified that a number of processes and procedures have been developed to ensure the integrity of payments made by the Council. Some areas could be further improved in relation to documenting business continuity procedures, procedure mapping the flow of all transactions (document still in development), access permissions and security of the BACS file for 2 applications. Internal Audit considers that the level of assurance we are able to give is Substantial. Largely satisfactory controls are in place including policies and procedures, reconciliation and exception reporting, segregation of duties applied, access permissions, and the security of relevant files to ensure the integrity of payments made by the Council. There is, however, some scope for continued improvement such as documenting the business continuity plan, procedure mapping the flow of all transactions (document still in development), more regularly reviewing access permissions, and an updated assessment of the security of the BACS file for 2 applications. There are either Management actions underway or we have made some recommendations.	0	2	4	Management have agreed the factual accuracy of the report, accepted the report findings and agreed the implementation of the Internal Audit recommendations.

Report	Summary of key findings and recommendations	Recommendations H	Recommendations M	Recommendations L	Status
Subject: Electronic Payment Systems (cont'd)	We made the following recommendations: • A Business Continuity Plan for the payment systems should be developed and should be subject to periodic testing (e.g. annual review). (Low) • All actions raised in the DCC report submitted to Audit Committee in June 2018 should be input to the Pentana system for tracking their implementation. (Low) • The signatory authorities detailed in the Authorised Signatories Database relating to electronic payments should be reviewed to make sure all the signatories are appropriate. (Low) • For the two systems identified in the audit review, there should be exception reporting and segregation of duties in place to review any changes to bank details made before payment. (Low) • File access for folders in relation to access to BACS files should be further reviewed. (Medium) • For the two applications where it was identified that the user generating the BACS file could choose the save file location, management should review with the supplier if this ability could be removed, or if automation could be developed in-house that could resolve this issue. (Medium)				

Report	Summary of key findings and recommendations	Recommendations			Status
		H	M	L	
Subject: Environmental Health Category: Assurance – Cyclical Date issued: 13 December 2019 Draft; 09 January 2020 Final Level of Assurance: Substantial for guidelines, training, maintaining records and monitoring; and Limited for fulfilling all statutory duties.	The purpose of this assurance audit was to review the business practices and ways of working within Environmental Health to ensure that regulatory obligations are met and risks are appropriately managed. The Environmental Health service has a wide range of responsibilities for enforcing legislation which has the purpose of protecting the community from harm. The main risk is that the Service will be unable to fulfil its statutory duties (Food and Safety, and Public Health) resulting in reputational damage. At a time of reducing budgets, reliance on specialist staff, increasing regulation and statutory functions, workload is being managed on a risk-based (reactive) approach. The Service Risk Register is regularly reviewed and updated but is not yet on the Pentana system. The following good practices were found: • Procedures are held within Environmental Health service and guidance has been updated to reflect current legislation; • Information is recorded on the Uniform system or in the Environmental Health directory which is visible to all relevant staff to ensure accurate and up to date records are maintained on visits and actions taken; • All training records are kept up to date, maintained and regular training is attended by EHOs to ensure they are aware of current legislation; • Regular performance reports are presented to Committees which ensures Elected Members and Senior Management are sighted on the challenges and success of Environmental Health Service including the impact of implementing new legislation. Internal Audit considers that the level of assurance we are able to give is Substantial for guidelines, training, maintaining records and monitoring and Limited for fulfilling all statutory duties. Our opinion is not a reflection of Management in this area as the challenges faced are mirrored nationally. In addition to the actions being progressed by Management, we made the following recommendation: • The level of all statutory duties of Environmental Health services (Food and Safety, and Public Health) being fulfilled should be reported on a regular basis to CMT. (Medium)	0	1	0	Management have agreed the factual accuracy of the report, accepted the report findings, and taken steps to implement the Internal Audit recommendation through an Environmental Health Service review report which detailed the current service delivery position. This was considered by the Corporate Management Team in December 2019 and will be submitted to the Business Transformation Steering Group for consideration in January 2020. However, it should be noted that even with the proposed actions the risk of not fulfilling all EHS statutory duties will not be fully mitigated.

