Notice of Meeting and Agenda

Midlothian

Audit Committee

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

Date: **Tuesday, 07 February 2023**

Time: **13:00**

Executive Director : Place

Contact:
Clerk Name: Democratic Services
Clerk Telephone:
Clerk Email: democratic.services@midlothian.gov.uk

Further Information:

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

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1 Welcome, Introductions and Apologies

2 Order of Business

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

3 Declaration of Interest

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

4 Minute of Previous Meeting

5 Public Reports

6 Private Reports

No items for discussion

7 Date of Next Meeting

The next meeting will be held on Tuesday 7 March 2023 at 11am.

Minute of Meeting

Midlothian

Audit Committee

Date	Time	Venue
Tuesday 6 December 2022	11.00am	Council Chamber

Present:

Councillor Smaill (Chair)
Councillor McEwan
Councillor McKenzie
Councillor Milligan
Councillor Scott

In Attendance:

Grace Vickers	Chief Executive
Kevin Anderson	Executive Director Place
Alan Turpie	Legal and Governance Manager / Monitoring Officer
Derek Oliver	Chief Officer Place
David Gladwin	Acting Chief Financial Officer
Saty Kaur	Chief Officer Corporate Solutions Acting
Elaine Greaves	Principal Internal Auditor
Gary Thomson	Senior Finance Business Partner
Andrew Henderson	Democratic Services Officer

1. Welcome and Apologies for Absence

The Clerk took the opportunity to welcome members to the meeting of Audit. The Clerk advised that an independent Chair had still not been appointed and invited members to nominate a chair for the meeting. It was noted that, in terms of the Scheme of Administration, this would require to be a non-cabinet member. Councillor Milligan, seconded by Councillor McEwan submitted a block proposal that Councillor Smaill sit as chair until the start of the summer recess of 2023, thereafter Councillor Milligan would sit as chair until the start of the summer recess of 2024 and thereafter Councillor McEwan would sit as chair until the start of the summer recess of 2025. The proposal was approved unanimously and Councillor Smaill presided as chair for the remainder of the meeting.

Apologies were submitted on behalf of Morag Barrow.

2. Order of Business

The order of business was as detailed in the agenda.

3. Declarations of interest

No declarations of interest were intimated at this stage of the proceedings.

4. Minutes of Previous Meetings

4.1 The minute of the meeting of 27 September 2022 was submitted and approved as correct record.

4.2 The Action log was submitted, Kevin Anderson provided a brief update in relation to each of the action points. The action log was subsequently noted.

5. Public Reports

Report No.	Report Title	Submitted by:
5.1	Treasury Management Mid-Year Review Report 2022/23	Acting Chief Financial Officer
Outline of report and summary of discussion		
David Gladwin provided a brief overview of the report and appendices making reference to the Treasury management activity undertaken during the first half of 22/23, forecast activity for the second half of 22/23 and prudential indicators for 22/23. Following comments from members, David Gladwin agreed to look into the possibility of setting up a session for members on responsible treasury management. David Gladwin then took the opportunity to respond to members questions.		

A discussion ensued in relation to over borrowing with reference being made to the councils over borrowed position and whether members should have had involvement prior to this occurring in addition to what measures could be used to ensure councillor involvement should this happen again in the future. David Gladwin highlighted that borrowing commitments are made on a long term perspective in line with the annual borrowing requirement and the capital financing requirement. David Gladwin outlined that council has been sighted on this, but that this could be brought back to members if they wished to discuss the matter further. In responding to comments regarding transient borrowing and the resultant ethical issues, Gary Thomson confirmed that environmental and social impacts were considered as part of the treasury management process and that councils are required to formulate a policy on this. With regard to the approach of borrowing when rates are more attractive, David Gladwin confirmed that the council had an overall borrowing requirement as opposed to individual projects and that the charge to the council's revenue account was a consequence of the overall position.
Decision
a) Session with members to be considered in relation to responsible treasury management/ethical issues and; b) Noted the report and the treasury activity undertaken in the period to 30 September 2022, as outlined in Section 5 and; b) Noted the actual and forecast activity during the second-half of the year as outlined in Section 6 and; c) Noted the technical revisions to the Prudential Indicators in Section 7 of this report and; d) Noted the updated Treasury Management Practices and the self-assessment tool on the scrutiny of Treasury Management as published by CIPFA and undertake a self-assessment in line with the tool.

Report No.	Report Title	Submitted by:
5.2	Internal Audit Work to October 2022	Principal Internal Auditor
Outline of report and summary of discussion		
In speaking to the report, Elaine Greaves provided a brief overview of the Internal Audit Work conducted up until October 2022, making reference to the ongoing audit on street lighting. Officers then took the opportunity to respond to members questions. Responding to comments in relation to street lights, the public use of the 'tell your council' system and the Council's ability to fund night time inspections, Derek Oliver confirmed that this came under the asset management system and that some street lights have technology which indicates if the light is defective so that this could be quickly picked up by partners on a prioritised basis. In response to comments regarding FOI delays, Grace Vickers confirmed that the Executive Director Children Young People and Partnerships would be looking into		

this internally and acknowledged that the outstanding FOI's had been received during bottleneck periods and that further information would be included on the Council's website.
Decision
a) Noted the Executive Summaries of the final Internal Audit assurance reports issued and; b) Noted the Internal Audit Assurance Work in Progress and Internal Audit and Other Work carried out and; c) Acknowledged the assurance provided on internal controls and governance arrangements in place for the areas covered by this Internal Audit work.

Report No.	Report Title	Submitted by:
5.3	Follow-Up Reviews of Completed Internal Audit Recommendations & Progress Update	Principal Internal Auditor
Outline of report and summary of discussion		
Elaine Greaves provided a brief overview of the Follow-Up Reviews of Completed Internal Audit Recommendations & Progress Update and highlighted that out of 40 sampled audit recommendations 36 had been satisfactory, 3 had been partially satisfactory and 1 was deemed unsatisfactory and that 4 recommendations had been reopened on Pentana. Elaine Greaves then took the opportunity to respond to points of clarity. In response to comments regarding how councillors could request internal audit work, Elaine Greaves acknowledged that the Internal Audit plan was fluid and that a plan for 2023/24 would be submitted in March outlining intended work. It was also advised that councillors could email herself or the corporate fraud/internal audit mail boxes with any areas of concern.		
Decision		
a) Noted the results from the sample check of Internal Audit recommendations that have been marked as completed by Management in the period April 2021 to March 2022 to improve internal controls and governance, and mitigate risks and; b) Acknowledged the progress made by Management in implementing Internal Audit recommendations to improve internal controls and governance, to mitigate risks, and consider whether it is satisfied with the progress made by Management and; c) Approved the report outcomes and; d) Noted that Internal Audit will continue to monitor for completion the outstanding recommendations and will provide update reports to the Audit Committee.		

Report No.	Report Title	Submitted by:
5.4	Risk Management Update – Strategic Risk Profile Quarter 2 2022/23	Chief Officer Place
Outline of report and summary of discussion		
Derek Oliver provided a brief overview of the Risk Management Update – Strategic Risk Profile Quarter 2 2022/23, making reference to the various risks highlighted and that these would continue to be monitored. Derek Oliver then made further reference to high risks and continued to open to members questions. Derek Oliver clarified that review of the service risk register was a regular process and is signed off by the corporate management team, and that the risk and resilience group has been proposed to help evaluate the risks.		
Decision		
Noted the current risk landscape and organisational response to the most significant risks in Quarter 2 (Q1) 2022/23 (1 July to 30 September 2022)		

Report No.	Report Title	Submitted by:
5.5	Audit Scotland Counter Fraud Reports,	Principal Internal Auditor
Outline of report and summary of discussion		
In speaking to the Audit Scotland Fraud and irregularity 2021/22 and The National Fraud Initiative in Scotland 2022 reports, Elaine Greaves made reference to staffing pressures resulting from the covid 19 pandemic and the strengthening of controls where previous fraud error has been identified. Elaine Greaves then took the opportunity to respond to members questions. A brief discussion ensued in relation to blue badge fraud and Elaine Greaves acknowledged a previous issue with the 'tell us once service' in which the appropriate service had not been notified and highlighted that this has since been rectified.		
Decision		
a) Acknowledged the Audit Scotland counter fraud reports published in recent months and; b) Acknowledged that the Integrity Group of officers considered both reports as part of their counter fraud role and responsibilities.		

6. Private Reports

None

7. Date of Next Meeting

Date of Next Meeting: Tuesday 24 January 2023 at 11am.
(Post meeting comment –rescheduled to Tuesday 7 February 2023 at 1pm.)

The meeting terminated at 11:54 am

Action Log

No	Subject	Date	Action	Action Owner	Expected completion date	Comments
1	**Responsible treasury management**	06/12/2022	Session with members to be organised with regard to Responsible treasury management/ethical issues.	Acting Chief Financial Officer	Ongoing	

Treasury Management and Investment Strategy 2023/24 & Prudential Indicators

Report by David Gladwin, Acting Chief Financial Officer

Report for Decision

1 Recommendations

The Audit Committee is invited to comment on this report before it is presented to Council. In particular, Audit Committee should note the following recommendations which are proposed to be put to Council on 21 February 2023:-

a) Approve the restriction of the Authorised Limit to the value of the Capital Financing Requirement at 31 March 2024 (£472.662 million), pending finalisation of the General Services Capital Plan Prioritisation;

b) To note the ongoing review in respect of incorporating ESG criteria into the decision making process for making deposits, and that officers will continue to monitor and evaluate emerging approaches as the marketplace develops;

c) Note that there are no other material changes proposed to the Treasury Management and Investment Strategy (TMIS) for 2023/24 from the strategy currently in place, other than to update the Prudential Indicators (Section 5 and Appendix 2), to reflect the revised capital plans;

d) Note the retention of the current approach for the repayment of loans fund advances as outlined in Section 7; and

e) Accordingly approve the Treasury Management and Investment Strategy for 2023/24.

2 Purpose of Report/Executive Summary

In accordance with the Treasury Management Code of Practice, the annual Treasury Management & Investment Strategy (TMIS) & Prudential Indicators report is required to be adequately scrutinised before being recommended to the Council. For Midlothian, this role is undertaken by the Audit Committee, with this report being presented to Audit Committee on 7 February 2023 prior to consideration by Council on 21 February 2023.

The purpose of the report to Council will be to provide an update on the implementation of the Council's TMIS 2022/23, and to make recommendations to facilitate consideration of the 2023/24 Strategy, specifically the TMIS for 2023/24, the 2021 update to the Prudential and Treasury Management Codes, the Prudential and Treasury indicators contained therein, and the approach to the statutory repayment of loans fund advances.

Any revisions arising from Audit Committee consideration of the report on 7 February 2023 will be incorporated into the final version of the report to Council on 21 February 2023.

Date: 27 January 2023
Report Contact:
Gary Thomson, Senior Finance Business Partner
gary.thomson@midlothian.gov.uk 0131 271 3110

3. Update on implementation of TMIS for 2022/23

3.1 Borrowing

The Council's borrowing position as set out in the 2022/23 Treasury Management Mid-Year Review Report was £323.271 million at 31 March 2022, and six months later was £322.838 million on 30 September 2022.

The principle source of borrowing is the UK Debt Management Office's Public Works Loans Board (PWLB) and fixed rate loans are taken at a time and tenure which takes cognisance of the PWLB rates (derived from the UK Gilts market) and the management of maturity risk in the long term across the Council's loan portfolio.

The Council's loan portfolio, as at 20 January 2023, is shown in table 1 below:-

Table 1: Current Loan Portfolio as at 20 January 2023

Loan Type	Principal Outstanding £000's	Weighted Average Rate
PWLB Annuity	505	8.91%
PWLB Maturity	284,776	2.92%
LOBO	20,000	4.51%
Market Loans	16,886	2.68%
Salix Loans	235	0.00%
Total Loans	**322,402**	**3.01%**

The repayment profile of this debt is shown in graphical and tabular form below:-

Figure 1: Loan Maturity Structure

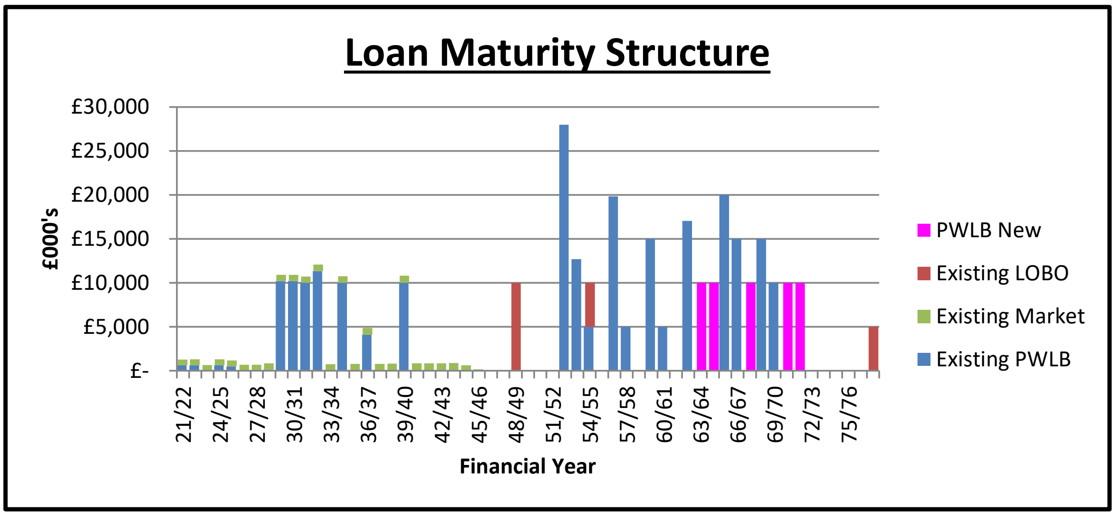


Table 2: Loan Maturity Profile

Financial Year	2022/23 Remaining £000's	2023/24-2026/27 £000's	2027/28-2031/32 £000's	2032/33-2036/37 £000's	2037/38+ £000's
Debt Maturing	648	4,330	33,857	29,258	254,309
% of total portfolio	0.20%	1.34%	10.50%	9.08%	78.88%

As can be noted in the graph and table above, proactive Treasury Management by the Council in the last decade has placed the Council in an extremely strong refinancing position for its existing external debt portfolio, with only £4.978 million, or just 1.54%, of the Council's total Loan Portfolio of £322.402 million requiring refinancing over the current and forthcoming four financial years. This extremely low short-term exposure to refinancing risk has put the Council in a strong position to plan its new borrowings in advance, take advantage of any dips in longer-term borrowing rates from PWLB (as demonstrated above) and other sources, and maintain a low weighted average coupon rate on external debt.

3.2 Deposits

The Council's position for funds on deposit fluctuates on a daily basis, with the 2022/23 Treasury Management Mid-Year Review Report setting out the position at 31 March 2022 of £156.367 million and six months later on 30 September 2022, at £167.399 million.

The position at 20 January 2023, as set out in Table 3 below, totals £146.055 million.

Table 3: Current Deposits as at 20 January 2023

Investment Type	Principal Outstanding £000's	Weighted Average Rate
Bank Call Accounts	14,940	3.30%
Money Market Funds	44,115	3.32%
Bank Fixed Term Deposits	70,000	3.17%
Other Local Authorities	17,000	2.30%
Total Investments	**146,055**	**3.23%**

The cash balances above represent the following:

- Funds held in Bank Fixed Term Deposits and on Deposit with other Local Authorities which are cash backing the Council's projected useable reserves (at 31 March 2023) of £70.273 million;
- A balance held in instant access accounts and money market funds which are used for day to day liquidity to meet cashflow requirements;
- The remainder reflects accumulated balances reflective of (a) the Scottish Government providing upfront funding to local authorities to support a range of grant schemes, (b) advanced

Revenue Support Grant payments and Early Years Capital Grant payments, (c) the receipt of developer contributions from sites across Midlothian, towards new school, community, road and other infrastructure, and (d) the impact of rephasing of the Council's capital plans as reported in the General Services and HRA Quarter 3 Financial Monitoring reports.

The Council's current deposit portfolio is broadly reflective of the wider UK Local Authority position, as noted in the Treasury Management & Annual Investment Strategy Statement – 2023/24 Detailed in Appendix 4, Section 4.4. .

4. Treasury Management & Investment Strategy 2023/24

4.1 Main Objectives of TMIS 2023/24

The objectives of the current and proposed TMIS are:-

- To secure long-term borrowing to fund capital investment, through locking in to long-term interest rates and de-risking the Council's Capital Financing Requirement (CFR);

- To ensure short-term liquidity to manage the Council's day-to-day cashflow. This is achieved through the utilisation of instant access Money Market Fund and Bank Accounts, with the amount held in these reflecting the Council's level of working capital and fluctuating throughout the year due to a number of factors;

- To cash back the Council's usable reserves.

No material changes are proposed to the current TMIS which was scrutinised by Audit Committee in January 2022 and approved by Council in February 2022, other than for the following:-

a) Approve the restriction of the Authorised Limit to the value of the Capital Financing Requirement at 31 March 2024 (£472.662 million), pending finalisation of the General Services Capital Plan Prioritisation;

b) To note the ongoing review in respect of incorporating ESG criteria into the decision making process for making deposits, and that officers will continue to monitor and evaluate emerging approaches as the marketplace develops;

Similarly no changes are recommended to the Permitted Investments, other than the removal of Qatar as an approved country for Investment.

More detail on the borrowing and investment strategy for 2023/24 is provided in Sections 4.2, 4.3 and 4.4 below.

4.2 Borrowing Requirement 2022/23 to 2026/27

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

The projected borrowing requirement arising from the Council's Capital Plans, the Midlothian Energy Limited (MEL) Shareholder Injection, and the maturing long-term loans that require to be refinanced, over the period 2022/23 to 2026/27 is shown in table 4:-

Table 4: Total Borrowing Requirement over the period 2022/23 to 2026/27

	2022/23 £000's	2023/24 £000's	2024/25 £000's	2025/26 £000's	2026/27 £000's	Total £000's
Capital Expenditure						
General Services	28,505	86,289	96,822	51,791	12,787	**276,194**
HRA	41,400	94,897	60,711	21,822	8,943	**227,773**
Total Capital Expenditure	**69,905**	**181,186**	**157,533**	**73,613**	**21,730**	**503,967**
Total Available Financing	-28,729	-43,082	-44,357	-21,697	-13,607	**-151,473**
Principal Debt Repayments	-5,986	-9,389	-11,238	-11,830	-12,185	**-50,628**
Capital Expenditure less available Financing	**35,189**	**128,715**	**101,938**	**40,086**	**-4,062**	**301,867**
MEL Shareholder Injection	4,420	710	3,560	0	0	**8,690**
Maturing Long-term Loans	1,465	830	1,448	1,355	851	**5,949**
Total Borrowing Requirement	**41,074**	**130,255**	**106,946**	**41,441**	**-3,211**	**316,506**
Borrowing secured from previous years	-16,024	0	0	0	0	**-16,024**
Total Remaining Borrowing Requirement	**25,050**	**130,255**	**106,946**	**41,441**	**-3,211**	**300,482**

4.3 Borrowing Strategy for remainder of 2022/23 and 2023/24

Borrowing is undertaken to finance the Council's approved Capital plans and to do so in the most cost effective way. As can been noted from Table 4 above the Council has a significant borrowing requirement across the current and forthcoming four financial years (2022/23 to 2026/27).

This TMIS provides for this capital investment to be underpinned by long-term borrowing, recognising the current interest rate environment, the significant borrowing requirement arising from the Council's capital plans, and the long term benefits of de risking the delivery and affordability of these capital plans by locking into the certainty brought by PWLB fixed rate loans.

The Council's external loan debt at 31 March 2023 is projected to be £322.402 million. Based on the Council's historic and current approved Capital Plans, the **Underlying Borrowing Requirement (UBR) –** which is the Council's underlying need to borrow for capital purposes (excluding the long-term liability arising from PFI/DBFM projects) – at 31 March 2023 is expected to equate to £343.625 million.

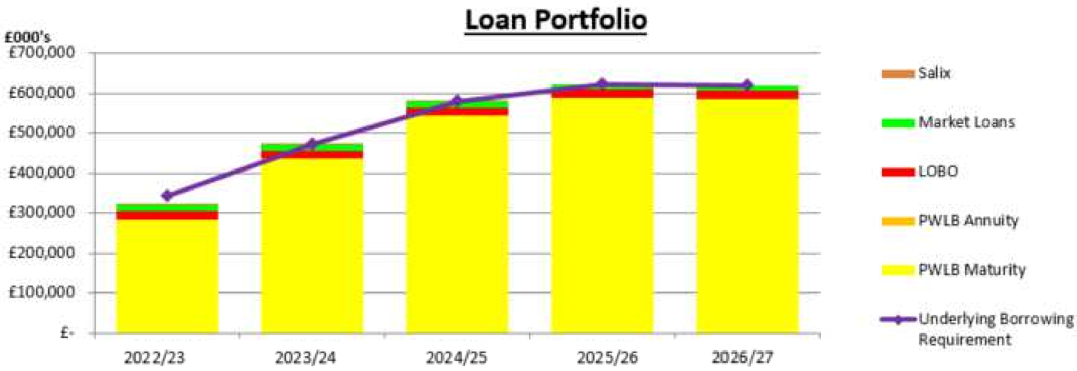
This means that the Council is expected to be £21.223 million (6%) under-borrowed at the end of the 2022/23 financial year i.e. the Council has funded the majority (94%) of its underlying borrowing requirement as at 31 March 2023.

The long-term borrowing the Council took in late 2021/22 to pre-fund part of its 2022/23 borrowing requirement has allowed the Council to defer taking long-term borrowing during 2022/23 when long-term borrowing rates rose significantly, and instead use part of its cash balances to support the in-year borrowing requirement during 2022/23.

In the current economic climate, this is a prudent approach which balances (a) de-risking the longer term borrowing requirement at current longer term borrowing rates; against (b) the current year and forthcoming financial year budget projections. The Council has an extremely low short-medium term exposure to refinancing risk and is therefore in a strong position to plan its new borrowing requirements in advance, taking advantage of any dips in longer-term borrowing rates from PWLB and other sources, and maintain a low weighted average coupon rate on external debt.

The **Underlying Borrowing Requirement** is projected to rise to £619.304 million by 31 March 2027 – almost double the current Underlying Borrowing Requirement. The profile of this, and the projected external loan portfolio to fund the Underlying Borrowing Requirement over the period 2022/23 to 2026/27, is shown in graphical format below.

Figure 3: Loan Portfolio & Underlying Borrowing Requirement



PWLB Borrowing

It is expected that the majority of the Council's remaining 2022/23 and 2023/24 borrowing requirement of £155.306 million (table 4) will be funded through new PWLB maturity loans.

Long-term PWLB borrowing rates for both HRA and non-HRA purposes, which were on a gradual upward trend during the early part of the 2022/23 financial year, saw a significant spike in interest rates due to the tumultuous market volatility experienced in autumn 2022 as a result of the government's economic policy, with longer term PWLB borrowing rates topping out at just under 6.00%. During late 2022, as a degree of market confidence in the UK Economy and Fiscal/Monetary policy returned, rates shifted downwards to around 3.60%-3.90%, before shifting gradually back north during early 2023 to sit at c. 4.24%-4.57% at the time of writing.

The short-medium-term forecast is for PWLB long-term rates to sit flat at around the 4.30% mark during the remainder of 2022/23 and into the early part of 2023/24, before starting to ease off gradually during the mid-latter part of the 2023/24 year, and forecast to sit at c 3.90% by March 2024.

Council officers will therefore continue to monitor PWLB and market rates throughout 2023/24 in order to take advantage of any dips in the market in order to resource the Council's remaining 2022/23, and 2023/24, borrowing requirement of £155.306 million (see table 4).

Temporary Borrowing
The Bank of England's Monetary Policy Committee raised base rate throughout the 2022/23 financial year, to a level of 3.50% at the time of writing and with further rises expected in the 2 remaining meetings in February and March. This is forecast to take base rate to a peak of 4.50% by the start of the 2023/24 financial year, before gradually dropping back to c. 4.00% towards the end of 2023/24.

As such, utilisation of an element of temporary borrowing – which typically tracks close to base rate levels – within the Council's overall loan portfolio may prove attractive whilst the market waits for inflation, and therein gilt yields and PWLB rates, to drop back later in 2023.

However, given the market volatility in 2023/24, this position can shift quickly and Council officers will continue to monitor the temporary borrowing and long-term borrowing markets to assess whether temporary borrowing would add value to the Council's overall portfolio.

The quantum of any temporary borrowing will also be assessed against the backdrop of potential long term costs if the opportunity is missed to take PWLB or other market loans to de-risk the Council's long-term Capital Financing Requirement.

Forward Borrowing
The opportunity also continues to exist to consider further loans on a 'forward dealing' basis, and officers will continue to explore the viability of these loans as part of securing the long term borrowing required to meet the Council's Underlying Borrowing Requirement.

4.4 Investment Strategy for remainder of 2022/23 and 2023/24

No changes are proposed to the Investment Strategy from that approved by Council in the 2022/23 TMIS.

Council should note that in parallel to securing its external borrowing to finance the capital financing requirement, the strategy means that Council should continue to cash back the Council's useable reserves. In doing so, the Council are able to continue to minimise the extent of under-borrowing and at the same time de-risk the Council's forward borrowing requirement; whilst also ensuring that all deposits are securely placed with high creditworthy counterparties, complying with the CIPFA Treasury Management Code principles of security, liquidity and then yield – in that order.

All deposits will be placed with high creditworthy counterparties in accordance with the approved creditworthiness policy as outlined in Appendix 1, with a tenor reflective of the expected drawdown of useable reserve forecasts, and at a yield commensurate with this.

The list of Permitted Investments in Appendix 1 also remains unchanged from that approved by Council in the 2022/23 TMIS, other than the removal of Qatar as an approved country for Investment.

As required by the CIPFA Treasury Management Code, Local authorities “must not borrow to invest for the primary purpose of financial return.” Midlothian Council does not and has not borrowed to invest for the primary purpose of financial return.

<u>Environmental, Social and Governance (ESG) in credit and counterparty policies (Treasury Management Practice 1)</u>

The inclusion of ESG criteria is still very much an emerging area in the Local Authority environment which will require ongoing monitoring. For the 2023/24 financial year, the Council’s priorities of security, liquidity and then yield remain paramount and unchanged (and in that order), with ESG criteria an added 4th element to consider in the decision making process.

Page 50 of CIPFA’s Treasury Management Code states:-

> “*ESG issues are increasingly significant for investors and investment managers. This is better developed in equity and bond markets than for short-term cash deposits, and there is a diversity of market approaches to ESG classification and analysis. This means that a consistent and developed approach to ESG for public service organisations is currently difficult.*
>
> *Organisations are therefore recommended to consider their credit and counterparty policies in light of ESG information and develop their own ESG investment policies and treasury management practices consistent with their organisation’s own relevant policies, such as environmental and climate change policies.*”

For short term investments with counterparties, this Council utilises the Link creditworthiness service which uses the ratings provided by Fitch, Moody’s and Standard & Poor’s to assess creditworthiness, which in themselves include analysis of ESG factors, and specifically the “G” element, when assigning ratings. Of the 3 elements of ESG, the most important element when considering treasury deposits is the Governance aspect – given the majority of treasury deposits undertaken by Midlothian Council are naturally short dated in duration, poor governance can have a more immediate impact on the financial circumstances of an entity and potential for a default event that could impact the amount of principal returned on the deposit.

Those financial institutions viewed as having poor/weak corporate governance are generally less well rated in the first instance or have a higher propensity for being subject to negative rating action, and the Council's existing creditworthiness policy will therefore take this into account.

Environment and Social factors are also important, but relate more to the long-term impact. Council should note that in relation to the security aspect of Treasury deposits, placing an undue weight on the Environmental and Social factors in the decision making process could have an adverse effect of limiting the list of potential counterparty options, thus decreasing diversification. This could then in turn lead to a widening of credit (security) criteria, or those with a stronger "ESG" performance, in order to restore a balance of diversification across the deposit portfolio, potentially increasing credit risk – and placing the cornerstone of prudent investing at risk.

The inclusion of ESG criteria therefore remains an area which requires ongoing review.

Council officers, in conjunction with the Council's treasury advisers Link, will therefore monitor and assess ongoing developments and emerging standards in this area, and methods in which the Council can incorporate ESG factors into our creditworthiness assessment process, and report back to Council accordingly.

5 Prudential Indicators – Midlothian Council

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

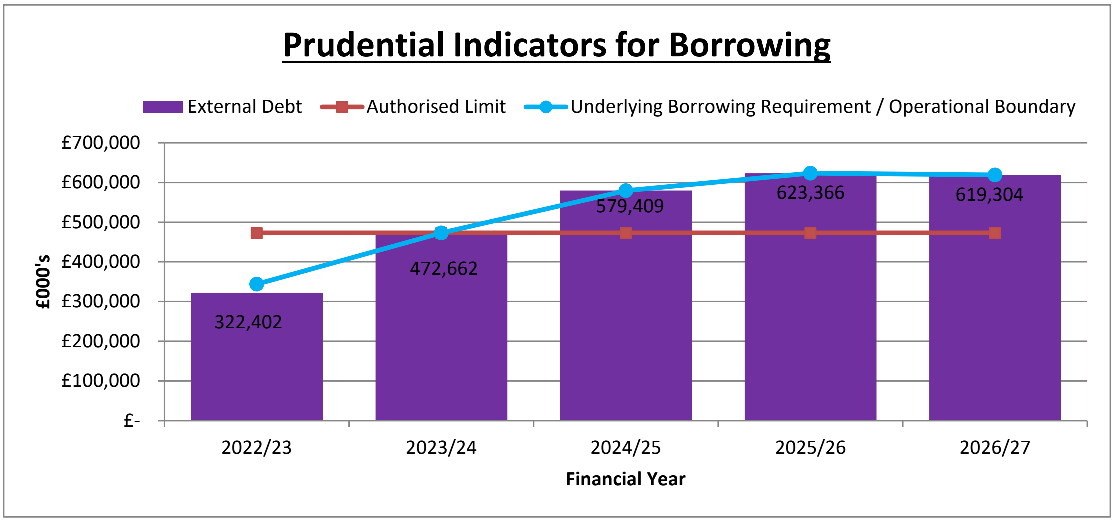
The Prudential Indicators that Councils need to consider relate to both actual, historic outcomes, and future estimated outcomes (covering the same period as the Council's Capital Plans), as follows:-

- Actual outcomes for 2021/22;
- Revised estimates of the 2022/23 indicators; and
- Estimates of indicators for 2023/24 to 2026/27.

The Prudential Indicators required by the Code are listed individually in Appendix 2.

The key Prudential Indicators relating to the Underlying Borrowing Requirement, the expected Gross External Debt, and the proposed Authorised Limit, are shown in graphical format below.

Figure 4: Prudential Indicators for Borrowing



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 PPP/DBFM contracts. The **Underlying Borrowing Requirement** as shown in Figure 4 above strips out the latter of these (long-term liability arising from the Council's PPP/DBFM contracts) from the CFR.

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

The Authorised Limit for Borrowing for the 2023/24 financial year has been calculated to equate to the maximum value of the Underlying Borrowing Requirement in 2023/24. This equates to £472.662 million as outlined in Table 5 below.

Table 5: Authorised Limit for Borrowing: Calculation

Authorised Limit for Borrowing	**Amount £000's**
CFR – General Services (31 March 2024)	192,891
CFR – HRA (31 March 2024)	279,771
Proposed Authorised Limit for Borrowing	**472,662**

Council is therefore asked to approve an authorised limit for borrowing of £472.662 million.

6 CIPFA Codes & CIPFA Toolkit

6.1 CIPFA Codes

CIPFA, on 20 December 2021, released the new editions of the Treasury Management Code and Prudential Code.

The main areas that have been updated were as noted to Council in the TMIS in February 2022.

CIPFA expect Local Authorities to integrate the requirements of the new Treasury Management and Prudential Codes, and the Treasury Management Guidance Note, into their decision-making, monitoring and management.

CIPFA make it clear that the reporting requirements of the new 2021 Prudential Code must be implemented for the 2023/24 financial year. For Midlothian Council, this will be as follows:-

- A fully updated set of Treasury Management Practices (TMPs) were presented to, and approved by, Audit Committee on 6 December 2022;

- The new Prudential Indicators in respect of (a) the Debt Liability Benchmark (Appendix 2, Section 5.5) and (b) Net Income from Service & Commercial Investments as a proportion of Net Revenue Stream (Appendix 2, Section 1.3) are included within this report;

- The reporting requirements of the Prudential Code requires that the Section 95 officer establish procedures to monitor and report Prudential Management Indicators on a quarterly basis.

  These are already currently reported to Council as part of the Treasury Mid-Year Review (Q2), Treasury Strategy (Q3), and Annual Treasury Outturn (Q4) reports.

  For the 2023/24 financial year, in addition to the existing reporting arrangements, the monitoring and reporting of Prudential Indicators, along with forecast debt and investments indicators, will be reported as part of the existing Quarter 1 integrated revenue and capital financial monitoring reports.

- Officers will incorporate the new Environmental & Sustainability provisions of the Prudential Code in the next update of the Capital Strategy.

6.2 CIPFA Scottish Treasury Management Forum Toolkit

The Council is a member, and represented at officer level on the Executive Committee, of the CIPFA Scottish Treasury Management Forum (Scottish TMF), who have recently undertaken work in partnership with CIPFA to develop a new Scottish Treasury Toolkit.

This Toolkit delivers on the Scottish TMF's vision to create a free (to all members of the Scottish TMF) online learning programme aimed at Elected Members and Treasury Practitioners within Scottish Local Authorities. The toolkit focuses on Scottish regulations with commentary on differences to England and Wales, and includes a series of online learning modules developed to assist Officers and Members in their knowledge and understanding of Treasury practices and procedures.

2022 saw the completion of the first 4 e-learning modules and these will be made available to member organisations from early February 2023, with a further 8 modules in the pipeline of development and which are expected to be made available as the year progresses.

The new Treasury Management Code of Practice (TMP10 Training & Qualifications: Knowledge and Skills) requires organisations to retain a knowledge and skills register of elected members and employees that includes a training schedule outlining the aims and objectives of training and the expected level of knowledge, skills and expertise required of those involved in Treasury Management. This is covered in more detail in the Council's TMPs as approved by Audit Committee on 6 December 2022, a copy of which is in the Members Library.

It is therefore proposed that to assist Elected Members to have the necessary expertise, knowledge and skills to undertake their role in the scrutiny of Treasury Management that officers will assemble a list of Elected Members to undertake the Scottish Treasury Toolkit online e-learning programme.

In parallel with this, officers will also assemble a list of employees charged with the execution of the Treasury Management Strategy to undertake the Scottish Treasury Toolkit online learning programme.

As Elected Members and employees progress through the series of online learning modules, the Council's TMP10: Training & Qualifications: Knowledge and Skills schedule will be updated accordingly.

