

# Notice of Meeting and Agenda



## Audit Committee

**Venue:** Virtual Meeting,

**Date:** Tuesday, 08 December 2020

**Time:** 11:00

**Director, Resources**

**Contact:**

### Further Information:

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

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## **1 Welcome, Introductions and Apologies**

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## **2 Order of Business**

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

## **3 Declaration of Interest**

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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**

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**4.1** Minute of Meeting of the Audit Committee of 12 October 2020 5 - 10

**4.2** Action Log 11 - 14

## **5 Public Reports**

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**5.1** Internal Audit Work to October 2020 - Report by Chief Internal Auditor 15 - 24

**5.2** Internal Audit Mid-Term Performance Report 2020/21 – Report by Chief Internal Auditor 25 - 36

**5.3** Risk Management Update, Quarter 2 2020/21 - Report by Service Manager – Waste, Risk and Resilience 37 - 44

**5.4** Annual Audit Plan – Update on External Audit Fees - Report by Chief Officer: Corporate Solutions 45 - 50

**5.5** Annual Governance Statement – Financial Improvement Update - Report by Chief Officer: Corporate Solutions 51 - 76

**5.6** Treasury Management Mid-Year Review Report 2020/21 - Report by Chief Officer: Corporate Solutions 77 - 98

## **6 Private Reports**

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No items for discussion

## **7 Date of Next Meeting**

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The next meeting will be held on Tuesday 26 January 2021 at 11.00am

Clerk Name:	Janet Ritchie
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Clerk Telephone:	0131 271 3158
Clerk Email:	<a href="mailto:janet.ritchie@midlothian.gov.uk">janet.ritchie@midlothian.gov.uk</a>



# Minute of Meeting



## Audit Committee

Date	Time	Venue
Monday 12 October 2020	2.00 pm	Virtual Meeting by MS Teams

### Present:

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

### In attendance:

Grace Vickers	Chief Executive
Kevin Anderson	Executive Director Place
Fiona Robertson	Executive Director Children, Young People and Partnerships
Gary Fairley	Chief Officer Corporate Solutions
Jill Stacey	Chief Internal Auditor
Stephen Reid	External Auditor, E.Y.
Grace Scanlin	External Auditor, E.Y.
Chris Lawson	Service Manager, Waste, Risk and Resilience
William Venters	Depute Monitoring Officer
Lisa Young	Accountant
Mike Broadway	Democratic Services Officer

## 1. Welcome and Apology

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The Chair, Mike Ramsay welcomed everyone to the meeting. An apology for absence was intimated on behalf of the Independent Member, Mr P de Vink.

## 2. Order of Business

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It was noted the order of business was as per the agenda circulated.

## 3. Declarations of interest

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No declarations of interest were received.

## 4. Minutes of Previous Meetings

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- 4.1 The Minute of the meeting of 18 August 2020 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 having received updates on various action points detailed therein, the Committee agreed as follows:-
- (i) 'Internal Audit Work': that in the absence of the Legal Manager the update on expired contracts be continued to the 8 December 2020 meeting.
  - (ii) 'Unaudited Accounts': that clarification on any outstanding matters could be either picked up as part of today's discussions or raised separately with Officers.

## 5. Public Reports

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Report No.	Report Title	Presented by:
5.1	External Audit Annual Audit Report 2019 - 2020	External Auditors
<b>Outline of report and summary of discussion</b>		
<p>Stephen Reid and Grace Scanlin, on behalf of External Auditors, EY presented the draft Annual Audit Report to Members and the Controller of Audit for the Financial Year ended 31 March 2020.</p> <p>The report advised, inter alia, that the external auditors intended to issue an unqualified opinion on the financial statements for the financial year ended 31 March 2020. In addition, the report provided detailed information on: Financial management; Financial sustainability; Governance and Transparency; and Value for Money.</p> <p>Having heard from the External Auditors who responded to Members questions and comments, the Committee discussed a number of issues arising therefrom, in particular the full impact and financial flexibilities available likely to be made available to Councils as a result of the global Coronavirus pandemic; valuation of, and the</p>		

risks associated with, the Council's shareholding in Lothian Buses; valuation of the Millerhill recycling plant; and issues relating to procurement.

Members in welcoming the terms of the report, remarked on the benefits arising from the joint working which was evident across the Council, but emphasised the continuing need for the Council to build on and ensure that it sustain the undoubted progress which was being made.

After further discussion, the Independent Chair thanked Mr Reid and Ms Scanlin for their presentation and the work undertaken by EY on behalf of the Council.

#### Decision

The Audit Committee agreed –

- (a) To note and approve the Annual Audit Report;
- (b) To record the Committee's appreciation of the work undertaken by the Finance Team in assisting the External Auditors in the preparation of the report;
- (c) To record the Committee's thanks to EY

#### Action

EY

Report No.	Report Title	Presented by:
5.2	Financial Statements for the year ended 2019/2020	Chief Officer Corporate Solutions
<b>Outline of report and summary of discussion</b>		
<p>The purpose of this report dated 5 October 2020 was to present the Council's audited Financial Statements for 2019/2020 to the Committee and to provide a brief overview of the changes made during the audit process. The Council submitted its unaudited annual accounts to the external auditor by the required date of 30th June 2020 and they were examined in detail at a special Audit Committee on Monday 18 August 2020.</p> <p>Thereafter, having heard the Chief Executive and the Chief Officer Corporate Solutions who responded to Member's questions and comments, the Committee discussed the Council's Transformation programme, noting that governance for this lay with the BTSG and full Council, albeit the Committee would be sighted on it through the quarterly financial monitoring reports and other internal audit reports.</p>		
<b>Decision</b>		
The Committee approved the 2019/2020 Accounts for signature having regard to the appointed Auditor's report for 2019/20.		
<b>Action</b>		
Chief Officer Corporate Solutions/Financial Services Manager		

Report No.	Report Title	Presented by:
5.3	Internal Audit Work to August 2020	Chief Internal Auditor
<b>Outline of report and summary of discussion</b>		
<p>There was submitted a report, dated 3 September 2020, by the Chief Internal Auditor providing 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.</p> <p>The Chief Internal Auditor outlined the main sections contained within the report and responded to questions and comments raised by Members, in particular those relating to ICT, in view of the increased reliance on digital systems as a result of the Coronavirus pandemic, and also some of the accounting implications arising from the implementation of the new Leisure Management Booking System.</p>		
<b>Decision</b>		
<p>The Committee:-</p> <ul style="list-style-type: none"> <li>(a) noted the three final assurance reports associated with the delivery of the approved Internal Audit Annual Plan 2019/20 that had been pending during the Covid-19 emergency response;</li> <li>(b) noted the Internal Audit Assurance Work in Progress and Internal Audit and Other Work 2020/21 carried out in accordance with the approved Internal Audit Charter; and</li> <li>(c) acknowledged the assurance provided on internal controls and governance arrangements in place for the areas covered by this Internal Audit work.</li> </ul>		
<b>Action</b>		
Chief Internal Auditor		

Report No.	Report Title	Presented by:
5.4	Internal Audit Follow-up of Completed Recommendations	Chief Internal Auditor
<b>Outline of report and summary of discussion</b>		
<p>The purpose of this report, dated 9 September 2020, by the Chief Internal Auditor was to provide an update to the Committee on the results of the Internal Audit Recommendation Follow-up Review which included a sample check on the adequacy of new internal controls for audit actions flagged as closed.</p> <p>The report explained that the objective of this follow-up audit was to review a sample of Internal Audit recommendations that had been signed off by Management as complete during the period 1 April 2019 and 31 March 2020 to assess the evidence that recommendations had been implemented satisfactorily and to ensure that the new controls had had the desired effect on improving internal control and governance, and reducing risk. Of the sample of 36 audit recommendations tested, 28 (78%) were found to have been completed satisfactorily, 7 (19%) were identified as partially satisfactory requiring further work and 1 (3%) was not completed. Follow-up discussions had been undertaken with</p>		



the action owners to highlight what was required to ensure the remaining elements of the audit actions were fully completed or a sustained control was established.

#### Decision

The Committee, having heard from the Chief Internal Auditor:-

- (a) noted the results of the spot check on Internal Audit recommendations marked as completed by management in the period April 2019 to March 2020 to improve internal controls and governance, and mitigate risks; and
- (b) were satisfied having considered the progress made that no further action was required, at this time.

#### Action

Chief Internal Auditor

Report No.	Report Title	Presented by:
5.5	Risk Management Update for 1 January to 30 June 2020	Service Manager, Waste, Risk and Resilience
<b>Outline of report and summary of discussion</b>		
<p>The Risk Manager presented a report dated 28 September 2020 providing the Audit Committee with the 2019/20 quarter 4 and 2020/21 quarter 1 strategic risk management update, covering the period 1 January 2020 to 30 June 2020. 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.</p> <p>The Risk Manager highlighted the main sections contained within the report and thereafter responded to questions and comments raised by Members of the Committee.</p>		
<b>Decision</b>		
The Committee, having considered the current response to the issues, risks and opportunities, noted the quarter 4 2019/20 and quarter 1 2020/21 Strategic Risk Profile report.		
<b>Action</b>		
Service Manager, Waste, Risk and Resilience		

Report No.	Report Title	Presented by:
5.6	Audit Scotland Report "Local Government in Scotland: Overview 2020"	Chief Executive
<b>Outline of report and summary of discussion</b>		
The purpose of this report, dated 1 September 2020, by the Chief Executive was to provide a summary of the Audit Scotland report, "Local Government in Scotland:		

Overview 2020” and the Council’s position in relation to the recommendations contained therein.

The report explained that whilst the Audit Scotland report had been produced prior to the pandemic, it nonetheless contained important messages which should be helpful as part of the recovery out of the crisis which emphasised the essential importance of effective leadership, good governance and good financial management for all Councils.

#### Decision

The Committee, having heard from the Chief Executive and Chief Internal Auditor, noted the Audit Scotland report and the Council’s positions in relation to the report’s recommendations.

#### Action

Chief Executive

Report No.	Report Title	Presented by:
5.7	Audit Scotland Counter Fraud Reports	Chief Internal Auditor
Outline of report and summary of discussion		
The purpose of this report, dated 3 September 2020, was to draw to the Committee’s attention the recently published counter fraud reports by Audit Scotland and the management actions required in response for improvement and assurance purposes.		
Decision		
The Committee, having heard from the Chief Internal Auditor, (a) acknowledged the Audit Scotland counter fraud reports published in recent months; (b) requested the Integrity Group of officers consider all 3 reports as part of their counter fraud role and responsibilities; and (c) requested the Integrity Group carry out an assessment of counter fraud controls associated with the Covid-19-emerging-fraud-risks and report back to the Committee on findings and necessary actions.		
Action		
Chief Internal Auditor		

## 6. Private Reports

No private reports were submitted.

## 7. Date of Next Meeting

The next meeting will be held on Tuesday 8 December 2020 at 11 am

The meeting terminated at 3.53 pm

# Actions Log

Audit Committee  
Tuesday 8 December 2020  
Item No 4.2



No	Subject	Date	Action	Action Owner	Expected completion date	Comments
1	<b>Internal Audit Recommendations</b>	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	January 2021	Two follow-up reports per year to Audit Committee as per approved Internal Audit Annual Plan.
2	<b>Internal Audit Work</b>	10/03/2020	Noted that a detailed report would be provided to Members on the 22 expired contracts.	Legal Services Manager	December 2020	Update will be provided at the Meeting.
3	<b>Minutes of Previous Meetings: Matters Arising re Internal Audit Strategy and Annual Plan 2020/21</b>	22/06/2020	Jill Stacey, Chief Internal Auditor advised the committee that with regards to the Audit Plan they would be reassessing potential changes in light of Council response to the pandemic. After discussions were held with senior management and the significant changes would be made to the Audit Plan this would be presented to this committee in due course.	Chief Internal Auditor	December 2020	Proposed amendments to the Internal Audit Annual Plan 2020/21 submitted as part of the Internal Audit Mid-Term Performance Report 2020/21 on the Agenda.

No	Subject	Date	Action	Action Owner	Expected completion date	Comments
4	<b>Internal Audit Annual Assurance Report 2019/20 – Local Code of Corporate Governance</b>	22/06/2020	Noted that a report would be presented to a future meeting of the Audit Committee on the updated Local Code of Corporate Governance prior to being presented to Council for approval.	Chief Internal Auditor	March 2021	Work ongoing with CMT August to December 2020 on 7 core principles to refresh Local Code of Corporate Governance. This will be presented to the Audit Committee in early 2021 prior to going to Council for approval.
5	<b>Internal Audit Annual Assurance Report 2019/20 – Risk Management Policy and Strategy</b>	22/06/2020	Agreed that a report would be requested on the review and scrutiny of the Risk Management Policy and Strategy	Waste, Risk and Resilience Manager	March 2021	Linked to update of Local Code.
6	<b>Annual Governance Statement 2019/20 – Financial Improvement Updates</b>	22/06/2020	Agreed that regular financial improvement updates would be provided by the Chief Officer Corporate Solutions (Section 95 Officer) to the Audit Committee and that the first update would be provided at the December meeting.	Chief Officer Corporate Solutions (Section 95 Officer)	December 2020	Report on Agenda.
7	<b>Financial Reports – Council Meeting - 25 August 2020</b>	18/08/2020	Send reports to the Independent Member of the Audit Committee	Democratic Services	December 2020	Future Reports with a financial element relevant to Audit to be circulated to Independent Members of the Audit Committee.

No	Subject	Date	Action	Action Owner	Expected completion date	Comments
8	<b>Audit Scotland Counter Fraud Reports</b>	12/10/2020	Requested the Integrity Group carry out an assessment of counter fraud controls associated with the Covid-19-emerging-fraud-risks and report back to the Committee on findings and necessary actions.	Chief Internal Auditor	March 2021	Assessment of counter fraud controls underway by Integrity Group chaired by Executive Director Place.



## **Internal Audit Work to October 2020**

### **Report by Chief Internal Auditor**

### **Report for Decision**

## **1 Recommendations**

The Audit Committee is asked to:

- a) Consider the Executive Summaries of the final Internal Audit assurance reports issued;
- b) Note the Internal Audit Assurance Work in Progress and Internal Audit and Other Work carried out; and
- c) Acknowledge the assurance provided on internal controls and governance arrangements in place for the areas covered by this Internal Audit work.

## **2 Purpose of Report/Executive Summary**

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.

The Internal Audit Annual Plan 2020/21 was approved by the Audit Committee on 10 March 2020. Internal Audit has carried out work 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.

An Executive Summary of the final Internal Audit assurance reports 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 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.

**Date 11 November 2020**

### **Report Contact:**

Jill Stacey      Tel No  
[jill.stacey@midlothian.gov.uk](mailto:jill.stacey@midlothian.gov.uk)

### 3 Progress Report

- 3.1** The Internal Audit Annual Plan 2020/21 was approved by the Audit Committee on 10 March 2020. Internal Audit has carried out the following work in the period to 31 October 2020 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.
- 3.2** 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.
- 3.3** Internal Audit issued final assurance reports on the following subjects:
- Change and Transformation Programme
  - Business Planning, Budget Setting and Monitoring (including Workforce Planning)
  - EU Funded Programme Tyne Esk LEADER
- 3.4** 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

- 3.5** Internal Audit assurance work in progress to deliver the Internal Audit Annual Plan 2020/21 consists of the following:

Audit Area	Audit Stage
Property Maintenance	Drafting the Report
Fleet Management	Testing underway
Passenger Transport	Testing underway
Council Tax	Testing underway
Social Housing Rents	Testing underway



## Internal Audit Consultancy and Other Work

- 3.6** 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:
- In its critical friend role provided an independent view and challenge at various forums including Business Transformation Board, Capital Plan and Asset Management Board, and Information Management Group.
  - Learning and development during the research stage of new audit areas for all Internal Audit team members and through joining virtual audit forums and meetings.
  - 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.
  - Attended and provided support for the new Integrity Group.
  - Consultation on development of revised Audit Plan 2020/21.

## Recommendations

- 3.7** 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:

<b>High:</b> 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.
<b>Medium:</b> 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.
<b>Low:</b> 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.

- 3.8** The table below summarises the number of Internal Audit recommendations made during 2020/21:

	2020/21 Number of Recs
High	0
Medium	1
Low	1
<b>Sub-total reported this period</b>	<b>2</b>
Previously reported	0
<b>Total</b>	<b>2</b>
Recommendations agreed with action plan	2
Not agreed; risk accepted	0
<b>Total</b>	<b>2</b>

## **4 Report Implications (Resource, Digital, Risk and Equalities)**

### **4.1 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.

### **4.2 Digital**

There are no digital implications arising from this report.

### **4.3 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.

### **4.4 Ensuring Equalities**

This report does not relate to a new or revised policy, service or budget change, which affects people (the public or staff), so an Integrated Impact Assessment (IIA) is not an applicable consideration.

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

### **4.5 Additional Report Implications (See Appendix A)**

## APPENDIX A – Additional Report Implications

### A.1 Key Priorities within the Single Midlothian Plan

Although this report does not relate directly to the key priorities within the Single Midlothian Plan to which Midlothian Council and its Community Planning Partners have made a commitment (Reducing the gap in economic circumstances; Reducing the gap in learning outcomes; Reducing the gap in health outcomes; and Reducing the impact of climate change), good governance is important to enable Midlothian Council to deliver its key priorities in support of achieving the Council's objectives.

### A.2 Key Drivers for Change

Key drivers addressed in this report:

- ☒ Holistic Working
- ☒ Hub and Spoke
- ☒ Modern
- ☒ Sustainable
- ☒ Transformational
- ☒ Preventative
- ☒ Asset-based
- ☒ Continuous Improvement
- ☒ One size fits one
- ☐ None of the above

Midlothian Council is committed to creating a great place to grow supported by the 9 drivers for change. Implementing the 9 drivers for change in practice is applicable to the Council's Internal Audit service provision to assist the Council in achieving its objectives.

### A.3 Key Delivery Streams

Key delivery streams addressed in this report:

- ☒ One Council Working with you, for you
- ☒ Preventative and Sustainable
- ☒ Efficient and Modern
- ☒ Innovative and Ambitious

### A.4 Delivering Best Value

The definition of Internal Auditing within the Public Sector Internal Audit Standards (PSIAS) is "Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes."

Implementation by Management of the actions associated with Internal Audit recommendations, that are designed to improve internal control and governance arrangements and management of risks, underpins the Council's own continuous improvement arrangements to enhance its effectiveness, thus supporting the delivery of the Council's best value duties.

#### **A.5 Involving Communities and Other Stakeholders**

The Chief Internal Auditor is accountable to the Audit Committee which, in fulfilling its governance role, acts as a bridge between the Council and other stakeholders. There is engagement between Internal Audit and the Council's External Auditors, EY.