Audit Commission: Local government in Scotland: Financial Overview 2018/19 (December 2019)

Report by: Gary Fairley, Chief Officer Corporate Solutions

1 Purpose of the Report

To provide Audit Committee with a summary of the Accounts Commission report, 'Local government in Scotland: Financial Overview 2018/19' and the Council's position in relation to the report's findings. The full report can accessed on the Audit Scotland website by following this link:

https://www.audit-scotland.gov.uk/report/local-government-in-scotland-financial-overview-201819

2 Background

2.1 Each year the Accounts Commission produces an overview of issues that have arisen from their local authority audits. In line with the previous publications these will again be encompassed in two reports. The first report, which is covered in this paper, focuses on financial matters, and the other, which will be published in later in 2020 and will focus on Council's performance and outcomes.

2.2 Local government in Scotland: Financial Overview 2018/19 was published by the Accounts Commission in December 2019. The overview report of the 2018/19 financial year, provides an independent, public assessment of how effectively Scottish local government is managing public money and responding to the financial challenges it faces. It is aimed primarily at councillors and senior council officers as a source of information and to support them in their complex and demanding roles. It is in four parts:

- Part 1: Councils' Income in 2018/19
- Part 2: Councils' Financial Position in 2018/19
- Part 3: Councils' Financial Outlook
- Part 4: Integration Joint Boards' Overview 2018/19

Audit Scotland's website contains some additional information relating to the Financial Overview for 2018/19 including a Supplement for Members: a Scrutiny Tool. This provides councillors with examples of questions they may wish to consider, to help identify how informed they are of their council's financial position in order to support them to scrutinise financial performance. Members can access this Supplement using the link above.

2.3 *In his introduction the Chair of the Accounts Commission indicates that of particular note to us (the Commission) this year, Integration Joint Boards (IJBs) continue to face very significant challenges and they need to do much more to address their financial sustainability. The pace of progress with integration has been too slow and we have yet to see evidence of a significant shift in spending and services from hospitals to community and social care. I continue to be concerned about the significant turnover in senior staff in IJBs. This instability inevitably impacts on leadership capacity and the pace of progress. The Commission has a strong interest in the performance and development of IJBs and we are planning arrangements to review their progress in delivering Best Value for their communities.*

2.4 The report recognises that councils face the increasing challenge of meeting changing and growing demands on their services, but their income is straining to keep pace. Although Scottish Government funding to councils has been relatively stable this year, since 2013/14 it has fallen in real terms. Funding is forecast to fall further in the medium term against a backdrop of increasing volatility in public finances. The Commission also notes that two-thirds of councils have reduced their general fund reserves over the last three years rather than maintaining or building their reserves. The signs of a trend in reducing reserves may be emerging. The Accounts Commission previously highlighted that ongoing use of reserves to manage funding gaps is not sustainable.

2.5 The report further noted that after several years of tightening budgets, the Accounts Commission recognise that councils have already made savings through restructuring and efficiencies, but transformation in terms of service redesign is required to deal with the further reductions forecast. The Commission will continue to have a close interest in how councils and IJBs are redesigning services to meet the needs of their communities.

2.6 The key messages identified in the 2018/19 report include:

- In 2018/19, Scottish council revenue income totalled £17.7 billion, an increase from 2017/18 (£17.3 billion).

- Scottish Government revenue funding remains the most significant source of income and this increased by 1.1 per cent in cash terms in 2018/19, a 0.7 per cent decrease in real terms. Since 2013/14, Scottish Government funding to councils has reduced by 7.6 per cent in real terms.

- In 2018/19, the funding gap was three per cent of total budget. councils planned to manage this primarily through savings, though a shortfall in savings achieved meant that more of the funding gap was met from reserves than planned.

- Councils are increasingly drawing on their revenue reserves. The net draw on revenue reserves in 2018/19 was £45 million. Twenty-three councils have reduced their general fund reserves over the last three years.