7 Statutory repayment of loans fund advances

Under the Local Government Finance Circular 7/2016, Council is now required to set out its policy for the statutory repayment of loans fund advances prior to the start of each financial year. The repayment of loans fund advances ensures that the Council makes a prudent provision each year to pay off an element of the accumulated loans fund advances made in previous financial years.
The TMIS retains the methodology adopted in 2022/23 – that is as follows:-

7.1 New Assets

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

7.2 Prudent Repayment of Loans Fund Advances

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

In line with the policy adopted in 2022/23, the Asset Life method shall be used for those assets in Table 6.

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

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

** Average loans fund advance length*

The annual repayments under the "Asset Life" method for those asset classes as noted above will be calculated using the asset lives and will use the annuity method, to ensure consistency of approach with the Statutory method for all other asset classes (see below). The annuity interest rate that will be used to calculate loans fund principal repayments under the "Asset Life" method will be the in-year loans fund rate, which for 2022/23 is currently estimated to be 2.21%.

For all other asset classes, the policy will be to maintain the practice of previous years and apply what is termed "the Statutory Method" – following the principles of Schedule 3 of the Local Government (Scotland) Act 1975 – with all loans fund advances being repaid by the annuity method. The annuity rate that is proposed to be applied to the loans fund repayments varies and will be the in-year loans fund rate, reflecting the Council's current loan and investment portfolio. The loans fund rate for 2022/23 is forecast to be 2.21%

Whilst neither the Depreciation nor the Funding/income profile methods are currently proposed, Council officers will continue to monitor whether it is appropriate to use this for future capital projects.

8 Performance Indicators 2021/22 – comparison with other Scottish Local Authorities

The Treasury Management Forum collates performance indicators for all Scottish Local Authorities. The indicators relating to financial year 2021/22 have been published and once again demonstrate the continuing effectiveness of the Council's Treasury function in maximising efficiency in Treasury Management activity, with the Council having the 5th lowest weighted average borrowing & investment (loans fund) rate across all Scottish mainland authorities in 2021/22 (2.98%). The Council has consistently maintained the loans fund rate as one of the lowest across all Scottish mainland authorities for the last decade and more. Appendix 3 outlines the loans fund rate for each Scottish Local Authority in 2021/22.

The forecast loans fund rate of 2.21% for 2022/23 is expected to once again be one of the lowest for all Scottish Local Authorities.

Were the internal loans fund rate to have equated to the Scottish weighted average of 3.33%, this would have generated loan charges in 2021/22 of £15.2m. The Council's actual 2021/22 loan charges for General Services and HRA were £14.1m, representing a cash saving (compared to the Scotland average) of £1.1m in 2021/22.

9. Report Implications

9.1 Resource

There are no direct resource implications arising from this report.

9.2 Digital

None

9.3 Risk

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

The Prudential Indicators contained in Appendix 2 maintain the effectiveness of the overall risk management of Capital Investment and Treasury Management.

9.4 Ensuring Equalities

There are no equality issues arising from this report.

9.5 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 Outcomes

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

A.7 Adopting a Preventative Approach

Not applicable.

A.8 Supporting Sustainable Development

Not applicable.

Background Papers:-
Appendix 1:- Permitted Investments
Appendix 2:- Prudential Indicators
Appendix 3: Performance Indicators 2021/22
Appendix 4:- Treasury Management & Annual Investment Strategy Statement – 2023/24 Detailed

Permitted Investments Appendix 1

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

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

Link Asset Services Colour Code	**Maximum Suggested Duration for Investment**
Yellow	6 years*
Dark Pink	6 years**
Light Pink	6 years**
Purple	2.5 years
Blue	1.25 years***
Orange	1.25 years
Red	7 months
Green	120 days
No colour	Not to be used

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

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

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

Note that the maximum suggested durations listed above have been extended by 1 year (when compared to the suggested maximum durations provided by Link) for the Yellow, Dark Pink, Light Pink categories (and so to 6 years); the Purple category by 6 months to 2.5 years; the Blue and Orange categories by 3 months to 1.25 years; the Red category by a month to 7 months, and the Green category by 20 days to 120 days. This is to allow flexibility around these durations on the margins e.g. the placement of a 13 month fixed term deposit for a counterparty rated Orange or Blue. A thorough appraisal of the additional risk involved in extending the duration of any deposit (marginally) beyond the maximum suggested by Link, against any enhanced value to the portfolio, will be undertaken prior to the placement of any deposit.

1.1 Deposits

Investment Category	Minimum Credit Criteria	Liquidity risk	Market risk	Max %/£m of total investments	Max. maturity period
Debt Management Agency Deposit Facility	--	Term	No	**100%**	**6 months**
Term deposits – local authorities	--	Term	No	**100%**	**5 years**
Call accounts – banks and building societies	Green	Instant	No	**100%**	**1 day**
Term deposits / Notice Accounts – banks and building societies	Yellow Purple Blue Orange Red Green No Colour	Term	No	**100%**	**Up to 6 yrs** **Up to 2.5 yrs** **Up to 1.25 yrs** **Up to 1.25 yrs** **Up to 7 mths** **Up to 120 days** **Not for use**
Fixed term deposits with variable rate and variable maturities: - Structured deposits	Yellow Purple Blue Orange Red Green No Colour	Term	No	**100%**	**Up to 6 yrs** **Up to 2.5 yrs** **Up to 1.25 yrs** **Up to 1.25 yrs** **Up to 7 mths** **Up to 120 days** **Not for use**

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

Investment Category	Minimum Credit Criteria	Liquidity risk	Market risk	Max %/£m of total investments	Max. maturity period
UK nationalised banks – Call accounts	Blue	Instant	No	**100%**	**1 day**
UK nationalised banks – Term Deposits / Notice Accounts	Blue	Term	No	**100%**	**1.25 years**
UK nationalised banks – Fixed term deposits with variable rate and variable maturities: - Structured deposits	Blue	Term	No	**100%**	**1.25 years**
Non-UK(high sovereign rated country) nationalised banks – Call accounts	Green	Instant	No	**100%**	**1 day**
Non-UK (high sovereign rated country) nationalised banks:- Term Deposits / Notice Accounts	Yellow Purple Blue Orange Red Green No Colour	Term	No	**100%**	**Up to 6 yrs** **Up to 2.5 yrs** **Up to 1.25 yrs** **Up to 1.25 yrs** **Up to 7 mths** **Up to 120 days** **Not for use**
Non-UK (high sovereign rated country) nationalised banks:- Fixed term deposits with variable rate and variable maturities: - Structured deposits	Yellow Purple Blue Orange Red Green No Colour	Term	No	**100%**	**Up to 6 yrs** **Up to 2.5 yrs** **Up to 1.25 yrs** **Up to 1.25 yrs** **Up to 7 mths** **Up to 120 days** **Not for use**

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

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

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

1.4 Securities issued or guaranteed by governments

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

1.5 Securities issued by corporate organisations

Investment Category	* Minimum Credit Criteria	Liquidity risk	Market risk	Max % of total investments	Max. maturity period
Certificates of deposit issued by banks and building societies	Yellow Purple Blue Orange Red Green No Colour	Sale T+0	Yes	**100%**	**Up to 6 yrs Up to 2.5 yrs Up to 1.25 yrs Up to 1.25 yrs Up to 7 mths Up to 120 days Not for use**
Commercial paper other	Yellow Purple Blue Orange Red Green No Colour	Sale T+0	Yes	**100%**	**Up to 6 yrs Up to 2.5 yrs Up to 1.25 yrs Up to 1.25 yrs Up to 7 mths Up to 120 days Not for use**
Floating rate notes	Yellow Purple Blue Orange Red Green No Colour	Sale T+2	Yes	**100%**	**Up to 6 yrs Up to 2.5 yrs Up to 1.25 yrs Up to 1.25 yrs Up to 7 mths Up to 120 days Not for use**
Corporate Bonds other	Yellow Purple Blue Orange Red Green No Colour	Sale T+2	Yes	**100%**	**Up to 6 yrs Up to 2.5 yrs Up to 1.25 yrs Up to 1.25 yrs Up to 7 mths Up to 120 days Not for use**

1.6 Other

Investment Category	Minimum Credit Criteria	Liquidity risk	Market risk	Max %/£m of total investments	Max. maturity period
Local authority mortgage guarantee scheme.	Blue	Term	No	**50%**	**5 years**
Loans to Third Parties	n/a	Term	No	**£25m**	**25 years**
Subordinated Debt Subscription to Newbattle Centre SPV	n/a	Term	No	**£0.326m**	**22 years**
Midlothian Energy Limited	n/a	Term	No	**£10.2m**	**n/a**

Treasury Risks and Mitigating Controls for each type of investment are as outlined in the Treasury Management & Annual Investment Strategy Statement – 2023/24 Detailed – Appendix 5.3. The Council's Treasury Management Practices have also been updated in line with the new CIPFA Prudential and Treasury Management Codes which were approved by Audit Committee on 6 December 2022.

Prudential Indicators Appendix 2

1. Prudential Indicators for Affordability

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

1.1 Estimates of Ratio of Financing Costs to Net Revenue Stream

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

Ratio of Financing Costs to Net Revenue Stream						
%	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27
	Actual	Estimate	Estimate	Estimate	Estimate	Estimate
General Services	1.08%	1.25%	1.57%	3.43%	4.47%	4.67%
HRA	38.27%	40.78%	43.67%	55.12%	54.22%	56.26%

The figures above are based on the current General Services and HRA Capital Plans.

1.2 HRA Ratios

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

HRA Debt as a % of Gross Revenue						
	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27
	Actual	Estimate	Estimate	Estimate	Estimate	Estimate
HRA debt £000's	£ 173,114	£ 199,340	£ 279,771	£ 327,765	£ 341,407	£ 342,046
HRA revenues £000's	£ 31,833	£ 31,143	£ 31,577	£ 32,928	£ 35,361	£ 35,094
Ratio of debt to revenues %	544%	640%	886%	995%	965%	975%

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

HRA Debt per Dwelling						
	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27
	Actual	Estimate	Estimate	Estimate	Estimate	Estimate
HRA debt £000's	£ 173,114	£ 199,340	£ 279,771	£ 327,765	£ 341,407	£ 342,046
Number of HRA dwellings	7,002	7,170	7,451	7,841	8,212	8,224
Debt per dwelling £	£ 24,724	£ 27,802	£ 37,548	£ 41,801	£ 41,574	£ 41,591

1.3 Net Income from Service & Commercial Investments as a proportion of Net Revenue Stream

A new indicator, which is a requirement of the new Prudential Code, identifies the ratio of net income from service and commercial investments as a proportion of the net General Services revenue stream.

Net Income from Service Investments as a proportion of Net Revenue Stream						
%	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27
	Actual £000's	Estimate £000's	Estimate £000's	Estimate £000's	Estimate £000's	Estimate £000's
Income from Service Investments	51	34	34	34	34	34
Net Revenue Stream	241,017	247,161	250,161	253,602	257,190	262,632
%	0.02%	0.01%	0.01%	0.01%	0.01%	0.01%

2. Prudential Indicators for Capital Expenditure

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

2.1 Estimated Capital Expenditure

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

Capital Expenditure	2021/22 Actual £000's	2022/23 Estimate £000's	2023/24 Estimate £000's	2024/25 Estimate £000's	2025/26 Estimate £000's	2026/27 Estimate £000's
General Services						
Children, Young People & Estates	£ 5,688	£ 6,954	£ 39,388	£ 51,710	£ 38,524	£ 5,511
Asset Management	£ 12,542	£ 12,622	£ 15,486	£ 11,656	£ 8,686	£ 7,686
Transport, Energy & Infrastructure	£ 1,440	£ 1,393	£ 3,302	£ 16,454	£ 2,862	£ 408
Regeneration & Development	£ 726	£ 2,731	£ 20,373	£ 13,776	£ 1,136	£ 11
Other	£ 3,232	£ 5,790	£ 8,476	£ 5,402	£ 3,058	£ 528
Provision for return of contingencies	£ (241)	£ (985)	£ (737)	£ (2,176)	£ (2,475)	£ (1,357)
Total General Services	**£ 23,386**	**£ 28,505**	**£ 86,289**	**£ 96,822**	**£ 51,791**	**£ 12,787**
Total HRA	**£ 39,477**	**£ 41,400**	**£ 94,897**	**£ 60,711**	**£ 21,822**	**£ 8,943**
Combined Total	**£ 62,863**	**£ 69,905**	**£ 181,186**	**£ 157,533**	**£ 73,613**	**£ 21,730**

2.2 Financing of Capital Expenditure

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

Capital Expenditure and Available Financing	2021/22 Actual £000's	2022/23 Estimate £000's	2023/24 Estimate £000's	2024/25 Estimate £000's	2025/26 Estimate £000's	2026/27 Estimate £000's
Capital Expenditure						
General Services	£ 23,386	£ 28,505	£ 86,289	£ 96,822	£ 51,791	£ 12,787
HRA	£ 39,477	£ 41,400	£ 94,897	£ 60,711	£ 21,822	£ 8,943
Total	**£ 62,863**	**£ 69,905**	**£ 181,186**	**£ 157,533**	**£ 73,613**	**£ 21,730**
Financed by:						
Capital receipts	£ 30	£ -	£ -	£ -	£ -	£ -
Capital grants	£ 17,492	£ 21,431	£ 27,244	£ 23,400	£ 9,185	£ 8,251
Capital reserves	£ 27,000	£ 3,000	£ 2,533	£ 7,694	£ -	£ -
Developer/Other Contributions	£ 5,825	£ 4,298	£ 13,305	£ 13,263	£ 12,513	£ 5,356
Net financing need for the year	**£ 12,516**	**£ 41,175**	**£ 138,104**	**£ 113,176**	**£ 51,916**	**£ 8,123**

2.3 Estimated Capital Financing Requirement

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

Capital Financing Requirement (CFR)						
	2021/22 Actual £000's	2022/23 Estimate £000's	2023/24 Estimate £000's	2024/25 Estimate £000's	2025/26 Estimate £000's	2026/27 Estimate £000's
Capital Financing Requirement						
CFR – General Services	£ 134,133	£ 144,286	£ 192,891	£ 251,645	£ 281,958	£ 277,258
CFR – HRA	£ 173,114	£ 199,340	£ 279,771	£ 327,765	£ 341,407	£ 342,046
CFR – PFI Schemes	£ 95,914	£ 92,433	£ 88,739	£ 84,815	£ 80,661	£ 76,277
Total CFR	**£ 403,161**	**£ 436,059**	**£ 561,401**	**£ 664,225**	**£ 704,026**	**£ 695,581**
Movement in CFR	**£ 9,259**	**£ 32,898**	**£ 125,341**	**£ 102,824**	**£ 39,802**	**£ (8,446)**
Movement in CFR represented by						
Net financing need for the year (previous table)	£ 12,516	£ 41,175	£ 138,104	£ 113,176	£ 51,916	£ 8,123
Less Scheduled Debt Amortisation	£ (5,670)	£ (5,986)	£ (9,389)	£ (11,238)	£ (11,830)	£ (12,185)
Less net PFI Finance Lease Principal Payments	£ (13,832)	£ (3,481)	£ (3,694)	£ (3,924)	£ (4,154)	£ (4,384)
Movement in CFR	**£ (6,986)**	**£ 31,708**	**£ 125,021**	**£ 98,014**	**£ 35,932**	**£ (8,446)**

3. Prudential Indicators for Prudence

3.1 Net Borrowing Requirement

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

Net Borrowing Requirement						
	2021/22 Actual £000's	2022/23 Estimate £000's	2023/24 Estimate £000's	2024/25 Estimate £000's	2025/26 Estimate £000's	2026/27 Estimate £000's
External Debt						
Debt at 1 April	£ 274,795	£ 323,271	£ 322,402	£ 472,662	£ 579,409	£ 623,366
Actual/Expected change in Debt	£ 48,476	£ (869)	£ 150,260	£ 106,747	£ 43,956	£ (4,062)
Other long-term liabilities (OLTL) at 1 April	£ 99,203	£ 95,914	£ 92,433	£ 88,739	£ 84,815	£ 80,661
Actual/Expected change in OLTL	£ (3,289)	£ (3,481)	£ (3,694)	£ (3,924)	£ (4,154)	£ (4,384)
Actual/Expected Gross Debt at 31 March	**£ 419,185**	**£ 414,835**	**£ 561,401**	**£ 664,224**	**£ 704,027**	**£ 695,581**
The Capital Financing Requirement	**£ 403,161**	**£ 436,059**	**£ 561,401**	**£ 664,225**	**£ 704,026**	**£ 695,581**
Under / (over) borrowing	**£ (16,024)**	**£ 21,224**	**£ -**	**£ -**	**£ -**	**£ -**
Deposits						
Cash & Cash Equivalents	£ 56,287	£ 65,000	£ 25,000	£ 25,000	£ 25,000	£ 25,000
Short-Term Investments	£ 74,985	£ 70,000	£ 55,000	£ 48,000	£ 48,000	£ 46,000
Total Deposits	**£ 131,272**	**£ 135,000**	**£ 80,000**	**£ 73,000**	**£ 73,000**	**£ 71,000**

4. Prudential Indicators for External Debt

4.1 Operational Boundary

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

For this Council:-

- the Operational Boundary for Borrowing has been calculated to equate directly to the value of the CFR for General Services and HRA combined, over the current financial year and the following 4 financial years (2022/23 to 2026/27); and
- the Operational Boundary for Other Long-Term Liabilities has been calculated to equate directly to the in-year CFR for Other Long-Term Liabilities, given the known contractual provisions for the repayment of debt within the Council's two PPP agreements.

Operational Boundary					
	2022/23 Estimate £000's	2023/24 Estimate £000's	2024/25 Estimate £000's	2025/26 Estimate £000's	2026/27 Estimate £000's
Operational Boundary - Borrowing	£ 343,626	£ 472,662	£ 579,410	£ 623,365	£ 619,304
Operational Boundary - Other long term liabilities	£ 92,433	£ 88,739	£ 84,815	£ 80,661	£ 76,277
Total	**£ 436,059**	**£ 561,401**	**£ 664,225**	**£ 704,026**	**£ 695,581**

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

4.2 Authorised Limit of Total External Debt

This indicator sets the limit for total external debt.

The Authorised Limit for Borrowing for the 2023/24 financial year has been calculated to equate to the maximum value of the Underlying Borrowing Requirement in 2023/24. This equates to £472.662 million as outlined below.

Authorised Limit for Borrowing	
	£000's
CFR - General Services at 31 March 2024	£ 192,891
CFR - HRA at 31 March 2024	£ 279,771
Authorised Limit for Borrowing	**£ 472,662**

5. Prudential Indicators for Treasury Management

5.1 Upper limits on Fixed and Variable Interest Rates

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

Upper Limits on Exposure to Fixed and Variable Interest Rates 2023/24	
Interest rate exposures	**Upper Limit**
Limits on fixed interest rates based on gross debt	100.00%
Limits on variable interest rates based on gross debt	30.00%
Limits on fixed interest rates based on investments	100.00%
Limits on variable interest rates based on investments	100.00%

5.2 Maturity Structure of Borrowing

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

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

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

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

Maturity Structure of Borrowing 2023/24		
Maturity structure of fixed interest rate borrowing 2023/24	**Lower**	**Upper**
Under 12 months	0.00%	50.00%
12 months to 2 years	0.00%	50.00%
2 years to 5 years	0.00%	50.00%
5 years to 10 years	0.00%	50.00%
10 years to 20 years	0.00%	50.00%
20 years to 30 years	0.00%	50.00%
30 years to 40 years	0.00%	50.00%
40 years to 50 years	0.00%	50.00%
50 years and above	0.00%	50.00%
Maturity structure of variable interest rate borrowing 2023/24	**Lower**	**Upper**
Under 12 months	0.00%	30.00%
12 months to 2 years	0.00%	30.00%
2 years to 5 years	0.00%	30.00%
5 years to 10 years	0.00%	30.00%
10 years to 20 years	0.00%	30.00%
20 years to 30 years	0.00%	30.00%
30 years to 40 years	0.00%	30.00%
40 years to 50 years	0.00%	30.00%
50 years and above	0.00%	30.00%

5.4 Total Principal Sums Invested for Periods Longer than 365 Days

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

Principal Sums Invested for > 365 Days		
Limit		£70m

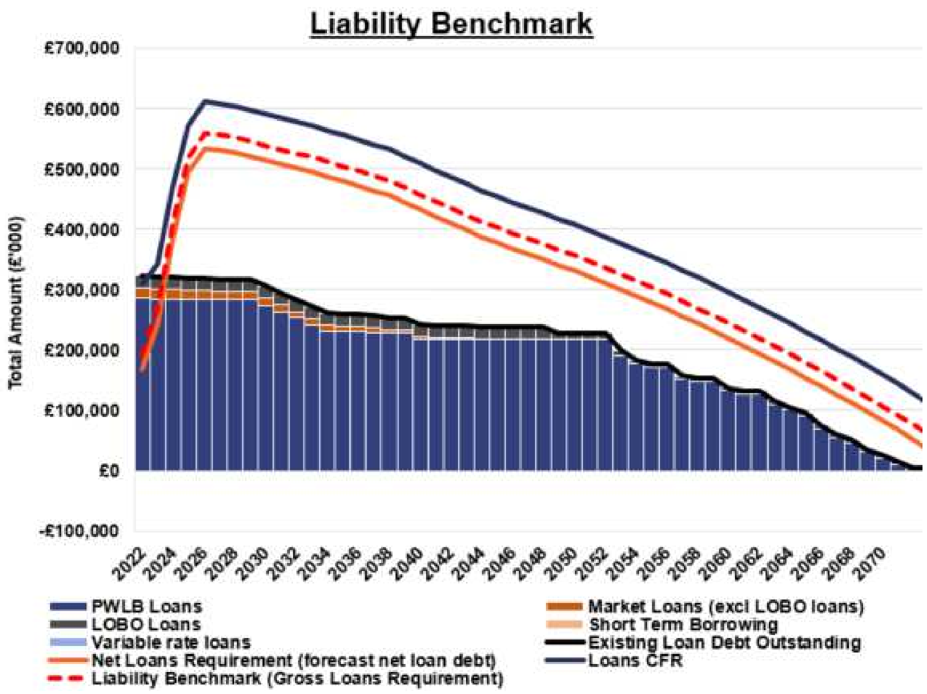
The current strategy as outlined in the body of these reports is to continue to cash-back the Council's balance sheet reserves. It is expected that the majority of this will be in the form of fixed term deposits and/or certificates of deposit. Given expected reserve forecasts and the current interest rate environment, in particular the short-medium term forecast for the Council's Capital Fund and HRA Reserve, the limit for prinicipal sums invested for > 365 days has been retained at £70m.

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access accounts and money market funds.

5.5 Liability Benchmark

In the new 2021 CIPFA Treasury Management Code of Practice, a new Treasury Management Indicator – the "Liability Benchmark" is required which identifies future borrowing needs across the short, medium and longer terms, against the maturity profile of the Council's existing loan portfolio.

The Council's Liability Benchmark in graphical format is as shown below.



There are four components to the Liability Benchmark: -

1. **Existing loan debt outstanding**: the Council's existing loans that are still outstanding in future years.
2. **Loans CFR**: this is calculated in accordance with the loans CFR definition in the Prudential Code and projected into the future based on approved prudential borrowing and planned Loans Fund advances/Loans Fund principal repayments.

3 **Net loans requirement**: this shows the Council's gross loan debt less treasury management investments at the last financial year-end, projected into the future and based on its approved prudential borrowing, planned Loans Fund principal repayments and any other major cash flows (drawdowns/enhancement of reserves) forecast.

4 **Liability benchmark (or gross loans requirement)**: this equals net loans requirement plus short-term liquidity/working capital allowance.

The Debt Liability Benchmark Indicator identifies the Council's expected future capital financing requirement, as driven by the Council's approved Capital Plans – and therefore the Council's future borrowing needs; along with how this matches to the existing debt maturity profile. It is therefore a key tool to support the financing risk management of the capital financing requirement.

As can be noted from the figure above, the Council has a significant borrowing requirement (which equates to £300.482 million) in the short-medium term, arising as a direct result of the Council's approved Capital Plans. The proposed approach to securing this borrowing need for the 2023/24 financial year is outlined in the main body of this report, Section 4.3.

The Debt Liability Benchmark also outlines the profile of the Council's CFR over the medium-long term, against the Council's existing debt portfolio maturity profile. As can be seen from the figure above, the profile of the CFR movements in the medium-long term broadly matches the movements in the Councils external debt portfolio over this period.

The Debt Liability Benchmark will assist the Council with plotting the tenor of borrowing to finance the Council's approved capital plans that is undertaken in the remainder of 2022/23 and the forthcoming 2023/24 period, to ensure that this aligns with the Council's future expected CFR profile and Liability Benchmark projections, taking into account the profile of existing loan maturities as identified in the figure above.

Authority	Loans Fund Rate
West Dunbartonshire	1.94%
Aberdeenshire	2.32%
North Lanarkshire	2.55%
East Lothian	2.81%
Midlothian	2.97%
East Dunbartonshire	3.00%
Aberdeen City	3.01%
Perth & Kinross	3.15%
Dumfries & Galloway	3.19%
Falkirk	3.23%
South Ayrshire	3.25%
East Ayrshire	3.27%
Stirling	3.32%
Orkney	3.33%
Fife	3.34%
Dundee City	3.36%
Argyll & Bute	3.41%
Inverclyde	3.43%
North Ayrshire	3.46%
Highland	3.50%
East Renfrewshire	3.52%
South Lanarkshire	3.61%
Scottish Borders	3.66%
West Lothian	3.70%
Glasgow City	3.71%
Moray	3.76%
Edinburgh City	3.84%
Renfrewshire	3.99%
Angus	4.44%
Clackmannanshire	5.07%
Comhairle Nan Eilean Siar	7.15%

Appendix 4

Treasury Management Strategy Statement
and Annual Investment Strategy

Midlothian Council
2023/24

INDEX

1 INTRODUCTION

1.1 Background

The 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 that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. As such, the second part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are deposited with low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

Whilst any loans to third parties, commercial investment initiatives or other non-financial investments will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure),and are separate from the day to day treasury management activities.

CIPFA defines treasury management 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."*

Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure), and are separate from the day-to-day treasury management activities

1.2 Reporting requirements

1.2.1 Capital Strategy

The CIPFA Prudential and Treasury Management Codes require all local authorities to prepare an additional report, a capital strategy report, which provides the following:

- a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

The aim of the capital strategy is to ensure that all elected members on the full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

1.2.2 Treasury Management Reporting

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals.

a) **Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report covers:
   - the capital plans (including prudential indicators) for 2022/23 to 2026/27;
   - a policy for the statutory repayment of debt, (how residual capital expenditure is charged to revenue over time);
   - the treasury management strategy (how the investments and borrowings are to be organised) for 2023/24, including treasury indicators; and
   - a permitted investment strategy for 2023/24 (the parameters on how investments are to be managed).

b) **A mid year treasury management report** – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the actual treasury strategy is meeting the strategy outlined in advance of the year, or whether any policies require revision.

c) **An annual treasury outturn report** – This provides details of a selection of actual prudential and treasury indicators for the previous financial year and actual treasury operations compared to the estimates within the strategy.

Scrutiny
The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Audit Committee with this report being presented to Audit Committee prior to consideration by Council. Revisions arising from Audit Committee consideration of the report on 25 January 2022 have been incorporated into the final version of this report.

Quarterly reports
From 2023/24 quarterly reporting is also required. In addition to the three major reports detailed above, Prudential and Treasury Management Indicators will be reported at Quarter 1 as part of the Council's integrated Revenue and Capital Monitoring reports.

1.3 Treasury Management Strategy for 2023/24

The strategy for 2023/24 covers two main areas:

Capital issues

- the capital expenditure plans and the prudential indicators (Section 2 of this report);
- The loans fund repayment policy (Section 2.4 of this report).

Treasury management issues

- policy on use of external service providers (Section 1.5);
- the current treasury position (Section 3.1);
- treasury indicators which limit the treasury risk and activities of the Council (Section 3.2);
- prospects for interest rates (Section 3.3);
- the borrowing strategy (Section 3.4);
- policy on borrowing in advance of need (Section 3.5);
- debt rescheduling (Section 3.6);
- the investment strategy (Section 4.1); and
- creditworthiness policy (Section 4.2).

These elements cover the requirements of the Local Government in Scotland Act 2003, the CIPFA Prudential Code, the CIPFA Treasury Management Code and The Scottish Government Local Authority (Capital Finance & Accounting) (Scotland) Regulations 2016.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsibe for scrutiny.

Furthermore, pages 47 and 48 of the Code state that they expect “all organisations to have a formal and comprehensive knowledge and skills or training policy for the effective acquisition and retention of treasury management knowledge and skills for those responsible for management, delivery, governance and decision making.

Organisations need to consider how to assess whether treasury management staff and board/ council members have the required knowledge and skills to undertake their roles and whether they have been able to maintain those skills and keep them up to date.

As a minimum, authorities should carry out the following to monitor and review knowledge and skills:

- Record attendance at training.
- Prepare tailored learning plans for treasury management officers and board/council members.
- Require treasury management officers and board/council members to undertake self-assessment against the required competencies.
- Have regular communication with officers and board/council members, encouraging them to highlight training needs on an ongoing basis.”

In further support of the revised training requirements, CIPFA’s Better Governance Forum and Treasury Management Network have produced a ‘self-assessment by members responsible for the scrutiny of treasury management’, which is available from the CIPFA website to download. This was presented to members of the Audit Committee and Council as part of the Council's Treasury Management 2022-23 Mid-Year Review Report.

A formal record of Knowledge & Skills Schedule has been developed as part of the Council's Treasury Management Practices. This will be periodically reviewed to assess suitability, and updated to reflect ongoing training, knowledge and skills gained. Similarly, a formal record of the treasury management/capital finance training received by members will also be periodically reviewed and updated.

1.5 Treasury management consultants

The Council uses Link Group, Treasury Solutions as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

2 THE CAPITAL PRUDENTIAL INDICATORS 2022/23 – 2026/27

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

2.1 Capital expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

The table below summarises the Capital Expenditure forecasts:-

Table 1: Capital Expenditure

	2021/22 Actual £000's	2022/23 Estimate £000's	2023/24 Estimate £000's	2024/25 Estimate £000's	2025/26 Estimate £000's	2026/27 Estimate £000's
General Services						
Children, Young People & Estates	£ 5,688	£ 6,954	£ 39,388	£ 51,710	£ 38,524	£ 5,511
Asset Management	£ 12,542	£ 12,622	£ 15,486	£ 11,656	£ 8,686	£ 7,686
Transport, Energy & Infrastructure	£ 1,440	£ 1,393	£ 3,302	£ 16,454	£ 2,862	£ 408
Regeneration & Development	£ 726	£ 2,731	£ 20,373	£ 13,776	£ 1,136	£ 11
Other	£ 3,232	£ 5,790	£ 8,476	£ 5,402	£ 3,058	£ 528
Provision for return of contingencies	£ (241)	£ (985)	£ (737)	£ (2,176)	£ (2,475)	£ (1,357)
Total General Services	**£ 23,386**	**£ 28,505**	**£ 86,289**	**£ 96,822**	**£ 51,791**	**£ 12,787**
Total HRA	**£ 39,477**	**£ 41,400**	**£ 94,897**	**£ 60,711**	**£ 21,822**	**£ 8,943**
Combined Total	**£ 62,863**	**£ 69,905**	**£ 181,186**	**£ 157,533**	**£ 73,613**	**£ 21,730**

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

Members are asked to approve the capital expenditure forecasts and the financing of these forecasts:-

Table 2: Capital Expenditure and Available Financing

	2021/22 Actual £000's	2022/23 Estimate £000's	2023/24 Estimate £000's	2024/25 Estimate £000's	2025/26 Estimate £000's	2026/27 Estimate £000's
Capital Expenditure						
General Services	£ 23,386	£ 28,505	£ 86,289	£ 96,822	£ 51,791	£ 12,787
HRA	£ 39,477	£ 41,400	£ 94,897	£ 60,711	£ 21,822	£ 8,943
Total	**£ 62,863**	**£ 69,905**	**£ 181,186**	**£ 157,533**	**£ 73,613**	**£ 21,730**
Financed by:						
Capital receipts	£ 30	£ -	£ -	£ -	£ -	£ -
Capital grants	£ 17,492	£ 21,431	£ 27,244	£ 23,400	£ 9,185	£ 8,251
Capital reserves	£ 27,000	£ 3,000	£ 2,533	£ 7,694	£ -	£ -
Developer/Other Contributions	£ 5,825	£ 4,298	£ 13,305	£ 13,263	£ 12,513	£ 5,356
Net financing need for the year	**£ 12,516**	**£ 41,175**	**£ 138,104**	**£ 113,176**	**£ 51,916**	**£ 8,123**

Note: The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments.

2.2 The Council's borrowing need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for (financed), will increase the CFR.

The CFR does not increase indefinitely, as annual repayments from revenue need to be made which reflect the useful life of capital assets financed from borrowing. From 1st April 2016, Local Authorities may choose whether to use scheduled debt amortisation (loans pool charges) or another suitable method of calculation in order to repay borrowing.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme already include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £95.914m of such schemes within the CFR. The Council is asked to approve the CFR projections below:

Table 3: Capital Financing Requirement (CFR)

	2021/22 Actual £000's	2022/23 Estimate £000's	2023/24 Estimate £000's	2024/25 Estimate £000's	2025/26 Estimate £000's	2026/27 Estimate £000's
Capital Financing Requirement						
CFR – General Services	£ 134,133	£ 144,286	£ 192,891	£ 251,645	£ 281,958	£ 277,258
CFR – HRA	£ 173,114	£ 199,340	£ 279,771	£ 327,765	£ 341,407	£ 342,046
CFR – PFI Schemes	£ 95,914	£ 92,433	£ 88,739	£ 84,815	£ 80,661	£ 76,277
Total CFR	**£ 403,161**	**£ 436,059**	**£ 561,401**	**£ 664,225**	**£ 704,026**	**£ 695,581**
Movement in CFR	**£ (6,986)**	**£ 32,898**	**£ 125,341**	**£ 102,824**	**£ 39,802**	**£ (8,446)**
Movement in CFR represented by						
Net financing need for the year (previous table)	£ 12,516	£ 41,175	£ 138,104	£ 113,176	£ 51,916	£ 8,123
Less Scheduled Debt Amortisation	£ (5,670)	£ (5,986)	£ (9,389)	£ (11,238)	£ (11,830)	£ (12,185)
Less net PFI Finance Lease Principal Payments	£ (13,832)	£ (3,481)	£ (3,694)	£ (3,924)	£ (4,154)	£ (4,384)
Movement in CFR	**£ (6,986)**	**£ 31,708**	**£ 125,021**	**£ 98,014**	**£ 35,932**	**£ (8,446)**

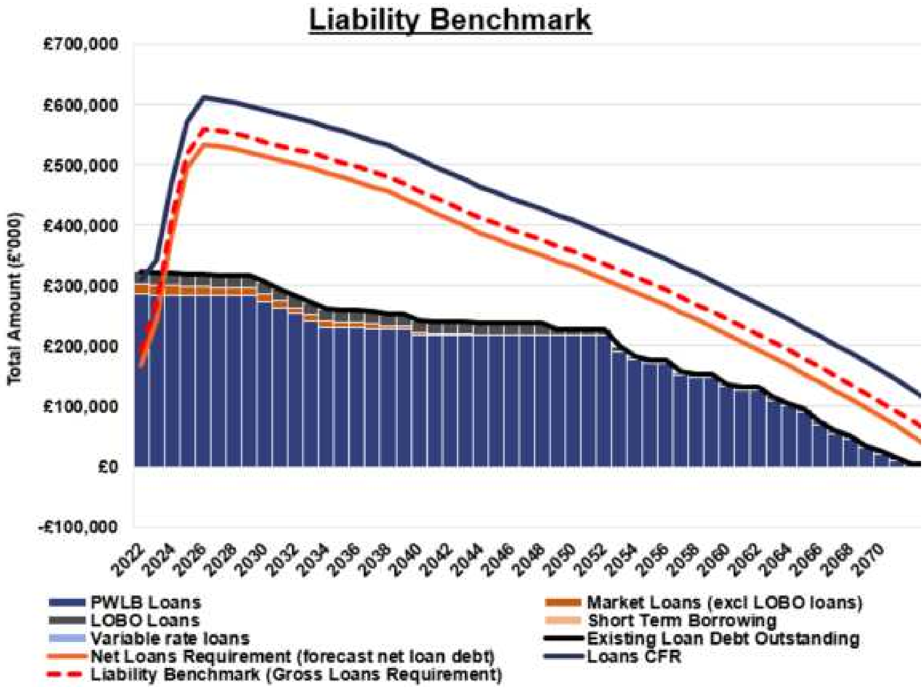
A key aspect of the regulatory and professional guidance is that elected members are aware of the size and scope of any commercial activity in relation to the authority's overall financial position. The capital expenditure figures shown in 2.1 and the details above demonstrate the scope of this activity and, by approving these figures, consider the scale proportionate to the Authority's remaining activity.