This report has been presented to the Corporate Management Team to outline the key messages of assurance and areas of improvement. Senior Management relevant to the areas audited have agreed the final Internal Audit assurance reports as set out in the relevant Executive Summary within Appendix 1.

#### **A.6 Impact on Performance and Outcomes**

The Findings and Recommendations from Internal Audit work during the year are designed to assist the Council in improving its performance and outcomes.

#### **A.7 Adopting a Preventative Approach**

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

#### **A.8 Supporting Sustainable Development**

This report does not relate directly to supporting sustainable development. Good governance is important to enable Midlothian Council to achieve its objectives.

Report	Summary of key findings and recommendations	Recommendations			Status
		H	M	L	
<p>Subject: Change and Transformation</p> <p>Category: Assurance – Risk</p> <p>Date issued: 13 October 2020 Draft; 11 November 2020 Final</p> <p>Level of Assurance: n/a Follow-up</p>	<p>The purpose of this assurance audit was to monitor through a continual audit approach the implementation of improvements to the governance and accountability arrangements for the change and transformation programme including processes for benefit (financial and other) identification, tracking and realisation.</p> <p>The Internal Audit report Change and Transformation Programme was issued on 12 February 2020. The Internal Audit recommendations apply to the foundations which underpin the Change and Transformation Programme. Without a sound foundation the programme is unlikely to successfully deliver the required outcomes.</p> <p>There is a clear impetus for change in order for the Council to deliver quality services on a financially sustainable basis. BTB and BTSG meetings in late 2019 and early 2020 enabled the latter to agree recommendations to be made to Council on 11 February 2020 in respect of final service budgets for 2020/21 and Council Tax.</p> <p>The impact of the coronavirus pandemic has had a very significant impact on the progress with the full implementation of the agreed recommendations. Key members of staff central to the programme were redeployed to the emergency response. Committee meetings were suspended. Neither the Business Transformation Board (BTB) nor Business Transformation Steering Group (BTSG) have formally met whilst the Council was in emergency response mode. Meetings have recently recommenced with BTB meeting on 26 August and 7 October and BTSG on 14 September 2020.</p> <p>Of the 6 recommendations made in the previous year's report: 3 have been implemented and 3 have been partially implemented for 2020/21. BTB and BTSG meetings are scheduled to enable the further opportunity to demonstrate the revised approach for future years, and full implementation of the recommendations.</p> <p>We completed the main audit fieldwork in late September 2020 and this report reflects our findings at that time. In this follow up report, Internal Audit has not given any assurance rating or made any further recommendations. Internal Audit will continue to follow-up on Management's progress with the implementation of these recommendations.</p>	0	0	0	<p>Management have accepted the factual accuracy of the report.</p> <p>To fully implement the 3 remaining recommendations the following are expected to be presented to the next scheduled BTB meeting on 25 November 2020: A separate and up-to-date remit of BTB; A new template that has been agreed by BTB which each Service is required to complete to reflect transformation plans; and BTB scrutiny of the underlying plans to assess how robust / realistic those plans are in terms of delivery.</p> <p>The next scheduled BTSG meeting thereafter is 7 December 2020.</p>

Report	Summary of key findings and recommendations	Recommendations			Status
		H	M	L	
<p>Subject: Business Planning, Budget Setting and Monitoring (including Workforce Planning)</p> <p>Category: Assurance – Risk</p> <p>Date issued: 13 October 2020 Draft; 11 November 2020 Final</p> <p>Level of Assurance: Substantial for the overall governance arrangements in place and Limited in respect of the implementation of previous audit recommendations.</p>	<p>The audit purpose was to evaluate the implementation of improvements to ensure that budgets set for 2020/21 are sustainable and based on realistic plans and that appropriate scrutiny and challenge is undertaken on revenue budget monitoring reports to enable service delivery within approved budget; and to review the Service business and workforce planning processes.</p> <p>Balanced budgets have been set for 2019/20 and 2020/21 which did not anticipate a call on General Reserves but also did not plan for any increase. The outturn for 2019/20 demonstrated overall that costs are being controlled within the totality of budget. There are Service areas which continue to overspend with that overspending being offset by underspending elsewhere. Budget setting and monitoring reports are subjected to appropriate scrutiny and challenge. The Medium Term Financial Strategy indicates the work that is required to set a sustainable in-year balanced budget for 2021/22 and for 2022/23; work is ongoing through the Council delegating to BTSG to bring forward proposals to deliver a balanced budget in future years.</p> <p>Service Plans have been developed for 2020/21 setting out the contribution that Services will make towards achievement of the Council's objectives which are set out in the Single Midlothian Plan. The expectation is that Services will be delivered within the approved budget – a necessary approach given the challenging financial environment in which the Council operates. Future opportunities exist to enhance the alignment of Service and Workforce Planning with the Medium Term Financial Strategy. A review of Service Plans is underway to take into account the Nesta report - lessons learned from the pandemic.</p> <p>Budget monitoring information is presented to CMT and Members using a format that has been in place for a number of years. Detailed reports are provided to budget holders and chief officers prior to consideration by CMT. In response to a prior year Internal Audit recommendation, alternative formats for budget monitoring reporting to CMT and Members have been considered by the Financial Services Manager but finalisation of the report format for consideration by CMT has been delayed due to changed priorities arising from Covid-19. The change in the Senior Leadership provides a further opportunity to assess financial management reporting needs.</p>	0	0	0	<p>Requests have been made by relevant Management to extend the due dates of the remaining Audit Actions in the Pentana system to enable their full implementation.</p> <p>Internal Audit will continue to follow-up on Management's progress with the implementation of these recommendations.</p>

Report	Summary of key findings and recommendations	Recommendations			Status
		H	M	L	
Subject: Business Planning, Budget Setting and Monitoring (including Workforce Planning) (Cont'd )	<p>The Annual Governance Statement 2019/20 highlighted that in 2019/20 meeting dates were aligned in order that reports would go to CMT or Financial Monitoring prior to Audit Committee or Council where appropriate and that accurate and timeous reports being provided to allow full analysis and scrutiny of financial matters was an area of improvement.</p> <p>Of the 7 recommendations made in the Revenue Financial Budget Monitoring 2018/19 report: 5 have been implemented, 1 has been partially implemented (Fill vacant Senior Accountant post for Education service and consider full adoption of Finance Business Partner model) and 1 has not been implemented (Better recognise commitments in projected outturn figures and address issues with feeder systems). Of the 3 recommendations made in the Business Planning, Budget Setting and Monitoring 2019/20 report: 1 has been implemented and 2 have been partially implemented (Review and revise quarterly budget monitoring reporting format; and Integrate the progress with the achievement of savings targets into the budget monitoring reports).</p> <p>Of the 4 recommendations made in the Workforce Strategy and Plans 2018/19 report: all 4 have been partially implemented (Review and update the Workforce Strategy; Revise the Service Workforce Plans and Action Plans in alignment with Strategy; Introduce a formal review process for monitoring their delivery; and Align workforce planning processes with business and financial planning processes.</p> <p>Internal Audit considers that the level of assurance we are able to give is Substantial for the overall governance arrangements in place and Limited in respect of the implementation of previous audit recommendations.</p> <p>The audit fieldwork was completed in September 2020. We have not made any new recommendations in this report; areas where further improvement is required are set out in recommendations previously made.</p>				



Report	Summary of key findings and recommendations	Recommendations			Status
		H	M	L	
<p>Subject: EU Funded Programme Tyne Esk LEADER</p> <p>Category: Legislative and Compliance</p> <p>Date issued: 21 October 2020 Draft; 04 November 2020 Final</p> <p>Level of Assurance: Substantial for governance and grant application management; Limited for grant claims processes.</p>	<p>The purpose of this legislative and compliance audit, required by the SLA, was to assess the adequacy of the internal controls in place for the administration of the Tyne Esk LEADER Programme to comply with the SLA.</p> <p>The LEADER programme is part of the Scotland Rural Development Programme 2014-2020 which aims to promote economic and community development within rural areas of Scotland. Grants are awarded by Local Action Groups (LAGs) to projects that support delivery of a Local Development Strategy. For each LAG there is an Accountable Body to support the administration of the programme. Midlothian Council (MLC) is the Accountable Body for the Tyne Esk LEADER programme.</p> <p>In the case of Tyne Esk LEADER, the SLA was signed on 30 December 2015 and the funding allocation was £3.5m, with 25% of this budget being for administration of the programme. This budget has since been reduced to £3.4m due to the programme now nearing completion and the budget being slightly underspent. Tyne Esk LEADER has now allocated £3.25m of its budget with £2.4m allocated to projects and the remainder allocated to administration. The programme was originally intended to conclude in December 2020; however, due to the impact of Covid-19, the programme was granted a 3 month extension by the Scottish Government to March 2021.</p> <p>Internal Audit considers that the level of assurance we are able to give is substantial in terms of governance of the programme and grant application management. Assurance is limited for the grant claims processes as there is a risk that the Council may have insufficient time to repay applicant claims or make the appropriate drawdowns from the Scottish Government by the programme closure date. There is currently a backlog in reclaiming administrative costs from the Scottish Government.</p> <p>Internal Audit made the following recommendations:</p> <ul style="list-style-type: none"> <li>• Management should ensure there is sufficient staffing resource to bring the LEADER programme to its end, support the completion of project claims and associated tasks, and support the grant drawdown process from the Scottish Government. (Medium)</li> <li>• Management should undertake a quality check of the LEADER projects information on the web-portal system provided by the Scottish Government for completeness and accuracy. (Low)</li> </ul>	0	1	1	<p>Management have accepted the factual accuracy of the report and its findings, and have agreed to implement the recommendations within acceptable timescales.</p> <p>Interim staff resources arrangements have been resolved.</p> <p>This Internal Audit Report has been submitted to the Scottish Government along with the Programme's Annual Confirmation Certificate by the due date of 13 November 2020.</p> <p>Internal Audit will follow-up on progress in February 2021.</p>



## **Internal Audit Mid-Term Performance Report 2020/21**

### **Report by Chief Internal Auditor**

### **Report for Decision**

## **1 Recommendations**

The Audit Committee is asked to:

- a) Note the progress Internal Audit has made with activity in the Internal Audit Annual Plan 2020/21 by the mid-year point;
- b) Acknowledge the audit planning work undertaken to reassess potential changes in light of the Council response to the Covid-19 pandemic to reflect the changing risks arising from Covid-19; and
- c) Approve the revisions to the Internal Audit Annual Plan 2020/21.

## **2 Purpose of Report/Executive Summary**

The purpose of this report is to inform the Audit Committee of the progress Internal Audit has made, in the first 6 months of the year to 30 September 2020, towards completing the Internal Audit Annual Plan 2020/21. It also summarises the statutory obligations for Internal Audit and requirements of the Public Sector Internal Audit Standards.

Internal Audit provides assurance to Management and the Audit Committee on the effectiveness of internal controls and governance within the Council.

The Internal Audit Annual Plan 2020/21 that was approved by the Audit Committee on 10 March 2020 sets out the audit coverage for the year utilising available Internal Audit staff resources to enable the Chief Internal Auditor, as the Council's Chief Audit Executive (CAE), to provide the statutory annual internal audit opinion regarding the adequacy and effectiveness of internal control within the Council.

The report provides details of the half yearly progress by Internal Audit with its programme of work and highlights changes that require approval to reflect the changing risks arising from Covid-19.

**Date 11 November 2020**

### **Report Contact:**

Jill Stacey                      Tel No  
[jill.stacey@midlothian.gov.uk](mailto:jill.stacey@midlothian.gov.uk)

### **3 Background**

- 3.1** As part of Midlothian Council's system of corporate governance, Internal Audit's purpose is to support the Council in its activities designed to achieve its declared objectives and to do so:
- In support of the Council's vision, values and priorities.
  - As a contribution to the Council's corporate management of risk, including assisting Management to improve the risk identification and management process in particular where there is exposure to significant financial, strategic, reputational and operational risk to the achievement of the Council's objectives.
  - As an aid to ensuring that the Council and its elected members, employees and contracted third parties are operating within the law and relevant regulations, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.
  - As a contribution towards establishing and maintaining a culture of honesty, integrity, openness, accountability and transparency throughout the Council in all its activities and transactions.
  - As a contribution towards ensuring that financial statements and other published performance information are accurate and reliable.
- 3.2** Internal Audit provides assurance to Management and the Audit Committee on the effectiveness of internal controls and governance within the Council.
- 3.3** The Internal Audit Annual Plan 2020/21 that was approved by the Audit Committee on 10 March 2020 sets out the audit coverage for the year utilising available Internal Audit staff resources to enable the Chief Internal Auditor, as the Council's Chief Audit Executive (CAE), to provide the statutory annual internal audit opinion regarding the adequacy and effectiveness of internal control within the Council.
- 3.4** Internal Audit assurance services are also provided during the year to the Midlothian Health and Social Care Integration Joint Board, and a statutory annual Internal Audit opinion is provided to its respective Management and Board/Audit and Risk Committee to meet its obligations.
- 3.5** Due to the effects of the Covid-19 emergency response, the Internal Audit Annual Plan 2020/21 has been re-assessed in terms of potential changes i.e. add audit to cover new risks, reschedule audit to later in the current year, and defer audits to a future year, in alignment with available Internal Audit resources and Management capacity. This re-assessment has been carried out in consultation with the Corporate Management Team and has resulted in significant changes that require approved by the Audit Committee. The proposed revised Internal Audit Annual Plan 2020/21 is presented at Appendix 1.

### **4 Half Year Results Against Internal Audit Plan 2020/21**

- 4.1** The Internal Audit programme of work led by the Principal Internal Auditor takes account of the availability of auditor resources and consultation with Management to consider operational service delivery demands and timing of the Council's transformation programmes.

- 4.2** In the first half of the year: Additional audits were added to the Plan to carry out assurance work on new risks associated with the Covid-19 emergency response; Two of the Internal Auditors were deployed part-time to assist with the administration of support grant payments (equivalent to approx. 63 days); and three Internal Audit assurance reports associated with the delivery of the approved Internal Audit Annual Plan 2019/20 that had been pending during the Covid-19 emergency response were finalised. As a result some planned 2020/21 audits have been delayed or will be deferred to 2021/22.
- 4.3** The Appendix 1 to this report provides details of the half yearly progress by Internal Audit with its programme of work to deliver the approved Internal Audit Annual Plan 2020/21. Those audits which are complete are highlighted in dark shading, those underway to reflect their continuous audit approach are highlighted in light shading, those scheduled for the second half of the year are not shaded, and those audits that have not been delivered as planned are marked \* or deferred to 2021/22 are marked \*\*.
- 4.3** The continuous audit approach, in accordance with the Internal Audit Strategy approved by Audit Committee on 10 March 2020, enables Internal Audit to provide added value advice on internal controls and governance and 'critical friend' consultancy services as the Council continues to transform its service delivery. For example, Business Transformation Board, Capital Planning and Asset Management Board, and Information Management Group. The continuous audit approach is applied to non-MLC Internal Audit work for the Midlothian Health and Social Care Integration Joint Board.

## **5 Completing the Revised Internal Audit Plan for 2020/21**

- 5.1** The proposed audits to be deferred to 2021/22 are as follows:
- Income Collection (Assurance - Cyclical);
  - Roads Maintenance Service (Assurance - Cyclical);
  - Homelessness (Assurance -Cyclical);
  - Learning and Physical Disabilities Services (Assurance – Risk)
  - School Excursions (Assurance – Risk)
- 5.2** The Internal Audit programme of work for the six months from October 2020 to March 2021, to complete the delayed work and incorporate the remaining revised planned audit work, based on maintaining current staffing levels within this period, presently indicates that the proposed revised Internal Audit Annual Plan 2020/21 can be delivered in full. The proposed revised Internal Audit Annual Plan 2020/21 is presented in Appendix 1 for approval by the Audit Committee.
- 5.3** The Internal Audit work will continue to be reported to the Corporate Management Team and to the Audit Committee. The Internal Audit Work reports will include: an Executive Summary of the audit objective, findings, good practice, recommendations (where appropriate) and audit opinion of assurance for each Final Internal Audit Report issued to relevant Service Management; a summary of Internal Audit Assurance Work in Progress; and an outline of Internal Audit Consultancy and other work carried out in accordance with the approved Internal Audit Charter.

- 5.4** Internal Audit's compliance with its Strategy and delivery of its risk-based Annual Plan will continue to be communicated to the Corporate Management Team and the Audit Committee within the Internal Audit Annual Assurance Report which will also provide the statutory annual Internal Audit opinion on the levels of assurance based on audit findings over the year.

## **6 The Local Authority Accounts (Scotland) Regulations 2014**

- 6.1** The Local Authority Accounts (Scotland) Regulations 2014 which came into force on 10 October 2014 require a local authority to operate a professional and objective internal auditing service. This service must be provided in accordance with recognised standards and practices in relation to internal auditing. Recognised standards and practices are those set out in the *Public Sector Internal Audit Standards: Applying the IIA International Standards to the UK Public Sector* (PSIAS). The standards require internal audit to have suitable operational independence from the authority.
- 6.2** The regulations require a local authority to assess the efficiency and effectiveness of internal auditing activity from time to time in accordance with recognised internal auditing standards and practices i.e. PSIAS.

## **7 Public Sector Internal Audit Standards (PSIAS) and Quality Assurance & Improvement Plan (QAIP)**

- 7.1** The MLC Internal Audit function follows the professional standards as set out in Public Sector Internal Audit Standards (PSIAS) effective April 2013 (updated April 2017) which includes:
- Definition of Internal Auditing;
  - Code of Ethics;
  - Attribute Standards (responsibility, independence, proficiency, quality);
  - Professional Standards (managing activity, nature of work, engagement planning, performing the engagement, communicating results, monitoring progress, risk management).
- 7.2** The PSIAS requires the Chief Audit Executive (CAE), the Council's Chief Internal Auditor, to carry out an annual internal self-assessment against the PSIAS, develop a quality assurance and improvement plan (QAIP) based on the outcome, and report the results of the QAIP to senior management and elected members.
- 7.3** An annual internal self-assessment against the PSIAS of the Internal Audit function will be completed prior to the end of 2020/21. The results and any associated improvement actions will continue to be reported to the Corporate Management Team and the Audit Committee within the Internal Audit Annual Assurance Report. This will enable the Council to meet the requirements of the Local Authority Accounts (Scotland) Regulations 2014 to consider the findings of assessments as part of the consideration of the system of internal control required by regulation 5.

- 7.4** The PSIAS also requires the self-assessment to be subject to an External Quality Assessment (EQA) each five years, by appropriately qualified and independent reviewers. This EQA was carried out by Highland Council in March 2018 and the results were outlined in the Internal Audit Annual Assurance Report 2017/18 reported to the Audit Committee in June 2018. The schedule for the second cycle of EQAs, with other participating Scottish Councils as peer reviewers, indicates that Midlothian Council will be reviewed by East Renfrewshire Council in 2022 and will review East Lothian Council in 2022.

