East Sussex County Council

AUDIT COMMITTEE

THURSDAY, 22 NOVEMBER 2018

10.00 am COMMITTEE ROOM - COUNTY HALL, LEWES

MEMBERSHIP - Councillor Colin Swansborough (Chair)
Councillors Gerard Fox (Vice Chair), John Barnes, Matthew Beaver, Bob Bowdler, Philip Daniel and Daniel Shing

A G E N D A

1 Minutes of the previous meeting held on 20 September 2018 *(Pages 3 - 8)*

2 Apologies for absence

3 Disclosures of interests

Disclosures by all members present of personal interests in matters on the agenda, the nature of any interest and whether the member regards the interest as prejudicial under the terms of the Code of Conduct.

4 Urgent items

Notification of items which the Chair considers to be urgent and proposes to take at the appropriate part of the agenda. Any members who wish to raise urgent items are asked, wherever possible, to notify the Chair before the start of the meeting. In so doing, they must state the special circumstances which they consider justify the matter being considered urgent.

5 Internal Audit Progress Report - Quarter 2, 2018/19 (01/07/18 - 30/09/18) *(Pages 9 - 22)*

6 Counter Fraud Update and Work Plan (including the proposed updated Anti-Money Laundering Policy) *(Pages 23 - 36)*

7 Risk Monitoring - Brexit Risk *(Pages 37 - 46)*

8 Annual Audit Letter *(Pages 47 - 56)*

9 Treasury Management Stewardship Report 2017/18 and mid year report 2018/19. *(Pages 57 - 74)*

10 Work programme *(Pages 75 - 78)*

11 Property Asset Disposal and Investment Strategy (including links to the Community Asset Transfer Policy) *(Pages 79 - 86)*

12 Any other non exempt items previously notified under agenda item 4

13 Exclusion of Public and Press

To consider excluding the public and press from the meeting for the remaining agenda item on the grounds that if the public and press were present there would be disclosure to them of exempt information as specified in paragraph 3 of Part 1 of the Local Government Act 1972 (as amended), namely information relating to the financial or business affairs of any particular person (including the authority holding that information).

14 Property Asset Disposal and Investment Strategy - Additional information *(Pages 87 - 98)*

15 Any other exempt items previously notified under agenda item 4

PHILIP BAKER
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14 November 2018

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AUDIT COMMITTEE

MINUTES of a meeting of the Audit Committee held at Committee Room - County Hall, Lewes on 20 September 2018.

PRESENT	Councillors Colin Swansborough (Chair) Councillors Gerard Fox (Vice Chair), John Barnes, Matthew Beaver, Bob Bowdler and Philip Daniel
LEAD MEMBERS	Councillor David Elkin
ALSO PRESENT	Kevin Foster, Chief Operating Officer Russell Banks, Chief Internal Auditor Ian Gutsell, Chief Finance Officer Nigel Chilcott, Audit Manager Marcus Ward, Grant Thornton Darren Wells, Grant Thornton

11 MINUTES OF THE PREVIOUS MEETING HELD ON 13 JULY 2018

11.1 The Committee RESOLVED to agree as a correct record the minutes of the meeting held on 13 July 2018.

12 APOLOGIES FOR ABSENCE

12.1 There were none.

13 DISCLOSURES OF INTERESTS

13.1 There were none.

14 URGENT ITEMS

14.1 None notified.

15 INTERNAL AUDIT PROGRESS REPORT - QUARTER 1, 2018/19

15.1 The Audit Manager introduced the report. The outcomes of the audits for the first quarter of 2018/19 are shown in the graph on page 11 of the report. The majority of opinions were reasonable assurance, and no audits had a minimum assurance opinion. There were two audits that had a partial assurance opinion, both of which related to school audits. The Chief Internal Auditor continues to be able to provide reasonable assurance that the Council has in place an effective framework of governance, risk management and internal control. A summary of investigations carried out during the quarter is given on page 22 of the report. The Key Performance Indicators for the Internal Audit Service are shown on page 23 onwards, all of which are being met.

Preparedness for the General Data Protection Regulation (GDPR) Audit

15.2 The Committee asked how significant the outstanding issues from the Audit are. The Audit Manager responded that he understood work on these issues was underway and that the Information Commissioner's Office (ICO) acknowledged that many organisations would still have work to do in this area after the 25 May 2018. The Chief Operating Officer outlined that regular update reports are produced by Heidi Judd, Data Protection Officer on the implementation of GDPR and no areas of significant concern have been highlighted when monitoring the implementation of GDPR. The Chief Internal Auditor outlined that there will be a follow up audit later in the year, which will look at GDPR compliance as well as implementation of the audit recommendations.

15.3 The Chief Operating Officer added that a County Council Information Strategy Board has been established to overview information governance and GDPR matters, to ensure personal data is held securely and to minimise the risk of data breaches. For example, the access controls for Council mobile phones are robust in terms of what applications can be accessed and used by staff.