2.3 Liability Benchmark

A third and new prudential indicator for 2023/24 is the Debt Liability Benchmark (LB). The Authority is required to estimate and measure the LB for the forthcoming financial year and the following two financial years, as a minimum.

There are four components to the Liability Benchmark: -

1. **Existing loan debt outstanding**: the Council's existing loans that are still outstanding in future years.
2. **Loans CFR**: this is calculated in accordance with the loans CFR definition in the Prudential Code and projected into the future based on approved prudential borrowing and planned Loans Fund advances/Loans Fund principal repayments.
3. **Net loans requirement**: this shows the Council's gross loan debt less treasury management investments at the last financial year-end, projected into the future and based on its approved prudential borrowing, planned Loans Fund principal repayments and any other major cash flows (drawdowns/enhancement of reserves) forecast.
4. **Liability benchmark (or gross loans requirement)**: this equals net loans requirement plus short-term liquidity/working capital allowance.



2.4 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year-end balances for each resource and anticipated day-to-day cash flow balances.

Table 4: Balance Sheet Resources

Reserve	2021/22 Actual £000's	2022/23 Estimate £000's	2023/24 Estimate £000's	2024/25 Estimate £000's	2025/26 Estimate £000's	2026/27 Estimate £000's
HRA Balances	£ 28,084	£ 31,988	£ 33,669	£ 33,217	£ 33,076	£ 31,588
General Fund Balances	£ 3,812	£ 3,812	£ 3,650	£ 3,650	£ 3,650	£ 3,650
Earmarked reserves	£ 28,620	£ 12,404	£ -	£ -	£ -	£ -
Provisions	£ 3,718	£ 3,214	£ 2,787	£ 2,600	£ 2,500	£ 2,400
Capital Fund	£ 22,178	£ 19,178	£ 16,646	£ 8,952	£ 8,952	£ 8,952
Total Reserves / Core Funds	**£ 86,412**	**£ 70,596**	**£ 56,752**	**£ 48,419**	**£ 48,178**	**£ 46,590**
Working capital*	£ 28,836	£ 85,628	£ 23,248	£ 24,581	£ 24,822	£ 24,410
Under/over borrowing	£ (16,024)	£ 21,224	£ -	£ -	£ -	£ -
Expected investments	**£ 131,272**	**£ 135,000**	**£ 80,000**	**£ 73,000**	**£ 73,000**	**£ 71,000**

**Working capital balances shown are estimated year-end; these may be higher mid-year*

2.5 Statutory repayment of loans fund advances

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

It is proposed to retain the methodology adopted in 2022/23 – that is as follows:-

<u>New Assets</u>

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

Prudent Repayment of Loans Fund Advances

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

In line with the policy adopted in 2022/23, the Asset Life method shall be used for those assets in Table 6.

Table 5: Asset Classes to adopt the "Asset Life" method

Infrastructure	**Curren Loans Fund Advance Period**
New Primary Schools/Extensions	60
New Leisure Centres	60
New Offices	60
Road Upgrades	50
Street Lighting Columns	50
Structures/Bridges	50
Footway/Cyclepaths	50
Town Centre Environmental Improvements	50
New Care Homes	45
Children's Play Equipment	20

** Average loans fund advance length*

The annual repayments under the "Asset Life" method for those asset classes as noted above will be calculated using the asset lives and will use the annuity method, to ensure consistency of approach with the Statutory method for all other asset classes (see below). The annuity interest rate that will be used to calculate loans fund principal repayments under the "Asset Life" method will be the in-year loans fund rate, which for 2022/23 is currently estimated to be 2.21%.

For all other asset classes, the policy will be to maintain the practice of previous years and apply what is termed "the Statutory Method" – following the principles of Schedule 3 of the Local Government (Scotland) Act 1975 – with all loans fund advances being repaid by the annuity method. The annuity rate that is proposed to be applied to the loans fund repayments varies will be the in-year loans fund rate, reflecting the Council's current loan and investment portfolio. The loans fund rate for 2022/23 is forecast to be 2.21%

Whilst neither the Depreciation nor the Funding/income profile methods are currently proposed, Council officers will continue to monitor whether it is appropriate to use this for future capital projects.

3 Borrowing

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Treasury management portfolio position

The overall treasury management portfolio as at 31 March 2022 and for the position as at 20 January 2023 are shown below for both borrowing and investments.

Table 6: Portfolio Position 31 March 2022 and 20 January 2023

Loan Type	31 March 2022		20 January 2023	
	Principal Outstanding £000's	Weighted Average Rate	Principal Outstanding £000's	Weighted Average Rate
PWLB Annuity	553	8.91%	505	8.91%
PWLB Maturity	284,776	2.92%	284,776	2.92%
LOBO	20,000	4.51%	20,000	4.51%
Market Loans	17,542	2.68%	17,064	2.68%
Salix Loans	400	0.00%	235	0.00%
Total Loans	**323,271**	**3.02%**	**322,580**	**3.01%**

Deposit Type	31 March 2022		20 January 2023	
	Principal Outstanding £000's	Weighted Average Rate	Principal Outstanding £000's	Weighted Average Rate
Bank Call Accounts	31,059	0.64%	14,940	3.30%
Money Market Funds	30,324	0.52%	44,115	3.32%
Bank Fixed Term Deposits	35,000	0.41%	70,000	3.56%
Other Local Authorities	45,000	1.56%	17,000	1.60%
Total Deposits	**141,383**	**0.85%**	**146,055**	**3.23%**

The Council's forward projections for borrowing and investments are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

Table 7: Net Borrowing Requirement	2021/22 Actual £000's	2022/23 Estimate £000's	2023/24 Estimate £000's	2024/25 Estimate £000's	2025/26 Estimate £000's	2026/27 Estimate £000's
External Debt						
Debt at 1 April	£ 274,795	£ 323,271	£ 322,402	£ 472,662	£ 579,409	£ 623,366
Actual/Expected change in Debt	£ 48,476	£ (869)	£ 150,260	£ 106,747	£ 43,956	£ (4,062)
Other long-term liabilities (OLTL) at 1 April	£ 99,203	£ 95,914	£ 92,433	£ 88,739	£ 84,815	£ 80,661
Actual/Expected change in OLTL	£ (3,289)	£ (3,481)	£ (3,694)	£ (3,924)	£ (4,154)	£ (4,384)
Actual/Expected Gross Debt at 31 March	**£ 419,185**	**£ 414,835**	**£ 561,401**	**£ 664,224**	**£ 704,027**	**£ 695,581**
The Capital Financing Requirement	**£ 403,161**	**£ 436,059**	**£ 561,401**	**£ 664,225**	**£ 704,026**	**£ 695,581**
Under / (over) borrowing	**£ (16,024)**	**£ 21,224**	**£ -**	**£ -**	**£ -**	**£ -**
Deposits						
Cash & Cash Equivalents	£ 56,287	£ 65,000	£ 25,000	£ 25,000	£ 25,000	£ 25,000
Short-Term Investments	£ 74,985	£ 70,000	£ 55,000	£ 48,000	£ 48,000	£ 46,000
Total Deposits	**£ 131,272**	**£ 135,000**	**£ 80,000**	**£ 73,000**	**£ 73,000**	**£ 71,000**

Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2023/24.

The Acting Chief Financial Officer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

3.2 Treasury Indicators: limits to borrowing activity

The operational boundary

This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

For this Council:-

- the Operational Boundary for Borrowing has been calculated to equate directly to the in-year value of the CFR over the current and following 4 financial years (2022/23 to 2026/27); and
- the Operational Boundary for Other Long-Term Liabilities has been calculated to equate directly to the in-year CFR for Other Long-Term Liabilities, given the known contractual provisions for the repayment of debt within the Council's two PPP agreements.

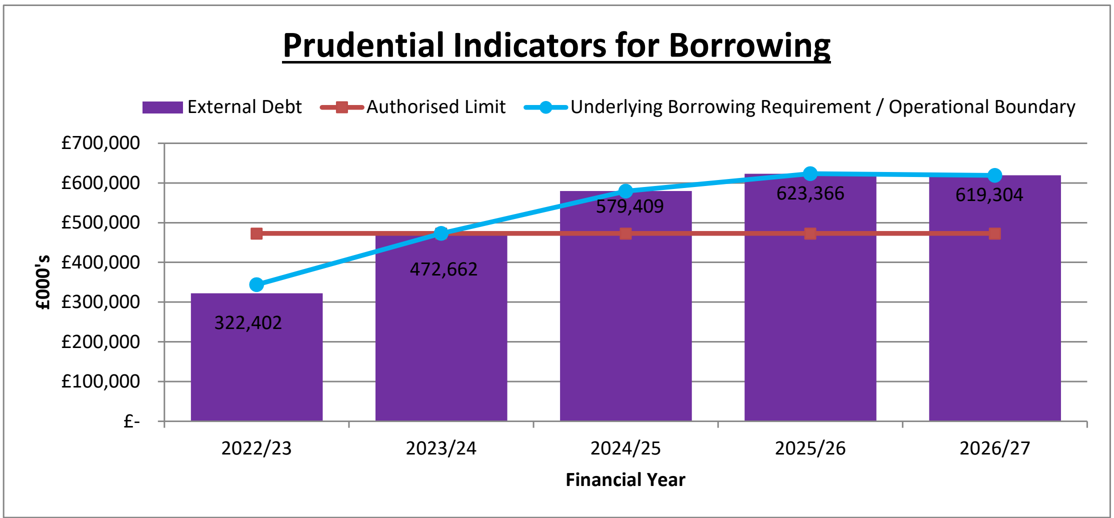
Operational Boundary					
	2022/23 Estimate £000's	2023/24 Estimate £000's	2024/25 Estimate £000's	2025/26 Estimate £000's	2026/27 Estimate £000's
Operational Boundary - Borrowing	£ 343,626	£ 472,662	£ 579,410	£ 623,365	£ 619,304
Operational Boundary - Other long term liabilities	£ 92,433	£ 88,739	£ 84,815	£ 80,661	£ 76,277
Total	**£ 436,059**	**£ 561,401**	**£ 664,225**	**£ 704,026**	**£ 695,581**

The authorised limit for external debt

This indicator sets the limit for total external debt.

The Authorised Limit for Borrowing for the 2023/24 financial year has been calculated to equate to the maximum value of the Underlying Borrowing Requirement in 2023/24. This equates to £472.662 million as outlined below.

Authorised Limit for Borrowing	
	£000's
CFR - General Services at 31 March 2024	£ 192,891
CFR - HRA at 31 March 2024	£ 279,771
Authorised Limit for Borrowing	**£ 472,662**



3.3 Prospects for interest rates

The Council has appointed Link Group, Treasury Solutions as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Link provided the following forecasts for certainty rates, gilt yields plus 80 bps.

UK Interest Rate Forecast

Bank Rate	NOW	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
Link Group	3.50%	4.25%	4.50%	4.50%	4.50%	4.00%	3.75%	3.50%	3.25%	3.00%	2.75%	2.50%	2.50%
Capital Economics	3.50%	4.50%	4.50%	4.50%	4.50%	4.25%	4.00%	3.50%	3.00%	-	-	-	-

5yr PWLB Rate	NOW	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
Link Group	4.17%	4.20%	4.20%	4.10%	4.00%	3.90%	3.80%	3.60%	3.50%	3.40%	3.30%	3.20%	3.10%
Capital Economics	4.17%	4.00%	3.80%	3.70%	3.50%	3.50%	3.40%	3.30%	3.30%	-	-	-	-

10yr PWLB Rate	NOW	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
Link Group	4.30%	4.40%	4.40%	4.30%	4.10%	4.00%	3.90%	3.80%	3.60%	3.50%	3.40%	3.30%	3.30%
Capital Economics	4.30%	4.00%	3.80%	3.70%	3.60%	3.50%	3.40%	3.40%	3.30%	-	-	-	-

25yr PWLB Rate	NOW	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
Link Group	4.64%	4.60%	4.60%	4.50%	4.40%	4.20%	4.10%	4.00%	3.90%	3.70%	3.60%	3.50%	3.50%
Capital Economics	4.64%	4.40%	4.20%	4.00%	3.80%	3.80%	3.70%	3.60%	3.60%	-	-	-	-

50yr PWLB Rate	NOW	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24	Mar-25	Jun-25	Sep-25	Dec-25
Link Group	4.26%	4.30%	4.30%	4.20%	4.10%	3.90%	3.80%	3.70%	3.60%	3.50%	3.30%	3.20%	3.20%
Capital Economics	4.26%	4.10%	4.00%	3.90%	3.80%	3.80%	3.70%	3.60%	3.60%	-	-	-	-

Link's central forecast for interest rates reflects a view that the MPC would be keen to further demonstrate its anti-inflation credentials by delivering a succession of rate increases. Bank Rate stands at 3.50% currently, but is expected to reach a peak of 4.50% in H1 2023.

Further down the road, Link anticipate the Bank of England will be keen to loosen monetary policy when the worst of the inflationary pressures are behind us – but that timing will be one of fine judgment: cut too soon, and inflationary pressures may well build up further; cut too late and any downturn or recession may be prolonged.

The CPI measure of inflation looks to have peaked at 11.1% in Q4 2022 (currently 10.7%). Despite the cost-of-living squeeze that is still taking shape, the Bank will want to see evidence that wages are not spiralling upwards in what is evidently a very tight labour market.

Regarding the plan to sell £10bn of gilts back into the market each quarter (Quantitative Tightening), this has started and will focus on the short, medium and longer end of the curve in equal measure, now that the short-lived effects of the Truss/Kwarteng unfunded dash for growth policy are firmly in the rear-view mirror.

In the upcoming months, Link's forecasts will be guided not only by economic data releases and clarifications from the MPC over its monetary policies and the Government over its fiscal policies, but the on-going conflict between Russia and Ukraine. (More recently, the heightened tensions between China/Taiwan/US also have the potential to have a wider and negative economic impact.)

On the positive side, consumers are still estimated to be sitting on over £160bn of excess savings left over from the pandemic so that will cushion some of the impact of the above challenges. However, most of those are held by more affluent people whereas lower income families already spend nearly all their income on essentials such as food, energy and rent/mortgage payments.

PWLB RATES

- The yield curve movements have become less volatile of late and PWLB 5 to 50 years Certainty Rates are, generally, in the range of 4.10% to 4.80%.
- We view the markets as having built in, already, nearly all the effects on gilt yields of the likely increases in Bank Rate and the elevated inflation outlook.

The balance of risks to the UK economy: -

- The overall balance of risks to economic growth in the UK is to the downside.

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

- Labour and supply shortages prove more enduring and disruptive and depress economic activity (accepting that in the near-term this is also an upside risk to inflation and, thus, rising gilt yields).

- The Bank of England acts too quickly, or too far, over the next year to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.

- UK / EU trade arrangements – if there was a major impact on trade flows and financial services due to complications or lack of co-operation in sorting out significant remaining issues.

- Geopolitical risks, for example in Ukraine/Russia, China/Taiwan/US, Iran, North Korea and Middle Eastern countries, which could lead to increasing safe-haven flows.

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

- 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 and for a longer period within the UK economy, which then necessitates Bank Rate staying higher for longer than we currently project or even necessitates a further series of increases in Bank Rate.

- The Government acts too quickly to cut taxes and/or increases expenditure in light of the cost-of-living squeeze.

- The pound weakens because of a lack of confidence in the UK Government's fiscal policies, resulting in investors pricing in a risk premium for holding UK sovereign debt.

- Longer term US treasury yields rise strongly and pull gilt yields up higher than currently forecast.

- Projected gilt issuance, inclusive of natural maturities and QT, could be too much for the markets to comfortably digest without higher yields consequently.

The long-term (beyond 10 years) forecast for Bank Rate stands at 2.5%. As all PWLB certainty rates are currently above this level, borrowing strategies need to be reviewed in that context. Better value can generally be obtained at the shorter end of the curve and short-dated fixed LA to LA monies should be considered. Temporary borrowing rates are likely, however, to remain near Bank Rate and may also prove attractive whilst the market waits for inflation, and therein gilt yields, to drop back later in 2023.

A more detailed interest rate view and economic commentary is provided at appendix 5.1.

3.4 Borrowing strategy

Borrowing is undertaken to finance the Council's approved Capital plans and to do so in the most cost effective way. As can been noted from Table 4 in the main report, above the Council has a significant borrowing requirement across the current and forthcoming four financial years (2022/23 to 2026/27).

The Council's external loan debt at 31 March 2023 is projected to be £322.402 million. Based on the Council's historic and current approved Capital Plans, the **Underlying Borrowing Requirement (UBR)** – which is the Council's underlying need to borrow for capital purposes (excluding the long-term liability arising from PFI/DBFM projects) – at 31 March 2023 is expected to equate to £343.625 million.

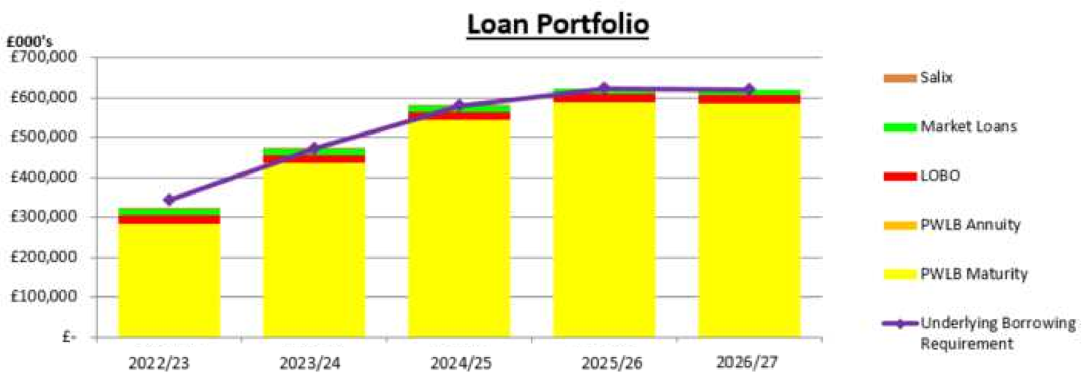
This means that the Council is expected to be £21.223 million (6%) under-borrowed at the end of the 2022/23 financial year i.e. the Council has funded the majority (94%) of its underlying borrowing requirement as at 31 March 2023.

The long-term borrowing the Council took in late 2021/22 to pre-fund part of its 2022/23 borrowing requirement has allowed the Council to defer taking long-term borrowing during 2022/23 when long-term borrowing rates rose significantly, and instead use part of its cash balances to support the in-year borrowing requirement during 2022/23.

In the current economic climate, this is a prudent approach which balances (a) de-risking the longer term borrowing requirement at current longer term borrowing rates; against (b) the current year and forthcoming financial year budget projections. The Council has an extremely low short-medium term exposure to refinancing risk and is therefore in a strong position to plan its new borrowing requirements in advance, taking advantage of any dips in longer-term borrowing rates from PWLB and other sources, and maintain a low weighted average coupon rate on external debt.

The Underlying Borrowing Requirement is projected to rise to £619.304 million by 31 March 2027 – almost double the current Underlying Borrowing Requirement. The profile of this, and the projected external loan portfolio to fund the Underlying Borrowing Requirement over the period 2022/23 to 2026/27, is shown in graphical format below.

The Council's projected loan portfolio over the period 2022/23 to 2026/27 is shown in graphical format below.



<u>PWLB Borrowing</u>
It is expected that the majority of the Council's remaining 2022/23 and 2023/24 borrowing requirement of £155.306 million (table 4 in main report) will be funded through new PWLB maturity loans.

Long-term PWLB borrowing rates for both HRA and non-HRA purposes, which were on a gradual upward trend during the early part of the 2022/23 financial year, saw a significant spike in interest rates due to the tumultuous market volatility experienced in autumn 2022 as a result of the government's economic policy, with longer term PWLB borrowing rates topping out at just under 6.00%. During late 2022, as a degree of market confidence in the UK Economy and Fiscal/Monetary policy returned, rates shifted downwards to around 3.60%-3.90%, before shifting gradually back north during early 2023 to sit at c. 4.24%-4.57% at the time of writing.

The short-medium-term forecast is for PWLB long-term rates to sit flat at around the 4.30% mark during the remainder of 2022/23 and into the early part of 2023/24, before starting to ease off gradually during the mid-latter part of the 2023/24 year, and forecast to sit at c 3.90% by March 2024.

Council officers will therefore continue to monitor PWLB and market rates throughout 2023/24 in order to take advantage of any dips in the market in order to resource the Council's remaining 2022/23, and 2023/24, borrowing requirement of £155.306 million (see table 4).

Temporary Borrowing

The Bank of England's Monetary Policy Committee raised base rate throughout the 2022/23 financial year, to a level of 3.50% at the time of writing and with further rises expected in the 2 remaining meetings in February and March. This is forecast to take base rate to a peak of 4.50% by the start of the 2023/24 financial year, before gradually dropping back to c. 4.00% towards the end of 2023/24.

As such, utilisation of an element of temporary borrowing – which typically tracks close to base rate levels – within the Council's overall loan portfolio may prove attractive whilst the market waits for inflation, and therein gilt yields and PWLB rates, to drop back later in 2023.

However, given the market volatility in 2023/24, this position can shift quickly and Council officers will continue to monitor the temporary borrowing and long-term borrowing markets to assess whether temporary borrowing would add value to the Council's overall portfolio.

The quantum of any temporary borrowing will also be assessed against the backdrop of potential long term costs if the opportunity is missed to take PWLB or other market loans to de-risk the Council's long-term Capital Financing Requirement.

Forward Borrowing

The opportunity also continues to exist to consider further loans on a 'forward dealing' basis, and officers will continue to explore the viability of these loans as part of securing the long term borrowing

Treasury management limits on activity

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates for borrowing based upon the gross debt position, and variable interest rates for investments based upon the total investment position;
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates for both borrowing and investments;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

The Council is asked to approve the following treasury indicators and limits:

Upper Limits on Exposure to Fixed and Variable Interest Rates 2023/24	
Interest rate exposures	**Upper Limit**
Limits on fixed interest rates based on gross debt	100.00%
Limits on variable interest rates based on gross debt	30.00%
Limits on fixed interest rates based on investments	100.00%
Limits on variable interest rates based on investments	100.00%

Maturity Structure of Borrowing 2023/24		
Maturity structure of fixed interest rate borrowing 2023/24	**Lower**	**Upper**
Under 12 months	0.00%	50.00%
12 months to 2 years	0.00%	50.00%
2 years to 5 years	0.00%	50.00%
5 years to 10 years	0.00%	50.00%
10 years to 20 years	0.00%	50.00%
20 years to 30 years	0.00%	50.00%
30 years to 40 years	0.00%	50.00%
40 years to 50 years	0.00%	50.00%
50 years and above	0.00%	50.00%
Maturity structure of variable interest rate borrowing 2023/24	**Lower**	**Upper**
Under 12 months	0.00%	30.00%
12 months to 2 years	0.00%	30.00%
2 years to 5 years	0.00%	30.00%
5 years to 10 years	0.00%	30.00%
10 years to 20 years	0.00%	30.00%
20 years to 30 years	0.00%	30.00%
30 years to 40 years	0.00%	30.00%
40 years to 50 years	0.00%	30.00%
50 years and above	0.00%	30.00%

3.5 Policy on borrowing in advance of need

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sum borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates (as detailed in Section 3.2) and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

3.6 Debt rescheduling

Rescheduling of current borrowing in our debt portfolio is unlikely to occur as there is still a large difference between premature redemption rates and new borrowing rates.

All rescheduling will be reported to the Council, at the earliest meeting following its action.

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy

The Council's investment policy implements the requirements of the following: -

- Local Government Investments (Scotland) Regulations 2010, (and accompanying Finance Circular 5/2010);
- CIPFA Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes 2021 ("the Code");
- CIPFA Treasury Management Guidance Notes 2021

The Council's investment priorities will be security first, portfolio liquidity second and then yield, (return). The Council will aim to achieve the optimum return (yield) on its investments commensurate with proper levels of security and liquidity and with the Council's risk appetite.

In the current economic climate, it is considered appropriate to maintain a degree of liquidity to cover cash flow needs but to also consider "laddering" investments for periods up to 12 months with high credit rated financial institutions, whilst investment rates remain elevated, as well as wider range fund options.

The above regulations and guidance place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

1. The Council applies **minimum acceptable credit criteria** in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short-term and long-term ratings.

2. Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "**credit default swaps**" and overlay that information on top of the credit ratings.

3. **Other information sources** used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

4. This authority has defined the list of **types of investment instruments** that are permitted investments authorised for use in appendix 5.2. Appendix 5.3 expands on the risks involved in each type of investment and the mitigating controls.

5. **Lending limits**, (maturity tenors), for each counterparty will be set through applying the matrix table in Section 4.2 (maturity durations).

6. Investments will only placed with counterparties from countries with a specified minimum **sovereign rating**, (see paragraph 4.3).

7. Lending per **Country** and **Institution** will be set through the application of the criteria in Section 4.3 (amounts).

8. **Transaction limits** are set for each type of investment in appendix 5.2.

9. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**, (see paragraph 4.4).

10. This authority has engaged **external consultants**, (see paragraph 1.5), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

11. All investments will be denominated in sterling.

However, this authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 4.5). Regular monitoring of investment performance will be carried out during the year.

4.2 Creditworthiness policy

This Council applies the creditworthiness service provided by Link Group, Treasury Solutions. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:-

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:-

Table 14: Recommended Maximum Durations for Investments	
Link Asset Services Colour Code	**Maximum Suggested Duration for Investment**
Yellow	6 years*
Dark Pink	6 years**
Light Pink	6 years**
Purple	2.5 years
Blue	1.25 years***
Orange	1.25 years
Red	7 months
Green	120 days
No colour	Not to be used

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

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

*** *Applies only to nationalised or semi-nationalised UK Banks*

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

The Link Group, Treasury Solutions creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

Typically the minimum credit ratings criteria the Council use will be (Fitch or equivalents):-

- Short term rating F1;
- Long term rating A-.

There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Link Group, Treasury Solutions creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately;
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to the Council by Link Group, Treasury Solutions. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on sovereign support for banks and the credit ratings of that supporting government.

UK banks – ring fencing

The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as "ring-fencing". Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

4.3 Country and sector limits

The Council has determined that it will only use approved counterparties from the UK, or approved counterparties from other countries with a minimum sovereign credit rating of AA- from Fitch.

The list of countries that qualify using the above criteria as at the date of this report are shown in Appendix 5.4. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

The Council will avoid a concentration of investments in too few counterparties or countries by adopting a spreading approach to investing whereby no more than £30 million will be invested in Lloyds Banking Group and the Royal Bank of Scotland Group, £15 million in any other UK counterparty, and £15 million in any one counterparty, group or country outwith the UK.

4.4 Investment strategy

Current Deposits

As at 20 January 2023, the Council's deposits were as follows:-

Counterparty	Amount £000's	Security *Long/Short Term Rating* (Colour)***	Liquidity	Yield	UK Local Authority Investment*** £000's
MMF Aberdeen	14,903	AAAmmf *(Yellow)*	Instant Access	3.40%	1,931,129
MMF Federated	14,503	AAAmmf *(Yellow)*	Instant Access	3.39%	1,008,282
MMF LGIM	14,709	AAAmmf *(Yellow)*	Instant Access	3.18%	306,784
Lloyds Bank Corporate Markets plc	30,000	A+/F1 (Red)	Start: 30 Nov 2022 End: 30 May 2023	4.25%	272,800
National Westminster Bank plc	15,000	A+/F1 *(Blue)*	Start: 31 May 2022 End: 31 May 2023	2.00%	1,052,317
Handelsbanken AB Call Account	14,940	AA/F1+ *(Orange)*	Instant Access	3.30%	721,491
Toronto Dominion Bank	10,000	AA-F1+ (Orange)	Start: 16 Jun 2022 End: 15 Jun 2023	2.85%	436,311
Landesbank Hessen-Thueringen Girozen	5,000	A+/F1+ (Orange)	Start: 30 Nov 2022 End: 29 Nov 2023	4.47%	306,000
Standard Chartered Bank	10,000	A+/F1 (Red)	Start: 30 Nov 2022 End: 30 May 2023	4.06%	944,807
Wokingham Borough Council	15,000	Quasi-UK Government (AA- / *Yellow*)	Start: 25 Mar 2020 End: 24 Mar 2023	1.60%	3,029,079
Stoke on Trent City Council	2,000	Quasi-UK Government (AA- / *Yellow*)	Start: 06 Apr 2020 End: 06 Apr 2023	1.60%	
Total	**146,055**				**10,009,000**

** Credit Rating from Fitch*
*** Colour represents maximum recommended duration for investment per Link Group, Treasury Solutions, Treasury Solutions Credit Scoring methodology – see Appendix 2.*
**** As at 30 November 2022*

In-house funds. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short -term interest rates. Greater returns are usually obtainable by investing for longer periods.

The current shape of the yield curve suggests that is the case at present, but there is the prospect of Bank Rate peaking in the first half of 2023 and possibly reducing as early as the latter part of 2023 so an agile investment strategy would be appropriate to optimise returns.

While an element of cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable;
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

Investment returns expectations
The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year, (based on a forecast for bank Rate to reach 4.50% in Q2 2023), are as follows.:

Average earnings in each year	
2022/23	4.00%
2023/24	4.40%
2024/25	3.30%
2025/26	2.60%
2026/27	2.50%
Long term later years	2.80%

As there are so many variables at this time, caution must be exercised in respect of all interest rate forecasts.

Investment treasury indicator and limit - total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and expected usable reserve forecasts, and are based on the availability of funds after each year-end.

The Council is asked to retain the following treasury indicator and limit: -

Principal Sums Invested for > 365 Days			
	2019/20	2020/21	2021/22
Limit	£70m	£70m	£70m

The current strategy as outlined in the body of these reports is to continue to cash-back the Council's balance sheet reserves. It is expected that the majority of this will be in the form of fixed term deposits and/or certificates of deposit. Given expected reserve forecasts and the current interest rate environment, in particular the short-medium term forecast for the Council's Capital Fund and HRA Reserve, the limit for prinicipal sums invested for > 365 days has been retained at £70m.

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access accounts and money market funds.

4.5 Investment risk benchmarking

The Council will use an investment benchmark to assess the investment performance of its investment portfolio of 6 month SONIA compounded. The Council also participates in Investment Benchmarking groups with Link Group, Treasury Solutions whereby performance with other Benchmarking club members and the wider Scottish and UK Local Authority Investment benchmarking is compared.

4.6 End of year investment report

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

5 Appendices

1. Economic background
2. Treasury Management Practice 1 – Permitted Investments
3. Treasury Management Practice 1 – Credit and Counterparty Risk Management
4. Approved countries for investments
5. Treasury management scheme of delegation
6. The treasury management role of the section 95 officer

5.1 APPENDIX: Economic Background

Against a backdrop of stubborn inflationary pressures, the easing of Covid restrictions in most developed economies, the Russian invasion of Ukraine, and a range of different UK Government policies, it is no surprise that UK interest rates have been volatile right across the curve, from Bank Rate through to 50-year gilt yields, for all of 2022.

Market commentators' misplaced optimism around inflation has been the root cause of the rout in the bond markets with, for example, UK, EZ and US 10-year yields all rising by over 200bps since the turn of the year. The table below provides a snapshot of the conundrum facing central banks: inflation is elevated but labour markets are extra-ordinarily tight, making it an issue of fine judgment as to how far monetary policy needs to tighten.

	UK	Eurozone	US
Bank Rate	3.5%	2.0%	4.25%-4.50%
GDP	-0.2%q/q Q3 (2.4%y/y)	+0.2%q/q Q3 (2.1%y/y)	2.6% Q3 Annualised
Inflation	10.7%y/y (Nov)	10.1%y/y (Nov)	7.1%y/y (Nov)
Unemployment Rate	3.7% (Oct)	6.5% (Oct)	3.7% (Nov)

Q2 of 2022 saw UK GDP revised upwards to +0.2% q/q, but this was quickly reversed in the third quarter, albeit some of the fall in GDP can be placed at the foot of the extra Bank Holiday in the wake of the Queen's passing. Nevertheless, CPI inflation has picked up to what should be a peak reading of 11.1% in October, although with further increases in the gas and electricity price caps pencilled in for April 2023, and the cap potentially rising from an average of £2,500 to £3,000 per household, there is still a possibility that inflation will spike higher again before dropping back slowly through 2023.

The UK unemployment rate fell to a 48-year low of 3.6%, and this despite a net migration increase of c500k. The fact is that with many economic participants registered as long-term sick, the UK labour force actually shrunk by c500k in the year to June. Without an increase in the labour force participation rate, it is hard to see how the UK economy will be able to grow its way to prosperity, and with average wage increases running at over 6% the MPC will be concerned that wage inflation will prove just as sticky as major supply-side shocks to food and energy that have endured since Russia's invasion of Ukraine on 22nd February 2022.