## **8 Report Implications (Resource, Digital, Risk and Equalities)**

### **8.1 Resource**

The Internal Audit function reports directly to the Chief Executive (operationally) and the Audit Committee (functionally). There is currently a staff resource of 4.64 FTE, comprising Chief Internal Auditor (0.5 FTE – shared with Scottish Borders Council; 0.42 FTE Other Audit Resources), Principal Internal Auditor (0.72 FTE), Internal Auditor (2.0 FTE), Other Internal Audit resources (1.0 FTE) with a mix of qualifications, knowledge, skills and competencies (such as the Code of Ethics set out in PSIAS) needed to perform the plan.

Budget monitoring of the Service is discussed by the Chief Internal Auditor and the Principal Internal Auditor with the Financial Services Manager on a quarterly basis to address any budgetary pressures.

There is a commitment to provide resource to the Midlothian Health and Social Care Integration Joint Board (MIJB) as part of the Council's commitment to partnership working. Separate plans and reports are presented to MIJB Audit and Risk Committee to fulfil this role.

### **8.2 Digital**

There are no digital implications arising from this report.

### **8.3 Risk**

The PSIAS require Internal Audit to evaluate the effectiveness of the Council's Risk Management arrangements and contribute to improvements in the process.

Key components of the audit planning process include a clear understanding of the Council's functions, associated risks, and potential range and breadth of audit areas for inclusion. During the development of the Internal Audit Annual Plan 2020/21, at the start of each audit engagement, and during the re-assessment of the Plan, to capture potential areas of risk and uncertainty more fully, key stakeholders have been consulted and risk registers have been considered, to ensure the Plan is formulated on a risk-based approach. This is illustrated by way of the amendments that have been proposed to the Plan.

If Internal Audit staffing levels fall below that assumed for the remaining six-month period or if there is an unexpected and unplanned level of contingency audit work, there is the risk that the revised Annual Plan

2020/21 will not be delivered in full. That in turn increases the risk of reduced assurance and not providing the statutory Internal Audit opinion to Management and the Audit Committee on the effectiveness of internal controls and governance within the Council. This will be mitigated by way of workforce planning, scheduling of audit programme of work, regularly monitoring progress, and taking action as necessary.

#### **8.4 Ensuring Equalities**

This report does not relate to a new or revised policy, service or budget change, which affects people (the public or staff), so an Integrated Impact Assessment (IIA) is not an applicable consideration.

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

#### **8.5 Additional Report Implications (See Appendix A)**

## **APPENDIX A – Additional Report Implications**

### **A.1 Key Priorities within the Single Midlothian Plan**

Although this report does not relate directly to the key priorities within the Single Midlothian Plan to which Midlothian Council and its Community Planning Partners have made a commitment (Reducing the gap in economic circumstances; Reducing the gap in learning outcomes; Reducing the gap in health outcomes; and Reducing the impact of climate change), by providing an independent and objective annual assessment of the adequacy of the entire control environment, Internal Audit supports the Council to achieve its objectives.

### **A.2 Key Drivers for Change**

Key drivers addressed in this report:

- ☒ Holistic Working
- ☒ Hub and Spoke
- ☒ Modern
- ☒ Sustainable
- ☒ Transformational
- ☒ Preventative
- ☒ Asset-based
- ☒ Continuous Improvement
- ☒ One size fits one
- ☐ None of the above

Midlothian Council is committed to creating a great place to grow supported by the 9 drivers for change. Implementing the 9 drivers for change in practice is applicable to the Council's Internal Audit service provision to assist the Council in achieving its objectives.

### **A.3 Key Delivery Streams**

Key delivery streams addressed in this report:

- ☒ One Council Working with you, for you
- ☒ Preventative and Sustainable
- ☒ Efficient and Modern
- ☒ Innovative and Ambitious

### **A.4 Delivering Best Value**

The definition of Internal Auditing within the Public Sector Internal Audit Standards (PSIAS) is "Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes."

Implementation by Management of the actions associated with Internal Audit recommendations, that are designed to improve internal control



and governance arrangements and management of risks, underpins the Council's own continuous improvement arrangements to enhance its effectiveness, thus supporting the delivery of the Council's best value duties.

#### **A.5 Involving Communities and Other Stakeholders**

Internal Audit's purpose is to support the Council in its activities designed to achieve its declared objectives for the benefit of Midlothian's communities and other stakeholders.

The Chief Internal Auditor is accountable to the Audit Committee which, in fulfilling its governance role, acts as a bridge between the Council and other stakeholders.

This report has been presented to the Corporate Management Team to outline the key messages of assurance plans.

#### **A.6 Impact on Performance and Outcomes**

The Findings and Recommendations from Internal Audit work during the year, which are designed to maintain and / or enhance internal controls, governance arrangements and risk management, assists the Council in improving its performance and outcomes.

#### **A.7 Adopting a Preventative Approach**

Having robust internal controls, governance arrangements and risk management in place contributes to safeguarding the Council's resources for delivery of services, as part of protecting the public purse. Internal Audit assurance and consultancy activity is designed to improve operations and assist the Council in accomplishing its objectives.

#### **A.8 Supporting Sustainable Development**

This report does not relate directly to supporting sustainable development. Good governance, including the provision of an Internal Audit service, is important to enable Midlothian Council to achieve its objectives.



APPENDIX 1

AUDIT	DAYS	COMMENTARY	STATUS
Assurance - Cyclical			
Annual Assessment of Internal Control and Governance	20	Prepare an annual assurance report for Management and the Audit Committee summarising the work undertaken by Internal Audit during the year and forming an opinion on adequacy of the Council's arrangements for risk management, governance and internal control based on key elements in the Local Code of Corporate Governance.	Continuous audit approach to follow-up on implementation of actions on Areas of Improvement set out in the Annual Governance Statement 2019/20; work with CMT August to December 2020 on 7 core principles to refresh Local Code of Corporate Governance. Annual evaluation scheduled 4th Qtr.
Income Collection	30	Review the collection of income and the Council's compliance with the Payments Card Industry Standards. The audit will include a review of the Parent-pay system, rechargeable repairs, car parking and licensing.	** Defer to 2021/22 - Rely on assurance from other income based audits in 2020/21 (Council Tax and Social Housing Rents) thus alleviating impact on Business Applications team on request from Management.
Fleet Management	30	Review the asset management planning and maintenance of the Council's fleet ensuring that fleet repairs and replacement decisions represent value for money. Include a review of the controls over fuel management.	Scheduled 3rd Qtr.
Property Maintenance	30	Review of the in-house building maintenance team undertaking repairs to the Council's housing and non-housing buildings. This will include a review of jobs from creation through to billing.	* Audit scope expanded on request by Management to cover specific risks in light of Budget Outturn 2019/20. Audit work nearly completed though slight delay compared to schedule in programme of work. Report to be issued 3rd Qtr.
Roads Maintenance Service	30	Review of the Roads Maintenance service including both capital and revenue jobs ensuring that the service is complying with the relevant code of practice / risk based inspection regime.	** Defer to Q1 2021/22 - Request from Management to defer by a few months to avoid potential peak winter maintenance period.
Council Tax	30	Review the adequacy of controls over the Council Tax System with coverage limited to liability, billing and collection.	Scheduled 3rd Qtr.
Information Governance	20	Continual audit approach to review the information governance framework including roles and responsibilities, policy development and implementation, specifically on information security.	Internal Auditor attends Information Management Group. ICT Security Controls six audit actions assessed as satisfactory in spot check of completed audit recommendations. Assessment scheduled 4th Quarter.
Schools	30	Review of internal financial controls and business administrative procedures in place to ensure the efficient and effective use of resources in the school establishments (sample of 2 High Schools and 2 Primary Schools), to complement the assurance received from Education Scotland arising from their inspection programme of schools.	Scheduled 3rd Qtr. Due to Covid-19 Pandemic restrictions, establishment visits will not be undertaken. Internal Audit will carry out data analytical work covering all schools regarding School Finance and Business Administration processes.
Homelessness	30	Review of controls in place to ensure the achievement of statutory obligations for the Homelessness service, including a focus on prevention and support.	** Defer to 2021/22 - Rely on assurance provided to Scottish Housing Regulator in 2020/21.
Social Housing Rents	30	Review the management arrangements and the adequacy of controls over the collection of Council house and garage rents.	Scheduled 3rd Qtr.
Trading Standards	30	To review the business practices and ways of working within Trading Standards to ensure that regulatory obligations are met and risks are appropriately managed.	Scheduled 3rd Qtr.
DSM Budgets	30	Ensure that DSM budgets set for 2020/21 are sustainable and based on realistic plans and that appropriate scrutiny is undertaken to enable service delivery within approved budget.	Scheduled 4th Qtr.
	340		

AUDIT	DAYS	COMMENTARY	STATUS
<b>Assurance - Risk-Based</b>			
<b>Change and Transformation Programme</b>	20	Continual audit approach to monitor implementation of improvements to the governance and accountability arrangements for the change and transformation programme including processes for benefit (financial and other) identification, tracking and realisation.	Final Report issued 11 November 2020, and Executive Summary to Audit Committee 8 December 2020.
<b>Business Planning, Budget Setting and Monitoring</b>	20	Evaluate the implementation of improvements to ensure that budgets set for 2020/21 are sustainable and based on realistic plans, and that appropriate scrutiny and challenge is undertaken on revenue budget monitoring reports to enable service delivery within approved budget.	Final Report issued 11 November 2020, and Executive Summary to Audit Committee 8 December 2020.
<b>Procurement and Management of Contracts</b>	20	Continual audit approach to monitor the implementation of improvements recommended and quality assurance arrangements.	Follow-up ongoing; Formal review scheduled 4th Qtr.
<b>Workforce Planning</b>	20	Review the Service workforce planning processes to provide skills, knowledge and competency requirements for service delivery to meet the Council's objectives, and to address issues such as recruitment and retention.	Incorporated within audit on Business Planning, Budget Setting and Monitoring.
<b>Passenger Transport</b>	30	Review over the governance, controls, costs and management of passenger transport services across the Council including end to end processes for client and provider.	Scheduled 3rd Qtr.
<b>Learning and Physical Disabilities Services</b>	30	Review of the governance and accountability arrangements and partnership working in place to ensure obligations are met to deliver services.	** Defer to 2021/22 - Request from Management to alleviate impact on Service capacity.
<b>Capital Investment</b>	20	Continual audit approach to assess compliance with established good practice by Accounts Commission - review, scrutiny and challenge; capital financial budget monitoring; delivery of the capital programme/projects. Specific focus on monitoring and scrutiny of delivery.	Chief Internal Auditor attends Capital Planning and Asset Management Board to monitor implementation of actions to address Areas of Improvement. Evaluation scheduled 4th Qtr.
<b>School Excursions</b>	30	Assess what policies and produres are in place to ensure the inclusion and safety of children on excursions.	** Defer to 2021/22 - Low risk due to Covid-19 pandemic restrictions in 2020/21.
<b>Early Years</b>	20	Review of the Council's progress with delivering the expansion in early learning and childcare to 1140 hours and the allocation of the capital funding received to deliver the additional capacity required.	Scheduled 4th Qtr.
<b>Automated Invoice Payments</b>	10	Assess the authorisation controls, including segregation of duties, and security controls over payments.	Brought forward from 2019/20 to reflect timing of planned system development. Scheduled 4th Qtr.
	220		

AUDIT	DAYS	COMMENTARY	STATUS
<b>Legislative &amp; Other Compliance</b>			
EU Funded Programme Tyne Esk LEADER	10	Annual requirement to review the controls in place to deliver the EU Funded Programme Tyne Esk LEADER and to undertake compliance related work as defined by the Service Level Agreement.	Final Report issued 4 November 2020, and Executive Summary to Audit Committee 8 December 2020.
	10		

AUDIT	DAYS	COMMENTARY	STATUS
<b>Consultancy</b>			
Consultancy	30	In its 'critical friend' role provide: an independent view and challenge of a sample of programmes and projects (including Learning Estate Strategy, Business Transformation Board, Information Management Group); and an objective assessment of self-evaluation arrangements.	Attended various forums including Business Transformation Board, Capital Plan and Asset Management Board, and Information Management Group as a critical friend. Audit Consultancy work carried out on request and in agreement by Chief Internal Auditor; undertaken audit consultancy work relating to community resilience funds, infrastructure developments, participatory budgeting, and housing allocation policy.
	30		

AUDIT	DAYS	COMMENTARY	STATUS
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Other
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PSIAS Self-Assessment	10	Undertake annual self-assessment of the Internal Audit function against the Public Sector Internal Audit Standards (PSIAS) and report findings to the Audit Committee.	Scheduled 4th Qtr
MLC Audit Committee Self-Assessment	5	Provide assistance to Chair in undertaking a self-assessment of the Audit Committee against the CIPFA best practice guidance.	Audit Committee Annual Report 2019/20 presented by Chairman to Council in August 2020. Informal Sessions scheduled prior to each Committee meeting for learning, development and improvement. 2020/21 self-assessment scheduled 4th Qtr.
MLC Recommendation Follow Up Reviews	30	Undertake 2 reviews: the first includes a sample check on the adequacy of new internal controls for Audit Actions flagged as closed, and the second assesses performance against closing Audit Actions by the agreed due date.	Completed Recommendations Report to Audit Committee 13 October 2020. Second review scheduled 3rd Quarter.
Contingency	30	Support / undertake any investigations and other reactive work to ensure high risk issues and concerns identified by Management or Audit Committee during the year are appropriately addressed.	Utilised days to finalise parked audit reports 2019/20 due to Covid-19 response impact on Management capacity. Contingency work carried out in agreement by Chief Internal Auditor.
Help Desk Enquiry system	22	Provide guidance and advice to Management and Staff on internal controls. Manage any enquiries received through the whistle-blowing facilities offered by the Council.	Ongoing. Tracker in place to record enquiries and monitor response timelines and content.
MLC Administration of Audit Scotland Reports	2	Monitor publication of Audit Scotland reports and co-ordinate submission by Management of Audit Scotland Reports to the Audit Committee or other Committee as relevant.	Ongoing. Tracker in place to coordinate relevant Management presenting reports to relevant Committee.
Risk Management, SOC and Integrity Groups	5	Attend and provide support to the Risk Management Group, the Serious and Organised Crime Group, and the new Integrity Group.	Ongoing.
MLC Attendance at Boards / Committees	10	Prepare for and attend Audit Committee meetings and other Boards/Committees as relevant.	Ongoing.
MLC Audit Planning for 2021/22	10	Renew risk assessment, develop and consult on proposed coverage within the Internal Audit Annual Plan 2021/22.	Re-assessment of Audit Plan 2020/21 in light of the impact of Covid-19 has had implications for 2021/22 due to deferment of some audits. Formal engagement with Management on Audit Plan 2021/22 scheduled in 4th Qtr.
	124		

MLC Total	724
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AUDIT	DAYS	COMMENTARY	STATUS
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Non MLC
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Midlothian Health and Social Care Integration Joint Board	70	Audit reviews and support to be determined and agreed by the Midlothian Health and Social Care Integration Joint Board Audit and Risk Committee for review of the adequacy of the IJB's arrangements for risk management, governance and internal control for delegated resources.	MIJB Internal Audit Annual Plan 2020/21 approved by MIJB Audit and Risk Committee on 5 March 2020. Audit work ongoing. In respect of joint services, assurances will be sought from partner Internal Audit service providers (i.e. NHS Lothian - GT; MLC - MLC IA). Progress against Plan will be presented in December 2020 and MIJB Internal Audit Annual Assurance Report will be presented in June 2021 to MIJB Audit and Risk Committee.
	70		

Overall Total	794
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**Title of Report** Risk Management Update, Quarter 2 2020/21

**Report by** Chris Lawson, Service Manager – Waste, Risk and Resilience

**Report for Information**

**1 Recommendations**

Audit Committee is recommended to note the current risk landscape and organisational responses to the most significant risk prevailing at this time.

**2 Purpose of Report/Executive Summary**

Audit Committee has requested regular reporting on the Council's Strategic Risk management approach and response.

The purpose of this report is to provide Audit Committee with an update on the risk responses Midlothian Council has had to implement during quarter 2 2020/21 to respond to the current risk climate.

**Date** 16 November 2020

**Report Contact:**

Chris Lawson                      Tel No 0131 271 3069  
[chris.lawson@midlothian.gov.uk](mailto:chris.lawson@midlothian.gov.uk)

### **3 Background/Main Body of Report**

**3.1** Midlothian Council has delivered a wide range of services to the people of Midlothian throughout quarter 1 of 2020/21 against a backdrop of operating within a series of government directed constraints, associated with responding to a global pandemic. The Scottish Government response to the above resulted in sectors being instructed to close as part of a national lockdown response in March 2020, with a phased recovery plan to facilitate business restart.

**3.2** While Midlothian Council responded to the initial lockdown in quarter 1 the focus during quarter 2 was on recommencing a range of services which were either considered non-essential and/or not permitted to resume until quarter 2.

**3.3** As the Council has responded to the risks introduced by the pandemic it has become apparent that the public sector face a new challenge in the coming months. There are 3 significant factors which will all interplay over quarter 3 and into quarter 4. These are the concurrent risks of:

- COVID 19,
- UK Exit from the EU, and
- Winter

**3.4** In addition to these new risks the Council continue to manage those risks recorded within the Strategic Risk Profile. The work required to maintain the necessary Corporate oversight over the broader strategic landscape continues, while there is a current focus on the particular set of external factors the organisation needs to prepare and respond to.

#### **3.5 COVID 19**

Midlothian Council have been responding to the global pandemic since February 2020. The Corporate Management Team established an Incident Management Team to respond to the incident as set out in the Council's Emergency response plan.

During this period the Council's Health and Safety team developed a series of risk assessment templates covering workplace risks, schools risks and employee risks to support re-establishing services. The team also carried out monitoring to confirm assessments were being carried out across the Council. There was a specific focus on school based monitoring visits to confirm the arrangements necessary to protect pupils, teachers and other support staff were in place.

During quarter 2, workplace COVID risk assessments were updated to reflect the requirements placed on the Council and to respond to guidance affecting different sectors within the Council and to support re-opening in a COVID safe manner. During the lockdown phase a number of employees had been taken out of the workplace as a result of having underlying health conditions, placing them at greater risk from the virus or where they were directed to stay at home due to Shielding requirements.

Employees in these categories were supported to return to work, where the default home working option, was not viable for their role. Staff roles were risk assessed with agreed risk assessments signed off by individual employees and their line managers, as part of the return to work process into a new COVID safe environment.

It has become apparent that the level of Community transmission has begun to increase across Scotland and the rest of the UK since the initial lockdown period. In response the Scottish Government introduced a new tiered restriction model which was deployed in quarter 3 in response to the rise in infection rate.