- Capital expenditure increased by £62 million (2.3 per cent) to £2.75 billion, with more spent on housing and less on education.

- All councils have medium-term financial planning covering three years or more. Long-term financial planning has not improved since last year and more progress is needed.

- Councils have made preparations for EU withdrawal but there are many potential implications that cannot be anticipated in financial planning.

3 Financial Overview 2018/19

3.1 Part 1 - Councils' Income in 2018/19

In addition to the key messages above the report highlights that an increasing proportion of council budgets is committed to national policy initiatives. This reduces the flexibility councils have for deciding how they plan and prioritise the use of funding to respond to local priorities.

In its response to the Local Government and Communities Committee on the 2019/20 budget, COSLA's view is that Scottish Government policies and fixed commitments represented 58 per cent of local government revenue expenditure budgets in 2018/19 and 60 per cent in 2019/20.

The position with income will be familiar to Elected Members from their experience in developing and setting budgets and more recently in progressing the Medium Term Financial Strategy.

3.2 Part 2 – Councils' Financial Position in 2018/19

- The 2018/19 funding gap of three per cent was less than the previous year (four per cent). Councils planned to manage this primarily through savings, though a shortfall in savings achieved meant that a higher proportion of the funding gap was met from reserves than planned.

- Across Scotland councils increased their use of revenue reserves. The net draw on revenue reserves in 2018/19 was £45 million. Over the past five years the position has changed, with councils increasingly drawing on their revenue reserves.

- Twenty-three councils have reduced their general fund reserves over the last three years. No council has a position where this rate of depletion would eliminate the total general fund within three years.

- Capital expenditure increased by £62 million or 2.3 per cent in 2018/19 to £2.75 billion, with more spent on housing and economic development and less on education.

- The value of pension liabilities in councils increased by £0.5 billion to reflect the impact of the McCloud case.

- Councils should continue to improve the transparency of the management commentary.

Again the key messages reflect the challenges the Council faces. The real terms reduction in the value of resources available to the Council reinforces the need to have a robust Medium Term Financial Strategy in place and which sets out the transformation plans which will be required to ensure the sustainability of services it is increasingly important that robust financial management and reporting is maintained.

All councils hold an uncommitted general fund to protect against unforeseen financial pressures. Exhibit 7 in the report sets out Council's General Fund reserves as a proportion of net annual revenue split between committed, uncommitted and HRA. The exhibit provides a useful comparison of Midlothian's uncommitted General Fund position compared to other councils.

Council has a significant requirement to invest in assets to support the growing population. Though the level of borrowing is increasing the Treasury Management Strategy and prudential indicators provide Council with reassurance that this level of investment is financially sustainable and can be serviced from the revenue budget.

In this respect the report specifically makes reference to the Newbattle Community Campus. Noting that this £38 million hub project opened in May 2018 as the Council's first 'centre of excellence in digital technology' providing enhanced education and leisure facilities for Newtongrange, Mayfield, Gorebridge and the surrounding communities.

There is no doubt that difficult decisions lie ahead for all councils and the report highlights the importance of being proactive in addressing the financial pressures.

3.3 Part 3 – Councils' Financial Outlook. Key messages:

- Scottish Government revenue funding to local government in 2019/20 increased by 2.9 per cent in cash terms (0.9 per cent in real terms).

- In 2019/20, the Scottish Government increased the cap on council tax increases. Twelve councils decided to increase council tax by the full amount (4.8 per cent).

- Many councils are also seeking other ways to increase income, including increasing fees and some have introduced new charges in 2019/20. Some councils also continue to pursue new local taxes.

- Councils' 2019/20 financial plans identified a total funding gap of £0.5 billion (three per cent of income). This continues the increasing pressure on councils to find further cost savings, redesign services, reduce services, increase income or use reserves. These decisions are likely to become increasingly difficult for councillors. Councils planned to manage their funding gaps mainly through identified cost savings.

- All councils have medium-term financial planning covering three years or more. Long-term financial planning has not progressed since last year.