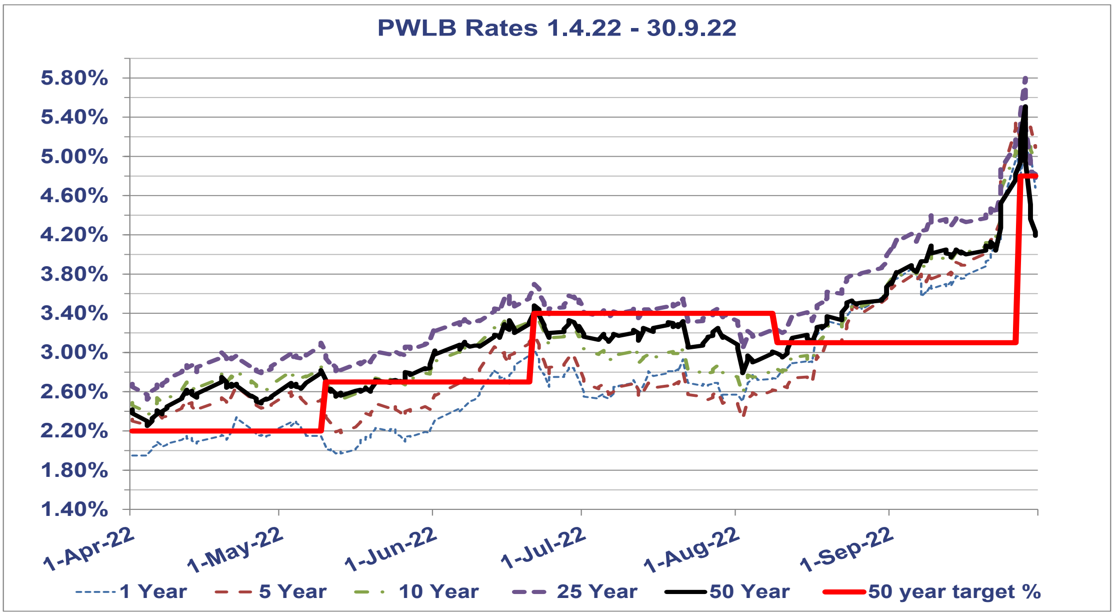
Throughout Q3 Bank Rate increased, finishing the quarter at 2.25% (an increase of 1%). Q4 has seen rates rise to 3.5% in December and the market expects Bank Rate to hit 4.5% by May 2023.

Following a Conservative Party leadership contest, Liz Truss became Prime Minister for a tumultuous seven weeks that ran through September and October. Put simply, the markets did not like the unfunded tax-cutting and heavy spending policies put forward by her Chancellor, Kwasi Kwarteng, and their reign lasted barely seven weeks before being replaced by Prime Minister Rishi Sunak and Chancellor Jeremy Hunt. Their Autumn Statement of 17th November gave rise to a net £55bn fiscal tightening, although much of the "heavy lifting" has been left for the next Parliament to deliver. However, the markets liked what they heard, and UK gilt yields have almost completely reversed the increases seen under the previous tenants of No10/11 Downing Street.

Globally, though, all the major economies are expected to struggle in the near term. The fall below 50 in the composite Purchasing Manager Indices for the UK, US, EZ and China all point to at least one, if not more, quarters of GDP contraction. In November, the MPC projected eight quarters of negative growth for the UK lasting throughout 2023 and 2024, but with Bank Rate set to peak at lower levels than previously priced in by the markets and the fiscal tightening deferred to some extent, it is not clear that things will be as bad as first anticipated by the Bank.

The £ has strengthened of late, recovering from a record low of $1.035, on the Monday following the Truss government's "fiscal event", to $1.22. Notwithstanding the £'s better run of late, 2023 is likely to see a housing correction of some magnitude as fixed-rate mortgages have moved above 5% and affordability has been squeezed despite proposed Stamp Duty cuts remaining in place.

In the table below, the rise in gilt yields, and therein PWLB rates, through the first half of 2022/23 is clear to see.



However, the peak in rates on 28th September as illustrated in the table covering April to September 2022 below, has been followed by the whole curve shifting lower. PWLB rates at the front end of the curve are generally over 1% lower now whilst the 50 years is over 1.75% lower.

	1 Year	5 Year	10 Year	25 Year	50 Year
Low	1.95%	2.18%	2.36%	2.52%	2.25%
Date	01/04/2022	13/05/2022	04/04/2022	04/04/2022	04/04/2022
High	5.11%	5.44%	5.35%	5.80%	5.51%
Date	28/09/2022	28/09/2022	28/09/2022	28/09/2022	28/09/2022
Average	2.81%	2.92%	3.13%	3.44%	3.17%
Spread	3.16%	3.26%	2.99%	3.28%	3.26%

After a shaky start to the year, the S&P 500 and FTSE 100 have climbed in recent weeks, albeit the former is still 17% down and the FTSE 2% up. The German DAX is 9% down for the year.

CENTRAL BANK CONCERNS – DECEMBER 2022

In December, the Fed decided to push up US rates by 0.5% to a range of 4.25% to 4.5%, whilst the MPC followed by raising Bank Rate from 3% to 3.5%, in line with market expectations. EZ rates have also increased to 2% with further tightening in the pipeline.

Having said that, the sentiment expressed in the press conferences in the US and the UK were very different. In the US, Fed Chair, Jerome Powell, stated that rates will be elevated and stay higher for longer than markets had expected. Governor Bailey, here in the UK, said the opposite and explained that the two economies are positioned very differently so you should not, therefore, expect the same policy or messaging.

Regarding UK market expectations, although they now expect Bank Rate to peak within a lower range of 4.5% - 4.75%, caution is advised as the Bank of England Quarterly Monetary Policy Reports have carried a dovish message over the course of the last year, only for the Bank to have to play catch-up as the inflationary data has proven stronger than expected.

In addition, the Bank's central message that GDP will fall for eight quarters starting with Q3 2022 may prove to be a little pessimistic. Will the £160bn excess savings accumulated by households through the Covid lockdowns provide a spending buffer for the economy – at least to a degree? Ultimately, however, it will not only be inflation data but also employment data that will mostly impact the decision-making process, although any softening in the interest rate outlook in the US may also have an effect (just as, conversely, greater tightening may also).

5.2 APPENDIX: Treasury Management Practice (TMP1): Permitted Investments

This Council is asked to approve the following forms of investment instrument for use as permitted investments as set out in tables 1.1-1.4.

Treasury risks

All the investment instruments in tables 1.1-1.4 are subject to the following risks:-

1. **Credit and counter-party risk:** this is the risk of failure by a counterparty (bank or building society) to meet its contractual obligations to the organisation particularly as a result of the counterparty's diminished creditworthiness, and the resulting detrimental effect on the organisation's capital or current (revenue) resources. There are no counterparties where this risk is zero although AAA rated organisations have the highest, relative, level of creditworthiness.

2. **Liquidity risk:** this is the risk that cash will not be available when it is needed. While it could be said that all counterparties are subject to at least a very small level of liquidity risk as credit risk can never be zero, in this document, liquidity risk has been treated as whether or not instant access to cash can be obtained from each form of investment instrument. However, it has to be pointed out that while some forms of investment e.g. gilts, CDs, corporate bonds can usually be sold immediately if the need arises, there are two caveats: - a. cash may not be available until a settlement date up to three days after the sale b. there is an implied assumption that markets will not freeze up and so the instrument in question will find a ready buyer. The column in tables 1.1-1.4 headed as 'market risk' will show each investment instrument as being instant access, sale T+3 = transaction date plus 3 business days before you get cash, or term i.e. money is locked in until an agreed maturity date.

3. **Market risk:** this is the risk that, through adverse market fluctuations in the value of the principal sums an organisation borrows and invests, its stated treasury management policies and objectives are compromised, against which effects it has failed to protect itself adequately. However, some cash rich local authorities may positively want exposure to market risk e.g. those investing in investment instruments with a view to obtaining a long term increase in value.

4. **Interest rate risk**: this is the risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately. This authority has set limits for its fixed and variable rate exposure in its Treasury Indicators in this report (see Section 3.4).

5. **Legal and regulatory risk:** this is the risk that the organisation itself, or an organisation with which it is dealing in its treasury management activities, fails to act in accordance with its legal powers or regulatory requirements, and that the organisation suffers losses accordingly.

Controls on treasury risks

1. **Credit and counter-party risk:** this authority has set minimum credit criteria to determine which counterparties and countries are of sufficiently high creditworthiness to be considered for investment purposes. See Sections 4.2 and 4.3.

2. **Liquidity risk:** this authority has a cash flow forecasting model to enable it to determine how long investments can be made for and how much can be invested.

3. **Market risk:** this authority does not purchase investment instruments which are subject to market risk in terms of fluctuation in their value.

4. **Interest rate risk**: this authority manages this risk by having a view of the future course of interest rates and then formulating a treasury management strategy accordingly which aims to maximise investment earnings consistent with control of risk or alternatively, seeks to minimise expenditure on interest costs on borrowing. See Section 4.4.

5. **Legal and regulatory risk:** this authority will not undertake any form of investing until it has ensured that it has all necessary powers and also complied with all regulations.

Unlimited investments

Regulation 24 states that an investment can be shown in tables 1 / 2 as being ‘unlimited’ in terms of the maximum amount or percentage of the total portfolio that can be put into that type of investment. However, it also requires that an explanation must be given for using that category. The authority has given the following types of investment an unlimited category: -

1. **Debt Management Agency Deposit Facility**. This is considered to be the lowest risk form of investment available to local authorities as it is operated by the Debt Management Office which is part of H.M. Treasury i.e. the UK Government’s sovereign rating stands behind the DMADF. It is also a deposit account and avoids the complications of buying and holding Government issued treasury bills or gilts.

2. **High credit worthiness banks and building societies**. See paragraph 4.2 for an explanation of this authority’s definition of high credit worthiness. While an unlimited amount of the investment portfolio may be put into banks and building societies with high credit worthiness, the authority will ensure diversification of its portfolio ensuring that no more than £15 million can be placed with any one institution or group at any one time, other than the Bank of Scotland or Royal Bank of Scotland where the limit is £30 million.

Objectives of each type of investment instrument

Regulation 25 requires an explanation of the objectives of every type of investment instrument which an authority approves as being 'permitted'.

1. DEPOSITS

The following forms of 'investments' are actually more accurately called deposits as cash is deposited in an account until an agreed maturity date or is held at call.

a) **Debt Management Agency Deposit Facility.** This offers the lowest risk form of investment available to local authorities as it is effectively an investment placed with the Government. It is also easy to use as it is a deposit account and avoids the complications of buying and holding Government issued treasury bills or gilts. As it is low risk it also earns low rates of interest. However, it is very useful for authorities whose overriding priority is the avoidance of risk. The longest period for a term deposit with the DMADF is 6 months.

b) **Term Deposits – Local Authorities.** They are quasi-Government bodies with low counterparty and value risk. Typical deposit terms vary from 1 month to 2 years, with longer term deposits offering an opportunity to increase investment returns by locking in high rates ahead of an expected fall in the level of interest rates. At other times, longer term rates can offer good value when the markets incorrectly assess the speed and timing of interest rate increases. This form of investing therefore, offers a lot of flexibility and typically higher earnings than the DMADF. Where it is restricted is that once a longer term investment is made, that cash is locked in until the maturity date other than with agreement of the counterparty, at which point penalties would typically apply.

c) **Call accounts with high credit worthiness banks and building societies.** See Section 4.2 for an explanation of this authority's definition of high credit worthiness. These typically offer a much higher rate of return than the DMADF and now that measures have been put in place to avoid over reliance on credit ratings, the authority feels much more confident that the residual risks around using such banks and building societies are at a low, reasonable and acceptable level. There is instant access to recalling cash deposited (or short-dated notice e.g. 15-30 days). This generally means accepting a lower rate of interest than that which could be earned from the same institution by making a term deposit (see 1d below). However, there are a number of call accounts which at the time of writing, offer rates 2 – 3 times more than term deposits with the DMADF. Some use of call accounts is highly desirable to ensure that the authority has ready access to cash when needed to pay bills.

d) **Term deposits with high credit worthiness banks and building societies.** The objectives are as for 1c. These offer a much higher rate of return than the DMADF and deposits made with other Local Authorities (dependent upon term) and, similar to 1c, now that measures have been put in place to avoid over reliance on credit ratings, the authority feels much more confident that the residual risks around using such banks and building societies are at a low, reasonable and acceptable level. This is the most widely used form of investing used by local authorities. The authority will ensure diversification of its portfolio of deposits ensuring that no more than £15 million is invested with any (non-nationalised) UK counterparty, and no more than £15 million is invested with any other non-UK counterparty, group or country. In addition, longer term deposits offer an opportunity to increase investment returns by locking in high rates ahead of an expected fall in the level of interest rates. At other times, longer term rates can offer good value when the markets incorrectly assess the speed and timing of interest rate increases. This form of investing therefore, offers a lot of flexibility and higher earnings than the DMADF. Where it is restricted is that once a longer term investment is made, that cash is locked in until the maturity date.

e) **Fixed term deposits with variable rate and variable maturities (structured deposits).** This encompasses ALL types of structured deposits. There has been considerable change in the types of structured deposits brought to the market over the last few years, some of which are already no longer available. In view of the fluidity of this area, this is a generic title for all structured deposits so as to provide councils with greater flexibility to adopt new instruments as and when they are brought to the market. This line encompasses ALL types of structured deposits. There has been considerable change in the types of structured deposits brought to the market over the last few years, some of which are already no longer available. In view of the fluidity of this area, this is a generic title for all structured deposits so as to provide greater flexibility to adopt new instruments as and when they are brought to the market.

2. DEPOSITS WITH COUNTERPARTIES CURRENTLY IN RECEIPT OF UK GOVERNMENT SUPPORT / OWNERSHIP

These banks offer another dimension of creditworthiness in terms of UK Government backing through either direct (partial or full) ownership. The view of this authority is that such backing makes these banks attractive institutions with whom to place deposits, and that will remain our view if the UK sovereign rating were to be downgraded in the coming year.

a. **Call accounts.** As for 1c. but UK Government stated support implies that the UK Government stands behind these banks and building societies and will be deeply committed to providing whatever support that may be required to ensure the continuity of such institutions. This authority feels this indicates a low and acceptable level of residual risk.

b. **Term deposits with high credit worthiness banks which are fully or semi nationalised.** As for 1d. but Government ownership partial or full implies that the UK Government stands behind this bank and will be deeply committed to providing whatever support that may be required to ensure the continuity of that bank. This authority considers this indicates a low and acceptable level of residual risk.

c. **Fixed term deposits with variable rate and variable maturities (structured deposits).** As for 1e but UK Government stated support implies that the UK Government stands behind eligible banks and building societies and will be deeply committed to providing whatever support that may be required to ensure the continuity of such institutions. This authority feels this indicates a low and acceptable level of residual risk. This line encompasses ALL types of structured deposits. There has been considerable change in the types of structured deposits brought to the market over the last few years, some of which are already no longer available. In view of the fluidity of this area, this is a generic title for all structured deposits so as to provide greater flexibility to adopt new instruments as and when they are brought to the market.

3. COLLECTIVE INVESTMENT SCHEMES STRUCTURED AS OPEN ENDED INVESTMENT COMPANIES (OEICS)

a. **Government liquidity funds.** These are the same as money market funds (see below) but only invest in government debt issuance with highly rated governments. Due to the higher quality of underlying investments, they offer a lower rate of return than MMFs. However, their net return is typically on a par with the DMADF, but with instant access.

b. **Money Market Funds (MMFs).** By definition, MMFs are AAA rated and are widely diversified, using many forms of money market securities including types which this authority does not currently have the expertise or capabilities to hold directly. However, due to the high level of expertise of the fund managers and the huge amounts of money invested in MMFs, and the fact that the weighted average maturity (WAM) cannot exceed 60 days, MMFs offer a combination of high security, instant access to funds, high diversification and good rates of return compared to equivalent instant access facilities. They are particularly advantageous in falling interest rate environments as their 60 day WAM means they have locked in investments earning higher rates of interest than are currently available in the market. MMFs also help an authority to diversify its own portfolio as e.g. a £2m investment placed directly with HSBC is a 100% risk exposure to HSBC whereas £2m invested in a MMF may end up with say £10,000 being invested with HSBC through the MMF. For authorities particularly concerned with risk exposure to banks, MMFs offer an effective way of minimising risk exposure while still getting much better rates of return than available through the DMADF.

c. **Ultra Short Dated Bond Funds .** These funds are similar to MMFs, can still be AAA rated but have Variable Net Asset Values (VNAV) as opposed to a traditional MMF which has a Constant Net Asset Value (CNAV). They aim to achieve a higher yield and to do this either take more credit risk or invest out for longer periods of time, which means they are more volatile. These funds can have WAM’s and Weighted Average Life (WAL’s) of 90 – 365 days or even longer. Their primary objective is yield and capital preservation is second. They therefore are a higher risk than MMFs and correspondingly have the potential to earn higher returns than MMFs.

d. **Gilt funds.** These are funds which invest only in U.K. Government gilts. They offer a lower rate of return than bond funds but are highly rated both as a fund and through investing only in highly rated government securities. They offer a higher rate of return than investing in the DMADF but they do have an exposure to movements in market prices of assets held.

e. **Bond funds.** These can invest in both government and corporate bonds. This therefore entails a higher level of risk exposure than gilt funds and the aim is to achieve a higher rate of return than normally available from gilt funds by trading in non-government bonds.

4. SECURITIES ISSUED OR GUARANTEED BY GOVERNMENTS

The following types of investments are where an authority directly purchases a particular investment instrument, a security, i.e. it has a market price when purchased and that value can change during the period the instrument is held until it matures or is sold. The annual earnings on a security is called a yield i.e. it is normally the interest paid by the issuer divided by the price you paid to purchase the security unless a security is initially issued at a discount e.g. treasury bills..

a. **Treasury bills.** These are short term bills (up to 12 months, although none have ever been issued for this maturity) issued by the Government and so are backed by the sovereign rating of the UK. The yield is higher than the rate of interest paid by the DMADF and another advantage compared to a time deposit in the DMADF is that they can be sold if there is a need for access to cash at any point in time. However, there is a spread between purchase and sale prices so early sales could incur a net cost during the period of ownership.

b. **Gilts.** These are longer term debt issuance by the UK Government and are backed by the sovereign rating of the UK. The yield is higher than the rate of interest paid by the DMADF and another advantage compared to a time deposit in the DMADF is that they can be sold if there is a need for access to cash at any point in time. However, there is a spread between purchase and sale prices so early sales may incur a net cost. Market movements that occur between purchase and sale may also have an adverse impact on proceeds. The advantage over Treasury bills is that they generally offer higher yields the longer it is to maturity (for most periods) if the yield curve is positive.

c. **Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government** e.g. National Rail. This is similar to a gilt due to the explicit Government guarantee.

d. **Sovereign bond issues (other than the UK govt) denominated in Sterling.** As for gilts but issued by other nations. Use limited to issues of nations with at least the same sovereign rating as for the UK.

e. **Bonds issued by Multi Lateral Development Banks (MLDBs).** These are similar to c. and e. above but are issued by MLDBs which are typically guaranteed by a group of sovereign states e.g. European Bank for Reconstruction and Development.

5. SECURITIES ISSUED BY CORPORATE ORGANISATIONS

The following types of investments are where an authority directly purchases a particular investment instrument, a security, i.e. it has a market price when purchased and that value can change during the period the instrument is held until it is sold. The annual earnings on a security is called a yield i.e. is the interest paid by the issuer divided by the price you paid to purchase the security. These are similar to the previous category but corporate organisations can have a wide variety of credit worthiness so it is essential for local authorities to only select the organisations with the highest levels of credit worthiness. Corporate securities are generally a higher risk than government debt issuance and so earn higher yields.

a. **Certificates of deposit (CDs).** These are shorter term securities issued by deposit taking institutions (mainly financial institutions). They are negotiable instruments, so can be sold ahead of maturity and also purchased after they have been issued. However, that liquidity can come at a price, where the yield could be marginally less than placing a deposit with the same bank as the issuing bank.

b. **Commercial paper.** This is similar to CDs but is issued by commercial organisations or other entities. Maturity periods are up to 365 days but commonly 90 days.

c. **Corporate bonds.** These are (long term) bonds (usually bearing a fixed rate of interest) issued by a financial institution, company or other non-government issuer in order to raise capital for the institution as an alternative to issuing shares or borrowing from banks. They are generally seen to be of a lower creditworthiness than government issued debt and so usually offer higher rates of yield.

d. **Floating rate notes.** These are bonds on which the rate of interest is established periodically with reference to short-term interest rates.

6. OTHER

a. **Local Authority Mortgage Scheme.** Authorities who are participating in the Local Authority Mortgage Guarantee Scheme (LAMS) may be required to place a deposit with the mortgage provider(s) up to the full value of the guarantee. The deposit will be in place for the term of the guarantee i.e. 5 years (with the possibility of a further 2 year extension if the account is 90+ days in arrears at the end of the initial 5 years) - and may have conditions / structures attached. The mortgage provider will not hold a legal charge over the deposit.

b. **Loans to third parties** – This would involve the Council borrowing from the PWLB/markets and onward lending to Registered Social Landlords to enable them to access lower cost loans and kickstart developments of affordable mid-market homes. The risk associated with such an investment would be mitigated by an assessment of the counterparty in advance of any loan being granted and through the application of a premium on the loan rate. Interest would be paid by the RSL over the term of the loan, with repayment of principal upon the earlier of 10/20 years or at the point of house sales. The Council will also request that a standard security is taken over the property which would allow the Council to require the sale of the homes to another landlord, providing greater risk mitigation.

c. **Subordinated Debt Subscription to the SPV set up to deliver the Newbattle Centre project –** this involved the Council subscribing £332,806 of subordinated debt to the SPV that was set up to deliver the Newbattle Centre project (2 year construction and 25 year operational contract length). The length of the investment is 25 years with the subscription made at operation commencement of the contract. The repayment profile will comprise 81% of the principal remaining invested until the final two years of the contract. The risk associated with this type of investment will be mitigated through an annual assessment as a minimum to review the holding of such debt, and whether the exposure to risk arising from the investment has changed over the period.

d. **ESCO:** Midlothian Energy Limited (MEL) Joint Venture between Midlothian Council and Vattenfall to deliver energy supply to Shawfair using heat supplied from the Millerhill Energy from Waste plant and related projects.

Table 1: Permitted Investments

1.1 Deposits

Investment Category	Minimum Credit Criteria	Liquidity risk	Market risk	Max %/£m of total investments	Max. maturity period	Max Transaction Value
Debt Management Agency Deposit Facility	UK Government	Term	No	**100%**	**6 months**	**n/a**
Term deposits – local authorities	Quasi-UK Government	Term	No	**100%**	**5 years**	**£15m**
Call accounts – banks and building societies	Green	Instant	No	**100%**	**1 day**	**£15m**
Term deposits / Notice Accounts – banks and building societies	Yellow Purple Blue Orange Red Green No Colour	Term	No	**100%**	**Up to 6 yrs** **Up to 2.5 yrs** **Up to 1.25 yrs** **Up to 1.25 yrs** **Up to 7 mths** **Up to 120 days** **Not for use**	**£15m**
Fixed term deposits with variable rate and variable maturities: - Structured deposits	Yellow Purple Blue Orange Red Green No Colour	Term	No	**100%**	**Up to 6 yrs** **Up to 2.5 yrs** **Up to 1.25 yrs** **Up to 1.25 yrs** **Up to 7 mths** **Up to 120 days** **Not for use**	**£15m**

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

Investment Category	Minimum Credit Criteria	Liquidity risk	Market risk	Max %/£m of total investments	Max. maturity period	Max Transaction Value
UK nationalised banks – Call accounts	Blue	Instant	No	**100%**	**1 day**	**£30m**
UK nationalised banks – Term Deposits / Notice Accounts	Blue	Term	No	**100%**	**2 years**	**£30m**
UK nationalised banks – Fixed term deposits with variable rate and variable maturities: - Structured deposits	Blue	Term	No	**100%**	**2 years**	**£30m**
Non-UK (high sovereign rated country) nationalised banks – Call accounts	Green	Instant	No	**100%**	**1 day**	**£15m**
Non-UK (high sovereign rated country) nationalised banks:- Term Deposits / Notice Accounts	Yellow Purple Blue Orange Red Green No Colour	Term	No	**100%**	**Up to 6 yrs** **Up to 2.5 yrs** **Up to 1.25 yrs** **Up to 1.25 yrs** **Up to 7 mths** **Up to 120 days** **Not for use**	**£15m**
Non-UK (high sovereign rated country) nationalised banks:- Fixed term deposits with variable rate and variable maturities: - Structured deposits	Yellow Purple Blue Orange Red Green No Colour	Term	No	**100%**	**Up to 6 yrs** **Up to 2.5 yrs** **Up to 1.25 yrs** **Up to 1.25 yrs** **Up to 7 mths** **Up to 120 days** **Not for use**	**£15m**

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

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

Investment Category	Minimum Credit Criteria	Liquidity risk	Market risk	Max %/£m of total investments	Max. maturity period	Max Transaction Value
Government Liquidity Funds	AAA	Instant	No	**100%**	**1 day**	**£15m**
Money Market Funds CNAV	AAA	Instant	No	**100%**	**1 day**	**£15m**
Money Market Funds LVNAV	AAA	Instant	No	**100%**	**1 day**	**£15m**
Money Market Funds VNAV	AAA	Instant	No	**100%**	**1 day**	**£15m**
Ultra Short Dated Bond Funds with a credit score of 1.25	AAA	T+1 to T+5	Yes	**100%**	**1 week**	**£15m**
Ultra Short Dated Bond Funds with a credit score of 1.5	AAA	T+1 to T+5	Yes	**100%**	**1 week**	**£15m**
Bond Funds	AAA	T+2 or longer	Yes	**50%**	**2 days**	**£15m**
Gilt Funds	AAA	T+2 or longer	Yes	**50%**	**2 days**	**£15m**

1.4 Securities issued or guaranteed by governments

Investment Category	* Minimum Credit Criteria	Liquidity risk	Market risk	Max %?£m of total investments	Max. maturity period
Treasury Bills	UK sovereign rating	Sale T+1	Yes	**100%**	**6 months**
UK Government Gilts	UK sovereign rating	Sale T+1	Yes	**100%**	**50 years**
Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government e.g. National Rail	UK sovereign rating	Sale T+3	Yes	**100%**	**50 years**
Sovereign bond issues (other than the UK govt)	AAA (or state your criteria if different)	Sale T+1	Yes	**100%**	**50 years**
Bonds issued by multilateral development banks	AAA (or state your criteria if different)	Sale T+1	Yes	**100%**	**50 years**

1.5 Securities issued by corporate organisations

Investment Category	* Minimum Credit Criteria	Liquidity risk	Market risk	Max % of total investments	Max. maturity period	Max Transaction Value
Certificates of deposit issued by banks and building societies	Yellow Purple Blue Orange Red Green No Colour	Sale T+1	Yes	**100%**	**Up to 6 yrs** **Up to 2.5 yrs** **Up to 1.25 yrs** **Up to 1.25 yrs** **Up to 7 mths** **Up to 120 days** **Not for use**	**£15m**
Commercial paper other	Yellow Purple Blue Orange Red Green No Colour	Sale T+0	Yes	**100%**	**Up to 6 yrs** **Up to 2.5 yrs** **Up to 1.25 yrs** **Up to 1.25 yrs** **Up to 7 mths** **Up to 120 days** **Not for use**	**£15m**
Floating rate notes	Yellow Purple Blue Orange Red Green No Colour	Sale T+2	Yes	**100%**	**Up to 6 yrs** **Up to 2.5 yrs** **Up to 1.25 yrs** **Up to 1.25 yrs** **Up to 7 mths** **Up to 120 days** **Not for use**	**£15m**
Corporate Bonds other	Yellow Purple Blue Orange Red Green No Colour	Sale T+2	Yes	**100%**	**Up to 6 yrs** **Up to 2.5 yrs** **Up to 1.25 yrs** **Up to 1.25 yrs** **Up to 7 mths** **Up to 120 days** **Not for use**	**£15m**

1.6 Other

Investment Category	Minimum Credit Criteria	Liquidity risk	Market risk	Max %/£m of total investments	Max. maturity period
Local authority mortgage guarantee scheme.	Blue	Term	No	**50%**	**5 years**
Loans to Third Parties	n/a	Term	No	**£25m**	**20 years**
Subordinated Debt Subscription to Newbattle Centre SPV	n/a	Term	No	**£0.326m**	**22 years**
ESCO	n/a	Term	No	**£10.2m**	**n/a**

5.3 APPENDIX: Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

Midlothian Council Permitted Investments, Associated Controls and Limits

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits
Cash type instruments			
a. Deposits with the Debt Management Account Facility (UK Government) (**Very low risk)**	This is a deposit with the UK Government and as such counterparty and liquidity risk is very low, and there is no risk to value. Deposits can be between overnight and 6 months.	Little mitigating controls required. As this is a UK Government investment the monetary limit is unlimited to allow for a safe haven for investments.	As shown in Appendix 5.2.
b. Deposits with other local authorities or public bodies **(Very low risk)**	These are considered quasi UK Government debt and as such counterparty risk is very low, and there is no risk to value. Deposits can only be broken with the agreement of the counterparty, and penalties can apply. Deposits with other non-local authority bodies will be restricted to the overall credit rating criteria.	Little mitigating controls required for local authority deposits, as this is a quasi UK Government investment. Non- local authority deposits will follow the approved credit rating criteria.	As shown in Appendix 5.2.
c. CNAV, LVNAV and VNAV Money Market Funds (MMFs) **(Low to very low risk)**	Pooled cash investment vehicle which provides very low counterparty, liquidity and market risk. These will primarily be used as liquidity instruments.	Funds will only be used where the MMF has a “AAA” rated status from either Fitch, Moody’s or Standard & Poors.	As shown in Appendix 5.2.
d. Ultra Short Dated Bond Funds **(low risk)**	Pooled cash investment vehicle which provides very low counterparty, liquidity and market risk. These will primarily be used as liquidity instruments.	Funds will only be used where the Ultra Short Dated Bond Fund has a “AAA” rated status from either Fitch, Moody’s or Standard and Poor’s.	As shown in Appendix 5.2.

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits
e. Call account deposit accounts with financial institutions (banks and building societies) **(Low risk depending on credit rating)**	These tend to be low risk investments, but will exhibit higher risks than categories (a), (b) and (c) above. Whilst there is no risk to value with these types of investments, liquidity is high and investments can be returned at short notice.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's, with the credit scoring methodology by Link Group, Treasury Solutions overlaid. On day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	As shown in Appendix 5.2.
f. Term deposits with financial institutions (banks and building societies) **(Low to medium risk depending on period & credit rating)**	These tend to be low risk investments, but will exhibit higher risks than categories (a), (b), (c) and (d) above. Whilst there is no risk to value with these types of investments, liquidity is low and term deposits can only be broken with the agreement of the counterparty, and penalties may apply.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's, with the credit scoring methodology by Link Group, Treasury Solutions overlaid. On day to day investment dealing, this criteria will be further strengthened by the use of additional market intelligence.	As shown in Appendix 5.2.

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits
g. Government Gilts and Treasury Bills **(Very low risk)**	These are marketable securities issued by the UK Government and as such counterparty and liquidity risk is very low, although there is potential risk to value arising from an adverse movement in interest rates (no loss if these are held to maturity.	Little counterparty mitigating controls are required, as this is a UK Government investment. The potential for capital loss will be reduced by limiting the maximum monetary and time exposures	As shown in Appendix 5.2.
h. Certificates of deposits with financial institutions **(Low risk)**	These are short dated marketable securities issued by financial institutions and as such counterparty risk is low, but will exhibit higher risks than categories (a), (b) and (c) above. There is risk to value of capital loss arising from selling ahead of maturity if combined with an adverse movement in interest rates (no loss if these are held to maturity). Liquidity risk will normally be low.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's. The selection defaults to the lowest available colour band / credit rating to provide additional risk control measures. Day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	As shown in Appendix 5.2.
i. Structured deposit facilities with banks and building societies (escalating rates, de-escalating rates etc.) (Low to medium risk depending on period & credit rating)	These tend to be medium to low risk investments, but will exhibit higher risks than categories (a), (b), (c) and (d) above. Whilst there is no risk to value with these types of investments, liquidity is very low and investments can only be broken with the agreement of the counterparty (penalties may apply).	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's, with the credit scoring methodology by Link Group, Treasury Solutions overlaid. On day to day investment dealing, this criteria will be further strengthened by the use of additional market intelligence.	As shown in Appendix 5.2.

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits
j. Corporate bonds **(Medium to high risk depending on period & credit rating)**	These are marketable securities issued by financial and corporate institutions. Counterparty risk will vary and there is risk to value of capital loss arising from selling ahead of maturity if combined with an adverse movement in interest rates. Liquidity risk will be low.	The counterparty selection criteria approved above restricts lending only to high quality counterparties, measured primarily by credit ratings from Fitch, Moody's and Standard and Poor's. The selection defaults to the lowest available colour band / credit rating to provide additional risk control measures. Corporate bonds will be restricted to those meeting the base criteria. Day to day investment dealing with this criteria will be further strengthened by the use of additional market intelligence.	As shown in Appendix 5.2.

Type of Investment	Treasury Risks	Mitigating Controls	Council Limits
Other types of investments			
k. Loans to third parties	Using the example of a loan to a RSL, these would be medium risk investments, exhibiting higher risks than categories (a)-(f) above. They are also highly illiquid and are only repaid at the end of a defined period of time (up to 20 years) or on the sale of a property, whichever is the earlier.	The risk associated with such an investment would be mitigated through the application of a premium on the loan rate. The Council will also request that a standard security is taken over the property which would allow the Council to require the sale of the homes to another landlord, providing greater risk mitigation.	£25m
l. Non-local authority shareholdings	These are non-service investments which may exhibit market risk, be only considered for longer term investments and will be likely to be liquid.	Any non-service equity investment will require separate Member approval and each application will be supported by the service rational behind the investment and the likelihood of loss.	Per Existing
m. Local Authority Mortgage Scheme (LAMS)	These are service investments at market rates of interest plus a premium.		As shown in Appendix 5.2.
n. Subordinated Debt Subscription to Newbattle Centre SPV	These are investments that are exposed to the success or failure of individual projects and are highly illiquid.	The Council and Scottish Government (via the SFT) are participants in and party to the governance and controls within the project structure. As such they are well placed to influence and ensure the successful completion of the project's term.	As shown in Appendix 5.2.
o. ESCO	These are investments that are exposed to the success or failure of individual projects and are highly illiquid.	The Council is in a joint venture partnership and therefore party to the governance and controls within the project structure. As such the Council is	As shown in Appendix 5.2.

		well placed to influence and ensure the successful completion of the project's term	

The Monitoring of Deposit Counterparties - The status of counterparties will be monitored regularly. The Council receives credit rating and market information from Link Group, Treasury Solutions, including when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Acting Chief Financial Officer, and if required new counterparties which meet the criteria will be added to the list.

5.4 APPENDIX: Approved countries for investments

Based on the lowest available rating as at 20.01.2022

AAA

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

AA+

- Canada
- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- France

AA-

- Belgium
- U.K.

5.5 APPENDIX: Treasury management scheme of delegation

(i) Full Council

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.
- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

(iii) Audit Committee

- reviewing treasury management reports, the treasury management policy and procedures, and making recommendations to the responsible body.

5.6 APPENDIX: The treasury management role of the section 95 officer

The S95 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers;
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe;
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money;
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority;
- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing;
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources;
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities;
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees ensuring that members are adequately informed and understand the risk exposures taken on by an authority;
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above;
- creation of Treasury Management Practices which specifically deal with how non-treasury investments will be carried out and managed, to include the following:-
    - Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;
    - Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;
    - Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;
    - Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;

- Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.