Ahead of the new tiered model being deployed, the Council's Incident Management Team (CIMT) was re-established to co-ordinate and oversee preparations and planned responses to the implementation of the new tiered system. During this time the CIMT have maintained a COVID-19 risk assessment to track potential risk impacts, the risk controls in place and to record progress on actions being taken to mitigate potential or expected impacts.

### **3.6 UK Exit from EU**

The UK stopped being a member of the European Union at 23:00 on 31 January 2020. The UK continues in a transition period up to, but not beyond, the 31 December 2020 as the UK Government have legislated not to extend the transition period beyond this point.

In the period between 31 January 2020 and 31 December 2020 the UK government have sought to negotiate the future relationship with the EU including trade arrangements. There remains a risk of significant change from the current established approaches in many areas. The Council have continued to monitor progress by the UK Government.

The Council's EU Exit Working Group was reconvened in quarter 1 2020/21 to enable suitable planning to take place in response to the emerging new relationship with the EU and any changes which may impact services or supplies. Midlothian Council are working with partners including CoSLA and the Local Authority Resilience Group to monitor developments in this area and plan accordingly.

The Council's EU exit risk register is being revised through the EU Exit working group, taking into account current government guidance and through appropriate use of the UK governments 'reasonable worst case scenario planning assumptions'.

### **3.7 Winter preparedness**

The winter months always present a potential risk of winter weather and/or severe weather, with the associated risk of impacts across a range of sectors. In preparation for this winter, Midlothian Council's severe weather plan has been reviewed. This review has included an update of the Council's Roads Service response given the significant

contribution they play in keeping essential roads and pedestrian routes open during severe weather.

The challenge facing Council's across the UK going into this winter is the concurrent risks associated with COVID-19 and the potential for rise in community transmission during the normal winter flu season.

Going into any winter period anyone of the above risks could have created a significant impact in their own right, this year Council's across the country need to contend with the potential of impacts across a range of concurrent risks. This is requiring careful planning to ensure that in the event of winter impacts and/or EU exit impacts, against a backdrop risking COVID 19 community based transmission, the Council remains in a position able to deliver the essential services the people of Midlothian rely on.

- 3.8** Outlined above is an overview of the response to the most significant risk facing the Council going into quarter 3 2020/21 and should act to provide assurance that Midlothian Council is taking a proportionate and planned approach to prepare and respond to each of these risks at this potentially challenging time.

#### **4 Report Implications (Resource, Digital, Risk and Equalities)**

##### **4.1 Resource**

There are no direct resource implications indicated in this report, although, individual risks have associated resource implications.

##### **4.2 Digital**

None.

##### **4.3 Risk**

The risks reported in this report are understood with the Council able to demonstrate the measures it is taking in response to these.

##### **4.4 Ensuring Equalities**

There are no direct equalities issues arising from this report.

##### **4.5 Additional Report Implications (See Appendix A)**

#### **Appendices**

#### **Appendix A – Additional Report Implications**





## APPENDIX A – Additional Report Implications

### A.1 Key Priorities within the Single Midlothian Plan

This report provides an overview of the Strategic Risk profile of Midlothian Council at a defined point in time. The issues, risks and opportunities affecting or supporting delivery of the council priorities are set out within the Strategic risk profile

### A.2 Key Drivers for Change

Key drivers addressed in this report:

- ☐ Holistic Working
- ☐ Hub and Spoke
- ☐ Modern
- ☐ Sustainable
- ☐ Transformational
- ☐ Preventative
- ☐ Asset-based
- ☐ Continuous Improvement
- ☐ One size fits one
- ☒ None of the above

### A.3 Key Delivery Streams

Key delivery streams addressed in this report:

- ☒ One Council Working with you, for you
- ☐ Preventative and Sustainable
- ☐ Efficient and Modern
- ☐ Innovative and Ambitious

### A.4 Delivering Best Value

The Council's commitment to best value and securing continuous improvement can best be delivered when decisions are made against a backdrop of understanding the risks and opportunities before an organisation. This report seeks to provide assurance that the current risk environment is understood and that Midlothian Council is taking appropriate action in response to those identified risks.

### A.5 Involving Communities and Other Stakeholders

This Strategic Risk Profile report has been compile with input from a range of internal key stakeholders.

### A.6 Impact on Performance and Outcomes

This report seeks to provide an overview of the challenging risk environment within which the Council is operating at this time. Being in

a risk aware position helps to inform current and future decision making, with the intention of enhancing decision making and the associated performance and outcomes which flow from well informed decision making.

#### **A.7 Adopting a Preventative Approach**

The Risk Management approach being taken by the Council is founded on a preventative approach to managing risks, where appropriate and more generally to decision making with far greater risk awareness.

#### **A.8 Supporting Sustainable Development**

Senior Managers must ensure the sustainability of the Council, which entails identifying, understanding and managing Strategic and Service level Risks and Opportunities.



## **Annual Audit Plan – Update on External Audit Fees**

**Report by Gary Fairley Chief Officer Corporate Solutions**

**Report for Noting**

### **1 Recommendations**

Audit Committee is asked to note this update on the position in respect of external audit fees for the year.

### **2 Purpose of Report/Executive Summary**

This report updates Audit Committee of the final position regarding audit fees for the year 2019/20.

**23 November 2020**

**Report Contact:**

Gary Fairley

[gary.fairley@midlothian.gov.uk](mailto:gary.fairley@midlothian.gov.uk)

### 3 Background

At its meeting on 10 March 2020 the Audit Committee were presented with the Annual Audit Plan for the year ended 31 March 2020 which set out at Appendix E the indicative position with audit fees for the year as follows:-

Audit Fees	2019/20	2018/19
Component of fee:		
Auditor remuneration –expected fee	£144,550	£141,260
Additional audit procedures	£TBD	£16,090
Audit Scotland fixed charges:		
Pooled costs	£14,140	£13,700
Performance audit and best value	£64,560	£63,730
Audit support costs	£8,740	£8,870
<b>Total fee</b>	<b>£TBD</b>	<b>£243,650</b>

The report noted that the expected fee for each body, set by Audit Scotland, assumes that it has sound governance arrangements in place and operating effectively throughout the year, prepares comprehensive and accurate draft financial statements and meets the agreed timetable for the audit.

It also noted that the expected fee assumes there is no major change in respect of the scope of work in the year and that fees can be agreed between the auditor and audited body by varying the auditor remuneration by up to 10% above the level set, for example, where significant local issues require additional work to be undertaken.

EY had outlined areas of additional audit focus this year which were likely to have an impact on the expected fee, including around the Council's review of loans fund accounting, PPP accounting, accounting for IFRS 16 and their follow up of findings within the Best Value Assurance Report. The audit plan noted that any fee variation would also depend on the progress made by the Council in addressing the matters raised in the 2018/19 Annual Audit Report and Best value Assurance report and that where further additional work is required, fees will be agreed with management and reported to the Audit Committee in the 2019/20 Annual Audit Report.

As outlined by EY in their Annual Audit Report, given the circumstances and to be pragmatic and flexible this year EY delayed the planned Best Value Follow up to the next financial year, subject to the planning arrangements being agreed for the 2020/21 audit. Accordingly the indicative additional fees of £12,600 associated with this work, which would have brought the total fee to £244,590, has also been deferred.

The addendum to the Annual Audit Plan presented to Audit Committee on 22 June 2020 noted that the changes to the Council and the associated risks to the audit as outlined in the addendum would have an impact on the audit work, in particular;

- The impact of Covid-19 on the financial statements audit, including a greater use of internal specialists to support our work

on significant and inherent risk areas, in particular the valuation of fixed assets;

- Additional work required around the appropriateness of going concern disclosures in the financial statements and the associated wider scope audit consideration required around financial sustainability; and
- The potential wider impact on the audit driven by the greater potential for audit issues to arise through the yearend audit process, in particular around the accounting for transactions around the yearend and the valuation of yearend balance sheet accounts.

The addendum noted that at that stage there remained uncertainty over the scale of impact of Covid-19 on the financial statements accounting requirements, and key judgements made by management and at that stage it was not appropriate to quantify any impact on fees from additional audit work.

#### 4 Current Position

At the time of presenting the Annual Audit Plan to Audit Committee on 12 October 2020 the fee position for 2019/20 was still to be finalised and accordingly this report sets out the final fee position for the year which is as follows:-

Audit Fees	2019/20	2018/19
Component of fee:		
Auditor remuneration –expected fee	£144,550	£141,260
Additional audit procedures	£50,200	£16,090
Audit Scotland fixed charges:		
Pooled costs	£14,140	£13,700
Performance audit and best value	£64,560	£63,730
Audit support costs	£8,740	£8,870
<b>Total fee</b>	<b>£282,190</b>	<b>£243,650</b>

The total fee is therefore £37,600 higher than previously anticipated with the breakdown as follows :-

Additional procedures arising from the pandemic, to fully reassess planning work and subsequent audit risk identification, significant additional focus on the assessment of going concern by management, additional audit consideration required around the valuation of the Council's share of assets in the Lothian Pension Fund and McCloud and Goodwin development subsequent to the yearend.

£13,200

Assessment of the accounting entries for the Millerhill Waste Plan Financial Model

£7,900

Fixed asset valuation work including specialist time involved in:

- Valuation uncertainty requiring us to designate the valuation of fixed assets as a significant audit risk to the financial statements;
- Resultant involvement of specialist valuers in a sample of valuations;
- Resolving the movement in valuation of Dalkeith Community Campus;
- Resolving queries with City of Edinburgh Council valuers;
- Disproportionate time to resolve valuation queries with internal valuers. £15,800

Procurement. Additional specialist work performed by EY's Forensics team to interrogate and analyse purchase orders and invoices in 2018/19, 2019/20 and the first quarter of 2020/21. £10,300

Assessment of the Loans Fund Review £3,000  
 Less Reduced Best Value audit time £(12,600)  
**£37,600**

As outlined in EY's Annual Audit Report, the Best Value Follow Up has been delayed to next financial year, subject to the planning arrangements being agreed for the 2020/21 audit.

The variation in fees will be reported to Audit Scotland for finalisation.

## 5. Implications for future years

A number of the additional audit procedures carried out this year are expected to be a one off though there will inevitable be additional procedures required in the 2020/21 audit given the significant divergence from the budget as a consequence of the pandemic and also as a consequence of the range of grant schemes administered by the Council in the year.

In respect of the valuation of fixed assets whilst there has been a steady improvement in the approach taken by the internal valuation team, particularly over the last two years, the extent of the additional audit procedures highlights that there is room for further improvement which in turn can reduce the need for additional work by EY. Accordingly the terms of engagement with the internal valuation team will be reviewed and improvements agreed as part of the year end planning arrangements.

As noted above there will be additional procedures in 2020/21 in respect of the best value follow up work.



## **6 Report Implications (Resource, Digital and Risk)**

### **6.1 Resource**

There additional audit fees will result in the budget for these costs being exceeded. Whilst some of the additional work arises as a consequence of the pandemic there is no specific funding from Scottish Government to mitigate this.

### **6.2 Digital**

There are no direct digital implications arising from this report.

### **6.3 Risk**

There are no specific risk arising from this report.

### **6.4 Ensuring Equalities (if required a separate IIA must be completed)**

There have been no changes to policies which require an IIA to be completed.

### **6.5 Additional Report Implications (See Appendix A)**

See Appendix A

## **Appendices**

Appendix A – Report Implications

## APPENDIX A – Report Implications

### A.1 Key Priorities within the Single Midlothian Plan

Maintaining financial governance is central to demonstrating strong financial management and financial sustainability and it is on these foundations that delivery of the priorities in the Single Midlothian Plan is based.

### A.2 Key Drivers for Change

Key drivers addressed in this report:

- ☐ Holistic Working
- ☐ Hub and Spoke
- ☒ Modern
- ☒ Sustainable
- ☒ Transformational
- ☐ Preventative
- ☐ Asset-based
- ☒ Continuous Improvement
- ☐ One size fits one
- ☐ None of the above

### A.3 Key Delivery Streams

Key delivery streams addressed in this report:

- ☒ One Council Working with you, for you
- ☐ Preventative and Sustainable
- ☒ Efficient and Modern
- ☒ Innovative and Ambitious
- ☐ None of the above

### A.4 Delivering Best Value

Effective Financial Governance is a core principal of Best Value.

### A.5 Involving Communities and Other Stakeholders

There has been no external engagement in preparing this report.

### A.6 Impact on Performance and Outcomes

The arrangements set out in the report do not have a direct impact on performance or outcomes.

### A.7 Adopting a Preventative Approach

Maintaining an effective Financial Governance and internal control arrangements is central to the prevention of error and or the risk of fraud.

### A.8 Supporting Sustainable Development

No direct impact.

## **Annual Governance Statement – Financial Improvement Update**

### **Report by Gary Fairley Chief Officer Corporate Solutions**

#### **Report for Noting**

#### **1 Recommendations**

Audit Committee is asked to note this update on the financial related improvement actions as set out in the 2019/20 Annual Governance Statement which in turn enhance compliance with the Council's Local Code of Corporate Governance.

#### **2 Purpose of Report/Executive Summary**

At its meeting on 22 June 2020 the Audit Committee, when considering the draft of the Annual Governance Statement for 2019/20, agreed that regular financial improvement updates would be provided by the Chief Officer Corporate Solutions and that the first update would be provided at this meeting.

**18 November 2020**

#### **Report Contact:**

Gary Fairley

[gary.fairley@midlothian.gov.uk](mailto:gary.fairley@midlothian.gov.uk)

### 3 Background

The Annual Governance Statement explains how the Council has complied with the terms of the CIPFA/SOLACE Framework, sets out the Council's governance arrangements and systems of internal control, and reports on their effectiveness. The statement also covers relevant governance matters as they affect those entities included as part of the Council's Group Accounts.

The overall aim of the CIPFA/SOLACE Framework 'Delivering Good Governance in Local Government' is to ensure that:-

- Resources are directed in accordance with agreed policy and according to priorities;
- There is sound and inclusive decision making; and
- There is clear accountability for the use of those resources in order to achieve desired outcomes for service users and communities.

An annual review of the adequacy and effectiveness of its overall governance framework is carried out with the output of this being the Annual Governance Statement which is presented to the Audit Committee as an integral part of the Financial Statements.

For 2019/20 the collective review activity identified the areas where improvement in governance arrangements could be made to enhance compliance with the Council's Local Code of Corporate Governance and to demonstrate Best Value, including financial sustainability, financial management and service transformation.

The final 2019/20 Annual Governance Statement highlighted that significant progress has been made in terms of the improvement actions agreed as follows:

1. The medium term financial strategy was approved by Council in June 2019.
2. The Council have worked hard to develop and sustain more constructive relationships between members and between members and officers. The cross-party Business Transformation Steering Group is driving forward the medium term financial strategy including the supporting transformation plans. Throughout the Covid-19 Pandemic emergency phase, the Chief Executive met weekly with the group leaders and deputy leaders of the three political groups as part of the regular reporting arrangements agreed.
3. The workforce strategy was approved by Council in December 2019 and further work, as part of the Covid-19 recovery phase, is now taking place to ensure that workforce planning reflects both the medium term financial strategy and the Council's future plans.
4. The capital programme has been accelerated in line with the Midlothian Route Map Through and Out of the Crisis which was

approved by Council in June 2020. Supporting capital projects were also approved by Council in June and August 2020.

5. The Council is continuing to implement financial planning arrangements to address remaining budget gaps, underpinned by robust financial budgeting and monitoring arrangements with a quarterly financial monitoring board now meeting to scrutinise in year and future year savings.
6. The Compact has been developed in partnership with the Third Sector in light of the outcome of consultation work through the Services with Communities and will be presented to Council in October 2020
7. Work is underway with elected members in light of the recommendation to exercise appropriate scrutiny at all times, take ownership for personal development plans and take up relevant training opportunities.
8. Reviews are progressing to continue to build on positive elements of community empowerment; increase community ownership of local neighbourhood plans and work with communities to improve how they monitor progress.

In addition the statement noted that other improvement actions were agreed during the year in order to enhance compliance with the Council's Local Code of Corporate Governance:

9. Strengthen resource capacity and skills in the Procurement function to better support Service Managers to comply with the Council's procurement strategy and procedures, and to undertake contract monitoring to demonstrate delivery of value for money.
10. Enhance the Performance Management Framework through the full application of appropriate and proportionate self-assessment processes in all Council services as a self-evaluation tool to demonstrate achievement of Best Value.
11. Review and update the Financial Regulations and policies, procedures and guidelines of the key financial planning, management and administration processes linked to the Financial Regulations to reflect changes arising from organisation structures and systems.
12. Provide ongoing leadership training for officers relating to their roles and responsibilities to apply procedures and practices with a focus on new or refreshed policies.
13. In 2019/20 meeting dates were aligned in order that reports would go to CMT or Financial Monitoring prior to Audit Committee or Council where appropriate. Unfortunately, the reporting process did not improve to the extent anticipated and therefore it is essential moving forward that both CMT and Audit Committee are given their place in terms accurate and timeous reports being provided to allow full analysis and scrutiny of financial matters which will help to ensure greater transparency of practice and stronger governance.

The aim of all these actions being to improve governance arrangements in 2020/21.

The update provided by this report encompasses the financial related items and others within the remit of Corporate Solutions service and therefore this report provides an update in respect of items 1, 3, 4, 5, 9, 11 and 13 from the above.

#### **4 Update on Improvement Actions**

##### **AGS 1. MTFS.**

Having approved the MTFS in June 2019, the Council subsequently agreed, on the recommendation of the BTSG, the 2020/21 budget on 11 February 2020.

During the year Council has been provided with three COVID Financial Update reports in June, August and latterly on 17th November. The August and November reports complemented the Q1 & Q2 Financial Monitoring reports and together these provided Council with a detailed update on the financial impact of the pandemic and the projected financial position of the Council overall. As reported to Council on 17 November 2020 the projected position for General Fund is a net overspend of £0.485 million for the year which is 0.21% of the revised budget. The general reserve is projected to be £3.410 million at 31 March 2021.

On 26 October 2020 BTSG unanimously endorsed the adoption of a corporate solution to secure financial balance for the 2021/22 and 2022/23 budgets. The three strands of the solution, as noted below, will now be presented to Council in December 2020.

- Applying an increase in Council Tax, in line with that expected to be provided for in the grant settlement, estimated at 4.8%.  
Noting that BTSG had previously agreed this as one of the main budget planning assumptions;
- The in-year impact of the Loans Fund review which is reported in more detail elsewhere on today's agenda; and
- Utilising the prior year adjustment which arises from the Loans Fund review.

As indicated BTSG had previously agreed the main planning assumptions on which the budget projected are predicated. In addition applying Council Tax increases, BTSG have agreed the assumptions for Scottish Government Grant (agreed a revised planning assumption of a 1% cut at national level each year) and the provision included for pay awards (agreed maintaining a planning assumption of 3% per annum).