- The Scottish Government has made a commitment to set out multiyear budgets, which will assist councils with financial planning.

- Councils have made preparations for EU withdrawal but there are many potential implications that cannot be anticipated in financial planning.

As Members will be aware, the Council approved a Medium Term Financial Strategy in June 2019, which covers the three year period to March 2023. It is acknowledged that there is further work to do to secure a balanced position over the three years and also to extend the period encompassed by the Medium Term Financial Strategy.

However the adoption of the Strategy in June 2019 has strengthened the Council's financial position and in particular for the year ahead, given the unprecedented position in respect of the delay in publication of government grant figures, it has helped reduced the risk and uncertainty for services and communities.

At the time of writing there is still no certainty as to when Scottish Government will present its 2020/21 budget to Parliament and when the circular setting out individual council grant allocations will be published. It is clear however that there will be no return to multiyear grant settlements at present.

3.4 Part 4 – Integration Joint Boards' Overview 2017/18

- The pace of health and social care integration has been too slow and there is limited evidence to suggest any significant shift in spending from health to social care.

- Overall, IJB budgets increased by three per cent in 2018/19. The identified budget gap reduced from £248 million (2.9 per cent of total income) in 2018/19 to £208 million (2.5 per cent of total income for 2019/20).

- A majority of IJBs struggled to achieve break-even and 19 would have recorded a deficit without additional funding from partners at the year end.

- Around a third of the IJBs failed to agree a budget with their partners for the start of the 2019/20 financial year. For several IJBs, although the budget was set on time, it still had an element of unidentified savings which meant it was unbalanced at the start of the year.

- A focus on long-term financial planning is required by IJBs to assist effective decision making that will support long-term financial sustainability.

- Over a third of IJB senior staff have changed during 2018/19.

The Midlothian IJB delivered a £2.9 million underspend against budget in 2018/19. The IJB's reserve balances now total £3.88 million, of which £1.4 million has been earmarked for committed projects. Like all IJB's Midlothian continues to face significant financial challenges given the increasing demand for services.

It is expected that the overview report will also be presented to the Midlothian IJB Audit and Risk Committee.

4 Report Implications

4.1 Resource

There are no additional resource implications.

4.2 Risk

There are no additional direct risks associated with this report.

4.3 Single Midlothian Plan

Themes addressed in this report:

☐ Community safety
☐ Adult health, care and housing
☐ Getting it right for every Midlothian child
☐ Improving opportunities in Midlothian
☐ Sustainable growth
☒ Business transformation and Best Value
☐ None of the above

4.4 Key Priorities within Single Midlothian Plan

Midlothian Council and its Community Planning Partners have made a commitment to treat the following areas as key priorities under the Single Midlothian Plan:-

- Reducing the gap in learning outcomes
- Reducing the gap in health outcomes
- Reducing the gap in economic circumstances

This report does not directly impact Midlothian Council's key priorities but a key message within the Accounts Commission report is that the way Council's respond to the financial challenge will inevitably impact on how they can deliver of key priorities and outcomes.

4.5 Impact on Performance and Outcomes
The report does not directly impact Midlothian Council's and wider partners performance and outcomes but it does stress the need to ensure consideration is given to the wider strategic planning and objectives as part of the council's response to the findings noted in the report.

4.6 Adopting a Preventative Approach
This report does not directly impact actions and plans in place to adopt a preventative approach.

4.7 Involving Communities and Other Stakeholders
This report does not directly relate to involving communities and stakeholders.

4.8 Ensuring Equalities
This report does not recommend any change to policy or practice and therefore does not require and Equalities Impact Assessment.

4.9 Supporting Sustainable Development
The recommendations in this report support Midlothian Council's position in relation to delivering sustainable services going forward.

4.10 IT Issues
There are no IT issues arising from this report at this time.

5 Recommendations
The Committee is asked to note the Accounts Commission report and the position of Midlothian Council in relation to the report's key messages.

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Background Papers:

Accounts Commission - Local government in Scotland: Financial Overview 2018/19 – (December 2019).