Internal Audit Work to December 2022

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 2022/23 was approved by the Audit Committee on 14 March 2022. 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 with 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 25 January 2023

Report Contact:
Duncan Stainbank
duncan.stainbank@midlothian.gov.uk

3 Progress Report

3.1 The Internal Audit Annual Plan 2022/23 was approved by the Audit Committee on 14 March 2022. Internal Audit has carried out the following work in the period from 1 November to 31 December 2022 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 with 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:

- Accounts Receivable – Sundry Debt; and
- Utilities: Energy and Water Consumption

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 2022/23 consists of the following:

Audit Area	Audit Stage
Employability Funded Programmes	Drafting the report
Care at Home	Drafting the report
Performance Management and Performance Indicators	Drafting the report
Mental Health Services	Planning underway
Construction projects / social housing programme	Planning 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:

a) In its critical friend role provided an independent view and challenge at various forums including Capital Plan and Asset Management Board, Capital Plan Management Group, Capital Plan Prioritisation Review Group, Chief Officers Risk & Resilience Group, Integrity Group, UKSPF Oversight Board and Information Management Group;

b) Learning and development during the research stage of new audit areas for all Internal Audit team members and through joining virtual audit forums (Computer Audit Sub-group) and meetings; and

c) 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.

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:

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

3.8 The table below summarises the number of Internal Audit recommendations made during 2022/23:

Recs Rating	2022/23 Number of Recs
High	0
Medium	6
Low	13
Sub-total reported this period	**19**
Previously reported	15
Total	**34**

Recommendations agreed with action plan	34
Not agreed; risk accepted	0
Total	**34**

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 the Council to deliver its key priorities in support of achieving the 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

The 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 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.

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.

APPENDIX 1

<table>
<tr><th rowspan="2">Report</th><th rowspan="2">Summary of key findings and recommendations</th><th colspan="3">Recommendations</th><th rowspan="2">Status</th></tr>
<tr><th>H</th><th>M</th><th>L</th></tr>
<tr><td>Subject: Accounts Receivable - Sundry Debt

Category: Assurance – Cyclical

Date issued:
17 November 2022 Draft
7 December 2022 Final

Level of Assurance:
Substantial</td><td>The purpose of the audit was to review the controls in place to set fees and charges for services, raise invoices promptly, and collect debts efficiently resulting in debtors' balances that are complete, accurate and recoverable with appropriate VAT treatment.

The Council uses Capita’s Integra 2 finance system for sales ledger and arrears management processes. Invoices are raised via the sales ledger for a wide range of chargeable services. For 2021/22 14,641 invoices were raised (£24,876,891), 1,135 credit notes were raised (£1,673,554), and 28,453 payments were received (£25,810,735). The Council’s sundry debt over 30 days old as at 31 March 2019 was £1,489,433 and this increased to £1,959,244 by 31 March 2022.

The Council had weaker collection performance during 2020 at the height of the Coronavirus pandemic, but from 2021 the collection performance improved and was similar to normal levels prior to the outbreak of the virus. The Council’s aged debt position has deteriorated when compared to pre-pandemic levels, but collection performance on invoices raised from the latter part of 2021 onwards is more in line with pre-pandemic performance.

Most invoices are raised on behalf of services by either the Sundry Debt Team or Business Support Services. Schools raise their own invoices for room and facility hires. Payments in respect of invoices raised are receipted onto the Civica ICON system. A daily upload from this system updates all of the customer accounts with the payments received. Responsibility for collection of sundry debt rests with the Sundry Debt Team. The Council contracts an external debt collector (Walker Love) who provide debt collection services for debts that need a specialist service.

Internal Audit considers that the level of assurance is substantial for the accounts receivable system. Accounts receivable processes have improved in terms of consistency, audit trail, and internal control over the years, and a significant part of the improvement is due to the Sundry Debt Team and the internal procedures developed by them.

Internal Audit made the following recommendations:
Management should review if the timescale for raising rechargeable repairs invoices could be reduced. (Low)</td><td>0</td><td>1</td><td>5</td><td>Management have accepted the factual accuracy of the report and its findings, and agreed to implement the recommendations.</td></tr>
</table>

	• The Fees and Charges Schedule should be published on the Council website annually to allow the public to view it and it should include all relevant fees and charges. (Low) • The service should finalise the implementation of a credit note E-form which would require all credit notes to undergo appropriate authorisation. (Medium) • Record retention requirements for invoice request slips should be clarified and the procedure should be applied consistently by all officers raising invoices. (Low) • Income Collection guidance on VAT should be more detailed. (Low) • For executory debt, comprehensive diary notes which reflect the complexity of the case, relevant action taken, evidence reviewed and the basis for the decision to no longer pursue the debt should be documented. (Low)				

<table>
<tr><th rowspan="2">Report</th><th rowspan="2">Summary of key findings and recommendations</th><th colspan="3">Recommendations</th><th rowspan="2">Status</th></tr>
<tr><th>H</th><th>M</th><th>L</th></tr>
<tr><td>Subject: Utilities: Energy and Water Consumption

Category: Assurance – Cyclical

Date issued:

15 December 2022 Draft

18 January 2023 Final

Level of Assurance:

Substantial for the procurement arrangements, invoicing and third party usage.

Limited for usage monitoring and the medium to long-term plans to reduce usage.</td><td>The purpose of the audit was to review the controls over the consumption of utilities (energy and water) ensuring utilisation is adequately controlled and represents value for money.

Utilities are procured through the national framework managed by Scottish Procurement - rates are agreed annually and it is predicted that prices will increase next year. The management of utilities is primarily the responsibility of the Energy Team within the Place Directorate. There is 1 FTE Energy Assistant Development Officer with responsibility for payment of utilities invoices, arranging for the installation or removal of meters, monitoring utilities usage, liaising with the supplier to address issues or errors in the Council's utilities billing, assisting in the preparation of utilities budgets, monitoring and identifying utilities anomalies, managing Salix funding, providing information relevant for Carbon Management reporting, and undertaking projects / campaigns to reduce energy usage. The 2022/23 budget for utilities (gas, water and electricity) is £4.686m and was increased by £1.058m at August Council due to the significant increase in gas prices since the budget was approved at the start of the year.

Electronic invoices are uploaded to the SystemsLink application for monitoring purposes and are paid following authorisation within the Council's Finance system, Integra 2. Utility costs are charged to the relevant Council sites by Financial Services using a report produced by the SystemsLink application. Baseline consumption levels have been set for all Council buildings and the budget forecast is based on these and utility price guidance received from Scottish Procurement and these are monitored throughout the year. Baseline consumption is based on average consumption for the property over a set number of years and is updated following changes to properties such as extensions or energy improvements.

The Council approved a Heating Policy in May 2019 which set target building temperatures for the different types of building (e.g. office space, school offices and classrooms, gymnasiums, sports centres, care homes, sports centre changing rooms, pool halls, gym halls, stores, etc.) and the Engineering Technician has advised that building temperatures have been set in line with the target temperatures in the policy.

Internal Audit considers that the level of assurance is Substantial for the procurement arrangements, invoicing and third party usage. Assurance is Limited for usage monitoring and the medium to long-term plans to reduce usage.</td><td>0</td><td>5</td><td>8</td><td>Management have accepted the factual accuracy of the report and its findings, and agreed to implement the recommendations.</td></tr>
</table>

Internal Audit made the following recommendations:

- Written procedures outlining the invoicing process for utilities should be updated and complete PDF version of utilities invoices should be appropriately filed and retained in line with the Council's Records Management Policy. Procedures for the usage monitoring process should be developed and a formalised process with an appropriate audit trail should be developed for requesting or removing an energy meter. (Low)
- The energy team should review if more of the smaller sites, such as the door entry and stair lighting sites and smaller buildings could have AMRs installed and whether AMRs for water consumption could be installed for additional sites. (Low)
- The contract rates for the utilities providers should be uploaded to SystemsLink each year to provide assurance for each invoice and every site that the utility providers are adhering to the agreed contract rates. In the interim, conformation of all relevant rates should be obtained from providers at the start of the year and evidence retained of sample checking of rates. (Low)
- Invoice verification services should be undertaken with increased frequency to ensure the Council is receiving best value for its utilities usage. (Low)
- The rates applicable for electricity generated by the Council's solar panels should be obtained annually from the provider. Additionally, the low electricity generation noted from a sample of panels should be reviewed to understand what caused this and if action is required to fix the issue. (Low)
- The property sharing arrangement with the NHS for the Recovery Hub including any rental contribution should be reviewed to ensure it reflects current usage and this should be documented in a written agreement between the Council and NHS Lothian. (Medium)
- As stipulated in the Heating Policy, a Buildings Register detailing the heating arrangements for each building should be developed and this should document any variations from the heating policy. The target temperatures for each building should be reviewed taking into account the rising costs of energy along with the ability to monitor non-compliance with the Heating Policy. (Medium)
- Management should review the scope for expanding the number of Council properties included on the Cylon Building Management System. Additionally, the system's reporting functionality should be reviewed. (Low)
- The service should review the resource allocated to the Energy Team to improve the Council's ability to monitor energy usage, reduce the key person dependency risk, and provide more segregation of duties / review controls over information input into the SystemsLink application. (Medium)

	• The Energy Team should work more closely with the Council's Engineering team and usage monitoring should consider information from the Building Management System. An inventory detailing boilers in all Council buildings should be collated and this should include the age of each boiler. (Low) • Management should review the scope for upgrading to the cloud based version of SystemsLink. This should be done in consultation with Digital Services and Business Applications (Low) • A review of future plans and management of the Bonnyrigg District Heating Scheme is required. (Medium) • Following the pilot exercise being undertaken for Fairfield House and Midlothian House, a longer term plan for improving building efficiency and reducing utilities usage across the Council estate should be developed. (Medium)				

Internal Audit Mid-Term Performance Report 2022/23

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 2022/23 to the end December 2022;

b) Confirm that it is satisfied with the performance of the Internal Audit service provision.

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 9 months of the year to 31 December 2022, towards completing the Internal Audit Annual Plan 2022/23. 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 2022/23 that was approved by the Audit Committee on 14 March 2022 sets out the audit coverage for the year utilising the expected 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 progress to date by Internal Audit with its programme of work and highlights changes that require approval to reflect the changes in resourcing available throughout the year.

Date 25 January 2022

Report Contact:
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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, risk management and governance within the Council.

3.3 The Internal Audit Annual Plan 2022/23 that was approved by the Audit Committee on 14 March 2022 set out the audit coverage for the year utilising anticipated 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.

4 Mid-Year Results Against Internal Audit Plan 2022/23

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.

4.3 The Appendix 1 to this report provides details of the progress by Internal Audit with its programme of work. Those audits which are complete are highlighted in dark shading, those underway to reflect their continuous audit approach are highlighted in light shading, and those scheduled for the final quarter of the year, or that will not now be completed in the year are not shaded.

4.4 In addition 2 audits Workforce Planning and Health and Safety, shaded in grey, have now been removed from the audit plan as this is not the appropriate time to complete these audits, given current risk and other external assurance.

4.5 The Internal Audit plan had, in addition to regularly required review processes 22 audits scheduled for completion in 2022/23, removing 2 audits results in a requirement to complete 20 audit assignments. The team has completed 6 assignments (30%), 3 further assignments will be complete for the March Audit Committee (15%). 4 further assignments (20%) are scheduled with current team capacity to substantially complete prior to the annual governance reports in May 2023. Work is underway to identify further resource to complete a further 3 assignments (15%) by May 2023. The 80% substantial completion of the plan would allow for an appoprite assessment of the Councils, governance, risk and control environment that is not limited.

4.6 Going forward further consideration will be given to creating a more risk based audit plan identifying potential efficiencies when possible, to ensure that appropriate assurance can be provided for the Council within the resources made available.

4.7 The continuous audit approach, in accordance with the Internal Audit Strategy approved by Audit Committee on 14 March 2022, enables Internal Audit to provide added value advice on internal controls and governance and 'critical friend' consultancy services. For example, Business Transformation Board, Capital Planning and Asset Management Board, and Information Management Group.

5 Continued Reporting on the Internal Audit Plan for 2022/23

5.1 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 Management; a summary of Internal Audit Assurance Work in Progress; and an outline of Internal Audit Consultancy & Other Work carried out in accordance with the approved Internal Audit Charter.

5.2 Internal Audit's compliance with its Strategy and delivery of its risk-based Annual Plan will be communicated within the Internal Audit Annual Assurance Report which will also provide the statutory annual Internal Audit opinion 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.

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 2022/23. 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 2023.

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 3.22 FTE, comprising Chief Internal Auditor (0.5 FTE – shared with East Lothian Council), Principal Internal Auditor (0.72 FTE), and Internal Auditor (2.0 FTE). Each member of the Internal Audit team has a professional internal audit or accountancy qualification, and has suitable experience, knowledge, skills and competencies (such as the Code of Ethics set out in PSIAS and the Seven Principles of Public Life) 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 2022/23, 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.

If Internal Audit staffing levels fall below that assumed for the remaining three-month period or if there is an unexpected and unplanned level of contingency audit work, there is a high level of risk that the remaining elements of the Annual Plan 2022/23 will not be delivered in full. This could only be mitigated by use of external resource Regular monitoring will be undertaken progress to ensure that a sufficient range and breadth of assurance audit work will be carried out during 2022/23 to underpin, a not limited statutory Internal Audit opinion to Management and the Audit Committee on the effectiveness of internal controls and governance within the Council.

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

MLC 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. Continuous audit approach on progress with areas of improvement. Annual evaluation of compliance with the Local Code of Corporate Governance covering the corporate whole and individual Directorates / Services.	Continuous audit approach to follow-up on implementation of actions on Areas of Improvement set out in the Annual Governance Statement 2021/22. Annual evaluation of compliance with the Local Code of Corporate Governance scheduled 4th Qtr. Internal Audit opinion, work undertaken and compliance with PSIAS will be outlined in Internal Audit Annual Assurance Report 2022/23.
PPP Schools Contract Management and payment mechanism	30	Review of the contract management arrangements over the PPP1&2 school contracts including review of the monthly payment mechanism.	Complete: Final Report issued 27 September 2022. Executive Summary to Audit Committee 06 December 2022.
Accounts Receivable - Sundry Debt	20	Review of controls in place to set fees and charges for services, raise invoices promptly and collect debts efficiently resulting in debtors' balances that are complete, accurate and recoverable including review of VAT treatment.	Complete: Final Report issued 07 December 2022. Executive Summary to Audit Committee 07 February 2023.
Complaints	20	Review of the controls in place to ensure complaints are dealt with adequately and in a timely manner.	Resource is being assessed to complete in Qtr 4
Construction projects / social housing programme	30	Review of the adequacy of the control framework established by management to allow successful delivery of construction projects including the Social Housing Programme.	Brought forward from 2020/21. Defer to 2022/23 - Low risk due to Covid-19 pandemic restrictions in 2020/21 and 2021/22. Scheduled for 4^{th} Qtr with planning underway.
Children's Residential and Day Services	20	Review of the controls in place to ensure sound budgetary control and the demand on service delivery for children's residential and day services.	Due to Resource Constraints in 2022/23 this audit is not scheduled for completion. Consideration will be given to inclusion in the 2023/24 Internal Audit work plan.
Schools	20	Review of internal financial controls and business administrative procedures in place and data analytics of expenditure (DSM, PEF	Due to Resource Constraints in 2022/23 this audit is not scheduled for

		and other Funds including Schools Funds) to ensure the efficient and effective use of resources in the school establishments.	completion. Consideration will be given to inclusion in the 2023/24 Internal Audit work plan.
Counter Fraud and Whistleblowing arrangements	20	Review of the Council's Counter Fraud controls including policies and whistleblowing arrangements.	This review has been completed and will be reported as part of the Annual Assurance Reporting in June 2023.
Freedom of Information	20	Review of the controls in place to ensure Freedom of Information enquiries and dealt with adequately and in a timely manner. This will include a review of the implementation of the new system.	Complete: Final Report issued 27 September 2022. Executive Summary to Audit Committee 06 December 2022.
Purchasing Cards	20	Review of the controls over the use of purchasing cards ensuring expenditure incurred is valid, appropriate and represents value for money.	Resource is being assessed to complete in Qtr 4
Lighting	30	Review of the controls over the installation of new lighting and the maintenance of existing lighting.	Complete: Final Report issued 29 September 2022. Executive Summary to Audit Committee 06 December 2022.
Utilities, Energy and Water Consumption	30	Review of the controls over the consumption of utilities ensuring utilisation is adequately controlled and represents value for money	Complete: Final Report to be issued 20 January 2022. Executive Summary to Audit Committee 07 February 2023.

AUDIT	DAYS	COMMENTARY	STATUS
Assurance – Risk Based			
External funded programmes - CLL	30	Review external funded programmes under the terms of the associated agreements to assess compliance with the requirements and delivery of outcomes.	Audit testing is now complete and final report is due in February 2023 with the Executive Summery being submitted to the March Audit Committee.
Criminal Justice	20	Review of the controls in place to ensure professionals work jointly and effectively and provide support in a timely manner to ensure the protection and welfare of children and young people.	Due to Resource Constraints in 2022/23 this audit is not scheduled for completion. Consideration will be given to inclusion in the 2023/24 Internal Audit work plan.
Mental Health Services	30	Assess the governance arrangements in place to commission specialist mental health services to promote closer integration and partnership working to meet the needs of people with	This audit is scheduled for completion in Qtr4 Initial Planning is underway.

		mental health needs. Ensure there is sound budgetary control in place.	
Schools Budgets (DSM)	30	Review the Council's implementation of the new DSM scheme.	Due to Resource Constraints in 2022/23 this audit is not scheduled for completion. Consideration will be given to inclusion in the 2023/24 Internal Audit work plan.
Systems Development, maintenance and support	30	Review of the controls in place to ensure new systems are adequately installed, tested and implemented in a timely manner.	This audit is scheduled to commence in Qtr4
Information Governance	20	Continual audit approach to review the information governance framework including roles and responsibilities, policy development and implementation.	Resource is being assessed to commence in Qtr 4
Financial Sustainability in Future Years	20	Continual audit approach to review the medium term financial strategy and plans to ensure they are based on realistic assumptions. Ensure that appropriate scrutiny and challenge is undertaken to deliver the plans.	This audit is scheduled to commence in Qtr4.
Workforce Planning	30	Review of the recruitment, training and performance management of employees.	Delayed awaiting service staff appointments. Consideration will be given to inclusion in the 2023/24 Internal Audit work plan.
Care at Home	30	Review of the contract management arrangements over the care at home contract to ensure that the Council is receiving value for money.	Audit testing is now underway and final report is due in February 2023 with the Executive Summery being submitted to the March Audit Committee.
Performance Management & Performance Indicators	20	Testing of a sample of performance indicators to ensure that they are complete, accurate, based on current data and conform to the stipulated criteria.	Audit testing is now underway and final report is due in February 2023 with the Executive Summery being submitted to the March Audit Committee.
Health & Safety	20	The Council is complying with relevant Health and Safety legislation, has a structured approach to Health and Safety awareness, including review of the Health and Safety Management system to ensure there are adequate and effective controls in place for health and safety.	Delayed as it is understood that external assessment of Health and Safety is being completed shortly. Consideration will be given to inclusion in future Internal Audit work plans.

AUDIT	DAYS	COMMENTARY	STATUS
Consultancy			
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.	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.

AUDIT	DAYS	COMMENTARY	STATUS
Other			
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. Findings will be outlined in Internal Audit Annual Assurance Report 2022/23.
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.	The Chair presented the Audit Committee Annual Report 2021/22 to Council on 4 October 2022. 2022/23 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.	Follow-Up Review of Completed Internal Audit Recommendations to Audit Committee 6 December 2022. Follow-Up Review of In Progress Internal Audit Recommendations scheduled 4th Qtr.
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.	Contingency days are being used to support completion of Internal Audit plan due to resource constraints and investigation/reactive work.
Help Desk Enquiry system	20	Provide guidance and advice to Management on internal controls.	Ongoing
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 relevant Committee.	Ongoing
Management Groups	4	Attend and provide support to Risk Management and Integrity Groups.	Ongoing
MLC Attendance at Boards / Committees	10	Prepare for and attend Audit Committee meetings and other Boards/Committees.	Ongoing

MLC Audit Planning for 2023/24	10	Update the Audit Universe, check risk registers and other sources of assurance, and develop and consult on proposed coverage within the Internal Audit Annual Plan 2023/24	Scheduled 4 Qtr. Internal Audit Annual Plan 2023/24 will be presented to Audit Committee for approval in March 2023.

AUDIT	DAYS	COMMENTARY	STATUS
Non MLC			
Midlothian Health and Social Care Integration Joint Board	40	Audit reviews and support to be determined and agreed by the MIJB Audit and Risk Committee for review of the adequacy of the MIJB's arrangements for risk management, governance and internal control for delegated resources.	MIJB Internal Audit Annual Plan 2022/23 approved by MIJB Audit and Risk Committee on 3 March 2022. Audit work ongoing. Reports will be presented to MIJB Audit and Risk Committee

Risk Management Update – Strategic Risk Profile Quarter 3 2022/23

Report by Derek Oliver, Chief Officer Place

Report for Information

1 Recommendations

Audit Committee is recommended to:

- Note the current risk landscape and organisational response to the most significant risks in Quarter 3 (Q3) 2022/23 (1 October to 31 December 2022).

2 Purpose of Report/Executive Summary

The purpose of this report is to provide Audit Committee with:

- An update on the risk responses Midlothian Council has implemented during Q3 2022/23 to respond to the current risk climate
- Assurance that Midlothian Council took a proportionate and planned approach to prepare and respond to the current risk climate
- The risk evaluation of current strategic risks and opportunities for the Council

14 January 2023

Report Contact:
Derek Oliver, Chief Officer Place

Derek.Oliver@midlothian.gov.uk

3 Q3 risk management overview

3.1 Midlothian Council has delivered a wide range of services to the people of Midlothian throughout Quarter 3 2022/23 (1 October to 31 December 2022) whilst operating within seasonal challenges including initiation of the Council's winter weather response.

3.2 The Council continues to manage and review risks recorded within the Strategic Risk Profile. The work required to maintain the necessary corporate oversight over the broader strategic landscape continues through the Risk and Resilience Chief Officer's group and Corporate Management Team (CMT).

3.3 Audit Committee should note that there are no changes this quarter to the evaluation of current risks and no new risks. Updates on actions taken are included in the full strategic risk profile (Appendix B).

Strategic Risk Profile Summary

3.4 The SRP is split into three sections:

- Strategic issues
- Strategic risks
- Opportunities

STRATEGIC ISSUES - SUMMARY

Strategic issues	Likelihood	Impact	Score	Evaluation Q3		Q2 22/23
COVID 19	4	4	16	High		High
The Change Programme	5	5	25	Critical		Critical
Financial Stability	5	5	25	Critical		Critical

COVID-19

3.5 The risk evaluation was reduced from Critical to High in Q1 22/23 and remains as high through Q2 22/23 and Q3 22/23. Whilst the rate of infection and case numbers was decreasing in Q2 and early Q3; data shows that towards the end of Q3 and into early Q4 that infection rates of COVID-19 and other respiratory and flu-related illnesses are increasing. This has not impacted on the risk evaluation yet however services continue to see the impact through absences, which impacts on service delivery. The Council continues to monitor and risk assess as appropriate.

The Change Programme

3.6 The Change Programme remains at Critical throughout 22/23. The financial challenges of the underlying budget gap pose a significant challenge for benefits realisation. Council agreed to a solution to balance the 2022/23 budget, however the increased costs associated with delivering change and transformation require longer term financial solutions. Work is ongoing to develop the next Medium Term Financial Strategy and associated Strategic Plan which will inform the future direction of the programme.

Financial Sustainability

3.7 Scottish Government grant settlements fall short of the resources needed to sustain core services. This core funding shortfall, combined with inflation pressures, pay awards and demographic pressures arising from a continued increasing ageing population of over 75's, increasing population of 0-15 age group and at a time when there are rising customer expectations poses a significant challenge for the Council.

3.8 The Scottish Budget was announced on 15 December 2022. The first version of the Local Government Finance circular was published on 20 December 2022 with subsequent revisions received late December 2022 and further revisions published in Q4 January 2023. Work is ongoing to determine the impact of the Scottish Budget and convert the cash figures contained within to real term figures and align to Midlothian's position.

3.9 Included knowns within the Scottish Budget are changes to the way that Non Domestic Rate Revaluation Appeals are handled, as well as a range of non-recurring commitments such as Scottish Child Bridging Payment and interim Care Funding; and a range of new commitments for 2023/24.

3.10 There are still unknowns within the Scottish Budget with a number of areas that remain to be confirmed following discussions between CoSLA and Scottish Government including Free School Meals, Early Learning and Childcare, Teachers Pay and other items that all play a significant part in informing the Council's short and medium term financial strategy.

3.11 It is clear however that the Local Government Funding is reducing significantly in real terms.

3.12 The scale of the financial challenge continues to be reported to Business Transformation Steering Group and Council (with the most recent financial position to be reported to a Special Council meeting on 31 January 2023). Discussions on proposals to inform the Medium Term Financial Strategy are ongoing. Balancing the budget for future years will require cross party support and agreement to identify sustainable solutions. Due to the current uncertainty and lack of a revised Medium Term Financial Strategy this issue remains Critical through Q3.

STRATEGIC RISKS – SUMMARY

Strategic Risks	Likelihood	Impact	Score	Evaluation Q2		Q1 22/21
Climate change	5	5	25	Critical		Critical
Financial Sustainability in future years	5	5	25	Critical		Critical
The Long Term Change Programme	5	5	25	Critical		Critical
Early Years Expansion (1140 Hours)	4	5	20	High		High
Scottish Child Abuse Inquiry	4	4	16	High		High
UK decision to leave the EU	4	5	20	High		High
Growing Council	4	4	16	High		High
Cost of Living Crisis	3	5	15	Medium		Medium
National Care Service	3	5	15	Medium		Medium
Asset Management	3	5	15	Medium		Medium
Cyber Security	3	5	15	Medium		Medium
Health and Safety	3	5	15	Medium		Medium
Care at Home	3	4	12	Medium		Medium
Governance and standards	3	4	12	Medium		Medium
Employee performance	3	4	12	Medium		Medium
Emergency planning and business continuity	3	4	12	Medium		Medium
Legal and Regulatory compliance	3	3	9	Medium		Medium
Internal control environment	3	3	9	Medium		Medium
Corporate policies and strategies	2	3	6	Low		Low

STRATEGIC RISKS – RATED CRITICAL/HIGH

Climate Change

3.13 The Council developed a Climate Change Action Plan as part of its Climate Change Strategy approved by Council in August 2020, as well as making the commitment to achieve Carbon Neutral by 2030.

3.14 The Carbon Neutral by 2030 strategic board is developing the overall cross Council response to the Council's statutory requirements. There are a range of projects underway which will contribute to the overall ambition but development of the programme and these projects is identifying that there is a significant financial investment that is required to be made to retrofit buildings, fleet replacement and change working practices.

3.15 The current financial resource and staffing capacity across the Council is insufficient and poses a critical risk to delivery. This is also impacted by the financial sustainability challenge that is articulated in this report.

3.16 A review of the current Climate Change Strategy and Action Plan is being undertaken and an update will be provided to Council in Q4 2022/23. The risk evaluation continues to remain Critical in Q3.

Early Years Expansion (1140 hours)

3.17 Following the Scottish Government's decision to increase the number of free early learning and childcare hours to 1140, the Council has continued to plan with its partners. The two key strands to the successful implementation are the recruitment and training of staff and the physical increase in estate capacity. These challenges are being considered in the wider context of the plan, in which the capacity and expansion of all funded providers (council, private and voluntary settings as well as childminders) combine to deliver the requirements.

3.18 This risk evaluation continues to remain High whilst the Council awaits an update on the funding provision.

Scottish Child Abuse Inquiry (SCAI)

3.19 The SCAI risk remains High. The Inquiry has heard all the evidence for the Sct 21 submissions around foster care. Many Chief Social Work Officers (CSWO's) were called to give evidence around abuse within their local authority. Midlothian CSWO was not called to give evidence. This part of the inquiry is now concluded with learning from this due to be written up by around March 2023. The learning will result in an action plan being developed which we shall consider and ensure that our policies and practice are updated accordingly.

UK decision to leave the EU

3.20 The last three quarters have demonstrated that the rate of inflation is impacting on the cost of living crisis for Midlothian residents and posing significant risk to a number of Council Capital Programme work streams. This was reported to the Business Transformation Steering Group (BTSG) in Q1 and Q2 and also through progress reports on programmes to Council i.e. the delivery of the A701 and increased school build costs. The current Capital Programme is subject to a reprioritisation review and will be reported to Council in Q4 22/23 alongside the Medium Term Financial Strategy. This risk evaluation remains High.

Growing Council

3.21 In Q2 22/23 the risk evaluation increased from Medium to High. This is in response to the current financial challenge as described above and the increased pressure the Council faces with growth. Some current examples of this include:

- Inflationary impact on the delivery of the capital programme
- Cost of living crisis and rent freeze response that could risk the delivery of the house building programme
- Pressure on the care sector as people are living longer and require more care provision
- General population growth places additional demand on infrastructure such as GPs, schools, waste services etc.

3.25 Work is ongoing to review the Learning Estate Strategy and a reprioritisation of the Capital Programme to be reported in Q4 22/23.

STRATEGIC OPPORTUNITIES

Shawfair

3.26 The Shawfair development, with its new Rail link provides a major incentive for house builders, employers, retail and commercial interests including opportunities to secure a low carbon community through district heating from Zero Waste. The Energy Services Agreement with Shawfair LLP has now been signed and work progresses to deliver the Energy Centre.

Easter Bush

3.27 Fast growing opportunities in Science, Technology, Engineering and Mathematics (STEM) with opportunities to link with education. Partnership links to schools and university sector at the 'Bush' to promote STEM. The rate of inflation is impacting on the costs of the A701 improvements which will was reported to Council at the end of June 2022. A funding application has been submitted to the UK Government's Levelling Up fund to close the funding gap, with the results to be announced in Q4 2022/23.

City Deal

3.28 Edinburgh and South East Scotland City Region Deal - bid for funding to Scottish and UK Governments to accelerate economic growth through investment in infrastructure/ housing/ skills and innovation was agreed by Council in June 2018. Projects continue to be progressed with realisation of regional enhancements and connectivity. In 2022, Midlothian Council took over the chairing of the City Deal programme. In Q3 2022/23 this annual chairing arrangement came to an end and the Council carried out the handover to Scottish Borders Council.

Creating a world class education system

3.29 The Centres of Excellence model is a core part of the Council's strategy to create a world-class education system in Midlothian. Funding has been approved by Scottish government to create a STEM centre of excellence as a replacement for Beeslack High school. Research is being carried with the University of Edinburgh to establish the impact of new school buildings on educational attainment.

4 Report Implications (Resource, Digital and Risk)

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 current risk controls and actions being taken in response to these.

The report provides an overview of the significant risks faced by the Council during Quarter 3 2022/23 and should act to provide assurance that Midlothian Council took a proportionate and planned approach to prepare and respond to each of these risks.

4.4 Ensuring Equalities (if required a separate IIA must be completed)

There are no direct equalities issues arising from this report.

4.4 Additional Report Implications (See Appendix A)

See Appendix A

Appendices

Appendix A – Additional Report Implications
Appendix B – Strategic Risk Profile (Quarter 3 2022/23)

APPENDIX A – 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
- ☐ None of the above

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 compiled 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.