This corporate solution for the financial years in question will be adapted as the details and quantum of the financial flexibilities agreed by Scottish Government are developed. The adoption of the Corporate Solution to the two remaining budgets which fall within the term of this Council will allow officers to commence work on developing a MTFS for the term of the next Council for consideration after the elections in May 2022.

### **AGS 3. Workforce Plans.**

As part of the Covid-19 recovery phase work is now taking place to ensure that service workforce plans are developed which reflects both the medium term financial strategy and the Council's future plans. The endorsement by BTSG of the Corporate Solution to the MTFs, as set out above, provides greater certainty on which to develop these service specific plans. It is intended to bring forward a draft of the Corporate Solutions workforce plan this calendar year and use the learning from that to support the development of plans for all service areas.

### **AGS 4. The Capital Programme.**

An update on both the General Fund and HRA Capital programmes were presented to Council on 17<sup>th</sup> November 2020. The forward capital programmes reiterate the extent of investment approved by the Council with expenditure of circa £400 million estimated over the period to 2024/25 with a net borrowing requirement of circa £285 million. The Capital Plan and Asset Management Planning Board maintains oversight of the capital plans and oversees the delivery of the wide range of investment projects provided for in the plans.

### **AGS 5. Financial planning arrangements and financial budgeting and monitoring arrangements.**

In addition to the progress outlined at above at 4.1 arrangements for the Financial Monitoring CMT meetings are now well developed with those meetings receiving both the draft quarterly financial monitoring report and appendices for scrutiny and challenge and also where appropriate additional information which outlines the basis of financial projections and the key risk associated with these.

From Q1 2019/20 the reporting arrangements to Council in respect of Adult Health and Social care have been revised to better recognise the Council's obligations arising from the Integration Scheme. Having approved the delegation of a budget to the Integration Joint Board (IJB) the responsibility for delivering services within that budget allocation then sits with the IJB and only as a last resort would the IJB approach its partners, the Council and NHS Lothian, to secure an additional budget allocation. In recognition of this detailed budget monitoring and reporting in respect of Adult Health and Social Care is encompassed in the IJB's Chief Finance Officer Reports to the IJB itself.

Financial Strategy meetings attended by the Chief Executive, Director Place, Chief Officer Corporate Solutions and Financial Services Manager are scheduled on a fortnightly basis and provide a forum to review and refine the financial strategy and address issues as they emerge.

External evaluation of the Council's financial management arrangements is carried out by external audit. As Committee is aware in their 2019/20 Annual Report EY recorded an improved Green Rating for Financial management. The report states that:-

*"The Council demonstrates good financial control of the in-year budget, including understanding the impact of Covid-19 in early 2020/21. Financial*



*reporting was clear and consistent throughout the year and improvements have been made to the management and monitoring of the capital programme. We note that while improved governance arrangements have been adopted to approve and monitor savings within the Business Transformation programme, the Council delivered only 71% of planned savings in 2019/20.*

*Some areas, including the delivery of savings and updating of financial regulations, will require continuing focus and attention”.*

### **AGS 9. Procurement.**

Action has been taken to strengthen the capacity and skills in the Procurement Team by recruiting an additional Procurement Officer specifically to support Service Managers within the Roads and Property functions to comply with the Council’s procurement strategy and procedures. Regular meetings to discuss service delivery strategy, new areas of spend, contracts that have or due to expire, current service provision including any off contract spend and supplier performance are now in place across the Directorates.

Arrangements are now being progressed to provide additional capacity through the recruitment of a second Procurement Assistant post which in turn will allow the Procurement Officers to have more capacity to both support and challenge service managers on commodity strategies and routes to market for their services. The additional capacity at the Procurement Assistant level will also assist in ensuring that the provider fitness checks arrangements put in place are sustainable (a recommendation arising from the Following the Public Pound 2018/19 audit). In this respect provider fitness checks have been issued to all parties and the majority returned satisfactorily. Work is now ongoing to chase up the 20 providers who have not yet returned the checks.

In addition the national procurement body, Scotland Excel, were engaged to provide specific support and expertise on the market offering and procurement of a replacement Customer Services Platform. This culminated in securing Council approval for the Online Payments and Services Platform (OPAS) earlier in the year.

Prior to the pandemic discussions had taken place with neighbouring Councils to explore opportunities for a shared approach to procurement. These considered a range of options from collaboration and joint working on specific procurements/areas of mutual interest to a fully aligned shared or hosted service. In the event the neighbouring Councils were unable to commit to taking these discussions beyond the initial exploratory stage.

Following the discussions with neighbouring Councils we continue to engage with Scotland Excel to explore opportunities to secure expert support from them through the consultancy service they offer to member Councils. This service is recognised to have delivered a range of successful projects thought the country and Scotland Excel currently have a wide range of projects underway across Councils, associate members, arms-length organisations and other public bodies. Most



notably this includes a successful programme in Fife Council where the approach is expected to deliver significant savings.

Whilst progress on the engagement with Scotland Excel has been hampered by the pandemic we are now seeking to conclude an arrangement aimed at securing the capacity and skills to take forward a range of key actions and also learning from the approach they have developed with Fife Council. The priority areas for this include:-

- To provide a route map to fully develop contract and supplier monitoring across all Council services to ensure that the Council can consistently demonstrate delivery of value for money.
- To undertake a strategic evaluation of the current arrangements, including capacity and skills, for Procurement and provide advice on the requirements needed to meet the Council's expectation in an effective and efficient manner going forward.
- Review the latest Scotland Excel PCIP assessment and re-evaluate the actions identified and develop a plan to secure improvement in preparation for the next PCIP assessment.
- Develop a Quality Assurance arrangement to ensure the necessary improvement actions are being implemented and to continuously improve this service area.

The 2019 /20 Audit of Procurement and Management of Contracts carried out by internal Audit identified contracts that had expired and recommended that these should be urgently retendered to ensure that the Council is obtaining Best Value. Furthermore the Audit Committee on 10 March 2020 sought details in respect of expired contracts. The Procurement Team had identified from the Contracts Register 50 contracts which had expired and sought instructions from the service leads.

It should be noted that it was never expected that all of these would go through full re-tendering process. This recognises that there are other routes to secure the services/commodities which may be better placed to secure best value. It also takes into account that re-tendering a contract is not a short process and it is not simply a matter of re-issuing previous tender documents. Instead the process must replicate a new procurement. Firstly, there is the need to identify continuing business needs and budget with the service department and to agree instructions. Thereafter, the Procurement Delivery Plan/Commodity Strategy must be agreed with the service leads, to identify suitable routes to market (including, where there is an appropriate business case proceeding by Non Competitive Action), to identify priority contracts and agree timetables. It is only once these have been agreed and committed to, can the contract then be exposed to the market.

Compliant arrangements have now been put in place for 35 of the contracts which had expired. This includes migrating the provision of services/commodities to national framework arrangements, through Scotland Excel, Scottish Government or other organisations who have already secured arrangements through extensive procurement exercises. This route avoids taking an offering to the market for goods

and or services where public sector contracts are already in place and in most cases readily accessible to the Council.

3 are services/ commodities that are no longer required with the remaining 12 have been identified as requiring retendering and or development of a procurement delivery plan/commodity strategy and in this regard the Procurement team are supporting service leads to progress these and have ensured that interim arrangements are appropriate.

### **AGS 11. Financial Regulations.**

At the onset of the pandemic it was recognised that the swift shift to remote working, coupled with an increasing range of expenditure pressures in services would require changes which not only needed to be implemented swiftly but which also required to comply with the Council's financial regulations framework and give assurance that the internal control framework was being maintained.

Accordingly an overview of the Financial Governance arrangements that would be of most relevance during the pandemic was provided to Corporate Incident Management Team (CMT) in April 2020 and subsequently presented to the Group Leaders meeting. These arrangements were designed to; Support the maintenance of strong and effective financial control; Provide effective financial oversight; Allow for both efficiency and completeness in determining the financial impact on the Council; Supporting the development of effective mitigation to maintain financial sustainability; Supporting reporting and or lobbying for additional funding from Scottish Government; and aid the recovery phase.

In this regard attached as Appendix B is a copy of the report taken to CMT on 4 October 2020 which provided an up-to-date overview of the enhancements which were made to the Council's financial assurance and internal control arrangements from March 2020 together with an overview of further work which is being undertaken to further enhance these arrangements.

As referenced earlier in the extract from the EY annual report for 2019/20 it is acknowledged that the Council's Financial Regulations would benefit from an update. As an interim measure these have been updated to reflect changes in the Council's Leadership structure and the wider changes as indicated by EY will be undertaken over the remainder of financial year 2020/21.

### **AGS 13. Alignment of meeting dates.**

As touched on above the schedule of meeting dates now fully supports the quarterly financial monitoring reports being presented to a dedicated Financial Monitoring meeting of CMT. The added challenges brought about by the pandemic earlier in the financial year were such only working drafts of the Q1 financial monitoring appendices were provided to the CMT meeting. However the arrangements for Q2 ensured the full draft of the reports and associated appendices were provided in advance of the CMT meeting.

As evidenced by the Treasury Management midyear report elsewhere on today Audit Committee agenda, the three Treasury Management reports provided through the year are now presented to Audit Committee prior to consideration by Council. In addition the informal Audit Committee sessions have provided an opportunity for Audit Committee members to be briefed during the year on key financial aspects of governance including the unaudited financial statements and the proposed Treasury Management and Investment Strategy.

## **5. Wider Financial Governance Update**

As noted in the Quarter 2 performance report (which will be reported to Cabinet on 1 December and then to Performance Review and Scrutiny Committee on 9 December) 29 of 39 internal/external audit actions in respect of Corporate Solutions are on target (20) or complete (9).

In respect of the remaining actions which are off target over the first half of the financial year much of the available resource to progress these was diverted to responding to COVID 19. As such a number of audit actions which had been progressing well and were nearing completion were delayed. In respect of those that are indicated to be off target:

- One, in relation to where staff fail to engage with the staff debt process, is scheduled to be finalised during November 2020.
- Two, which relate to the issue of feeders systems, have been progressed with a recommendation that they are now replaced with specific actions in respect of the main risk areas relating to Building Maintenance, Roads Maintenance and Waste Disposal.
- Three are in respect of Procurement. These have been delayed as a consequence of the pandemic and the prioritisation of joint working on digital service delivery. These are now being prioritised with support provided by Scotland Excel as outlined above.
- Four continue to be delayed by Covid pressures and extensions have been requested to the end of the calendar year. These include an action in respect of the service workforce plan (which is referenced earlier in this report). Three are in respect of systems documentation and processes which in any event have been adapted as we have responded to the pandemic.

The Corporate Solutions Leadership team is focused on ensuring that the 20 internal/external audit actions that are noted as being on target for completion are progressed to completion within the scheduled target dates.

## **6 Report Implications (Resource, Digital and Risk)**

### **6.1 Resource**

There are no direct resource implications arising from this report. The continued areas of improvements will be met from existing resources.

### **6.2 Digital**

There are no direct digital implications arising from this report.

### **6.3 Risk**

There are no specific risk arising from this report. The progress outlined in the report strengthens the Council's governance arrangements and in turn supports effective mitigation of risk.

### **6.4 Ensuring Equalities (if required a separate IIA must be completed)**

There have been no changes to policies which require an IIA to be completed.

### **6.5 Additional Report Implications (See Appendix A)**

See Appendix A

## **Appendices**

Appendix A – Report Implications

Appendix B – CIMT Report, Update on Financial Assurance and Internal Control arrangements during Covid-19 Pandemic

## APPENDIX A – Report Implications

### A.1 Key Priorities within the Single Midlothian Plan

Maintaining financial governance and effective internal controls is central to demonstrating strong financial management and financial sustainability and it is on these foundations that delivery of the priorities in the Single Midlothian Plan is based.

### A.2 Key Drivers for Change

Key drivers addressed in this report:

- ☐ Holistic Working
- ☐ Hub and Spoke
- ☒ Modern
- ☒ Sustainable
- ☒ Transformational
- ☐ Preventative
- ☐ Asset-based
- ☒ Continuous Improvement
- ☐ One size fits one
- ☐ None of the above

### A.3 Key Delivery Streams

Key delivery streams addressed in this report:

- ☒ One Council Working with you, for you
- ☐ Preventative and Sustainable
- ☒ Efficient and Modern
- ☒ Innovative and Ambitious
- ☐ None of the above

### A.4 Delivering Best Value

Effective Financial Governance is a core principal of Best Value.

### A.5 Involving Communities and Other Stakeholders

There has been no external engagement in preparing this report.

### A.6 Impact on Performance and Outcomes

In the main the arrangements set out in the report do not have a direct impact on performance or outcomes.

### A.7 Adopting a Preventative Approach

Maintaining an effective Financial Governance and internal control arrangements is central to the prevention of error and or the risk of fraud.

### A.8 Supporting Sustainable Development

No direct impact.



## **Update on Financial Assurance and Internal Control arrangements during Covid-19 Pandemic**

**Report by Gary Fairley Chief Officer Corporate Solutions**

**Report for Noting**

### **1 Recommendations**

To note this update on the Financial Assurance and Internal Control arrangements which remain in place during Covid-19 Pandemic together with those areas where further improvement work being undertaken.

### **2 Purpose of Report/Executive Summary**

To provide CMT with an overview of the enhancements to the Council's Financial Assurance and internal control arrangements which have been applied during the period since March 2020 together with an overview of further work which is being undertaken to further enhance arrangements.

**08 October 2020**

**Report Contact:**

Gary Fairley

[gary.fairley@midlothian.gov.uk](mailto:gary.fairley@midlothian.gov.uk)

### 3 Background

Section 95 of the Local Government (Scotland) Act 1973, requires all Local Authorities in Scotland to have adequate systems and controls in place to ensure the “proper administration of their financial affairs”.

Central to these arrangements are the Council’s Financial Regulations which detail the responsibilities of Elected Members, the Chief Executive and Chief Officials within the context of the Council’s political management framework.

As the ‘proper officer’ for the proper administration of the Council’s financial affairs, the Chief Officer Corporate Solutions oversees the operation of the Financial Regulations within the Council and provides to the Chief Executive, and Responsible Officers a written framework which governs the Council’s financial affairs. This framework consists of the Financial Regulations themselves supported by:

**Financial Directives:** The directives cover all relevant aspects of financial administration with delegated authority to the Chief Officer Corporate Solutions to alter the Financial Directives except for any matters which are covered by the Financial Regulations where Council approval will be required. Changes to the Financial Directives are required to be reported to Audit Committee for their endorsement.

**Financial Guidance Notes:** These guidance notes provide employees with detailed guidance and advice on specific procedures to be followed and any such guidance notes issued will require the prior approval of the Chief Officer Corporate Solutions.

In addition to this regulatory framework all of the business processes operated by the Council have a range of internal controls inbuilt. These are the mechanisms, rules, and procedures which have been implemented to ensure the integrity of financial and accounting information, promote accountability, and prevent fraud or error. These internal controls encompass such aspects as separation of duties, access controls to systems and data, physical audits, standardised documentation, trial balances, periodic reconciliations, and approval authorities.

The annual internal audit plan also provides further assurance with the core financial business processes and systems being subject to regular audit.

At the onset of the pandemic it was recognised that the swift shift to remote working, coupled with an increasing range of expenditure pressures in services would require changes which not only needed to be implemented swiftly but which also required to comply with the Council financial regulations framework and give assurance that the internal control framework was being maintained.

## 4 Financial Governance

An overview of the Financial Governance arrangements that would be of most relevance during the COVID19 pandemic was provided to Corporate Incident Management Team (CIMT) in April 2020 and subsequently presented to the Group Leaders meeting. The aim of the report (see Appendix B) was to provide the CIMT and other colleagues understanding of the arrangements and so:-

- a) Support the maintenance of strong and effective financial control;
- b) Provide effective financial oversight;
- c) Allow for both efficiency and completeness in determining the financial impact on the Council;
- d) Supporting the development of effective mitigation to maintain financial sustainability;
- e) Supporting reporting and or lobbying for additional funding from Scottish Government; and
- f) Aiding the recovery phase.

The report identified six broad streams of financial impact on the Council which would have differing governance arrangements.

## 5. Internal Controls

This section provides CMT with visibility of the changes to internal controls and provides an overview of where existing control remained applicable and effective with the shift to remote working or where new services were implemented at pace. It provides assurance that the governance and internal control regime around these areas remained fit for purpose.

It covers arrangements for

- Procurement
- Purchase to Pay
- COVID Grant Schemes and external payments
- Payroll and Recruitment
- Income collection and Receipts
- Financial transactions including treasury

### **Procurement**

The Procurement regime relied heavily on wet signatures and paper records prior to the pandemic. Given the importance of procurement in fraud prevention and delivering best value, the required procedures in terms of the Procurement Manual were maintained albeit using electronic signatures and e-mail communications for authorisation.

Contract award and variation letters were issued electronically. Formal documents, if required, were signed in part and using e-signatures as per Law Society guidance.



The Procurement team has worked closely with suppliers, Scotland Excel and other public sector colleagues to protect the supply chain. In addition, use was made of the provisions in Regulation 72 of the Public Contracts (Scotland) Regulations 2015 and the Council's Non Competitive Action procedure to modify and extend existing contracts, where appropriate, to avoid disrupting the supply of goods and services. As an example the Occupational Health Service provided by PAM has extended using the Non Competitive Action mechanism recognising that it would have been, at best, untimely to seek to tender and change the service provided in the midst of the pandemic.

### **Purchase to Pay**

The Integra system and associated invoice approval workflows provides a digital route from the ordering of goods and services through to payment of suppliers. Internal control are inbuilt into the systems and associated workflows. As such there is a continued reduction on the reliance for "wet signatures" as a means to evidencing authorisation of orders or payments.

Accordingly the onset of the pandemic meant that nothing significant needed to be changed to maintain the internal control environment. The use of the invoice approval process was however rolled out at pace to additional service areas in March/April as follows:

- Street Lighting
- Energy/Property Management
- Transportation
- Construction & Projects

Invoice approval was also rolled to a specific supplier (Richard Irvin) within Property Services. This facilitated the digital receipt and capture and storage of CP12 (Gas Safety) certificates.

The Performance Indicator for invoice payments for Q1 2020/21 was on target at 95%. This compares to 92.2% for Q1 2019/20 and 88.9% for Q2 2019/20. Of note the total number of invoices and payments has gone up by 11.6% and the average number of days to pay has gone down from 11.3 to 8.8.

The Business Apps team will continue to monitor invoice payment performance on quarter by quarter basis for the rest of the year and continue to progress further improvements and complete the roll out of P2P.