Appendix B

Strategic Risk Profile

Midlothian

Strategic issues

SRP.IR.02 The Change Programme

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.IR.02	**Risk cause** The pace of transformation strands of activity, reporting to the Business Transformation Board, does not secure service transformation, delivery of outcomes or benefit realisation. **Risk event** Delayed progress or non-achievement of outcomes and benefits. **Risk effect** Slow or delayed financial benefits arising from service redesign, requiring the adoption of recovery plans or requiring short term service reductions which impact on the Council's ability to deliver against its priorities.	Chief Executive, Executive Director Children, Young People and Partnerships, Executive Director Place, Director Health and Social Care, Head of Adult and Social Care; Chief Officer Corporate Solutions; Chief Finance Officer, Chief Officer Place, Chief Operating Officer Education, Chief Officer Young People and Partnerships	1. Strategic Boards established reporting to the Business Transformation Board covering the full range of transformation strands: Capital Strategy; Carbon Neutral by 2030; Digital First; Economic Renewal; Education Recovery; HSCP Transformation; Hub & Spoke Place Based Solutions; Remote Working. 2. Regular reporting to Council setting out scale of financial challenge ahead with recurring expenditure for current service delivery projected to exceed recurring income. 3. Cross Party Business Transformation Steering Group engaged in consideration of measures to secure balanced budgets alongside the development of a Strategic Plan to support decisions about what services, beyond those which are statutory can be provided. 4. Financial monitoring reports and work of the Financial Management Corporate Management Team evidence continued financial sustainability, in so far as services are delivered within the overall budget in year.	5	5	

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SPR.RA-02.08	Strategic Plan 2023 to 2027	**Q3 22/23:** Development of Strategic Plan and MTFS for next term of Council being progressed to support decisions about what services, beyond those which are statutory can be provided. This facilitates setting of the 2023/24 budget in February 2023.	Chief Executive, Chief Finance Officer	28-Feb-2023	
SRP.RA.02.03	Develop Medium Term Financial Strategy with greater oversight, clearer responsibility and accountability.	**Q3 22/23:** An ongoing assessment of the projected gap for 2023/24 through to 2027/28 has been presented to BTSG alongside a series of officer savings proposals to bring recurring expenditure back in line with recurring income.	Chief Executive, Chief Finance Officer	28-Feb-2023	

SRP.IR.07 Financial Sustainability

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.IR.07	**Risk cause** Scottish Government Grant settlements fall short of the resources needed to sustain core services. Core funding falling short of inflation pressures, pay awards and demographic pressures arising from an Increasing ageing population of over 75's Increasing population of 0-15 age group and at a time when there are rising customer expectations. **Risk event** Transformation activity and the flexibility available to Councils as part of the grant settlement does not address future years projected budget gaps **Risk effect** Inadequate government funding makes securing balanced budgets challenging. It turn erodes the Council's ability to deliver services to the community and potentially means that resources available fall short of those the Council assess as required to meet its statutory obligations. Whilst transformation activity can help reshape services and ensure best value in the delivery of services it is not a solution to continued erosion of core funding.	Chief Executive, Executive Director Children, Young People and Partnerships, Executive Director Place, Director Health and Social Care, Head of Adult and Social Care; Chief Officer Corporate Solutions; Chief Finance Officer, Chief Officer Place, Chief Operating Officer Education, Chief Officer Young People and Partnerships	1. There is an approved Capital Strategy and Reserve Strategy in place. 2. There is an approved budget for 2022/23. Services are being delivered within the totality of that budget and the 2022/23 budget has been approved albeit with heavy reliance on one off funding. 3. There are effective arrangements in place to monitor financial performance including quarterly reporting to Council with draft reports considered at a dedicated CMT session each quarter to bring greater focus. 4. Directorates have budget boards in place to monitor and agree actions for those items which are identified as needing specific attention or present a risk to the financial position of services. 5. Strategic Boards in place and BTB focus and attention on driving transformation to support future year's financial sustainability. 6. Working through COSLA to influence government spending decisions to influence Scottish Government's budget allocation to Councils. 7. Capital Plan and Asset Management Board will scrutinise and challenge slippage on capital programmes recognising that slippage can have an adverse impact on financial sustainability and also the delivery on assets required to support capital growth. 8. Chief Executive continues to emphasise the need for effective financial control and underlined the benefit to the organisation of such an approach. Enhanced monitoring arrangements have been put in place for the Place Directorate. 9. Scottish Governments May 2022 Resource Spending Review provided planning parameters for term of parliament, albeit these are challenging and present a real terms reduction in grant funding of circa 7% over the period. 10. Report to Council 23 August 2022 sets out scale of financial challenge ahead with recurring expenditure for current service delivery projected to exceed recurring income. 11. "Mini Budgets" progressed in 2020/21 and in 2021/22 that removed non-deliverable legacy savings targets given focus on response to and recovery from pandemic. 12. Cross Party Business Transformation Steering Group engaged in consideration of measures to secure balanced budgets alongside the development of a Strategic Plan to support decisions about what services, beyond those which are statutory can be provided.	5	5	

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SPR.RA-02.09	Strategic Plan 2023 to 2027	**Q3 22/23:** Development of Strategic Plan and MTFS for next term of Council being progressed to support decisions about what services, beyond those which are statutory can be provided. This facilitates setting of the 2023/24 budget in February 2023.	Chief Executive, Chief Finance Officer	28-Feb-2023	
SRP.RA.02.03	Develop Medium Term Financial Strategy with greater oversight, clearer responsibility and accountability.	**Q3 22/23:** An ongoing assessment of the projected gap for 2023/24 through to2027/28 has been presented to BTSG alongside a series of officer savings proposals to bring recurring expenditure back in line with recurring income.	Chief Executive, Chief Finance Officer	28-Feb-2023	

SRP.IR.10 COVID 19

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.IR.10	**Risk cause:** COVID 19 Virus **Risk event:** Virus evident in all communities with rates of positive infection increasing. In a Sottish setting the focus on increase is within the central belt. **Risk effect:** Potential for widespread impacts with the risk of significant levels of community transmission leading to increased government restrictions aimed at reducing community transmission. Delivery of services making use of remote working solutions as far as possible. National lockdown measures to limit and control spread, impact on income generating services. Rapid pace of guidance change following government announcements and expectation of quick changes to service delivery in line with new controls.	Chief Executive, Executive Director Children, Young People and Partnerships, Executive Director Place, Director Health and Social Care, Head of Adult and Social Care; Chief Officer Corporate Solutions; Chief Finance Officer, Chief Officer Place, Chief Operating Officer Education, Chief Officer Young People and Partnerships, HR Strategic Lead	1. CIMT established to take the strategic approach to managing the response to COVID 19 and stands ready to be re-initiated at any time. 2. Hybrid working has been adopted by the Council as well as a dedicated Hybrid Working Board as part of the Transformation Programme 3. COVID-19 guidance monitored and continually revised, with particular focus on Adult Services, Children's Services, Education and Communities and Lifelong Learning around how they would continue to maintain contact with children and young people who were deemed to be at risk. 4. Keeping employees briefed and supported through the Chief Executive's weekly staff briefings; Communications weekly email and routine HR updates. (e-mailed to all employees through combination of work and personal e-mail addresses). Includes Wellbeing advice, guidance and support and signposting to PAM and EAP providers. 5. Promotion of digital tools to support employees and prevent employees becoming isolated. 6. Council website kept up-to date, providing details of which services were operating and any changes on how to access services. 7. A range of interventions, including digital equipment and tools such as MS Teams put in place to support remote and hybrid working 8. Following safe working guidance issued by Scottish Government relevant to sectors. 9. Economic Recovery Strategy 10. School and workplace based COVID risk assessments continually reviewed to support the identification and control of risk (and personal risk assessments where required)	4	4	

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status

SRP.RA.10.1	Hybrid Working	**Q3 22/23:** Hybrid Working project is a key project contributing to the Council's transformation programme. Project Board regularly reports to Business Transformation Board and Business Transformation Steering Group.	Executive Director Place, Chief Digital Officer	31-Mar-2023	

SRP.IR.11 National Care Service

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.IR.11	**Risk cause** In August 2022 the Scottish Government launched a 12 week consultation on the way in which social care is delivered in Scotland. The consultation followed recommendations made in the Independent Review of Adult Social care. The independent analysis of responses was published in February 2022. On 20 June 2022 the Scottish Parliament published the National Care Service (NCS) Bill which will provide the foundation for the NCS. **Risk event** A Bill passes through various Parliamentary stages. The Bill is currently in Stage 1 of the process. The most significant part of the legislation which poses the most risk is the intention to transfer social care responsibility from local authorities to a new, national service. **Risk effect** The details of the logistics of any transfer are not yet provided within the Bill. It is not clear the extent to which powers will be removed from local authorities or what the provision or delivery of services will or will not be. At this stage, the risk effect is anticipated to be significant financial impact to local authorities and IJBs, as well as the potential for impacts on staffing, transfer of property and facilities and the reshaping of the delivery of care. It should be noted that the initial impact on the Council is staff time to contribute to the ongoing discussions and understanding of the impact of the Bill.	Chief Executive, Executive Director Health & Social Care, Head of Adult and Social Care; Executive Director Children, Young People and Partnerships, Executive Director Place; Chief Officer Children, Young People and Partnerships	1. The Bill is under consultation and it is anticipated that additional information will be released by April 2023. 2. Officer Working Group established to engage with the NCS Design School and to continue the existing work with COSLA, SOLACE, SOLAR and other relevant bodies 3. Ongoing briefings with elected members 4. Continued dialogue and engagement with Scottish Government and IJB/H&SCP/Children's Services	3	5	

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status

SRP.RA.11.1	Officer Working Group	**Q3 22/23:** COSLA and Social Work Scotland have formally requested a pause on the NCS Bill. **Q1 22/23:** Officer Working Group agreed to be established by CMT	Chief Executive	31 March 2023	✔

Strategic Risks

SRP.RR.01 Financial Sustainability in future years

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.01	**Risk cause:** Scottish Government Grant settlements fall short of the resources needed to sustain core services. Core funding falling short of inflation pressures, pay awards and demographic pressures arising from an Increasing ageing population of over 75's Increasing population of 0-15 age group and at a time when there are rising customer expectations Policy decisions by UK & Scottish Governments which are not fully funded. Changes to the responsibilities of Local Government and the funding implication that arise from that, particularly in respect of the creation of a National Care Service. Future year pay award settlements. **Risk event:** Real terms reduction in core grant settlements. Policies decisions at Government level not fully funded to Council's. Implementation of a National Care Service and impact on grant settlements Securing the extent of change required in order to deliver financial sustainability and a change program that recognises the size of the challenge. Cost pressures exceeding budget estimates. Uncertainty around service delivery models and income	Chief Executive, Executive Director Children, Young People and Partnerships, Executive Director Place, Director Health and Social Care, Head of Adult and Social Care; Chief Officer Corporate Solutions; Chief Finance Officer, Chief Officer Place, Chief Operating Officer Education, Chief Officer Young People and Partnerships	1. Development of Strategic Plan and MTFS for term of new Council. 2. Maintaining a level of reserves to deal with unforeseen or one off cost pressures. 3. Capital and Reserves Strategies in place. 4. Working through COSLA to influence government spending decisions to influence Scottish Government's budget allocation to Councils. 5. Implement a lobbying strategy with government to recognise the unique position Midlothian Council is in. 6. Best Value Audit report actions. 7. Strategic Boards in place to drive transformation in line with the Route Map through and out of the Pandemic budget approved for 22/23 albeit with reliance on one off funding sources 8. Dedicating capacity to understand impact of NCS Bill, but limited details mean this is challenging and many unanswered questions (refer to specific risk on NCS for further detail)	5	5	

	streams and prospects for public finances associated with COVID impact and recovery. **Risk effect:** Gap in Council budget between budget commitments / pressures and funding level and inadequate options presented to address this, resulting in a structural deficit. The pace of growth coupled with the shortfall in grant settlements adds pressure to Council budgets which will be unable to deliver capital and revenue work programmes.					

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.02.03	Develop Medium Term Financial Strategy with greater oversight, clearer responsibility and accountability.	**Q3 22/23:** An ongoing assessment of the projected gap for 2023/24 through to 2027/28 has been presented to BTSG alongside a series of officer savings proposals to bring recurring expenditure back in line with recurring income.	Chief Executive, Chief Finance Officer	28-Feb-2023	
SRP.RA.02.04	Strategic Plan 2023 to 2027	**Q3 22/23:** Development of Strategic Plan and MTFS for next term of Council being progressed to support decisions about what services, beyond those which are statutory can be provided. This facilitates setting of the 2023/24 budget in February 2023	Chief Executive, Chief Finance Officer	28-Feb-2023	
SRP.RA.02.05	Understanding impact of NCS Bill	**Q2 22/23:** COSLA and Social Work Scotland have formally requested a pause on the NCS Bill. **Q1 22/23:** Officer Working Group agreed to be established by CMT. Note details on the NCS Bill are currently limited – see new risk within Strategic Risk profile for further information and actions	Chief Executive	31 March 2023	
NEW	Capital Plan prioritisation	**Q3 22/23:** Work is ongoing to review the overall Capital Plan and committed expenditure, with a reprioritisation of the programme reflective of the escalating inflationary pressures. Reprioritisation plan to be presented to Council in Q4 for approval, aligned to the Medium Term Financial Strategy.	Executive Director Place, Executive Director Children, Young People and Partnerships, Chief Finance Officer, Head of Development	31 March 2023	

SRP.RR.02 The Long Term Change Programme

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk

						Evaluation
SRP.RR.02	**Risk cause** A MTFS that doesn't address the projected budget shortfall or contextual factors relating to the Midlothian area Reduced resources Leadership fit for the future Lack of clarity or clear compelling vision for the future Delay or shortfall in securing savings Lack of or not securing transformational change in service provision **Risk event** Delayed progress in applying various strands of the Change Programme including Delivering Excellence Framework Slow benefits realisation and budget savings Cuts in service provision rather than service transformation **Risk effect** Objectives of change not actually met Adverse impact on services Slow or delayed proposals/savings arising from service redesign. Potentially further eroding reserves or requiring short term service reductions which impact on Council's ability to deliver against its priorities. Staff morale negatively affected, Government step-in Short term savings instead of transformation	Chief Executive, Executive Director Children, Young People and Partnerships, Executive Director Place, Director Health and Social Care, Head of Adult and Social Care; Chief Officer Corporate Solutions; Chief Finance Officer, Chief Officer Place, Chief Operating Officer Education, Chief Officer Young People and Partnerships	1. Development of Strategic Plan and MTFS for term of new Council and service options which identify what can /cannot be delivered within the resources available. 2. Leadership from all Elected Members, Executive Team and Senior Leadership Group. 3. Appropriate governance in place across the BTB Strategic Boards 4. Resilience planning. 5. Capacity to deliver change. 6. Dedicating capacity to understand impact of NCS Bill, but limited details mean this is challenging and many unanswered questions (refer to new risk on NCS for further detail)	5	5	

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SPR.IA.02.06	Strategic Plan 2023 - 2027	**Q3 22/23:** Development of Strategic Plan and MTFS for next term of Council being progressed to support decisions about what services, beyond those which are statutory can be provided. This facilitates setting of the 2023/24 budget in February 2023	Chief Executive, Chief Finance Officer	28-Feb-2023	
SRP.RA.02.03	Develop Medium Term Financial Strategy with greater oversight, clearer responsibility and accountability.	**Q3 22/23:** An ongoing assessment of the projected gap for 2023/24 through to 2027/28 has been presented to BTSG alongside a series of officer savings proposals to bring recurring expenditure back in line with recurring income.	Chief Executive, Chief Finance Officer	28-Feb-2023	

SRP.RR.03 Legal and Regulatory Compliance

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.03	**Risk cause** Current or new legislation applying to Midlothian Council **Risk event** Council and or Services not identifying all applicable legislation impacting Council activities and Service requirements. **Risk effect** Council failing to meet its statutory obligations resulting in a potential negative impact for service users or employees. Reputational impact of not meeting statutory obligations.	Chief Executive, Executive Director Children, Young People and Partnerships, Executive Director Place, Director Health and Social Care, Head of Adult and Social Care; Chief Officer Corporate Solutions; Chief Finance Officer, Chief Officer Place, Chief Operating Officer Education, Chief Officer Young People and Partnerships, Legal and Governance Manager	1. Executive Directors, Chief Officer(s) and Head(s) of Service responsible for identifying applicable legislation and propose Council or Service responses to CMT and Cabinet/Council as required. 2. Annual Assurance Statement. 3. Internal Audit testing of internal controls as part of risk based audit plan. 4. External Audit. 5. Range of external inspection. 6. Local Scrutiny Plan 7. BTSG oversight of new legislation	3	3	

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.03.0 2	Rights of the Child Bill	**Q3 22/23:** Scotland is set to become the first country in the UK to directly incorporate the UN Convention on the Rights of the Child into domestic law. The Scottish Government's new bill on the rights of the child is expected to have far reaching implications for public bodies. Midlothian Council is beginning to roll out training with regards to the implication this new piece of legislation shall have on all services. **Q2 22/23:** Scotland is set to become the first country in the UK to directly incorporate the UN Convention on the Rights of the Child into domestic law. The Scottish Government's new bill on the rights of the child is expected to have far reaching implications for public bodies. With guidance beginning to be disseminated from the Scottish Government, the Council is continuing to monitor and plan.	Executive Director Children, Young People and Partnerships, Chief Social Work Officer	31-Mar-2023	

SRP.RA.03.0 3	National Care Service	**Q3 22/23:** COSLA and Social Work Scotland have formally requested a pause on the NCS Bill. **Q1 22/23:** Officer Working Group agreed to be established by CMT. Note details on the NCS Bill are currently limited – see new risk within Strategic Risk profile for further information and actions.	Chief Executive	31-Mar-2023	
SRP.RA.03.0 5	Standing Orders	**Q3 22/23:** The Standing Orders Working Group was approved and appointed at the Council meeting on 13.12.2022 and will meet in Q3 to ensure that these issues are included within this work programme and that all staffing changes are incorporated into the Scheme of Delegation. In the interim, mitigations will be put in place to ensure authorisations are valid. **Q2 22/23:** Structural reviews within the Midlothian Council resulting in the Standing Orders being outdated. Authorised Officers within Regulatory Services may be open to challenge in relation to statutory enforcement work on grounds of delegated authority. Statutory enforcement work including the service of Statutory Notices, Fixed Penalties and Court proceedings may require to be withdrawn resulting in reputational damage and or financial penalty (e.g. case costs awarded against the LA). Structural reviews approved by Council have been incorporated into Standing Orders.	Executive Director Place; Legal and Governance Manager	31- Mar 2023	

SRP.RR.04 Employee performance

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.04	**Risk cause** Employees not suitably trained/developed for the roles required of them. limited availability of qualified practitioners in certain sectors Change program not informed by all key stakeholders Ageing work force Employees unclear on expected behaviours. Employees constrained to innovate as a result of management practice Employee productivity rate below the required level because of ineffective use of the People Policies particularly Maximising Attendance Salaries significantly lower in social work area in comparison to other LA's resulting in recruitment issues particularly with trying to recruit experienced staff	Chief Executive, Executive Director Children, Young People and Partnerships, Executive Director Place, Director Health and Social Care, Head of Adult and Social Care; Chief Officer Corporate Solutions; Chief Finance Officer, Chief Officer Place,	Over-riding risk control measure = Focus on having the right people, here, healthy, performing, behaving and well led via effective utilisation of the workforce strategy and accompanying action plan. **Attendance / Wellbeing** 1. Continuing implementation of the Wellness@Midlothian agenda. 2. Creation of an Employee Health and Wellbeing Strategy and supporting policy. 3. Maintaining the Healthy Working Lives Gold Award. 4. Proactive use of Occupational Health, Midlothian Physiotherapy, Employee Assistance Programme and the Workplace Chaplaincy Service. 5. Change of EAP supplier to ensure provision of best possible service. 6. Development of progressive People Policies. 7. Roll-out of mental health training for staff and managers. **Performance**	3	4	

	Risk event Employees not engaged/consulted as part of organisational transformation. Experienced employees leaving the organisation Inability to recruit suitably qualified / trained staff to fill vacancies negatively impacting on remaining workforce Unacceptable behaviours demonstrated by employees Stated organisational culture not consistently reinforced by managers Poor employee performance will stifle transformational change **Risk effect** Difficulties recruiting the right staff Challenges retaining quality staff Low skill levels Low morale, especially during change High absence rates, loss of experience in service areas. 'A Great Place to Grow' our values including respect ,collaboration, pride and ownership not realised, potentially resulting in missing the opportunity to capitalise on the abilities, experience and ideas of team members. Poor employee performance will Exacerbate the financial challenge	Chief Operating Officer Education, Chief Officer Young People and Partnerships, HR Strategic Lead	1. Service-level workforce plans. 2. Structured, robust, well established 'Making Performance Matter' Framework where expected standards of behaviour and Council values are re-enforced. 3. Continued re-enforcement of all People Policies involving various communication methods. 4. Development of a suite of management information to ensure Service Managers are informed e.g. turnover, absence levels/reasons etc. **Organisational Change** 1. Policy for Organisational Change includes strong emphasis on early engagement of employees. 2. Redeployment Procedure to ensure maximum chance of successful redeployment. **Conduct** 1. Resolution Policy encourages early intervention of workplace issues. 2. Professional standards and values build into the induction process and management development programme. **Communication** 1. A range of initiatives to keep staff informed of change (Chief Executive's weekly email, Connect, All staff emails, tailored team briefings etc.			

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.02.04	Revisions to Service Workforce Plans - including analysis of future workforce requirements, gap analysis and gap closing strategies, and performance measures and target setting.	**Q3 22/23:** Workforce plan guidance issued to all Directorates. Refreshed workforce plans to be developed in line with the new service plans for the next financial year 23/24	HR Strategic Lead	31-Mar-2023	
SRP.RA.02.06	Workforce wellbeing	**Q3 22/23:** Continuing to embed the new Employee Health and Wellbeing Strategy.	HR Strategic Lead	31-Mar-2023	

SRP.RR.07 Care at Home

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.07	**Risk cause** Internal and External providers of Care at Home services unable to meet service and quality requirements as a result of a lack of capacity. **Risk event**	Director Health and Social Care, Head of Adult Health and Social Care	1. Care at Home winter assurance plan and business continuity plan complete 2. Development of Care at Home Service Improvement action plan near completion 3. External commissioning complete and ongoing contract monitoring in place	3	4	

	Capacity of Community Support outstripped by demand **Risk effect** There is a risk that patients will have their discharge delayed because there is insufficient community supports to enable timely discharge leading to deterioration in their health, beds being blocked and elective operations potentially being cancelled.		4. External provider audits complete 5. Re-established Multi-Agency Quality in Care at Home quarterly review meetings jointly with East Lothian 6. Weekly provider meetings in place 7. Additional locum team members and contracts with agency staff in place 8. Daily discharge meeting with Multidisciplinary and Multi-agency team planning to plan and coordinate discharge to ensure care at hone support in place			

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.07.01	Independent review of adult and social care	**Q3 22/23:** COSLA and Social Work Scotland have formally requested a pause on the NCS Bill. **Q1 22/23:** NCS Bill published June 2022. Consultation at Stage 1, concludes in Sept. See separate risk on NCS for further information.	Head of Adult and Social Care; Chief Executive	30-Jun-2022	

SRP.RR.08 Asset Management – buildings, vehicles, roads and Digital assets/networks

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.08	**Risk cause** Many of the assets the Council own by their nature are in a position of ongoing deterioration through their normal use, e.g. roads - normal wear and tear, street lights and vehicles & buildings used to deliver services. **Risk event** Many assets will deteriorate under normal conditions although buildings, roads and street lights as an example can be damaged during more extreme weather events or as a result of a lack of maintenance. **Risk effect** In the case of Roads Services there is a real risk of increased potholes and insurance claims, reduced skid	Chief Executive, Executive Director Children, Young People and Partnerships, Executive Director Place, Director Health and Social Care, Head of Adult and Social Care; Chief Officer Corporate Solutions; Chief Finance	1. There is provision in place within the capital plan for investment in the asset base. 2. Asset register 3. Condition Survey 4. Understanding of future asset needs 5. Asset Strategy: . Roads . Land . Fleet . Digital Service Network . Digital Service hardware 6. Capital program - investment in estate. 7. Ongoing monitoring of properties by: Maintenance Surveyors, Facilities Management and Property Users. 8. Established Capital Plan and Asset Management Board and	3	5	

	resistance leading to higher accident potential and building up of higher costs in the future. In respect of vehicles, increased breakdowns, service failures, greater maintenance inevitable, higher short-term hire costs. In terms of property, health and safety issues arise, failure to meet current standards and higher running costs. There is also the risk of two-tier accommodation, some high quality, some low.	Officer, Chief Officer Place, Chief Operating Officer Education, Chief Officer Young People and Partnerships, Head of Development	dedicated Asset Management Board 9. Establishment of 7 thematic Estate Safety and Management Groups chaired by Chief Officer Place			

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.08.02	Plan for appropriate investment in capital works and remedial maintenance over the lifespan of each property asset.	**Q2 22/23:** Programme of work agreed to progress for building condition surveys on a phased approach, over a three year period. Move to implementation into 22/23. Check w/Gareth	Chief Officer Place	31-Mar-2023	
SRP.RA.08.05	Learning Estate Strategy	**Q2 22/23:** Potential risk to delivery of Learning Estate projects due to .inflated costs from a number of factors. Factoring the commitment to net zero into our projects has added another cost pressure and may affect the affordability and viability of some projects. Oversight of Learning Estate programme through the Capital plan & Asset Management Board MB	Executive Director Children, Young People and Partnerships, Head of Development	31-Mar-2023	
SRP.RA.08.06	Asset Management systems	**Q2 22/23:** Work is ongoing through Place services to identify appropriate asset management systems	Chief Officer Place	31-Mar-2023	

SRP.RR.09 Emergency Planning and Business Continuity Management

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.09	**Risk cause** The Council not preparing or timeously reviewing Emergency Plans and testing arrangements to respond to Civil Contingencies Incidents **Risk event** There are a wide range of potential events the Council may be expected to respond to e.g. Severe weather incident, Pandemic, Utility disruption etc. **Risk effect** Censure through non-compliance with the Civil Contingencies Act Not adequately recovering from the loss of major	Chief Executive, Executive Director Children, Young People and Partnerships, Executive Director Place, Director Health and Social Care, Head of Adult and Social Care; Chief Officer Corporate Solutions;	Potential sub risks include:- 01 – Civil Contingencies Risk Register used to highlight key risks and record response, - Council's plans developed and maintained in response to identified risks, - Risk and Resilience Group support development, peer review and roll out of plans. 02 – Establishment based incident response plans in place and maintained locally. 03 – Emergency response plan setting out general approach to respond to a major emergency in-line with key partner organisations. 04 – As part of the Council's Emergency response the importance of recording decisions made and information available at the time is highlighted as this would be scrutinised in the event of an FAI.	3	4	

	accommodation (e.g. secondary school, main offices), computer systems and staff Not able to respond to a major emergency in the community Fatal Accident Inquiries	Chief Finance Officer, Chief Officer Place, Chief Operating Officer Education, Chief Officer Young People and Partnerships, Head of Development, Senior Manager Protective Services, Health, Safety & Resilience Manager	05 – Care for People Group meeting 6 weekly to continue support for Communities in response to COVID – 19 to establish and co-ordinate support for people on a multi-agency basis. 06 – Care for People Group: Afghan, Ukrainian and UASC support programmes			

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.09.02	Development of Emergency Planning Improvement Plan	**Q3 22/23:** New Health, Safety and Resilience Team Manager in pos **Q2 22/23:** New Contingency Planning Officer in post and work progressing on improvement plan	Chief Officer Place; Senior Manager Protective Services, Health, Safety & Resilience Manager	31-Mar-2023	
SRP.RA.09.03	Business Continuity System	**Q3 22/23:** Pilot areas identified and champions across Directorates for the roll out **Q2 22/23:** System currently being populated ahead of roll out to all services. A small number of Council services engaged to test and validate operational functionality. Project governance now overseen through the Customer Service Platform Board	Chief Officer Place; Senior Manager Protective Services, Health, Safety & Resilience Manager	31-Mar-2023	

SRP.RR.10 Governance and Standards in Public Life

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.10	**Risk cause** Code of conduct for Members and employees actions falling short of International Standards. **Risk event** Failure in openness, accountability, clarity. **Risk effect** Service, partnerships and project outcomes not achieved Non-compliance with conduct standards and reduction in standards in public life	Chief Officer Corporate Solutions; Chief Executive; Chief Officer Place; Executive Director Place; Alan Turpie	Potential sub risks include:- 01 Macro governance at the top – failure in openness, accountability, clarity; 02 Micro governance in services, partnerships and projects and outcomes not achieved 03 Non-compliance with codes of conduct and reduction in standards in public life 04 Annual Assurance Statement. 05 Standing Orders 06 Scheme of Administration 07 Scheme of Delegation	3	4	

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RR.10.0 1	Corporate Governance	**Q3 22/23:** Annual Assurance Statement submitted annually**,** People Policies and Standing Orders subject to review process (see separate risks contained within the strategic risk profile for further information)	Executive Director Place; Chief Officer Corporate Solutions; Legal and Governance Manager	31-Mar-2023	

SRP.RR.11 Corporate Policies and Strategies

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.11	**Risk cause** Policies may not match the aspirations of the Council's Strategic priorities or cultural perspective. **Risk event** Policies not monitored may become out of date Policies not reviewed to ensure alignment with strategic priorities. **Risk effect** Policies not monitored could result in non-compliance with legislation Policies not align to strategic priorities will inhibit the rather than support implementation of strategic priorities.	Chief Executive, Executive Director Children, Young People and Partnerships, Executive Director Place, Director Health and Social Care, Head of Adult and Social Care; Chief Officer Corporate Solutions; Chief Finance	1. Single Midlothian Plan providing overarching direction 2. Service plans aligned to Single Midlothian Plan. 3. Leadership team to ensure correct approaches are adopted to get the right results. 4. Strategic housing investment plan, submitted to Scottish Government in October 2022 5. Procurement Strategy 2018 6. Capital Strategy 7. Integrated Joint Board (IJB) Plan 8. IJB Strategic needs assessment 9. Midlothian Local Development Plan 2017 – the Council's corporate spatial strategy.	2	3	

		Officer, Chief Officer Place, Chief Operating Officer Education, Chief Officer Young People and Partnerships				

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.11.02	Accessibility Strategy	**Q3 22/23:** Work progresses through the building audit programme **Q2 22/23:** Education working with Property colleagues to refresh building data including information on building accessibility. Once work is complete, a work stream will be progressed to ensure Council compliance.	Chief Officer Place; Chief Operating Officer Education; Senior Manager Property and Facilities Management	31-Mar-2023	
SRP.RA.11.05	Antisocial Behaviour Policy	**Q3 22/23:** Work continues	Chief Officer Place	31-Mar-2023	
SRP.RA.11.06	Strategic Plan 2023 - 2027	**Q3 22/23:** Development of Strategic Plan and MTFS for next term of Council being progressed to support decisions about what services, beyond those which are statutory can be provided. This facilitates setting of the 2023/24 budget in February 2023	Chief Executive; Chief Finance Officer	31-Mar-2023	
SRP.RR.11.01	Parental Engagement Strategy	**Q3 22/23:** A Parental Engagement strategy and a Parent Council Toolkit have been developed and implemented in October 2022. The Parental Learner Liaison Officer continues to engage with parents and learners through Parent Council Chairs, Parent/ learner Conferences as well as hearing their voice through National Discussions and consultations. **Q2 22/23:** Parental Learner Liaison Officer has produced a draft Parental Engagement Strategy looking at examples throughout Scotland and a consultation with all stakeholders is underway. Following a review with Parent Council Chairs, a Parental Engagement calendar has been created for next session to support PC Chairs with the information and structure they need. The National Parental Involvement & Engagement survey has been rolled out to all Primary, Secondary & Special School parents with data to be evaluated in July. Parent Working Groups have been created to support specific interests and priorities – Consultation, Equity, Digital Learning, ASN & DWY/Positive Destinations. A Parent Council 'Toolkit' has been created to inform Parents of the functions of a Parent Council, provide support, signposting and remits. This will provide a more consistent structure within Midlothian of all Parent Councils and potentially boost numbers. Social Media has been created for Parental	Chief Operating Officer Education	31-Oct-2022	

		Engagement and the design of a webpage to add to the Council Website is underway. Draft plans for our first Parent Conference in Q1 of next session is underway. The same is to be said for a Pupil Conference. The PLLO is now an active member in the SEIC Young Persons Involvement Group and regularly meets the Education Scotland's Attainment Advisor.			

SRP.RR.12 Internal Control Environment

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.12	**Risk cause** Work procedures/process inadvertently create the capacity for fraud and waste to occur. Internal Controls requiring more time, effort or cost than the risk being managed. Mangers failing to follow procedures and keep systems updated with accurate information **Risk event** Persons exploiting opportunities to commit fraud Waste and errors Changing risk landscape associated with remote working solutions. **Risk effect** Waste and loss Risks over managed with risk controls costing more than the potential loss being managed. Increased opportunity for fraud or financial loss has direct impact on management information. Has adverse effect on service performance	Chief Executive, Executive Director Children, Young People and Partnerships, Executive Director Place, Director Health and Social Care, Head of Adult and Social Care; Chief Officer Corporate Solutions; Chief Finance Officer, Chief Officer Place, Chief Operating Officer Education, Chief Officer Young People and Partnerships	1. Services have been prompted to consider fraud and waste within Service Risk Registers. 2. Risk Management Guide provides direction on the need to balance time, effort and cost against benefit of risk controls. 3. Internal Audit examine internal control arrangements based largely on the risk registers. 4. Whistleblowing Policy (subject to review) 5. Internal and external assurance. 6. E-learning for staff to complete mandatory training for fraud awareness. 7. Implemented changes to business processes and procedures to maintain and enhance internal control. 8. Bi-annual updates to Audit committee on progress with recommendations noted in the annual governance statement. 9. Continue remind staff of secondary employment/outside interests and gifts & hospitality 10. Digital induction for all new employees (with service exceptions), including legal, HR, procurement, health and safety. Control at entry to organisation. 11. Management Development Programme, delivered in partnership with Edinburgh College, provides reinforcement of organisational regulatory obligations. 12. The Integrity Group continues to meet to improve the Council's resilience to fraud, corruption, theft and crime (including cybercrime), maintaining proper risk management, governance and internal control processes and systems to ensure probity in systems and operations, and mitigation of risks, including the prevention, detection and resolution of fraud and irregularities. Management is also responsible for checking that the arrangements and controls are operating effectively and obtaining assurances from internal compliance, risk, inspection, quality, and control functions.	3	3	

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status

SRP.RA.12.04	Review of Serious Organised Crime (SOC) group	**Q3 22/23:** Review continues **Q2 22/23:** Review of SOC has begun with stakeholder engagement underway	Chief Officer Place	31-Mar-2023	

SRP.RR.13 Climate Change

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.13	**Risk cause** Council Services not adequately engaged, resourced or directed to fulfil the requirements of the Climate Change Act. **Risk event** Council Services not responding to the Climate Change Act with sufficient pace. **Risk effect** Council failing to meet its obligation under the Climate Change (Scotland) Act 2009 and incurring the associated reputational damage.	Chief Executive, Executive Director Children, Young People and Partnerships, Executive Director Place, Director Health and Social Care, Head of Adult and Social Care; Chief Officer Corporate Solutions; Chief Finance Officer, Chief Officer Place, Chief Operating Officer Education, Chief Officer Young People and Partnerships; Senior Manager Planning, Sustainable Growth and Investment	1. Statutory requirement to report on compliance with climate change duties. 2. Council Carbon Management Plan 3. Approval of a Corporate Climate Change Strategy and action plan 4. CPP Board for Climate Change to bring strategic focus and oversight of plans and progress. 5. Resilience Seminars	5	5	

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.13.03	Recruitment of Climate Change Officer	**Q3 22/23:** Service Review continues.	Chief Officer Place; Senior Manager Planning, Sustainable Growth and Investment	31 March 2023	

SRP.RA.13.0 4	Delivery of the BTB Board Carbon Neutral by 2030	**Q3 22/23:** Work underway to develop a fully costed Climate Change action plan to be presented to members in Q4 2022/23 **Q2 22/23:** Carbon Management Plan requires to be reviewed and resourced adequately. There is a requirement for a cross Council approach to achieve carbon neutral by 2030. Work is underway in discrete areas to contribute to achievement of the ambition, but financial resource and staffing is required to develop an overarching engagement and action plan.	Chief Officer Place; Senior Manager Planning, Sustainable Growth and Investment	31-Mar-2030	
SRP.RA.13.0 5	Development of the Strategic Plan 2023-27	**Q3 22/23:** Carbon Neutral by 2030 is a strategic priority within the draft strategic plan	Chief Officer Place; Senior Manager Planning, Sustainable Growth and Investment	31-Mar-2023	

SRP.RR.14.1 Scottish Child Abuse Inquiry

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.14.1	**Risk Cause:** Midlothian Council and its legacy organisations, predating the creation of Midlothian Council in 1996, have been involved in the provision of care of children going back to living memory. During this time there is the likelihood that the care children received fell below standards of care now in place. There is the further potential the some people in the care of Midlothian Council and its legacy organisations were subject to abuse by those who were employed to care for them. **Risk Event:** The Scottish Government began an Inquiry into cases of Child Abuse occurring prior to 17 December 2014, the intention of this enquiry is to identify historic case of abuse which have to date gone unreported. The most recent Section 21 notice around the Foster Care Case Study is a significant piece of work. The request for information from 1930 to date is very challenging given the volume of files that require to be read and analysed. **Risk Effect:** If the inquiry finds historic cases of abuse in Midlothian this could damage the reputation of the Council and could place doubt in the eyes of the public as to the safety of these currently in care. There is significant scope for a substantial financial impact arising from claims of historic abuse. Some existing employees may be affected	Chief Executive; Executive Director Children, Young People and Partnerships; Chief Social Worker	The Council have set up an Abuse Inquiry Project Team to support the Council to prepare for information requests to support the Inquiry. In addition we have a Claims Project Team who have mapped out how we shall manage any future claims reported against the Local Authority. The Inquiry Team have established a Project Plan covering: 1. Residential establishments, List D Schools and Foster Carers: identifying Children's homes, Foster Carers and any List D Schools in Midlothian over the last 100 years and researching historic records. 2. Record Audit: reviewing the Council's existing paper and electronic recordkeeping systems to identify relevant records and map them to residential establishments. This also includes, where possible, noting the Council's historic recordkeeping policies, such as retention schedules. 3. Cataloguing/Indexing: checking and updating existing recordkeeping systems for accuracy and consistency, enabling effective information retrieval when requested by the Inquiry. The Project Team have established a Project Plan covering: 4. Ascertaining the succession and insurance position in relation to potential historic child abuse claims. 5. Ascertaining and agreeing Midlothian Council's legal position/ approach in dealing with the potential historic child abuse claims. 6. Identifying the need for guidance, protocol, templates etc. should/if any claims be made against the council.	4	4	

	by the inquiry and subsequent claims of abuse. We have request an extension for Parts B, C & D of the last Section 21 to April 2020, which has been granted. To date there has been no evidence from the extensive file read to suggest there has been systemic abuse within our foster care system.		7. Consideration to identifying if additional staffing will be required as expected deluge of FOI's SAR's in 2018 from solicitors of potential claimants. 8. Project team is in place with project plan with a range of identified actions which are being progressed. Monthly meetings to progress project plan. 9. The SCAI Social Worker is very competent and experienced in this area of work and provides quarterly updates on their findings from the file read. This is a real strength within this area of work. The CSWO and Principal Solicitor meet regularly with the social worker to discuss findings from the file read.			