### **Business Grant Payments, Self Employed and B&B Grants**

The main Business Grant scheme which resulted 1,194 awards and payments totalling £13.750 million was administered on the Council's behalf by the City of Edinburgh Council. Edinburgh administer Non Domestic Rates billing and collection on our behalf and the close alignment of this grant scheme to non-domestic rates records meant there was a necessity to have Edinburgh administer the scheme. Edinburgh Council applied their own internal control and financial governance arrangements for the scheme.

In respect of Self Employed and B&B Grants this was of a smaller scale with total payments totalling £161,000 with the schemes administered directly by the Council. A small project team was convened to take this forward with representation from Business Gateway Team, Business Services and Internal Audit.

As there is no dedicated customer platform that would allow customers to submit a digital application, the best approach was to provide a mailbox for applicants to submit the application form and associated supporting evidence. This was fed into an Integra E-form which provided the following stages:

- Input – Business Services
- Scrutiny – Internal Audit/Business Gateway
- Authorisation – Economic Development Manager/Senior Economic Development Officer
- Integra Registration – Business Apps

There is a full audit trail captured in Integra for each e-form at every stage.

A sundry supplier specifically for Self Employed Grants was used and the e-forms used to export a file into Purchase Ledger. Each E-form has its own unique reference number and this was used as the unique ref required for Integra in the Purchase Ledger. The Integra Reg Ref was referenced on the e-form as a final stage once the payment was generated. Payments Team and Treasury team were emailed with number of transactions and total values for each import file processed in Integra. Weekly reporting of stats were submitted to Scottish Government.

### **Free School Meals**

The challenge around Free School Meal (FSM) payments were the volume of recipients for payments and not having a dedicated system to generate a BACS file for these. Bank details for parents/carers were held securely in SEEMiS for School Clothing Grants but there was no functionality available to generate a BACS file in respect of FSM.

Following testing, it was established that Integra was the only application capable of generating a BACS file for the volume of transactions required. Given that the number of payment recipients would be in the thousands, creating suppliers for each payee would have been logistically unworkable and too time consuming given the need to make payments quickly.

The Business Apps team created a specific sundry supplier in Integra to process payments for FSM. With strict control between The Business Applications Manager and Lead Applications Officer for SEEMiS export files with bank details were exported from SEEMiS and imported into Integra using Quick Import functionality.

Each transaction was giving a unique reference (Integra requirement) and a narrative outlining the payment period. The export files from SEEMiS have been updated with the same unique reference and stored in CS16 to provide an audit trail. Each individual Integra import

file was sequentially numbered and also updated on the SEEMiS file stored in CS16. Bank details were authorised in bulk in Integra by Business Applications Manager.

Following the import of a file, the Payments and Treasury teams were emailed the number of transactions and total value to be processed in the payment run. This provided additional transparency and a further check.

### **Payroll and Recruitment**

There have been no changes in the process for payroll checking and reconciliation. The use of Finance e-forms for the request and authorisation of BACS and Bankline payments has been implemented.

E-forms and workflows were already in place for contractual change notifications so no changes were required for these. E-forms and workflows have been implemented for the submission of sickness absence notification and COVID related special leave to remove the requirement for paper based processes. The process for the submission and processing of timesheets has not been changed and this continues to be primarily office based.

In respect of recruitment where interviews were carried out virtually and it was not possible for the physical verification of documents the recruiting manager verification was based on sight of the person at interview and notified to Employment and Reward by email. Physical verification of documents was carried out retrospectively when the candidate commenced employment. This was primarily for schools recruitment.

Disclosure Scotland brought forward the implementation for online PVG requests and this has been introduced though as highlighted at CIMT on 8 October 2020 there are concerns over the performance of Disclosure Scotland at this time.

### **Income Collection and Receipts**

Again there was no requirement to make changes to the income collection processes/procedures. The method of payment available to customers was by necessity restricted reflecting the closure of public facing services. However a range of payment options remained available and payments could be made online or via the automated telephone payment service as the cash office was closed and those working from home were unable to take payments. Staff working in the office were able to continue take payments by telephone.

More recently and following a risk assessment review arrangements have been implemented to allow the contact centre advisors to take payments whilst working at home. As part of this further risk mitigation measures were required to maintain compliance with the requirements of the Payment Card Industry Data Security Standard (PCI DSS).

### **Financial Transactions including Treasury**

Strictly applied internal controls including segregation of duties are in place for financial transactions, particularly Treasury transactions.

The onset of the pandemic saw planned work to adopt e-forms to digitise the authorisation workflows completed. This supports the maintenance of the existing control arrangements and removes reliance on “wet signatures” and paper records. The changes also provide a record in integra of the authorisations for each transaction.

Payments made from the Council’s bank accounts with the Royal Bank of Scotland are either via bankline (business online banking) or the BACS system. Authorisation of bankline transactions have been carried out on the online for some time and the staff who have permissions to authorise payments utilise the security procedures which are part of the bankline system. E-forms have also been adopted to provide a digital record of the authorisations.

The software used to processes BACS files for payment was held securely on a separate PC and so could only be operated from the office. Arrangements have been progressed over the last six months to shift this to allow this to be performed remotely. Progress was reliant on securing the services of the software provider which, given the number of client making the same transition, took time and also required extensive work by Digital Services colleges to maintain network and firewall security aspects.

E- Forms the workflow functionality within the integra financial application has enabled a swift transition away from a paper based systems and controls to digital workflows with controls imbedded in these.

## **6 Areas for further improvement**

There are three main areas of further improvement which are underway.

Firstly a refresh of the Financial Directives was underway prior to the Pandemic. The first stage of this review, to reflect the most up-to-date leadership structure and other more material changes is now reaching completion. As required when approved by the Chief Officer Corporate Solutions these changes will be presented to the next available Audit Committee for their endorsement.

Secondly while records used by procurement can currently be managed electronically the arrangements would benefit from the adoption of the e-form and workflow arrangements put in place elsewhere. This would improve efficiency build in controls and provide better audit trail. Work had started to document workflows to start this process. This work has been delayed due to a change in staff but will re-commence as soon as possible when resources allow.

Prior to the Pandemic a range of improvements were being progressed under the direction of the Financial Transactions Project Board. The work overseen by this board includes data cleansing of financial and other records, improvements to the control of the staffing establishment

in the ITrent system. Roll out of tableau Dashboards, sales to cash, workflows for write off processes and further adoption of e-forms.

Whilst the focus has been on the delivery of changes and maintaining internal controls there is retrospective work required to refresh some of the operational guidance and business continuity plans.

## **7 Report Implications (Resource, Digital and Risk)**

### **7.1 Resource**

There are no direct resource implications arising from this report. The further improvements will be met from existing resources.

### **7.2 Digital**

The implementation of the OPAS project and delivery of the Firmstep solution will provide further enhancements, particularly in respect of the mitigation of risk associated with maintaining Payment Card Industry Standards.

### **7.3 Risk**

There are no specific risk arising from this report. The governance and internal control arrangements outlined in the report set out how internal controls have been maintained or enhanced since the onset of the pandemic to provide for the effective mitigation of risk.

### **7.4 Ensuring Equalities (if required a separate IIA must be completed)**

There have been no changes to policies which require an IIA to be completed.

### **7.5 Additional Report Implications (See Appendix A)**

See Appendix A

## **Appendices**

Appendix A – Report Implications

Appendix B – CIMT Report, Overview of Financial Governance Arrangements related to COVID19

## APPENDIX A – Report Implications

### A.1 Key Priorities within the Single Midlothian Plan

Maintaining financial governance and effective internal controls is central to demonstrating strong financial management and financial sustainability and it is on these foundations that delivery of the priorities in the Single Midlothian Plan is based.

### A.2 Key Drivers for Change

Key drivers addressed in this report:

- ☐ Holistic Working
- ☐ Hub and Spoke
- ☒ Modern
- ☒ Sustainable
- ☒ Transformational
- ☐ Preventative
- ☐ Asset-based
- ☒ Continuous Improvement
- ☐ One size fits one
- ☐ None of the above

### A.3 Key Delivery Streams

Key delivery streams addressed in this report:

- ☒ One Council Working with you, for you
- ☐ Preventative and Sustainable
- ☒ Efficient and Modern
- ☒ Innovative and Ambitious
- ☐ None of the above

### A.4 Delivering Best Value

Effective Financial Governance is a core principal of Best Value.

### A.5 Involving Communities and Other Stakeholders

Engagement with communities or other stakeholders has mainly been limited to the outward facing changes, for example the grant schemes, though these have been regulated by Government.

### A.6 Impact on Performance and Outcomes

In the main the arrangements set out in the report do not have a direct impact on performance or outcomes though as noted we have experienced an improvement in the PI for payment of invoices.

### A.7 Adopting a Preventative Approach

Maintaining an effective Financial Governance and internal control arrangements is central to the prevention of error and or the risk of fraud.

### A.8 Supporting Sustainable Development

No direct impact



## Overview of Financial Governance Arrangements related to COVID19

### Briefing Note by Gary Fairley, Chief Officer Corporate Solutions

#### 1. Introduction

This document is designed to provide a brief summary of the Financial Governance arrangements that are of most relevance during the COVID19 pandemic. The aim of what follows is to provide the Corporate Incident Management Team (CIMT) and other colleagues understanding of these and so:-

- g) Support the maintenance of strong and effective financial control;
- h) Provide effective financial oversight;
- i) Allow for both efficiency and completeness in determining the financial impact on the Council;
- j) Supporting the development of effective mitigation to maintain financial sustainability;
- k) Supporting reporting and or lobbying for additional funding from Scottish Government; and
- l) Aiding the recovery phase.

There are six broad streams of financial impact on the Council and these have differing governance arrangements which need to apply. There will undoubtedly be areas of cross over and so where in any doubt as to which stream is most applicable please contact the Financial Services team to discuss.

#### 2. The six identified streams are as follows.

##### 2.1 Policy Changes/Standing Order 19.2

Where specific policy decisions are taken which incur spend, impact on income or otherwise have financial implications. These would be changes which would normally be captured in reports to Cabinet/Council and for elected members to determine. Accordingly, in the absence of these decision making forums the governance route is that of Standing Order 19.2.

*“The Chief Executive, after discussion with the Leader of the Council, whom failing the Deputy Leader of the Council, will have authority to take decisions where urgent or immediate action is required. Where such decision(s) is required, the Chief Executive will provide a report to the next available full Council meeting to inform the Council of such decision(s).”*

To progress decisions via Standing Order 19.2 (and this covers both financial and non-financial matters) a report, in the normal committee



format, requires to be completed and provided to Democratic Services. The normal approval/checks apply to ensure equalities, Financial, Legal, HR etc. aspects are addressed) and the reports should be “signed off” by Executive Directors or Chief Officers before submission to Democratic Services.

These reports will be passed via Gary Fairley, Chief Officer Corporate Solutions and Alan Turpie, Legal Services Manager, to Dr Grace Vickers, Chief Executive. The Chief Executive will, if minded to approve, discuss these at a weekly meeting with the Leader or Depute Leader of the Council. A record of the decision including any amendments will be shared with the report author.

A Standing Order 19.2 log has been created to record all decisions taken including the financial implications. This log is held centrally and open to key officers who have been advised of the shared folder. This log will be used to prepare a report to Council in due course and also maintains an overview of the financial and service implications.

## **2.2 Services Delegated to Midlothian Integration Joint Board**

This stream encompasses decisions which would normally be taken by the Midlothian Integration Joint Board or which relate to service areas which are delegated to the Integrated Joint Board.

Claire Flannigan, the Chief Financial Officer for the IJB has in place arrangements to capture costs incurred by the IJB in respect of its Mobilisation Plan and or as a consequence of COVID19. The IJB is also required to submit a weekly financial return to Scottish Government.

Accordingly, all financial matters related to IJB services will be captured by Claire and follow the IJB governance arrangements. The Council’s Financial Services team are supporting Claire with this and with the weekly reporting regime.

Along with NHS Lothian, the Council will maintain an overview of the financial impact on the IJB and recognises that, as provided for in the Integration Scheme, the Council may be called on to provide additional financial support to the IJB. Decisions on funding support for the IJB would be for full Council or a matter which would need to be progressed via the Standing Order 19.2 route detailed above.

## **2.3 Impact on Approved 2020/21 Savings Measures**

It is anticipated that the current situation will have an adverse impact on delivery of the approved savings measures within the Medium Term Financial Strategy. This might result in deferred implementation of some measures which could result in an inability to fully achieve savings targets. While the due diligence work carried out at the start of the year “rooted out” a number of weak savings proposals the ongoing situation means that work to deliver a range of the savings may have had to be suspended or slowed down as resources are diverted



elsewhere. Total savings measures for 2020/21 totalled circa £4.4 million with a risk adjustment of £400,000.

Clearly, any material underachievement of these savings will adversely affect the Council's financial stability and so as a matter of urgency the Financial Services team will, in conjunction with CIMT and service managers, reassess all measures and provide the most up-to-date position. As part of this work, the Financial Services team will also explore options to mitigate the immediate impact.

The findings of the initial assessment will be shared with the Corporate Incident Management Team together with any recommendations arising. A routine of regular updates will be established.

This will also be reflected in the overall cost impact reporting touched on later.

## **2.4 Emergency Spending Not Covered by the Existing Service Budget**

This strand encompasses situations where a conscious decision is made to incur expenditure or waive or reduce income, which is not provided for in the service's revised budget.

In normal circumstances where an Executive Director or Chief Officer/Head of Service wishes to incur expenditure or reduce income not originally included in approved revenue budget this would require a supplementary estimate to be approved by Council.

The Council's Financial Directives make provision for emergency situations which are set out in Financial Directives in sections 5.7 to 5.9:-

- 5.7 *Where no financial provision exists in either the Capital or Revenue Budgets, these Financial Directives do not prevent Directors and Heads of Service from incurring expenditure essential to meet immediate needs arising from a statutory requirement, or which relate to Section 84 of the Local Government (Scotland) Act 1973. This is dependent on the expenditure being approved by Cabinet.*
- 5.8 *Where it is not feasible for expenditure to be deferred pending Cabinet approval, Directors and Heads of Service may incur expenditure subject to the estimated cost not exceeding £50,000. Where such expenditure exceeds £50,000 the prior agreement of the Chief Executive is required.*
- 5.9 *Where approval in advance has not been obtained for such expenditure, a report must be submitted to the next meeting of the Cabinet after the expenditure has been incurred.*

Since the CIMT was activated services will have incurred a range of costs as they have implemented Business Continuity Plans and or Mobilisations Plans in response to the needs of our communities and partners. Examples of expenditure over the last few weeks will include setting up School hubs, increasing Early Years partner provider

payments, cleaning materials, PPE, additional digital equipment (capital), overtime etc.

The Financial Services team will work with you and your service managers to identify and cost emergency spending decisions taken to date and also help develop a proportionate means of capturing these costs going forward. A number of officers within each service have delegated authority to incur expenditure and you should take the opportunity to consider if all of these staff should have the authority to incur emergency expenditure, or whether you wish to restrict this to a smaller group of officers within your service. Again, the Financial Services team can work with you to facilitate this.

Once an overview is available and reported to CIMT a decision can be made on any additions to be made to service budgets to fund these costs.

In terms of financial regulation 5.9 I would anticipate that this can be facilitated through reporting in the quarterly financial overview reports at a summary level.

Again, capturing these costs will also be reflected in the overall cost impact reporting touched on later.

## **2.5 Ring Fenced or Specific Government Funding Support**

Where Scottish Government provide ring fenced funding or specific funding for programmes, this will automatically be added to the relevant service budget. To date this includes the Business Grant Scheme and increase in the Scottish Welfare Fund.

## **2.6 Other Financial Impacts**

Other impacts will include the loss of service income or variations in expenditure from that estimated in the budget. While some of this may be captured as policy decisions (for example facility closure, Tone Zone charging and Garden Waste suspension), there is no doubt that a number of others service variations where there will be an impact on the net cost of the service whether positive or negative. There will also be an impact on Council Tax and Rent collection rates and an assessment will need to be made whether to reduce collection assumption and or increase other bad debt provisions as the year progresses.

In terms of financial governance, these are deemed as performance against revised budget issues and so will be assessed and reported through the existing budget monitoring arrangements. There is clearly urgent work to do to assess for each service the most significant of these and to report to CIMT as soon as possible. The Financial Services Team will work with services managers to assess the position and collate so that an overview can be provided to CIMT. The team will endeavour to separate out COVID19 related variations from those that are for other reasons.

### **3.0 Impact on Medium Term Financial Strategy**

In addition to capturing the financial impact of the Pandemic, the Financial Services team will implement any decisions by CIMT to allocate additional resources to service budgets. They are also already exploring measures to help mitigate the adverse financial impact on the Council's Finances.

### **4.0 Financial Reporting and Lobbying for Additional Funding from Government**

COSLA are coordinating the capture of costs across Local Government to support discussions with Scottish Government aimed at securing further funding support. To facilitate this a template is expected to be issued on 6 April 2020 with the first submission required on or about 24 April 2020 and thereafter an update provide every two weeks. It is recognised that the first submission date will be challenging but it is necessary to set out Local Governments position to Scottish Government as soon as possible.

The capture of this information will sit alongside the need for internal reporting and the Financial Services team will lead on the capture and submission of information to COSLA.

06 April 2020

Report contact

Name: Gary Fairley

Telephone: 0131 271 3110

[Gary.fairley@midlothian.gov.uk](mailto:Gary.fairley@midlothian.gov.uk)



## **Treasury Management Mid-Year Review Report 2020/21**

**Report by Gary Fairley, Chief Officer Corporate Solutions**

**Report for Consideration**

### **1 Recommendations**

The Audit Committee is invited to comment on this report before the final report is presented to Council. In particular, Audit Committee should note the following recommendations which are proposed to be put to Council on 15 December 2020:-

- a) Note the report and the treasury activity undertaken in the period to 30 September 2020, as outlined in Section 5;
- b) Note the forecast activity during the second-half of the year as outlined in Section 6;
- c) Approve the Prudential Indicators in Section 7 of this report.

### **2 Purpose of Report/Executive Summary**

The purpose of this report is to inform members of the Audit Committee, and subsequently Council, of the Treasury Management activity undertaken during the first half of 2020/21, the forecast activity for the second half of 2020/21 and an update to the Treasury and Prudential Indicators for 2020/21.

**Date: 23 November 2020**

**Report Contact:**

**Gary Thomson, Senior Accountant**

**[gary.thomson@midlothian.gov.uk](mailto:gary.thomson@midlothian.gov.uk)**

**0131-271-3230**

### 3 Background

#### Audit Committee Role

The Prudential Code recommends that the main Treasury Management reports are presented for scrutiny by Audit Committee in advance of consideration by Council. This report is being presented to Audit Committee on 8 December 2020 for consideration prior to being presented to Council on 15 December 2020. Any revisions arising from Audit Committee consideration of the report on 8 December 2020 will be incorporated into the final version of the report to Council on 15 December 2020.