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.14.03	Foster Care and Residential Care File Review	**Q3 22/23:** Inquiry has heard all the evidence for the Sct 21 submissions around foster care. Many CSWO's were called to give evidence around abuse within their local authority. Midlothian CSWO was not called to give evidence. This part of the inquiry is now concluded with learning from this due to be written up by around March 2023. The learning will result in an action plan being developed which we shall consider and ensure that our policies and practice are updated accordingly. **Q1 22/23:** Inquiry is taking evidence in relation to Sct 21 submissions around foster care findings. Many CSWO's have been called to give evidence around abuse within their local authority. To date Midlothian have not been called to give evidence. We have a QC offering advice on our submission, which do not suggest that there is evidence to suggest there has been systemic abuse, based on our file read to date.	Children's Services Management Team; Chief Social Worker	31-Mar-2023	

SRP.RR.16 Growing Council

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.16	**Risk cause** Population growth in Midlothian over the next 10 - 15 years will see Midlothian become the fastest growing Council in Scotland. . 0-15 population increase, projected at 20% and 75+ population increase projected to increased by 100% between 2014 and 2039. **Risk event** Failure to resource and plan for these rises will significantly impact the Councils ability to fulfil its statutory obligations in	Head of Adult and Social Care; Director of Education; Chief Executive; Executive Director Place; Joan Tranent	1. Local development plan and supplementary guidance on developer contributions. 2. Services planning future service provision on the basis of anticipated service demands 3. The change programme 4. Learning Estate Strategy 5. Capital Plan Prioritisation 6. Strategic Housing Investment Strategy 7. Rent Review Strategy 8. Joint needs assessment used to develop - IJB Strategic Plan	4	4	

	relation to these groups. **Risk effect** Inadequate capacity within the school estate to cope with the projected increase in pupil numbers. In sufficient provision to support an aging population placing costly inefficiencies on other parts of the care sector. General population increase placing additional demand on infrastructure including GP services. Increased pressure on infrastructure, services e.g. waste collection and growth of road network as new development roads are adopted.		9. Capital Plan and Asset Management Board will scrutinise and challenge slippage on capital programmes recognising that slippage can have an adverse impact on financial sustainability and also the delivery on assets required to support capital growth. 10. City Deal provides the opportunity to support inclusive growth.			

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.16.01	Capital Programme	**Q3 22/23:** Capital Plan prioritisation also includes Learning Estate Strategy expanded to meet statutory requirements. **Q2 22/23:** Latest roll projections indicate that that we will breach capacity in some schools in Aug 2023. Capital programme updated based on outcome of review of Learning Estate Strategy underway	Director of Education; Executive Director Place	31-Aug-2023	
SRP.RA.16.02	Capital Plan reprioritisation	**Q3 22/23:** In light of rising costs through inflationary impacts, EU Exit and post pandemic economic shifts, work is ongoing to review the current capital plan and reprioritise the programme. This will be reported to Council in Q4 22/23 for review and approval.	Executive Director Place, Executive Director Children, Young People and Partnerships, Chief Finance Officer, Head of Development	31-Mar-2023	

SRP.RR.17 UK Decision to leave the EU

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.17	**Risk cause** UK vote to leave the European Union **Risk event** UK leaving the European Union **Risk effect** The impacts associated with the UK's decision to leave the UK have yet to be realised and will only become clear once the final terms of the UK's departure are finalised. There are some direct potential impacts such as an end to EU funding of Council co-ordinated projects	Chief Executive, Executive Director Children, Young People and Partnerships, Executive Director Place, Director Health and Social Care, Head of Adult and Social Care;	01 – Risk and Resilience Group 02 – Taking a risk management approach to identifying and assessing anticipated impacts 03 – Working with a range of national and local bodies to inform preparatory arrangements. 04 – EU Settlement scheme promoted on Council Internet to support those living and working in Midlothian to access the Home Office scheme.	4	5	

	and indirect impacts on industries undertaken within the geographical area which have relied on EU funding, such as agriculture. There are wider potential implications arising from uncertainty regarding the resident status of EU nationals, post any exit agreement, and the availability of workers from outside the UK accessing the job market here in the future. These factors have the potential to impact on the availability of the right people with the right skills being available to help grow the economy here in Midlothian. One area this could affect the Council could be in the delivery of future building projects within Midlothian which could curtail further economic growth.	Chief Officer Corporate Solutions; Chief Finance Officer, Chief Officer Place, Chief Operating Officer Education, Chief Officer Young People and Partnerships				

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.17.0 1	Refresh of Economic Strategy	**Q2 22/23:** Report recommendations agreed by Council in Oct 2022. Work is now underway to refresh the Economic Strategy by March 2023	Chief Officer Place	31-Mar-2023	

SRP.RR.19 Health & Safety

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.19	**Risk cause** Failing to identify and rectify non-compliance with Health and Safety regulations. **Risk event** Employees required to undertake tasks they are not competent to. Statutorily driven health and safety protective arrangements for service users and employees not implemented correctly. Non-compliance with policy and procedure Not undertaking audits and inspections to confirm adherence to policy and legislative requirements. **Risk effect** Serious injury of ill health impact on employees and or service users. Negative impact on outcomes for customers/service users. Service users and employees exposed to hazards where statutory requirements exist. Statutory health and safety - duty of care over services users and employees not met. Criminal prosecution of the Corporate body and or	Chief Executive, Executive Director Children, Young People and Partnerships, Executive Director Place, Director Health and Social Care, Head of Adult and Social Care; Chief Officer Corporate Solutions; Chief Finance Officer, Chief Officer Place, Chief Operating Officer Education, Chief Officer Young People and Partnerships; Protective	1 - Health Safety and Wellbeing Strategy 2 - Suite of Health and Safety Management Arrangements developed setting out council response to statutory obligations (Revised 2021) 3 - Comprehensive range of Health & Safety Management & Assessment based development opportunities for line managers 4 - Use of Health & Safety Management Information System to enhance information transfer and organisational efficiency 5 - Comprehensive training programme in place to support those with responsibility for managing health and safety. 6 - Guidance and Risk assessment templates to support COVID 19 response. 7 - Use of comprehensive audit programme to confirm the application of agreed management Arrangements and Council Policy. 8 - New risk assessment guidance and support for managers rapidly deployed in response to COVID 19 in line with associated Scottish Government guidance.	3	5	

	individuals through Corporate Homicide (Corporate Manslaughter) Significant financial penalties from Criminal Prosecution.	Services Senior Manager; Health, Safety and Resilience Manager				

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.19.0 1	Delivery of Health, Safety and Wellbeing Strategy	**Q3 22/23:** Health, Safety and Resilience Manager started 9 January 2023. **Q2 22/23:** Appointment made for Team Manager Health, Safety & Resilience. Due to take up post in Jan 2023.	Chief Officer Place; Edel Ryan	31-Mar-2023	
SRP.RA.19.0 7	H&S audit across all Council estate	**Q3 22/23:** Zurich rolling out training across the Council **Q2 22/23:** Protective Services and Property Service are progressing a Health and Safety building audit across the full Council estate, which will inform the development of associated action plans taking a risk based assessment of the findings. Asbestos inspection programme commenced with first round of inspections focussed on the learning estate over the summer holiday period. Review of arrangements for first aid and fire warden provision commenced.	Chief Officer Place	31-March-2023	

SRP.RR.20 Early Years Expansion (1140 Hours)

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.20	**Risk cause** Population growth in Midlothian over the next 10 - 15 years will see Midlothian become the fastest growing Council in Scotland. . 0-15 population increase, projected at 20% in addition the Scottish Government has made a commitment to increase the current provision of free early years care from 600 to 1140 hours. **Risk event** Failure to resource and plan for these rises will significantly impact the Councils ability to fulfil its statutory obligations in relation to these groups. The sustainable rate review may lead to significant increase in funding to providers; maintaining current rate is not an option if not deemed sustainable. The result could lead to a funding gap in future years. **Risk effect** Inadequate capacity within the school estate and/or Early	Chief Executive; Executive Director Place; Executive Director Children, Young People and Partnerships; Chief Finance Officer	1. Learning Estate Strategy 2. Early Years Expansion to 1140 hours updates 3. Capital Strategy 4. School Roll Projections will be reviewed and updated 5. Business Support and Finance Business Partners reviewing external funding landscape closely for future funding options	4	5	

	Years to cope with the projected increase in numbers. Lack of staffing and/or financial support to build new schools Potential for additional unfunded request to place 4 year olds with August to December birthdays requesting additional year of 1140 hours, not currently funded by Scottish Government.					

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RR.20.01	1140 future years funding	**Q3 22/23:** No change – awaiting outcome of funding position **Q2 22/23:** Potential increased costs associated with paying a sustainable rate to partner providers may place further pressure on containing service delivery costs within available funding. Scottish Government funding for 2023/24 will be known during Q3.	Executive Director Children, Young People and Partnerships, Chief Officer Corporate Solutions; Chief Finance Officer	31-Mar-2023	

SRP.RR.21 Cyber Security

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.RR.21	**Risk Cause:** Malicious attempts to damage, disrupt or gain unauthorised access to Council computer systems, networks or devices **Risk Event:** The Council is at significant risk of cyber-attack from Ransomware Phishing Emails, Advanced Persistent Threats (APT) and Distributed Denial of Service Attacks (DDOS) attacks. Hacking and Social Engineering. **Risk Effect:** Access to Council systems by cyber criminals and foreign intelligence agencies for financial, commercial or information gathering reasons. This could lead to significant financial losses, data compromise and subsequent regulatory sanction if our technical and organisational measures are deemed insufficient. Severe business disruption including the almost total loss of critical IT systems and networks leading to significant service delivery challenges.	Chief Executive, Executive Director Children, Young People and Partnerships, Executive Director Place, Director Health and Social Care, Head of Adult and Social Care; Chief Officer Corporate Solutions; Chief Finance Officer, Chief Officer Place, Chief Operating Officer Education, Chief Officer Young People	1. Implementation of and compliance with the Scottish Government Cyber Resiliency Public Sector Action Plan 2. Cyber Essentials Plus Certification 3. Public Sector Network Certification 4. Appropriate technical and organisational measures deployed to reduce the likelihood and impact of an attack 5. Employing an Information Governance and Security Lead 6. Implementing Scottish Government Cyber Security Action Plan 7. Creating a Midlothian Cyber Defence Action Plan. 8. Adoption of the NCSC (National Cyber Security Centre) Active Cyber Defence programme	3	5	

		and Partnerships, Head of Development, Senior Manager Protective Services, Health, Safety & Resilience Manager				

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.21.1	Appropriate Technical and Organisational Measures	**Q3 22/23:** Action/mitigation includes:- 1. Appointment of Cyber Security Analyst to support the Cyber Lead 2. On-going phishing exercise on staff and the purchasing of new cyber security training software 3. The implementation of new software to scan for security vulnerabilities. Establishing new password security protection software	Chief Digital Officer; Cyber Security, Information Governance and Compliance Manager	31-Mar-2023	

SRP.IR.12 Cost of Living Crisis

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.IR.12	**Risk cause** The UK is currently facing an unprecedented storm of increasing prices, bills and tax. The 40 year high inflation rate of 9% is the main driver of the cost of living crisis which has outstripped wage and benefit increases. **Risk event** Rapid ongoing rise of energy prices (gas, electricity and fuel) as well as food and drink prices. **Risk effect** The impact on households is already being noted with 87% of adults in the UK reported an increase in their cost of living in April 2022 (**Office for National Statistics; Francis-Devine et al, 2022**). The price rises will impact low-income households the hardest as a larger proportion	Chief Executive, Executive Director Children, Young People and Partnerships, Executive Director Place, Director Health and Social Care	1. Council Cost of Living Task Force to oversee the Council's response to the crisis 2. Allocation of LACER funding to support those most affected 3. Strategic Evaluation Partner appointed to create poverty profile 4. Community Planning Partnership has established a Midlothian Strategic Poverty Prevention Group co-chaired by Council Leader and Director of Public Health 5. New Child Poverty chair and lead appointed (Executive Director Children, Young People and Partnerships) 6. Child Poverty self-evaluation underway with Improvement Service	3	5	

	of their bills are on energy and food. The Resolution Foundation estimates an extra 1.3 million people will fall into absolute poverty in 2023, including 500,000 children.					

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.12.1	Cost of Living Task Force	**Q3 22/23:** Establishment of Warm and Welcoming Hubs in Lasswade and Newbattle libraries for the winter **Q2 22/23:** The Council agreed to establish a Cost of Living Crisis Task Force at its meeting on 28 June 2022 and is now meeting fortnightly. Membership is drawn across CMT, cross party member representation and NHS.	Chief Executive	31 March 2023	
SRP.RA.12.2	LACER funding	**Q2 22/23:** Identification of 15 trusted partners to distribute funding in communities for food and fuel, wash and dry provision and support to establish reheatable food initiatives.	Lifelong Learning and Employability	31 March 2023	

Strategic Opportunities

SRP.OP.01 Shawfair

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.OP.01	The delivery of a new sustainable low carbon community at Shawfair.	Chief Executive, Executive Director Children, Young People and Partnerships, Executive Director Place, Director Health and Social Care, Head of Adult and Social Care; Senior Manager Planning, Sustainable Growth and Investment	1. Shawfair Landowners Group meets quarterly. 2. Legal agreement with developers to secure developer contributions (Section 75) towards infrastructure. 3. Approved masterplan and design guide for the entire community 4. Business and industrial provision, including small business incubator space. 5. Circa 4000 new homes 6. A school campus comprising Early Years, Nursery, Primary, Secondary & Life Long Learning provision 7. New Primary schools 8. Public Transport infrastructure including railway station. 9. Midlothian Energy Ltd (Joint Venture between MLC and Vattenfall)	5	4	

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status

SRP.OP.02 Borders Rail

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.OP.02	Passenger numbers after three years of operation are above projections. The railway has been, and continues to be a catalyst for economic development, access to training and labour markets, tourism growth, environmental improvements must notably in town centres, and access to the countryside.	Chief Executive, Executive Director Place, Chief Officer Place	1. Monitored by Economic Development. 2. Maximising the Impact: A blueprint for the Future - published by the blueprint group involving Scottish Government, Scottish Borders, Midlothian and City of Edinburgh Council, Transport Scotland, Scottish Enterprise and Visit Scotland. The document sets out the ambitions of the partners to realise the full potential of the new Railway. 3. Timely submission of bids for approval by the Blueprint Group 4. Close monitoring of approved funded projects. 5. Borders rail subgroup chaired by Midlothian Council Chief Executive.	5	4	

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status

SRP.OP.03 Easter Bush - Penicuik

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.OP.03	One of Midlothian's largest and most significant employment areas. Fast Growing opportunities in Science Technology Engineering and Mathematics (STEM) with opportunities to link with education. Partnership links to schools and university sector at the 'Bush' to promote STEM. Need to secure long-term strategic road access to ensure continued growth.	Chief Executive, Executive Director Children, Young People and Partnerships, Executive Director Place, Director Health and Social Care, Head of Development	1. Planning in place around creating Secondary Schools as centres for excellence linked to specialisms including Science Technology Engineering and Mathematics (STEM). 2. Land allocated for expansion. 3. Midlothian Science Zone. 4. City Deal funding to provide for growth and strategic road access.	5	4	

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.OP.03.A 2	A701/A702 Trunk Road Improvements	**Q3 22/23:** Escalating costs of this project has resulted in a significant funding gap which requires to be addressed in order for the project to proceed. MLC has submitted an		31- March - 2023	

		application to the Levelling Up Fund to address this gap. Progress report to Council on 28 June – STAG Appraisal (stage 2) complete. Report highlighted that cost inflation and increased project costs as outstanding areas of concern. Feedback from Government is that outcome of the Levelling Up application should be known in Q4 2022/23- awaiting update.				

SRP.OP.04 City Deal

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.OP.04	South East Scotland Region City Deal - a bid for funding to Scottish and UK Governments to accelerate economic growth through investment in infrastructure/ housing/ skills and innovation. 200 Council Houses linked to the City Deal.	Chief Executive, Executive Director Children, Young People and Partnerships, Executive Director Place, Director Health and Social Care, Head of Adult and Social Care; Chief Officer Corporate Solutions; Chief Finance Officer, Chief Officer Place, Chief Operating Officer Education, Chief Officer Young People and Partnerships,	1. City Deal signed in August 2018. 2. Maintain strong Midlothian involvement through the City Deal governance structure. 3. Midlothian City Deal Key Officer (Internal) Group. 4. Securing best arrangements for Midlothian through close liaison with partners and conclusion of business cases.	4	5	

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.OP.04.02	Realisation of outcomes of respective work streams	**Q3 22/23:** Midlothian has now completed its year as chair. Work continues on the relevant programmes. **Q2 22/23:** For the 2022 calendar year Midlothian is the chair of the CRD programme (annual rotation across the six Local Authorities).	Executive Director Place	31-Mar-2023	

SRP.OP.05 Growing Council

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk

						Evaluation
SRP.OP.05	Midlothian Council has been identified as the fastest growing Council's in Scotland. This brings the opportunity to support the Council vision of being 'A Great Place to Grow'. As a growing Council this brings the opportunity to redevelop parts of Midlothian, improve infrastructure with a focus on area targeting, improving economic opportunities, improving education and health outcome. This growth creates the opportunity to meet the housing need with 25% of new homes being built in the affordable housing bracket, in addition to the expansion in Council House building. This construction will directly support employment in construction and will see a steady increase in the volume of Council tax received over time.	Chief Executive, Executive Director Children, Young People and Partnerships, Executive Director Place, Director Health and Social Care, Head of Adult and Social Care; Chief Officer Corporate Solutions; Chief Finance Officer, Chief Officer Place, Chief Operating Officer Education, Chief Officer Young People and Partnerships,	1. Community Planning Partnership 2. The Single Midlothian Plan 3. Strategic Housing Investment Plan (SHIP)	5	5	

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.RA.16.01	Capital Programme	**Q3 22/23:** Capital Plan prioritisation also includes Learning Estate Strategy expanded to meet statutory requirements. **Q2 22/23:** Latest roll projections indicate that that we will breach capacity in some schools in Aug 2023. Capital programme updated based on outcome of review of Learning Estate Strategy underway	Director of Education; Executive Director Place	31-Aug-2023	
SRP.RA.16.02	Capital Plan reprioritisation	**Q3 22/23:** In light of rising costs through inflationary impacts, EU Exit and post pandemic economic shifts, work is ongoing to review the current capital plan and reprioritise the programme. This will be reported to Council in Q4 22/23 for review and approval.	Executive Director Place, Executive Director Children, Young People and Partnerships, Chief Finance Officer, Head of Development	31-Mar-2023	

SRP.OP.07 Creating a world Class Education System

Risk Code	Risk Identification	Managed by	Risk Control Measures	Likelihood	Impact	Risk Evaluation
SRP.OP.07	The Centres of Excellence model is a core part of the Council's strategy to create a world-class education system in Midlothian. This is an ambitious project designed to deliver excellence and equity with a particular emphasis on interrupting the cycle of poverty. **Risk event:** The Phase 2 *Equipped for Learning* plan has a strong focus on transforming classroom practice and learner outcomes. This can only be achieved if effective technical support for EfL is in place to support this change. Programme is at risk of succeeding due to escalating inflation costs and resultant pressure on the overall capital plan budget, as well as resourcing to deliver Learning Estate programme. **Risk Effect:** Without the technical support and appropriate infrastructure we will not achieve the change resulting in a negative impact on learners experiences and outcomes	Chief Executive, Executive Director Children, Young People and Partnerships, Executive Director Place, Director Health and Social Care, Head of Adult and Social Care; Chief Officer Corporate Solutions; Chief Finance Officer, Chief Officer Place, Chief Operating Officer Education, Chief Officer Young People and Partnerships, Head of Development	1. Digital Centre of Excellence at Newbattle Community High School 2. Partnership agreement with the University of Edinburgh 3. Beeslack Replacement High School, pilot project for next round of SFT funding – funding model building in energy efficiency targets 4. Accelerating our ambition – Digital Strategy 5. Review of Digital team to support Digital Centre for Excellence	4	5	

Related Action Code	Related Action	Related action latest note	Managed By	Due Date	Status
SRP.OP.A.07 .01	Research and development	**Q2 22/23:** CIVTECH research project progressing well in partnership with University of Edinburgh and SFT. Ongoing dialogue with the University of Edinburgh and Edinburgh College in relation to the new centre of excellence.	Executive Director Children, Young People and Partnerships	31-Aug-2023	
SRP.OP.A.07 .03	Equipped for Learning	**Q3 22/23:** Appointment made for Google Administrator and commenced 4 Jan 2023. **Q2 22/23:** Recruitment has commenced for the Google Administrator post which will provide additional capability and enhance the programme delivery	Executive Director Children, Young People and Partnerships	31-Dec-2022	

Scotland's Public Finances: Challenges and Risks

Report by David Gladwin, Acting Chief Financial Officer

Report for Information

1 Recommendations

Audit Committee is recommended to:

- Consider the Audit Scotland report; and
- Note that the key messages have been considered by Council Officers and are embedded in the Medium Term Financial Strategy Report considered by Council on Tuesday 31st January and also the quarter 3 suite of financial governance reports to be presented to Council on Tuesday 21st February.

2 Purpose of Report / Executive Summary

The purpose of this report is to provide Audit Committee with a summary of the Scotland's Public Finance: challenges and risks report published by Audit Scotland in November 2022 and is appended to this report.

Three main messages come from the report covering rising costs and increasing demand, limitations on Scottish Government's ability to manoeuver in balancing their 22/23 and 23/24 budgets and commentary on the pace and scale of reform required across the public sector.

Date Thursday 26 January 2023

Report Contact:
David Gladwin, Acting Chief Financial Officer

David.Gladwin@midlothian.gov.uk

3 Background

3.1 Audit Scotland is a statutory body established in April 2020, under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission for Scotland.

3.2 Audit Scotland has prepared the attached report 'Scotland's public finances – challenges and risks' (Appendix B) for the Auditor General for Scotland. The Auditor General appoints auditors to Scotland's central government and NHS bodies; examines how public bodies spend money; helps them to manage their finances to the highest standards; and checks whether they achieve value for money.

3.3 The report sets out the challenges and risks that affect the current financial position (up to the point of issue), the significant financial pressure that public finances are under and information on how the Scottish Government aim to tackle these in its resource spending review.

Key Messages

3.4 Rising costs and increasing demands mean that the Scottish Government has to closely and carefully manage its position, to avoid the real risk that it will overspend on the 2022/23 budget. Whilst cost and inflation pressures are well documented for all areas of the public sector and beyond the main concern highlighted is the risk that an in-year 2022/23 overspend on the Scottish Government budget would have on 2023/24.

3.5 Recognition of the restrictive position that the Scottish Government find themselves in to balance their 2022/23 budget due to limited areas of flexibilities that remain available.

3.6 The pace and scale of reform across the public sector needs to increase. A gap exists between ambition and delivery which must narrow but also which must be resourced and delivered in a sustainable way.

4 Report Implications (Resource, Digital and Risk)

4.1 Resource

None

4.2 Digital

None

4.3 Risk

None

4.4 Ensuring Equalities (if required a separate IIA must be completed)

None

4.4 Additional Report Implications (See Appendix A)

See Appendix A

Appendices

Appendix A – Additional Report Implications
Appendix B – Scotland's public finances – challenges and risks

APPENDIX A – Report Implications

A.1 Key Priorities within the Single Midlothian Plan

Not applicable

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

Not applicable

A.5 Involving Communities and Other Stakeholders

Not applicable

A.6 Impact on Performance and Outcomes

Not applicable

A.7 Adopting a Preventative Approach

Not applicable

A.8 Supporting Sustainable Development

Not applicable

APPENDIX B

Scotland's public finances – challenges and risks

Briefing

Scotland's public finances

Challenges and risks

AUDITOR GENERAL

Prepared by Audit Scotland
November 2022

Contents

Introduction

1. The pressures placed on Scottish public finances have been significant and varied for several years. The level of funding available to the Scottish Government has fluctuated, falling in real terms between 2010/11 and 2017/18 but steadily increasing since.[1] The response to the Covid-19 pandemic saw further, significant increases to the Scottish budget but this funding was temporary and has now come to an end.

2. The Scottish public sector has had to adapt to these changes in funding levels alongside managing increasing demand for services and external events such as the Covid-19 and cost of living crises. These challenges continue to grow, with real-life implications for people in Scotland.

3. The re-opening of economies following Covid-19 led to inflation across the world because of growing demand, labour shortages and increased transport costs. The war in Ukraine has increased energy prices.[2] Inflation is outstripping any increases that people are seeing to wages or benefits, and real earnings fell at the fastest rate since records began between April and June.[3]

The rising cost of living is described as a ‘cost of living crisis’

4. According to the Office for National Statistics, 87 per cent of adults in the UK reported an increase in their cost of living in August-September 2022.[4] Businesses, the third sector and the public sector also face higher operating costs, including higher labour costs as wages rise in response to inflation. In this paper, when we talk about the cost of living crisis, or the cost crisis, we mean all these pressures across the economy that are caused by rising prices.

5. The Scottish Government has said that it faces ‘significant financial challenges’ because of the cost crisis,[5] as it supports individuals and businesses affected by rising prices, at the same time as inflation means its funding buys less than was expected when the budget was set in December.

6. This paper focuses on the pressures facing the Scottish budget this financial year and in the medium term, and the implications this has for public services. It intends to inform and support scrutiny of proposed spending and tax plans in the current context, and emphasise the need for reform to public services.

[1] Institute for Fiscal Studies, How and why has the Scottish Government’s funding changed in recent years?, March 2021
[2] Institute for Fiscal Studies, The Cost of Living Crisis, accessed August 2022
[3] BBC, Inflation drives fastest fall in real pay on record, August 2022
[4] ONS, Public opinions and social trends, Great Britain, 30 September 2022
[5] Deputy First Minister, Letter to the Finance and Public Administration Committee, September 2022

Key messages

Scotland's public finances: challenges and risks

- **Rising costs and increasing demands mean that the Scottish Government has to closely and carefully manage its position, to avoid the real risk that it will overspend on the 2022/23 budget.** There have been significant financial pressures on public services for some time before the cost of living crisis. The current high level of inflation means that the Scottish Government faces higher public-sector pay and other costs, at the same time as it faces increasing demand for support from people impacted by the crisis. The budget was set when inflation was lower, and the Scottish Government is unlikely to receive additional funding to address this issue in the near future.

  If the Scottish Government were to overspend against its budget, this money could be clawed back from the following year's budget. This would be the first such occasion since the creation of the Scottish Parliament.

- **The Scottish Government has limited room for manoeuvre to make changes to balance the 2022/23 budget, and will face difficult choices setting the 2023/24 budget.** Within the year, much of the Scottish budget is committed, which means that there is limited flexibility available to the Scottish Government in the short term. Setting the 2023/24 budget will be challenging, and the UK Government's spending and tax decisions will impact on this. A balance must be struck between short-term necessities and longer-term priorities, and the Scottish Government will need to revisit its priorities if the economic and fiscal conditions worsen.

- **The pace and scale of reform required across the public sector needs to increase.** While the Scottish Government must continue to react to immediate events and financial pressures, this must not distract from the immediate need for broader reform. The Scottish Government's Resource Spending Review sets out its planned reforms and next steps. In the past, the Auditor General has highlighted an implementation gap between the Scottish Government's ambitions for reform and delivery on the ground. It is vital that these reforms are delivered effectively, and with public engagement, to deliver sustainable services that improve people's outcomes.

The cost of living crisis adds to the pressures on the Scottish budget

Sustainability pressures on Scotland's public finances pre-date the current cost crisis and the Covid-19 pandemic, and have worsened because of them

7. Significant risks to the financial sustainability of public services in Scotland are not new:

- In 2018, the Auditor General first stated that the NHS was not in a financially sustainable position.[6] NHS boards were increasingly reliant on additional financial support from the Scottish Government or non-recurring savings to break even.
- The Accounts Commission has also highlighted for some years that councils in Scotland are also facing financial sustainability pressures. In the Local Government Overview published in June 2020, the Accounts Commission highlighted that councils making continued use of reserves to manage the funding gap was unsustainable.[7]

8. The long-term financial and operational effects of Covid-19 are still being felt. The pandemic has had a range of indirect and direct health and societal impacts, such as backlogs in NHS treatments and court cases.

9. No additional separate funding was provided by the UK Government for Covid-19 in 2022/23, although the overall Scottish budget has grown in comparison to pre-pandemic levels. The extra pressures caused by the pandemic are being funded through the core Scottish budget, placing more pressure on Scottish public finances.

The Scottish Government must meet any additional spending above UK measures from its existing budget

10. The current high levels of inflation bring further uncertainty and volatility to UK and Scottish government budgets. During the Covid-19 pandemic, the UK Government response included both direct support for individuals and businesses (for example, the furlough scheme) and also increased departmental spending, which led to increased funding for the Scottish

[6] Audit Scotland, NHS in Scotland 2018, October 2018
[7] Accounts Commission, Local government in Scotland: Overview 2020, June 2020

Government. As set out in Scotland's financial response to Covid-19, the UK Government provided the majority of funding for the Scottish Government's £15.5 billion spending response to the pandemic in 2020/21 and 2021/22.

11. To date, the main financial responses to the cost crisis have been in reserved rather than devolved areas, which do not directly impact the Scottish budget. To help manage energy costs, the UK Government has announced the Energy Price Guarantee (for households) and the Energy Bill Relief Scheme (for non-domestic customers). Both these schemes were expected to cost £60 billion in 2022/23 across the UK when they were announced.[8]

12. Funding from the UK Government provided through the block grant is the main source of funding for the Scottish budget. This gives Scotland a proportion of the amount that the UK Government allocates to its departments for spending on devolved issues (such as health and education). The block grant only changes in response to UK Government decisions, and is not automatically uprated for inflation.

13. The UK Government has not changed its departmental spending this year to account for the higher costs facing the public sector, meaning that if the Scottish Government wishes to spend more money to support individuals and business through the cost of living crisis, this must be funded from the existing Scottish budget, rather than through additional Barnett consequentials.

14. Increased inflation means the public pound buys less than was expected when the budget was set. As part of the Programme for Government, the First Minister highlighted that because of inflation, the Scottish 2022/23 budget is worth £1.7 billion less than it was when it was set in December.[9]

15. The Comprehensive Spending Review (CSR) sets out the UK Government's intended spending over the medium term and was announced when forecasts for inflation were much lower. The CSR projected 3.3 per cent real-terms growth in its departmental resource budgets between 2021/22 and 2024/25. In August 2022, the Institute for Fiscal Studies estimated that the real terms growth in spending over that period has now dropped to 1.9 per cent.[10] Any increased costs must be met through the original spending envelope given to UK Government departments – and consequently, that given to the Scottish Government.

16. The UK Government as announced that it will deliver an Autumn Statement on 17 November. This will contain important information for the Scottish Government to consider as it sets its 2023/24 budget.

[8] UK Government, The Growth Plan, September 2022

[9] Scottish Government, Programme for Government 2022-2023: First Minister's speech, 6 September 2022

[10] Institute for Fiscal Studies, The inflation squeeze on public services, 10 August 2022. This is based on levels of inflation for the GDP deflator as opposed to the Consumer Price Index. Please see the article for more information.

The Scottish Government must manage the increased costs of running the public sector on an ongoing basis

17. Although inflation is not forecast to stay high over the long term,[11] the like-for-like increased costs are locked in for future budgets, and will not fall back to their previous levels. As a result, the Scottish Government must manage these higher unit costs permanently, or change the way it operates. Examples of the rising costs the Scottish Government faces are set out in Exhibit 1.

Exhibit 1
Examples of cost pressures on the public sector

The enhanced pay offers that have been made to date total over £700 million.[12] Agreement has yet to be reached with unions in some key areas of the public sector.
Electricity costs through the National Framework Agreement have increased by 27.5 per cent over the last year.
Gas prices through the National Framework Agreement have increased by 197 per cent over the last year.[13]
Food costs are estimated to increase by five per cent over the next year. Councils currently spend around £86 million on food each year.[14]
The costs of capital projects are also increasing, with councils reporting increases of around 30 per cent on anticipated costs.[15] This is likely to be reflected more widely across the public sector.

Source: Audit Scotland

18. Wages are the most significant of these costs, accounting for over £22 billion across the devolved public sector (including local government).[16] The Scottish Government pay policy set in December 2021 reflected inflation of 3.1 per cent,[17] but by the time of the next Medium-term Financial Strategy in May, this had increased to nine per cent.[18]

[11] Bank of England, Monetary Policy Report, August 2022
[12] Deputy First Minister, Letter to the Finance and Public Administration Committee, September 2022
[13] Scottish Parliament Written Answer, S6W-07596, March 2022
[14] COSLA/SOLACE/CIPFA Directors of Finance Section, Finance and Public Administration Committee consultation response, August 2022
[15] COSLA/SOLACE/CIPFA Directors of Finance Section, Finance and Public Administration Committee consultation response, August 2022
[16] Scottish Government, Scotland's Fiscal Outlook, May 2022
[17] Scottish Government, Scotland's Fiscal Outlook, December 2021. This is CPI inflation.
[18] Scottish Government, Scotland's Fiscal Outlook, May 2022

19. Public-sector trade unions have called for pay rises that match inflation.[19] The Scottish Government, local government, and trade unions agreed a deal over the summer. Funding for any future pay deals will need to be found from the 2022/23 budget.

The costs of supporting people through the crisis have increased

20. Social security spending is a key channel through which the Scottish Government provides support to individuals, and in 2022/23 accounts for approximately ten per cent of the Scottish Government budget.[20] The Scottish Fiscal Commission (SFC) forecast that higher inflation will increase social security spending by £156 million in 2023/24 and by £213 million in 2026/27, compared to their forecast in December 2021.[21] Social security spending is forecast to rise from £5,072 million in 2023/24 to £6,490 million in 2026/27.

21. The Scottish Child Payment (SCP) will also be increased from £20 per week to £25 when it is rolled out to households with children aged 6–15 in November 2022. From 2024/25 onwards the benefit is forecast to cost around £25 million more than forecast in May 2022, because of higher inflation.[22]

22. It is not clear if the current environment will lead to more people being eligible and applying for benefits. In their latest SCP costing from September, the SFC has not changed its assumption of the number of families receiving qualifying benefits or the underlying forecasts of unemployment. These will be updated in the SFC's next forecasts which will be published to accompany the Scottish Government's 2023/24 budget announcement. This could mean further cost pressures if the economic position were to worsen as social security spending is demand-led and needs-based.