#### Treasury management

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

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

Accordingly, treasury management is defined as:

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

Council, on 11 February 2020, approved the Treasury Management and Annual Investment Strategy Statement for the financial year 2020/21.

### 4 Economic update for first half of 2020/21

An economic update for the first part of the 2020/21 financial year is included as Appendix 1. PWLB borrowing rates for the first half of the year are outlined in Appendix 2.

## 5 Treasury Activity during first half of 2020/21

The main points arising from treasury activity in the year to 30 September 2020 were:-

- Taking advantage of the historically low PWLB rates and the HRA discounted rate in the first half of the year, a new £15.000 million long term loan was sourced from PWLB on 28 April 2020 with a 46.5 year tenor at a fixed interest rate of 1.17%;
- Long term borrowing of £0.552 million matured, this being £0.319 million of Market Loans, £0.183 million of Salix loans and £0.020 million PWLB Annuities;
- Three short term investments beyond a duration of 1 year were placed:-
  - £13.000 million fixed term deposit for 2.5 years, placed with London Borough of Croydon on 3 April 2020, earning an interest rate return of 1.85% per annum;
  - £2.000 million fixed term deposit for 3 years, placed with Stoke on Trent City Council on 6 April 2020, earning an interest rate return of 1.60% per annum;
  - £15.000 million fixed term deposit for 2 years, placed with London Borough of Waltham Forest on 30 April 2020, earning an interest rate return of 1.25% per annum;
- One short-term investment of £30.000 million with Bank of Scotland matured on 26 June 2020. This short-term investment was originally placed on 26 June 2019 for a period of 1 year at a fixed interest rate of 1.25%;
- The Scottish Government provided upfront funding to local authorities to support a range of grant schemes, in particular schemes to support local businesses. This, in addition to advanced Revenue Support Grant payments and Early Years Capital Grant payments in the spring/summer, has resulted in a large increase in investment balances and the level of temporary borrowing reduced to nil;
- The average interest rate earned on external investments was 1.05%, exceeding the benchmark rate of 0.41%.

The Council's loan and investment portfolio as at 30 September 2020 is shown in tables 1 and 2 below (position at 31 March 2020 also shown for comparison):-

Table 1: Council's Loan Portfolio at 31 March 2020 and 30 September 2020.

Loan Type	31 March 2020		30 September 2020	
	Principal Outstanding £000's	Weighted Average Rate	Principal Outstanding £000's	Weighted Average Rate %
PWLB Annuity	637	8.90%	617	8.90%
PWLB Maturity	228,824	3.41%	243,824	3.27%
LOBO	20,000	4.51%	20,000	4.51%
Market Loans	18,831	2.68%	18,512	2.68%
Temporary Market Loans	0	n/a	0	n/a
Other Loans	785	0.00%	601	0.00%
<b>Total Loans</b>	<b>269,077</b>	<b>3.44%</b>	<b>283,555</b>	<b>3.33%</b>
<b>Underlying Borrowing Requirement*</b>	<b>284,454</b>		<b>288,299</b>	
<b>Internal Borrowing</b>	<b>15,377</b>		<b>4,744</b>	

\* The Underlying Borrowing Requirement is the Capital Financing Requirement excluding the "Public Private Finance" (PPP) Contract Liabilities

Table 2: Council's Investment Portfolio at 31 March 2020 and 30 September 2020

Investment Type	31 March 2020		30 September 2020	
	Principal Outstanding £000's	Weighted Average Rate	Principal Outstanding £000's	Weighted Average Rate %
Money Market Funds	14,902	0.31%	44,712	0.05%
Bank Call Accounts	11,476	0.30%	14,588	0.01%
Bank Notice Accounts	14,985	1.10%	14,985	0.70%
Bank Fixed Term Deposits	30,000	1.25%	0	n/a
Deposits with other Local Authorities	40,000	1.56%	70,000	1.55%
<b>Total Investments</b>	<b>111,363</b>	<b>1.12%</b>	<b>144,285</b>	<b>0.84%</b>

Debt rescheduling opportunities have been very limited in the current economic climate given the consequent structure of interest rates, and following the increase in the margin added to gilt yields that has influenced PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year.



## 6 Expected Treasury Activity during second half of 2020/21

### Borrowing

Long term borrowing of £8.843 million will mature in the second half of 2020/21, this being a £8.400 million maturity loan with PWLB, £0.321 million of Market Loans, £0.101 million of Salix loans and £0.021 million PWLB Annuities.

The £8.400 million maturity loan with PWLB which matures on 14 December 2020 has already been refinanced with new longer term PWLB borrowing.

It is expected that no further long-term borrowing will be sourced in the second half of 2020/21, and that if any borrowing is required, it will be sourced by temporary borrowing, taking advantage of the rates in this market sitting at less than the 0.10% Bank of England Base Rate.

However, given the current forecasts of capital expenditure and any revisions to these forecasts for 2020/21 and beyond as previously reported to Council, consideration will be given to borrowing now (for capital expenditure beyond 2020/21) if it is determined that this would offer value compared with forward interest rate projections. Equally, consideration will continue to be given as to whether any forward borrowing opportunities offer value (this would allow the Council to secure loans now at an agreed rate, to be drawn down at later dates when interest rates are forecast to be significantly higher, eliminating the majority of the cost of carry).

Appendix 3 provides forecasts for interest rates from the Council's Treasury Management advisor, Link Asset Services. The forward forecast rates, are in line with the Council's forward budgeted borrowing projections that have been incorporated into previous Medium Term Financial Strategy reports, which mitigates any pressure on the medium term financial strategy from increased loan charges.

### Investments

In accordance with the Code, it is the Council's priority to ensure security of capital, then liquidity, and finally to obtain an appropriate level of return which is consistent with the Council's risk appetite.

As shown by the interest rate forecasts in Appendix 3, it is now impossible to earn the level of interest rates commonly seen in previous decades as most investment rates are barely above zero now that Bank Rate is at 0.10%,. Furthermore, some entities, including more recently the Debt Management Account Deposit Facility (DMADF), are offering negative rates of return in some shorter time periods. Given this risk environment and the fact that increases in Bank Rate are unlikely to occur before the end of the current forecast horizon of 31st March 2023, investment returns are expected to remain low.

£70.000 million of the Council's investments are held in fixed term deposits with other Local Authorities (see table 4 below) that mature across the current and forthcoming 3 financial years, with a further £14.985 million in bank notice accounts (with the notice period equating to 180 days).

Day to day liquidity to meet cashflow requirements are sourced from the Council's three Money Market Funds and call bank account with the Royal Bank of Scotland, which all operate on an instant access basis. Interest rates receivable from these are currently between 0.01% and 0.06%, in line with the low Bank of England Base Rate.

The Chief Officer Corporate Solutions confirms that the approved limits within the Annual Investment Strategy were not breached during the first 6 months of 2020/21.

Given the current low interest rate environment, it is proposed that Council officers, in conjunction with Link Asset Services, continue to review the range of investment options available to the Council within its stated investment policy in the Treasury Management & Annual Investment Strategy approved by Council on 11 February 2020 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 updated list of approved Countries for Investments as at 30 September 2020 is included as Appendix 4.

#### Expected Loan & Investment Portfolio at 31 March 2021

Taking all of the above into account, the expected loan and investment portfolio at 31 March 2020 is shown in Tables 3 and 4 below:-

Table 3: Council's forecast Loan Portfolio at 31 March 2021

Loan Type	31 March 2021	
	Principal Outstanding £000's	Weighted Average Rate
PWLB Annuity	597	8.90%
PWLB Maturity	235,424	3.28%
LOBO	20,000	4.51%
Market Loans	18,191	2.68%
Temporary Market Loans	0	n/a
Other Loans	583	0.00%
<b>Total Loans</b>	<b>274,795</b>	<b>3.34%</b>
<b>Underlying Borrowing Requirement</b>	<b>313,640</b>	
<b>Internal Borrowing</b>	<b>38,845</b>	

Table 4: Council's forecast Investment Portfolio at 31 March 2021

Investment Type	31 March 2021	
	Principal Outstanding £000's	Weighted Average Rate
Money Market Funds	19,718	0.02%
Bank Call Accounts	0	n/a
Bank Notice Accounts	14,985	0.58%
Bank Fixed Term Deposit Accounts	0	n/a
Other Local Authority Fixed Term Deposits	70,000	1.46%
<b>Total Investments</b>	<b>104,703</b>	<b>1.06%</b>

## 7 Prudential Indicators 2020/21

The following prudential indicators have been refreshed from those reported to Council on 11 February 2020 in the original Treasury Management and Annual Investment Strategy Statement 2020/21, based on the actual outturn for 2019/20 and the Council's Capital Plans for 2020/21 to 2024/25, and are shown in Table 5:-

Table 5: Prudential Indicators 2020/21 – Mid Year Update

Indicator	2020/21 Original Estimate £000's	2020/21 Current Position £000's	2020/21 Revised Estimate £000's
2020/21 Capital Expenditure	144,893	13,618	63,782
2020/21 Required Borrowing	88,432	8,055	38,309
2020/21 Underlying Borrowing Requirement*	387,918	288,299	313,640
2020/21 Gross External Borrowing	346,660	283,555	274,795
Operational Boundary – Borrowing	387,918	313,640	313,640
Authorised Limit – Borrowing	551,806	551,806	647,284
2020/21 Capital Financing Requirement**	468,277	373,633	398,975

\* Excludes "On balance sheet" PPP schemes.

\*\* Includes "On balance sheet" PPP schemes.

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. It is recommended that this is increased to £647.284 million, reflecting the current Capital Plans.

## **8 Other Treasury related issues**

### Loans Fund Review

A review of Loans Fund advances was completed during the first half of the financial year. This review examined in detail the alignment of the period over which the Loans Fund advances made to fund capital expenditure were in line with the expected useful life of the assets they financed. This work identified that the period over which loans fund advances were being made was shorter than the expected life of assets, which meant that the financing charge made to the revenue account did not match the economic consumption of those assets.

Accordingly the Loans Fund review concluded that it was appropriate to extend the period over which loans fund advances are repaid. This in turn results in an in-year adjustment to the current and future years' loans fund charges to the revenue account and also a one off prior year adjustment of £8.250 million.

The 2020/21 in-year adjustment to loan charges of £0.950 million was reported to Council on 17 November 2020 in the Financial Monitoring 2020/21 General Fund Revenue report, and the in-year adjustment for the next two financial years is reflected in the corporate solution to the draft 2021/22 and 2022/23 budget which has been endorsed by Business Transformation Steering Group. This corporate solution to the next two years' budget also utilises £7.400 million of the prior year adjustment.

### PWLB Consultation

The Government's consultation on the future lending terms of the Public Works Loans Board was opened on 2 March 2020 and closed on 31 July 2020, having been extended from its original deadline of 4 June 2020 due to the coronavirus pandemic.

As part of this consultation, the government cut the interest rate on new loans for social housing (HRA Certainty Rate) by 100 basis points, to gilts + 80 basis points. The Council utilised this reduction in borrowing rate to finance HRA capital expenditure through the drawing of a long term loan from PWLB on 28 April 2020 as noted in Section 5.

It is possible that the PWLB's non-HRA Certainty Rate (currently gilts + 180 basis points) will be subject to revision downwards after the conclusion of the PWLB consultation; however, the quantum and timing of such a change is currently an unknown, although it would be likely to be within the current financial year.

## **9 Summary**

Treasury Management activity during the year to 30 September 2020 has been effective in minimising borrowing costs and maximising investment income within the parameters set by the strategy for the year. The conclusion of the Loans Fund review ensures that the cost of financing assets is charged to the revenue account in line with the useful lives of those assets. The review also supports the delivery of a corporate solution to addressing the projected budget gaps for financial years 2021/22 and 2022/23.

No further long-term borrowing is forecast for the remainder of 2020/21, reflective of the borrowing undertaken in the first half of the year and the General Services and HRA capital plans reported to Council on 17 November 2020.

Consideration will continue to be given to whether borrowing now (for capital expenditure beyond 2020/21) to secure historically low rates offers value compared with forward interest rate projections, and/or whether any forward borrowing opportunities offer value (this would allow the Council to secure loans now at an agreed rate, to be drawn down at later dates when interest rates are forecast to be significantly higher, eliminating the majority of the cost of carry).

The investment climate remains challenging given the extremely low interest rate environment and economic climate. Officers will continue to review the investment opportunities available to the Council.

The Prudential Indicators have been updated to reflect current capital expenditure and income projections.

## **10 Report Implications**

### **10.1 Resource**

Expenditure from Treasury Management activity i.e. loan charges, was reported in the quarterly financial positions to Council, with Quarter 2 monitoring reflected in the Financial Monitoring 2020/21 – General Fund Revenue report that was presented to Council on 17 November 2020.

### **10.2 Digital**

None.

### **10.3 Risk**

As the Council follows the requirements of the CIPFA Code of Practice for Treasury Management, and the Prudential Code, there is a reduced

level of risks involved in Treasury Management activities. Those risks that do exist are further controlled through written Treasury Management Practices which define the responsibilities of all staff involved and these have recently been reviewed and updated.

#### **10.4 Ensuring Equalities**

There are no equalities issues arising directly from this report.

#### **10.5 Additional Report Implications**

See Appendix A.

## **Appendix A: Report Implications**

### **A.1 Key Priorities within the Single Midlothian Plan**

Not applicable.

### **A.2 Key Drivers for Change**

### **A.3 Key Delivery Streams**

Themes addressed in this report:

- ☐ One Council Working with you, for you
- ☒ Preventative and Sustainable
- ☐ Efficient and Modern
- ☐ Innovative and Ambitious
- ☐ None of the above

### **A.4 Delivering Best Value**

The report does not directly impact on Delivering Best Value.

### **A.5 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.

### **A.6 Impact on Performance and Outcome**

The strategies 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.

### **A.7 Adopting a Preventative Approach**

Not applicable.

### **A.8 Supporting Sustainable Development**

Not applicable.

**Background Papers:**

Appendix 1: Economic Update for first part of 2020/21 financial year

Appendix 2: PWLB Borrowing Rates 1 April 2020 to 30 September 2020

Appendix 3: Link Asset Services Interest Rate Forecasts

Appendix 4: Approved Countries for Investments as at 30 September 2020



## Appendix 1: Economic Update for first part of 2020/21 financial year

### UK

As expected, the Bank of England's Monetary Policy Committee kept Bank Rate unchanged on 6th August. It also kept unchanged the level of quantitative easing at £745bn. Its forecasts were optimistic in terms of three areas:

- The fall in GDP in the first half of 2020 was revised from -28% to -23% (subsequently revised to -21.8%). This is still one of the largest falls in output of any developed nation. However, it is only to be expected as the UK economy is heavily skewed towards consumer-facing services – an area which was particularly vulnerable to being damaged by lockdown.
- The peak in the unemployment rate was revised down from 9% in Q2 to 7½% by Q4 2020.
- It forecast that there would be excess demand in the economy by Q3 2022 causing CPI inflation to rise above the 2% target in Q3 2022, (based on market interest rate expectations for a further loosening in policy). Nevertheless, even if the Bank were to leave policy unchanged, inflation was still projected to be above 2% in 2023.

It also quashed any idea of using negative interest rates, at least in the next six months or so. It suggested that while negative rates can work in some circumstances, it would be “less effective as a tool to stimulate the economy” at this time when banks are worried about future loan losses. It also has “other instruments available”, including QE and the use of forward guidance.

The MPC expected the £300bn of quantitative easing purchases announced between its March and June meetings to continue until the “turn of the year”. This implies that the pace of purchases will slow further to about £4bn a week, down from £14bn a week at the height of the crisis and £7bn more recently.

In conclusion, this would indicate that the Bank could now just sit on its hands as the economy was recovering better than expected. However, the MPC acknowledged that the “medium-term projections were a less informative guide than usual” and the minutes had multiple references to downside risks, which were judged to persist both in the short and medium term. One has only to look at the way in which second waves of the virus are now impacting many countries including Britain, to see the dangers. In addition, Brexit uncertainties ahead of the year-end deadline are likely to be a drag on recovery.

Overall, the pace of recovery is not expected to be in the form of a rapid V shape, but a more elongated and prolonged one after a sharp recovery in June through to August which left the economy 11.7% smaller than in February. The last three months of 2020 are now likely to show no, or negative, growth as consumers will probably remain cautious in spending and uncertainty over the outcome of the UK/EU trade negotiations concluding at the end of the year will also be a headwind. If the Bank felt it did need to provide further support to recovery, then it is likely that the tool of choice would be more QE.

There will be some painful longer term adjustments as e.g. office space and travel by planes, trains and buses may not recover to their previous level of use for several years, or possibly ever. There is also likely to be a reversal of globalisation as this

crisis has shown up how vulnerable long-distance supply chains are. On the other hand, digital services is one area that has already seen huge growth.

One key addition to the Bank's forward guidance was a new phrase in the policy statement, namely that "it does not intend to tighten monetary policy until there is clear evidence that significant progress is being made in eliminating spare capacity and achieving the 2% target sustainably". That seems designed to say, in effect, that even if inflation rises to 2% in a couple of years' time, do not expect any action from the MPC to raise Bank Rate – until they can clearly see that level of inflation is going to be persistently above target if it takes no action to raise Bank Rate.

The Financial Policy Committee (FPC) report on 6th August revised down their expected credit losses for the banking sector to "somewhat less than £80bn". It stated that in its assessment "banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection". The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%.

## US

The incoming sets of data during the first week of August were almost universally stronger than expected. With the number of new daily coronavirus infections beginning to abate, recovery from its contraction this year of 10.2% should continue over the coming months and employment growth should also pick up again. However, growth will be dampened by the continuing outbreaks of the virus across the US leading to local restrictions. At its end of August meeting, the Fed tweaked its inflation target from 2% to maintaining an average of 2% over an unspecified time period i.e. following periods when inflation has been running persistently below 2%, appropriate monetary policy will likely aim to achieve inflation moderately above 2% for some time. This change is aimed to provide more stimulus for economic growth and higher levels of employment and to avoid the danger of getting caught in a deflationary "trap" like Japan. It is to be noted that inflation has actually been under-shooting the 2% target significantly for most of the last decade so financial markets took note that higher levels of inflation are likely to be in the pipeline; long term bond yields duly rose after the meeting. The Fed also called on Congress to end its political disagreement over providing more support for the unemployed as there is a limit to what monetary policy can do compared to more directed central government fiscal policy. The FOMC's updated economic and rate projections in mid-September showed that officials expect to leave the fed funds rate at near-zero until at least end-2023 and probably for another year or two beyond that. There is now some expectation that where the Fed has led in changing its inflation target, other major central banks will follow. The increase in tension over the last year between the US and China is likely to lead to a lack of momentum in progressing the initial positive moves to agree a phase one trade deal.