23. The Scottish Government has also announced other new support in response to the cost of living crisis, including an extra £21.75 million to provide free school meals to eligible children over the school holidays[23] and the expansion of home energy schemes, including £161 million for the Warmer Homes Scotland scheme, Area Based schemes, and Home Energy Scotland.[24] The Scottish Government has also committed to doubling the quarterly bridging that will be paid in December to children and young people in receipt of free school meals.[25]

[19] STUC, Scotland Demands a Pay Rise, 2022
[20] The Scottish Fiscal Commission, Scotland's Economic and Fiscal Forecasts, May 2022
[21] The Scottish Fiscal Commission, Scotland's Economic and Fiscal Forecasts, Figure 5.11, May 2022
[22] The Scottish Fiscal Commission, Supplementary Costing – Scottish Child Payment, September 2022
[23] Scottish Government, Summer support for children, July 2022
[24] Scottish Government, Cost of living support, July 2022
[25] Scottish Government, Extra winter cash for children and young people in receipt of free school meals, October 2022

The Scottish Government faces tough choices for the 2022/23 and 2023/24 budgets

Without very close management of the budget, there is a real risk the Scottish Government overspends against its 2022/23 budget

24. The Scottish Government has reported balanced budgets since devolution was introduced in 1999. Early in 2022/23, the Scottish Government was forecasting a significant budget gap for the financial year, which was larger than could be managed through its usual budget processes. The Scottish Government identified the need for more substantial changes to spending, which were announced through the Emergency Budget Review process. The fiscal environment continues to be uncertain, and the Scottish Government must closely manage its budget for the rest of the financial year.

25. The Scottish Government has recognised that the financial situation it faces is by far the most challenging since devolution. An overspend on the budget would be a new development for Scottish public finances. The potential consequences and how this would take shape are unclear at this stage. Our understanding is that HM Treasury rules mean that any overspend against the 2022/23 budget would be deducted from the following year's block grant.[26] This would mean that there is less funding available for spending on next year's budget, exacerbating existing pressures on future public spending.

26. As set out in the fiscal framework, the Scottish Government can borrow to cover a temporary cash shortfall in year. Borrowing powers available to the Scottish Government are limited, and those available for resource borrowing must be paid back over three to five years. Ultimately, the Scottish Government's finances will not be sustainable if its spending commitments cannot be met by its funding and its tax raising powers.

[26] HM Treasury, Statement of Funding Policy, October 2021

Savings have already been found from the 2022/23 budget

27. In September, the Scottish Government has announced £560 million of additional income and savings to the 2022/23 budget to fund the increased cost of public sector pay deals.[27] In November, a further £615 million of savings were identified through the Emergency Budget Review process, the majority (£400 million) of which were changes within the health portfolio to support the proposed pay offer.[28]

28. At just under £1.2 billion, these changes include nearly £200 million of income and funding not expected at the time the budget was set and of the remainder, £300 million relates to capital changes, and £700 million relates to day to day spending.

29. The details of these changes are set out below, and in Exhibit 2 (page 11):

- **Changes to capital:** This includes deferral and reprofiling of capital spending, as well as some changes as result of reduced demand. An example includes £120 million of capital reprioritisation identified from multiple portfolios and transferred to local government to increase their overall resources available to support the local government pay offer.

- **Deferral of funding:** spending can be delayed into future years' budgets. For example, ring-fenced UK funding has been deferred for the Rural Affairs and Islands portfolios, and £70 million of Social Care and National Care Service (NCS) spending has been re-profiled.

- **Increased income and additional consequential funding:** additional funding has been applied to cover increased costs. For example, in September the Scottish Government applied £56 million of funding generated by the ScotWind clearance process to the 2022/23 budget, and has received an additional £82 million in Barnett consequentials.

- **Demand changes:** Where demand is less than expected, underspends are redeployed. Examples include a cut of £37 million in funding for concessionary fares, a £20 million reduction in further education student support, based on a forecast reduction in demand, and a reduction in justice spending based on a lower than anticipated requirement for services within the justice system as it recovers from backlogs. The Scottish Government notes that this does not impact on service delivery.

- **Reduced spending:** this includes a reduction of £53 million in funding for employability schemes, and £38 million of mental health spending that has been reprioritised to support the NHS pay offer.

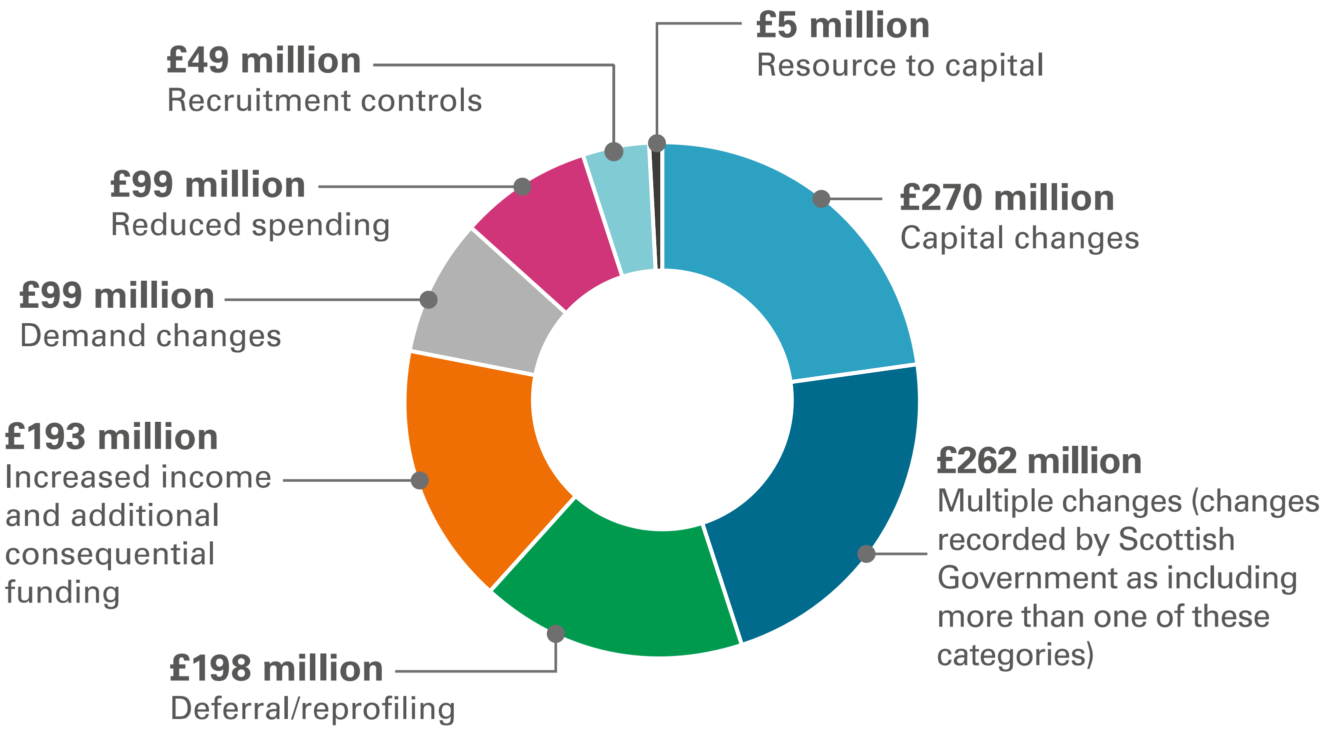
[27] Deputy First Minister, Letter to the Finance and Public Administration Committee, 7 September 2022

[28] Scottish Government, Emergency Budget Review 2022/23, 2 November 2022

- **Recruitment controls:** restrictions in hiring across a range of public bodies.
- **Resource to capital switches:** resource spending is being replaced by capital spending, for example, within the Education and Skills portfolio for Gaelic support.

30. The EBR notes that as a result of the ongoing uncertainty, there remains a risk to balancing the 2022/23 budget.[29]

Exhibit 2
Breakdown of types of savings and reductions included in 2022/23 savings announced to date



Source: Scottish Government, Audit Scotland analysis. September changes come from the Deputy First Minister's letter to the Finance and Public Administration Committee, dated 7 September, and the November changes come from the Emergency Budget Review.

The Scottish Government has tools available to manage its budget, but its options are limited

31. The Scottish Government's options – its ability to flex its budget in response to events – comes from multiple sources, as set out in the following paragraphs.

[29] Scottish Government, Emergency Budget Review 2022/23, 2 November 2022

Fiscal framework tools and powers

32. The Fiscal Framework agreed between the Scottish and UK governments in 2015 includes levers that the Scottish Government can use to manage volatility in its budget. However, these were largely designed to address volatility that arises from forecasting error and were not designed to help balance the budget.

33. The Scotland Reserve is used to manage spending across years. In his letter to the Finance and Public Administration Committee, the Deputy First Minister confirmed that all the available funds from the reserve have been allocated to support spending in the 2022/23 budget.[30] As highlighted in Scotland's new financial powers: Operation of the Fiscal Framework 2018/19, when the Government plans to use the Scotland Reserve to carry forward significant amounts of budget and spending power from one financial year to the next, this will limit the extent to which the reserve is able to operate as a buffer against budget pressures, and this money can only be spent once.

34. The fiscal framework also included borrowing powers. As set out in paragraph 25, the in-year cash management borrowing powers can only be used to fund a temporary shortfall in cash flow or working capital, and do not enable the Scottish Government to spend beyond the funding as set in the budget.[31]

35. The Scottish Government also has capital borrowing powers. While capital borrowing cannot be used to support revenue spending, in the wider public sector (for example, local government) certain types of capital spending could be moved to resource spending. For example, during the Covid-19 pandemic, the Scottish Government identified a package of financial flexibilities for councils, including permitting the use of capital receipts received to fund day-to-day costs.[32] In such a scenario, the Scottish Government could use its capital borrowing powers to offset this, and to restore capital funding available. This would need to be done in line with HM Treasury's Consolidated Budgeting Guidance.

36. Taxes are another source of funding for the Scottish Government budget, and higher inflation can lead to higher tax takes as prices or wages grow faster than tax thresholds. However, Scotland's tax revenues will not change significantly for the rest of 2022/23, because the contribution that Scottish Income Tax, (which accounts for 94 per cent of Scotland's tax revenues)[33] makes to the 2022/23 budget was fixed in cash terms when the budget was agreed. The income tax policy for 2023/24 will be announced alongside the budget in December.

[30] Deputy First Minister, Letter to the Finance and Public Administration Committee, 7 September 2022
[31] For more information, see Audit Scotland, Operation of the Fiscal Framework, October 2018
[32] Scottish Government, Local Government Finance Circular No 2/2021, February 2021
[33] This is the share of Scottish Income Tax, Land and Building Transaction Tax and Scottish Landfill Tax. It does not include Non-domestic Rates revenues.

Controllable and non-controllable costs

37. Reducing budgets in an unmanaged way can have significant impacts on the quality of services provided, how accessible services are, and on people's long-term outcomes. The Scottish Government and other public bodies will need to understand well in advance what constraints there are to their flexibilities to cut spending. Examples include statutory services and duties that must be provided by law (for example, statutory targets for net zero commitments), the Scottish Government's human rights duties, and commitments such as no compulsory redundancies.

38. In addition, in the short term, much of the budget is fixed and committed, and there are limits to what can be changed without significant disruption. Much of the public spending incorporated in the Scottish budget is for areas such as staff costs that are difficult to change quickly.

39. The Scottish Government will need to understand where it is most able to quickly alter spending, and understand what options are available to it in responding to budget fluctuations. Public bodies are also likely to be required to budget more flexibly as a result. For example, to fund the local government pay deal agreed in August, the Scottish Government allowed councils to take some funding that had previously been ringfenced for another use and use this to cover the cost of the pay agreement.

40. In the medium to long term, fewer costs are fixed and more can be changed. This means there is more opportunity for reforming public services, as discussed in more detail in section 3.

Wider public sector flexibilities

41. Some public bodies, such as councils and integration health and social care authorities, also have reserves that can be used to carry funding over from one financial year to the next. However, funding held in reserves can only be spent once and cannot be reliably used to cover recurring costs. As highlighted in Scotland's financial response to Covid-19, some of the money held in council and integration authority reserves has been earmarked for specific purposes, such as the ongoing response to Covid-19. The Scottish Government has requested that some funding which is currently allocated for Covid-19 in integration authority reserves is now used for wider Covid-19 purposes.

42. As the Auditor General has highlighted in previous section 22 reports on the audit of the Scottish Government Consolidated Accounts,[34] there remains a need for a public consolidated account to provide a comprehensive and transparent assessment of the state of Scotland's public finances. This is important for decision-making over the longer term as it will provide information about the impact of past decisions on future budgets, the potential risks to financial sustainability and the scale of assets and liabilities, including those held by publicly owned companies. The report on the 2021/22 audit of the Scottish Government Consolidated Accounts will update on this matter when it is published later in 2022.

[34] Auditor General for Scotland, The 2020/21 audit of the Scottish Government Consolidated Accounts, December 2021

The Scottish Government will have to consider UK Government policies when setting the 2023/24 budget

43. The level of funding that will be available to the 2023/24 Scottish Budget is not yet known. There is ongoing uncertainty around UK Government policy on spending, tax, and social security, with the Chancellor of the Exchequer stating that 'nothing is off the table' in terms of changes to tax and cuts to public spending. Changes to UK Government spending in devolved areas impacts the size of the Scottish budget, and reductions to the budgets of public services such as the NHS in England will reduce the funding available to the Scottish Government. The Scottish Government will need to manage this uncertainty when setting the 2023/24 Scottish Budget.

44. While most of the changes to UK tax policy announced in the September mini-budget have been reversed, the changes that had been announced to Stamp Duty have been retained and will impact on the Scottish budget. While the Scottish Government is responsible for setting its own equivalent to Stamp Duty in the form of the Land and Buildings Transaction Tax (LBTT), changes to UK Government tax policy impact the net benefit to the Scottish budget as a result of this devolved tax. If the Scottish Government chooses to retain the existing rates and thresholds for LBTT, then UK Government changes to Stamp Duty would result in additional funding of approximately £65 million for the Scottish Budget in 2023/24.[35]

45. In March 2022, the UK Government announced that working age benefits would rise in line with inflation for 2023/24. It is unclear if this is still the UK Government's intention.[36] If the UK Government chooses not to increase benefits to fully cover inflation this has implications for Scottish social security spending.

46. If the UK Government decides to uprate the reserved benefits by less than inflation in April 2023, the devolved Scottish benefits that are administered by the Department for Work and Pensions (DWP) may need to be updated by the same rate. This is because of an agreement between the Scottish Government and DWP to ensure payments are consistent while clients are transferred to Scotland.[37]

47. In addition, this means that there would be less funding available for the benefits that are now administered by Social Security Scotland (such as Adult Disability Payment and Child Disability Payment) because the Block Grant Adjustment that the Scottish Government receives from the UK Government would increase at the lower rate. There is a statutory requirement in the Social Security Scotland Act (2018) to consider the effect of inflation and respond if

[35] Deputy First Minister, Letter to the Convener of the Finance and Public Administration Committee, 3 October 2022
[36] House of Commons Work and Pensions Committee, Letter to Chancellor of the Exchequer, October 2022
[37] For example, please see: the Secretary of State for Work and Pensions and the Scottish Ministers, Agency Agreement in respect of Personal Independence Payment for people resident in Scotland, 2020

that effect is, in the opinion of the Scottish Government, material. The Scottish Government has not yet published its report on the effect of inflation on benefits for 2023/24 so it is not clear what rates it will apply in 2023/24.

The Scottish Government has been developing its approach to managing financial sustainability risk

48. The Scottish Government recognises the issues and risks relating to the sustainability of the public finances over the medium term, and is changing how it manages its financial sustainability risks.

49. The Director-General Scottish Exchequer is responsible for managing the financial sustainability risks to the Scottish Government, and the core purpose of the Scottish Exchequer Directorate is 'a fiscally sustainable Scotland'. The directorate is developing its strategy for fiscal sustainability, with the goal of balancing the 2023/24 Budget. The Scottish Government has informed us that the work being undertaken aims to ensure there is an understanding of fiscal risks across the whole of the Scottish Government, and an early priority of this work is to strengthen the spending data available.

50. In Scotland's financial response to Covid-19, the Auditor General and the Accounts Commission highlighted that when the Scottish Government is understanding spending and performance information across several portfolios, it should consider the lessons learned from Covid-19, when the Scottish Government had difficulties in tracking actual spending because its budget processes were not designed to separate specific spending in areas across portfolios.

51. It will be important that the results of the Scottish Government's fiscal sustainability work are transparently shown to improve scrutiny of the financial position, and to highlight risks early.

The financial pressures faced may have implications for the scale, range and types of public services that can be provided

52. Worsening economic conditions will increase demand for public services. The Scottish Government may be in the difficult position of deciding what spending programmes and areas of government it will deliver differently, deliver less of, and which programmes it may need to stop delivering completely.

53. The Scottish Government set out four priority spending areas in the Resource Spending Review (RSR) published in May:

- tackling child poverty
- addressing the climate crisis
- securing a stronger, fairer, greener economy
- delivering excellent public services.[38]

[38] Scottish Government, Resource Spending Review, May 2022

54. If spending in these areas is protected, then reductions and changes to services will have to be applied to non-priority areas. In the RSR, the Scottish Government planned real-terms decreases in spending to areas such as local government, the police, prisons, justice, universities and rural affairs over the spending review period.

55. The current new financial realities mean that if the economic or fiscal environment continues to worsen, the Scottish Government may need to revisit all current priorities and policy commitments. Even if spending in priority areas is protected, services may be under significant pressure due to higher demands, especially on top of backlogs and challenges caused by Covid-19.

The Scottish Government needs to understand how its decisions will affect different groups

56. Recent research by the Glasgow Centre for Population Health has indicated that there is an increasing body of UK and international evidence attributing falls in life expectancy in the UK between 2011 and 2019 to reductions in UK Government spending, particularly in relation to social security, during that period.[39] To minimise the negative impacts from the any future changes to public spending on people's outcomes, the near-term pressures on the budget must be managed while maintaining a focus on long-term priorities.

57. This will be difficult in the current context, when it may be unavoidable that some of the choices that need to be made will negatively impact on wider work to improving outcomes. The more challenging the financial situation, the larger the impact this is likely to have on people and outcomes.

58. The Scottish Government and public bodies must understand how the decisions they make will impact on different groups in society. In advance of the Emergency Budget Review, several gender equality organisations wrote to the Deputy First Minister to highlight the importance of analysing the impact that the budget will have on women, children, and other marginalised groups.[40] Alongside the Emergency Budget Review, the Scottish Government published a summary of the evidence on equality and fairness of the Emergency Budget Review. This considers the evidence at a high level and focuses on the most substantial changes, but is more limited than a full Equality Impact Assessment.[41]

[39] Walsh D, Wyper GMA, McCartney G, Trends in healthy life expectancy in the age of austerity, Journal of Epidemiology and Community Health 2022
[40] Engender, Gender Budget Analysis in Budgetary Reviews, letter to DFM, October 2022
[41] Scottish Government, Emergency Budget Review: equality and fairness – evidence summary, November 2022

Reforms to public services are now required

Failure to make the necessary changes to how public services are delivered will likely mean further budget pressures in the future

59. In the long term, the economic and fiscal outlook means that continuing to make small-scale budget cuts is unfeasible. The Auditor General and the Accounts Commission have continued to underline the importance of reforming public services to manage the sustainability of public finances.

60. Reforming public services means changing how services are delivered to people in a way that more effectively meets both their needs and the Government's policy aspirations. Reform is most successful when it is planned and targeted – in contrast with flat budget reductions across the board which reduce spending across the public sector, without considering the impact on wider ambitions.

61. The significant pressures which require immediate reform are even greater than when medium-term plans were last set out by the Scottish Government. The Medium-term Financial Strategy (MTFS) published in December 2021, projected that by 2026/27 there would be a £3.5 billion gap between its central funding and spending scenarios.[42] The MTFS was then updated in May 2022 and published alongside the RSR.[43] This reflected a balanced medium-term position, where the central funding scenario and central spending scenario align, closing the previously identified funding gap. A key part of how the Scottish Government planned to close the funding gap was by making necessary budgetary savings through public service reform.

62. The RSR includes reference to four main types of reform, summarised in Exhibit 3 (page 18).

[42] Scottish Government, Medium Term Financial Strategy, December 2021
[43] Scottish Government, Medium Term Financial Strategy, May 2022

Exhibit 3
Public service reforms included in the RSR

Type of reform	Summary from RSR
New approaches to public services	Key reforms over the course of this Parliament include: • the establishment of the National Care Service • keeping the Promise (as set out following the Care Review), including by investing £500 million in preventative spend through the Whole Family Wellbeing Funding • the Vision for Justice in Scotland – the future justice system • Education Reform – replacing existing education bodies • National Strategy for Economic Transformation.
Public sector capacity and pay	The RSR includes plans to: • from 2023/24, a broad aim to keep the total cost of the overall annual pay bill the same as 2022/23 • a broad aim to return the total size of the devolved public sector workforce to around pre-Covid-19 levels by 2026/27, through effective vacancy and recruitment management • continued development of the use of technology within the public sector to support hybrid and flexible working.
Efficiencies for the public sector	Recurring annual efficiencies of at least three per cent will be required from public bodies. Planned efficiencies include: • further use of shared services • management of the public sector estate (around 30,000 properties) • effective procurement (current levels of procurement spending stood at £13.3 billion in 2020/21, or around a quarter of the Scottish budget) • management of public sector grants.
Reform to public bodies	The RSR notes that there are currently 129 public bodies in Scotland, and notes ‘reform is inevitable’.

Source: Audit Scotland, Scottish Government

63. The cost of living crisis, and the pressures on public spending and public services, mean that these reforms are more necessary than they were even when the RSR was announced earlier this year.

In the past, delivery of the reform of public services has not matched the original ambition

64. Both the Auditor General and the Accounts Commission have highlighted previously how difficult it is to reform public services, for example in their papers on health and social care integration, Scotland's colleges, drug and alcohol policy, and police and fire reform.

65. Reflecting on the progress made ten years on since the Christie Commission, the Auditor General commented that, "concerted action has been taken to try and implement progressive policies... But audit work consistently shows a major implementation gap between policy ambitions and delivery on the ground."[44]

66. For example, social care reforms aimed to offer people more choice and control about the services they received. A 2017 progress audit on self-directed support found that, after seven years, there was no evidence that authorities had made a transformation in services.[45]

67. The recent Social care briefing sets out key learning points from past public service reforms, including:

- realistic costs in financial memorandums accompanying parliamentary bills for legislative change
- a comprehensive business case, clearly setting out the purpose and objectives of reform
- evidence to support major changes and being clear about how they will improve outcomes, options, appraisals and economic modelling
- governance, accountability, roles and responsibilities in the new structure.

68. These points will be more important during a period of tight budgets to ensure reform achieves maximum value for money. Investing in good processes and data for reform may be challenging in the current context when money and capacity is restricted, but learning from previous reforms will help ensure reforms deliver the expected outcomes.

69. Audit Scotland has raised concerns about the approach being taken to some of the reforms currently planned. For example, in the recent Social care briefing paper, the Auditor General and the Accounts Commission noted that the proposals were not fully costed and there is much to do to establish the true costs of reform.[46] This briefing paper also noted the importance of strong, stable, and collaborative leadership. In recent years, the Auditor General and

[44] Auditor General for Scotland, Christie's clarion call can't wait another decade, September 2021
[45] Auditor General for Scotland, Christie's clarion call can't wait another decade, September 2021
[46] Auditor General and the Accounts Commission, Social care briefing, January 2022

the Accounts Commission have reported on the leadership capacity across the public sector, emphasising the critical need for effective leadership at a time of increasing pressures and change. Public bodies, including councils, integration authorities and the NHS are experiencing a high turnover in senior staff and are competing not only with each other for the best quality leaders but also with the private and third sectors.

70. In the face of the financial challenges, the pace and scale of reform needs to increase, and this will require a sense of urgency from the Scottish Government, at a time when it is also pressing to resolve short-term issues facing the budget.

71. If this does not happen, it will become increasingly difficult for the Scottish Government to manage the pressures on the budget, meaning that the cuts to spending necessary to balance the budget will become larger, and the quality of public services delivered will worsen.

72. Following the publication of the RSR, the Scottish Government has set up a new Public Spending Portfolio Board, to ensure the delivery of the RSR across directorates, identify links across workstreams, and provide advice across Scottish Government as needed. This aims to link the RSR both to the Emergency Budget Review and to the 2023/24 budget.

73. The board has met three times since June, and is at the early stages of its role of overseeing the implementation of the required reforms, and has focused so far on the workstreams (such as public sector pay and the reform of public bodies) which will feature in the 2023/24 budget. A Public Spending Analytical Unit has also been set up to monitor public spending and support the reform agenda.

74. To be effective, the Scottish Government's new approaches will need to clearly set out what reform intends to deliver, how it intends to track and monitor both savings and other financial impacts and the impacts on outcomes, and how these link across the public sector.

A shift to preventative spend is essential alongside meeting immediate challenges

75. The recent Social care briefing reflected that the Christie Commission stated that one of the major barriers to increasing preventative spending – that is, public spending that aims to prevent negative social outcomes from occurring in the first place – was the extent to which resources are currently tied up in dealing with short-term problems. The report warned that without a shift to preventative action, increasing demand would swamp public services' capacity to achieve outcomes.

76. This still holds true, over a decade later. Although it will be difficult, investing in preventative spending will be necessary to meet some of the Scottish Government's core outcomes. Recently the Auditor General and the Accounts Commission have reported on two areas where preventative spend in priority areas may be under pressure because of the cost of living crisis:

- The Scottish Government had significantly increased in investment in employability support for parents to reduce child poverty. In September 2022, this spending was reduced from £81 million to £29 million as part of the Emergency Budget Review statement.[47]

- The Accounts Commission's recent briefing on Scotland's councils' approach to addressing climate change reported that the cost of living crisis could lead to climate change activity being deprioritised or delayed by councils.[48]

77. In the recent Drug and alcohol services update, we highlighted that public health prevention programmes are cost-effective in drug and alcohol services, but it was not clear what percentage of spending in this area was targeted on early intervention and prevention. The Auditor General noted that over the last ten years since the Christie Commission report the focus has still been on short-term metrics for public services.[49] Preventative spend, like the reform agenda, will stop the problems Scotland is facing now from growing over time.

Covid-19 has shown that public bodies can change how services are provided – and at speed

78. The Covid-19 pandemic and the lockdowns that were implemented to reduce the spread of the virus completely changed what was possible in terms of providing public services, at the same time as individuals and communities needed entirely new forms of support.

79. In our work on public services' response to the pandemic, we have highlighted that public bodies worked well together to deliver new funding and work in different ways. As reported in the Covid-19: Vaccination programme briefing paper, excellent progress was made in rolling out the Covid-19 vaccination programme, and new digital tools were developed at pace to support this. In the Local government in Scotland: Overview 2021, the Accounts Commission noted that councils' working practices changed at a pace and scale 'that would have been considered impossible in the past'.

80. Since the pandemic, the number of challenges has multiplied, and uncertainty can make it harder to focus on the longer term and reform. However, the pandemic response has shown that change can be achieved quickly, and decisions can be taken in different ways with wider public participation (paragraph 85).

[47] Auditor General for Scotland and the Accounts Commission, Tackling child poverty, September 2022
[48] Audit Scotland, Scotland's councils' approach to addressing climate change, September 2022
[49] Auditor General for Scotland, Christie's clarion call can't wait another decade, September 2021

The public should be fully involved in the key decisions about how public services will need to change

81. The changes required to public services are significant, will be long standing, and will impact on people's lives. As such, it is important that citizens and communities are informed about the scale of the challenge and have a say in how services change.

82. The Accounts Commission's community empowerment and Best Value audit work has noted limited progress in citizen participation in budget processes, particularly for marginalised groups, for example in relation to participatory budgeting. The recent Tackling child poverty briefing paper reported that not enough involvement of children and families with lived experience of poverty are hindering the development of sufficiently targeted policies for tackling child poverty.

83. We have however found good examples of public engagement from our work on social security.[50] The programme continues to learn from existing benefit recipients through user experience panels and engagement with targeted client groups to inform its design decisions.

84. Empowering communities to participate in democratic processes can help to reduce disadvantage and inequality and improve outcomes for communities and individuals. There are many benefits of getting community empowerment and public participation right, as set out in our Principles of community empowerment work with scrutiny bodies in 2019. However, good public participation needs a lot of investment and capacity building to include a cross-section of the community, not just the most vocal, articulate, or resourced.

85. The Community empowerment: Covid-19 update found communities played a crucial role in the response to the pandemic. Public bodies can learn from this by encouraging public participation and adopting new ways of working. Issues to consider include:

- designing flexible governance and decision-making processes best suited to the communities they serve
- implementing more local decision-making structures with active local participation
- reducing the digital divide and continue to learn from and improve digital engagement with communities.

[50] Auditor General for Scotland, Social Security: Implementing the devolved powers, May 2019

It must be clear how changes in budgets affect performance if value for money is to be attained

86. It is important that it is clear how spending is affecting the outcomes the Scottish Government wants to achieve. In The 2020/21 audit of the Scottish Government Consolidated Accounts, the Auditor General noted that based on the current information published on Scottish Government spending and outcomes, it is hard to form an overall picture of the performance of the Scottish Government and assess whether the national outcomes are being achieved.

87. In its recent paper on the National Performance Framework (NPF), the Finance and Public Administration Committee (FPAC) set out some recommendations to better link budgets to outcomes. This highlighted the need to consider how money can be allocated (including through procurement and grants) based on the intended impact of the programmes it will fund and how these will contribute to the NPF. It also recommended looking at how funding can be used to incentivise different parts of the public sector to work together.[51]

Linking performance and budgets requires good quality data

88. To understand how to best target support and monitor how reform and change is affecting people, it is essential that public bodies have access to good quality and up-to-date data.

89. A lack of data limits public bodies' ability to target spending to where it is needed, as it is harder to understand and predict where demand for services will come from. For example, in recent outputs both the Auditor General and the Accounts Commission have highlighted some significant gaps in the outcome data available:

- The NHS in Scotland 2021 report (February 2022) highlights a lack of robust data in relation to health inequalities and the need for intersectional equality data. Without this data it will be hard to measure the impact of the cost of living crisis and find appropriate ways to target support.
- The Accounts Commission's Local government in Scotland: Overview 2022 highlights that a lack of up-to-date, publicly available data makes it difficult to assess the extent to which council activities have returned to pre-pandemic levels, the level of demand for services and levels of unmet need.

90. The national indicators that underpin the NPF give a measure of national wellbeing. Ideally, these indicators could be monitored in real time to evaluate the impacts of budget changes and prioritisations on the people of Scotland. However, many of the indicators reflect data from the pre-pandemic period, or have no data available at all.

[51] Finance and Public Administration Committee, Report on the National Performance Framework: Ambitions into Action, October 2022

91. Given that outcomes are long-term in nature, milestones are helpful in judging progress. The current lack of milestones for National Outcomes will make monitoring how changes to budgets impact on people and longer-term goals much more difficult. It also makes it harder for parliament and other bodies to scrutinise the work of public bodies and have assurance that spending is providing maximum value for money.

92. The Planning for outcomes briefing paper published in 2019 noted that for equalities and poverty outcomes, public bodies should consider whether the data they have is sufficient to measure the impact of decisions about services, funding and taxation on different equality groups affected.

93. Collecting this data will require both time and money, but will be an important step towards mapping spending to the aspirations of the Scottish Government. We have recently published a blog on data and the radical action needed in Scotland’s public sector.

Conclusion

94. At the time of writing, the picture for the Scottish public spending is still developing. The UK Autumn Statement is expected 17 November, with the Scottish Budget 2023/24 budget to be announced in December. The Spring Budget Revision in the new year will set out the final budget for 2022/23. In March 2023, the Scottish Fiscal Commission will publish its first Fiscal Sustainability Report, which will give a long-term outlook for the Scottish Government's finances.

95. Audit Scotland will continue to monitor how the Scottish Government's financial position develops, through both financial audit work and performance audit work. The Auditor General will shortly publish the 2021/22 audit of the Scottish Government Consolidated Accounts, which will contain key information from the 2021/22 Consolidated Accounts and explain what they show about the Scottish Government's management of its budget.

96. This paper has set out the urgent case for the reform of public services. The Auditor General and the Accounts Commission will return to these issues through the forward work programme in the coming months. Examples of relevant planned work for 2023/24 includes performance audits relating to:

- Early learning and childcare
- Drug and alcohol services
- Social care
- Climate change.

97. For more information on planned outputs, please see our work programme. This is dynamic and regularly updated, meaning that we can respond to changing circumstances as required.

Scotland's public finances

Challenges and risks

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Internal Audit Service – Update on Shared Internal Audit Service between Midlothian and East Lothian Councils

Report by Kevin Anderson, Executive Director Place

Report for Information

1 Recommendations

Audit Committee are recommended to note that the Shared Internal Audit Service between Midlothian and East Lothian Councils is now formally agreed and has commenced.

2 Purpose of Report/Executive Summary

This report advises Audit Committee that Midlothian Council and East Lothian Council have now established a shared Internal Audit Service and is anticipated to be in place for a minimum 18 month period.

Date: Thursday 26 January 2023

Report Contact:
Kevin Anderson, Executive Director Place

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3 Background/Main Body of Report

3.1 At its meeting of 27 September 2022, Audit Committee were presented with a report providing detail of the Council's interim internal audit arrangements and the work that was ongoing to develop a shared service with East Lothian Council.

3.2 On 4 January 2023, the shared Internal Audit Service commenced between Midlothian Council and East Lothian Council. The shared service is led by East Lothian's Service Manager – Internal Audit (Duncan Stainbank) and is anticipated to be in place for a minimum 18 month period (subject to regular review).

3.3 The shared service supports both Councils and Integrated Joint Board. The service is working to align audit plans for all bodies and further information on the audit forward work plan is also on today's agenda.

4 Report Implications (Resource, Digital and Risk

4.1 Resource

Financial implications of the shared service are being met from existing budgets.

4.2 Digital

None

4.3 Risk

There is significant risk to the Council of not having a robust and effective audit arrangement.

4.4 Ensuring Equalities (if required a separate IIA must be completed)

None

4.4 Additional Report Implications (See Appendix A)

See Appendix A

Appendices

Appendix A – Additional Report Implications
Appendix B – Background information/Links

APPENDIX A – Report Implications

A.1 Key Priorities within the Single Midlothian Plan

Taking steps to maintain the resilience, capability and effectiveness of Internal Audit services is necessary to support the delivery of the priorities of Single Midlothian Plan.

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

Maintaining an effective internal audit service and the relevance of the audit plan is an important aspect on delivering best value.

A.5 Involving Communities and Other Stakeholders

Engagement took place between both Councils as part of developing the agreement.

A.6 Impact on Performance and Outcomes

An effective internal audit service will support continuous improvement across all Council service and in its governance arrangements and the Council's business processes.

A.7 Adopting a Preventative Approach

Internal audit provides an important line of defence in reducing risk, fraud and error.

A.8 Supporting Sustainable Development

Not applicable

APPENDIX B

Background Papers/Resource Links (insert applicable papers/links)

Internal Audit Service report- Audit Committee, 27 September 2022