## EU

The economy was recovering well towards the end of Q2 after a sharp drop in GDP, (e.g. France 18.9%, Italy 17.6%). However, the second wave of the virus affecting the majority of countries could cause a significant slowdown in the pace of recovery, especially in countries more dependent on tourism. The fiscal support package, eventually agreed by the EU after prolonged disagreement between various

countries, is unlikely to provide significant support and quickly enough to make an appreciable difference in weaker countries. The ECB has been struggling to get inflation up to its 2% target and it is therefore expected that it will have to provide more monetary policy support through more quantitative easing purchases of bonds in the absence of sufficient fiscal support.

## **China**

After a concerted effort to get on top of the virus outbreak in Q1, economic recovery was strong in Q2 and has enabled it to recover all of the contraction in Q1. However, this was achieved by major central government funding of yet more infrastructure spending. After years of growth having been focused on this same area, any further spending in this area is likely to lead to increasingly weaker economic returns. This could, therefore, lead to a further misallocation of resources which will weigh on growth in future years.

## **Japan**

There are some concerns that a second wave of the virus is gaining momentum and could dampen economic recovery from its contraction of 8.5% in GDP. It has been struggling to get out of a deflation trap for many years and to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. The resignation of Prime Minister Abe is not expected to result in any significant change in economic policy.

## **World growth**

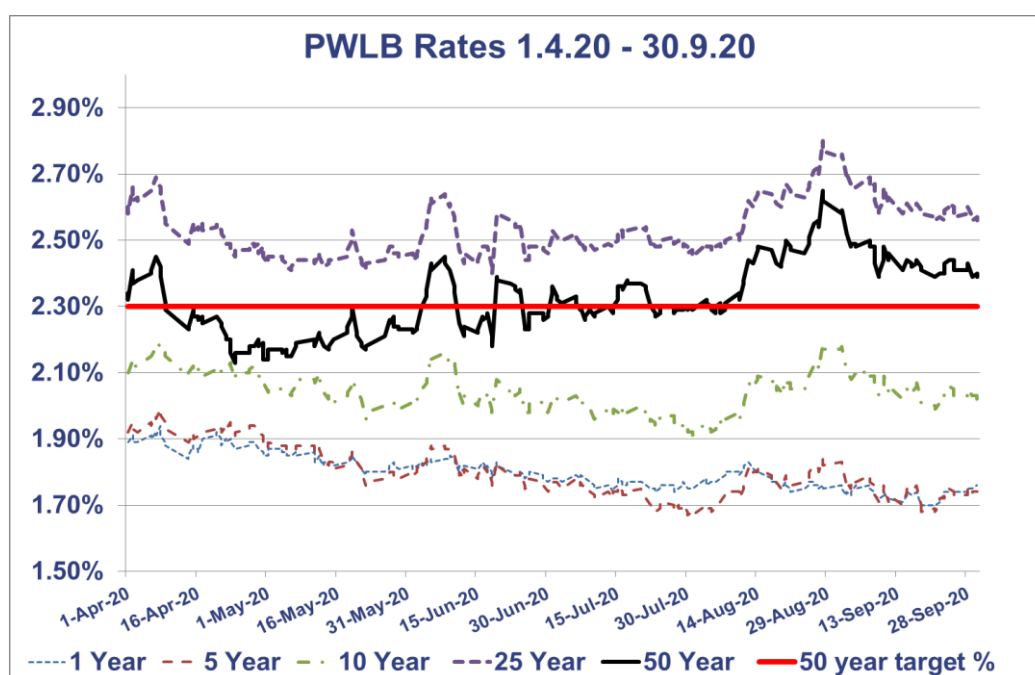
Latin America and India are currently hotspots for virus infections. World growth will be in recession this year. Inflation is unlikely to be a problem for some years due to the creation of excess production capacity and depressed demand caused by the coronavirus crisis.

## Appendix 2: PWLB Borrowing Rates 1 April 2020 to 30 September 2020

The graph and table below show the movement in PWLB certainty rates for the first six months of the year to date:

### PWLB certainty rates 1 April 2020 to 30<sup>th</sup> September 2020

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.70%	1.67%	1.91%	2.40%	2.13%
Date	18/09/2020	30/07/2020	31/07/2020	18/06/2020	24/04/2020
High	1.94%	1.99%	2.19%	2.80%	2.65%
Date	08/04/2020	08/04/2020	08/04/2020	28/08/2020	28/08/2020
Average	1.80%	1.80%	2.04%	2.54%	2.33%



### Appendix 3: Link Asset Services Interest Rate Forecasts

The Council's treasury advisor, Link Asset Services, has provided the following forecast:

Link Group Interest Rate View 11.8.20		Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View		0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
3 month average earnings		0.05	0.05	0.05	0.05	0.05	-	-	-	-	-
6 month average earnings		0.10	0.10	0.10	0.10	0.10	-	-	-	-	-
12 month average earnings		0.15	0.15	0.15	0.15	0.15	-	-	-	-	-
5yr PWLB Rate		1.90	2.00	2.00	2.00	2.00	2.00	2.10	2.10	2.10	2.10
10yr PWLB Rate		2.10	2.10	2.10	2.10	2.20	2.20	2.20	2.30	2.30	2.30
25yr PWLB Rate		2.50	2.50	2.50	2.60	2.60	2.60	2.70	2.70	2.70	2.70
50yr PWLB Rate		2.30	2.30	2.30	2.40	2.40	2.40	2.50	2.50	2.50	2.50

The coronavirus outbreak has done huge economic damage to the UK and economies around the world. After the Bank of England took emergency action in March to cut Bank Rate to first 0.25%, and then to 0.10%, it left Bank Rate unchanged at its meeting on 6th August (and the subsequent September and November meetings), although some forecasters had suggested that a cut into negative territory could happen. However, the Governor of the Bank of England has made it clear that he currently thinks that such a move would do more damage than good and that more quantitative easing is the favoured tool if further action becomes necessary. As shown in the forecast table above, no increase in Bank Rate is expected within the forecast horizon ending on 31st March 2023 as economic recovery is expected to be only gradual and, therefore, prolonged.

#### PWLB Rates / Gilt Yields

There was much speculation during the second half of 2019 that bond markets were in a bubble which was driving bond prices up and yields down to historically very low levels. The context for that was heightened expectations that the US could have been heading for a recession in 2020. In addition, there were growing expectations of a downturn in world economic growth, especially due to fears around the impact of the trade war between the US and China, together with inflation generally at low levels in most countries and expected to remain subdued. Combined, these conditions were conducive to very low bond yields. While inflation targeting by the major central banks has been successful over the last 30 years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers. This means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. The consequence of this has been the gradual lowering of the overall level of interest rates and bond yields in financial markets over the last 30 years. Over the year prior to the coronavirus crisis, this has seen many bond yields up to 10 years turn negative in the Eurozone. In addition, there has, at times, been an inversion of bond yields in the US whereby 10 year yields have fallen below shorter term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities.

Gilt yields had therefore already been on a generally falling trend up until the coronavirus crisis hit western economies during March. After gilt yields spiked up during the initial phases of the health crisis in March, we have seen these yields fall

sharply to unprecedented lows as major western central banks took rapid action to deal with excessive stress in financial markets, and started massive quantitative easing purchases of government bonds: this also acted to put downward pressure on government bond yields at a time when there has been a huge and quick expansion of government expenditure financed by issuing government bonds. Such unprecedented levels of issuance in “normal” times would have caused bond yields to rise sharply. At the close of the day on 30th September, all gilt yields from 1 to 6 years were in negative territory, while even 25-year yields were at only 0.76% and 50 year at 0.60%.

From the local authority borrowing perspective, HM Treasury imposed two changes of margins over gilt yields for PWLB rates in 2019-20 without any prior warning. The first took place on 9th October 2019, adding an additional 1% margin over gilts to all PWLB period rates. That increase was then at least partially reversed for some forms of borrowing on 11th March 2020, but not for mainstream General Fund capital schemes, at the same time as the Government announced in the Budget a programme of increased infrastructure expenditure. It also announced that there would be a consultation with local authorities on possibly further amending these margins; this was to end on 4th June, but that date was subsequently put back to 31st July. It is clear HM Treasury will no longer allow local authorities to borrow money from the PWLB to purchase commercial property if the aim is solely to generate an income stream (assets for yield).

Following the changes on 11th March 2020 in margins over gilt yields, the current situation is as follows: -

- **PWLB non-HRA Standard Rate** is gilt plus 200 basis points (G+200bps)
- ***PWLB non-HRA Certainty Rate*** is gilt plus 180 basis points (G+180bps)
- **PWLB HRA Standard Rate** is gilt plus 100 basis points (G+100bps)
- ***PWLB HRA Certainty Rate*** is gilt plus 80bps (G+80bps)
- ***Local Infrastructure Rate*** is gilt plus 60bps (G+60bps)

*\* Those in italics are those currently applicable/available to Midlothian Council.*

It is possible that the non-HRA Certainty Rate will be subject to revision downwards after the conclusion of the PWLB consultation; however, the timing of such a change is currently an unknown, although it would be likely to be within the current financial year.

As the interest forecast table for PWLB non-HRA certainty rates, (gilts plus 180bps), above shows, there is likely to be little upward movement in PWLB rates over the next two years as it will take economies, including the UK, a prolonged period to recover all the momentum they have lost in the sharp recession caused during the coronavirus shut down period. Inflation is also likely to be very low during this period and could even turn negative in some major western economies during 2020/21.

### **The balance of risks to the UK**

- The overall balance of risks to economic growth in the UK is probably relatively even, but is subject to major uncertainty due to the virus.
- There is relatively little UK domestic risk of increases or decreases in Bank Rate and significant changes in shorter term PWLB rates. The Bank of England has effectively ruled out the use of negative interest rates in the near term and increases in Bank Rate are likely to be some years away given the underlying economic expectations. However, it is always possible that safe haven flows, due to unexpected domestic developments and those in other major economies, could impact gilt yields, (and so PWLB rates), in the UK.



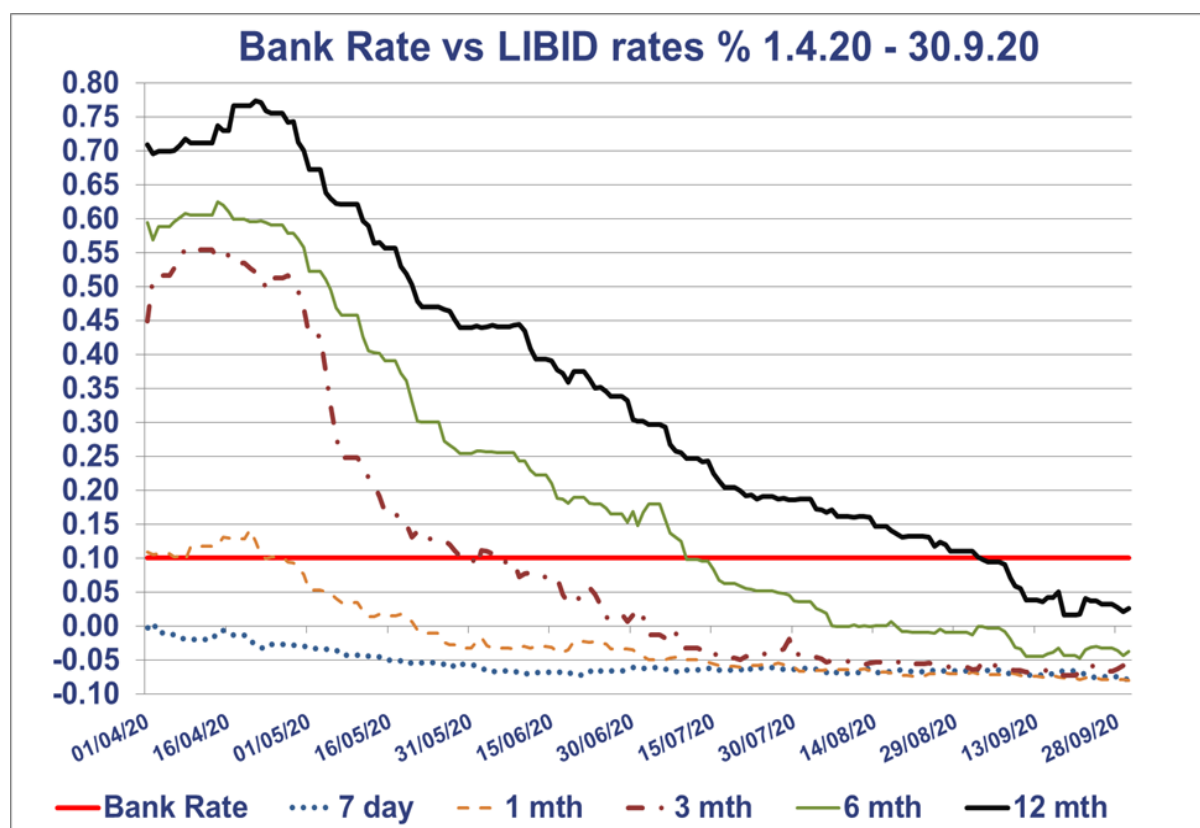
### Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- **UK** - second nationwide wave of virus infections and local and national lockdowns;
- **UK / EU trade negotiations** – if it were to cause significant economic disruption and a fresh major downturn in the rate of growth.
- **UK** - Bank of England takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- **A resurgence of the Eurozone sovereign debt crisis.** The ECB has taken monetary policy action to support the bonds of EU states, with the positive impact most likely for “weaker” countries. In addition, the EU recently agreed a €750bn fiscal support package. These actions will help shield weaker economic regions for the next year or so. However, in the case of Italy, the cost of the virus crisis has added to its already huge debt mountain and its slow economic growth will leave it vulnerable to markets returning to taking the view that its level of debt is unsupportable. There remains a sharp divide between northern EU countries favouring low debt to GDP and annual balanced budgets and southern countries who want to see jointly issued Eurobonds to finance economic recovery. This divide could undermine the unity of the EU in time to come.
- **Weak capitalisation of some European banks**, which could be undermined further depending on extent of credit losses resultant of the pandemic.
- **German minority government & general election in 2021.** In the German general election of September 2017, Angela Merkel’s CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. The CDU has done badly in subsequent state elections but the SPD has done particularly badly. Angela Merkel has stepped down from being the CDU party leader but she intends to remain as Chancellor until the general election in 2021. This then leaves a major question mark over who will be the major guiding hand and driver of EU unity when she steps down.
- **Other minority EU governments.** Austria, Sweden, Spain, Portugal, Netherlands, Ireland and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Austria, the Czech Republic, Poland and Hungary now form a strongly anti-immigration bloc within the EU.** There has also been a rise in anti-immigration sentiment in Germany and France.
- **Geopolitical risks**, for example in China, Iran or North Korea, but also in Europe and other Middle Eastern countries, which could lead to increasing safe haven flows.
- **US** – the impact of the Presidential election in 2020, including repercussions for the US economy and SINO-US trade relations.

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

- **UK** - stronger than currently expected recovery in UK economy.
- **Post-Brexit** – if an agreement was reached that removed the majority of threats of economic disruption between the EU and the UK.
- **The Bank of England** is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.

## Interest Rates



### Negative investment rates

While the Bank of England has said that it is unlikely to introduce a negative Bank Rate, at least in the next 6 -12 months, some deposit accounts are already offering negative rates for shorter periods. As part of the response to the pandemic and lockdown, the Bank and the Government have provided financial markets and businesses with plentiful access to credit, either directly or through commercial banks. In addition, the Government has provided large sums of grants to local authorities to help deal with the Covid crisis; this has caused some local authorities to have sudden large increases in investment balances searching for an investment home, some of which was only very short term until those sums were able to be passed on.

As for money market funds (MMFs), yields have continued to drift lower. Some managers have suggested that they might resort to trimming fee levels to ensure that net yields for investors remain in positive territory where possible and practical. Investor cash flow uncertainty, and the need to maintain liquidity in these unprecedented times, has meant there is a glut of money swilling around at the very short end of the market. This has seen a number of market operators, now including the DMADF, offer nil or negative rates for very short term maturities. This is not universal, and MMFs are still offering a marginally positive return, as are a number of financial institutions.

Inter-local authority lending and borrowing rates have also declined due to the surge in the levels of cash seeking a short-term home at a time when many local authorities are probably having difficulties over accurately forecasting when disbursements of funds received will occur or when further large receipts will be received from the Government.



### Creditworthiness

Although the credit rating agencies changed their outlook on many UK banks from stable to negative outlook during the quarter ended 30th June 2020 due to upcoming risks to banks' earnings and asset quality during the economic downturn caused by the pandemic, the majority of ratings were affirmed due to the continuing strong credit profiles of UK banks. However, during Q1 and Q2 2020, banks made provisions for expected credit losses and the rating changes reflected these provisions. As we move into the next quarters ahead, more information will emerge on actual levels of credit losses. (Quarterly performance is normally announced in the second half of the month following the end of the quarter.) This has the potential to cause rating agencies to revisit their initial rating adjustments earlier in the current year. These adjustments could be negative or positive, although it should also be borne in mind that UK banks went into this pandemic with strong balance sheets. Indeed, the Financial Policy Committee (FPC) report on 6th August revised down their expected credit losses for the banking sector to "somewhat less than £80bn". They stated that in their assessment, "banks have buffers of capital more than sufficient to absorb the losses that are likely to arise under the MPC's central projection". The FPC stated that for real stress in the sector, the economic output would need to be twice as bad as the MPC's projection, with unemployment rising to above 15%.

All three rating agencies have reviewed banks around the world with similar results in many countries of most banks being placed on negative watch, but with a small number of actual downgrades.

The Council's Treasury Advisers, Link, have conducted some stress testing on their credit methodology based list of counterparties supplied to clients, to test for the results of a 1 notch downgrade to all Long Term Ratings from all agencies. Under such a scenario, only Commerzbank, Norddeutsche Landesbank, NatWest Markets Plc (non-ring-fenced entity), Leeds, Skipton and Yorkshire Building Societies moved from Green to No Colour. While there are a further 17 drops in other entities' suggested durations, in these instances, these entities still remain potentially available for use.

### CDS prices

Although CDS prices, which are market indicators of credit risk, for UK banks spiked upwards at the end of March / early April due to the liquidity crisis throughout financial markets, CDS prices have returned to more average levels since then, although they are still elevated compared to end-February. Pricing is likely to remain volatile as uncertainty continues. However, sentiment can easily shift, so it remains important to undertake continual monitoring of all aspects of risk and return in the current circumstances.

**Appendix 4: Approved Countries for Investments as at 30 September 2020****AAA**

- Australia
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

**AA+**

- Canada
- Finland
- U.S.A.

**AA**

- Abu Dhabi (UAE)
- France

**AA-**

- Belgium
- Hong Kong
- Qatar
- U.K.