School Audits

15.4 The Chair noted that the School audits (on page 21 of the report) received a partial assurance opinion and asked what the issues were. The Audit Manager agreed to provide the Chair with details of the main issues from the full audit report.

Contract Management Audits

15.5 The Committee asked for clarification on whether the audit of contracts, such as the Management of Mobile Phone Contract audit (page 14 of the report), consider conformance with local government transparency code. The Chief Internal Auditor confirmed that audits do look at this issue, but it was not in the scope of this specific piece of work.

15.6 The Committee RESOLVED to note the outcomes of the audits carried out during the reporting period and did not identify any issues that require further action, or any risks for inclusion in the Internal Audit Plan.

16 RISK MANAGEMENT FRAMEWORK AND STRATEGIC RISK MONITORING REPORT - QUARTER 1, 2018/19

16.1 The Chief Operating Officer introduced the report. The report incorporates the latest risk register and outlines the changes since the last strategic risk monitoring report. Section 3 of the report outlines the risk management process.

Schools

16.2 The Committee noted that the risk register has two risks concerning schools but neither appears to be concerned with the long term funding of small schools. The Committee understands that the national funding formula cut off is around 150 pupils, but there are many smaller schools which may get into financial difficulties. This is a risk to the budget of the whole Council as there is a potential impact on capital spending for schools, and an increase in the school transport budget if children have to travel further to school.

16.3 The Committee would like more information on how many schools may be affected, the nature of the problems they may face and how the Council is planning to address this issue. Although this risk may be on the departmental risk register, the Committee would like more detail on why the Council is satisfied that the risk is being controlled.

16.4 The Chief Finance Officer responded that work has been undertaken to model the impact of the proposed changes to the national funding formula based on discussions with Children's Services. The Chief Operating Officer advised that the implications of the national funding formulae would be considered as part of the Reconciling, Policy, Performance and Resources (RPPR) planning process. The Committee's view on the risk to small schools being on the corporate risk register will be referred to the People Scrutiny Committee.

16.5 The Committee commented that the risk to small schools should be on strategic risk register until an assessment has been completed and the Audit Committee is assured that mitigation measures are in place. The work that is being undertaken should be summarised in the mitigation column of the risk register, where it is visible to Members. The Committee recommended that the funding risk to small schools is added to the strategic risk register.

Cyber Attack

16.6 The Committee asked if the Council has the capability to react rapidly to a Cyber-attack. The Chief Operating Officer responded that the Council is well prepared and its information management practices are strong. However, there is always a first organisation to be subject to a new threat. The Chief Operating Officer gave reassurance that the Council has the controls in place to protect the Council's and residents' information.

Disorderly Brexit

16.7 The Committee commented that Brexit is not mentioned on strategic risk register if there is a disorderly exit. There is a risk from an adverse currency fluctuation and higher inflation, plus an impact on ports. Therefore, a disorderly Brexit should be on the strategic risk register. The Chief Operating Officer responded that the Brexit risk had been considered but further review was required to define the risk and mitigations. At present it is difficult to put in place mitigations when the actual impacts remain unknown. However, the Committee's comments have been noted and this risk will be will revisited in November.

16.8 The Committee considered that November is too late to start work on this issue and would like assurance that this work is going on now. The Brexit timeframe is very tight and it is not ideal for it not to be on the register until we have a fully informed approach. Although the Council may not know what the exact impacts will be, it is likely to have impact on the economy and cause transport disruption. The Committee accepts that is difficult to model impacts, but it is better to have made an assessment and examined what the mitigations might be.

16.9 The Committee outlined that the impact of higher inflation and currency fluctuations, plus the impact on ports are the most likely outcomes of a disorderly Brexit. The Committee suggested that it might to helpful to focus on specific areas of risk such as:

1. A break down in the supply chain for the Council's suppliers and local businesses;
2. Blockages to the transport system especially at ports (e.g. Newhaven).
3. The cost inflation impact on staffing and suppliers of an adverse currency fluctuation and higher inflation.

16.10 The Chief Operating Officer explained that the Procurement Team has taken these impacts into account. The fact that Brexit is not on the strategic risk register, does not mean officers are not working on this. However, he accepted the point that the Committee is making about the visibility of the work being undertaken to Members.

16.11 The Committee agreed that it would be good to idea to have a report in November on the impact of a disorderly Brexit, so that the Committee can be assured that work is being undertaken on mitigating the specific impacts. So the risk is defined, quantified and assessed as far as is possible.

Risk Management Framework

16.12 The Committee commented that the strategic risk register contains two types of risk. Some are external factors and some arise due to the failure to do something. In terms of the strategic risk register it would be helpful if officers could include work that is being undertaken, as it is not currently visible to Members. The Committee does not want the risk process to obscure the work that is being undertaken and would like the process to reflect the work that is underway that may not appear on register.

16.13 The Committee RESOLVED to:

1) Recommend that the financial risk to small schools is added to the strategic risk register; and
2) Have a report on the risk arising from a disorderly Brexit at the November meeting, and recommend that it is added to the strategic risk register.

17 MINIMUM REVENUE PROVISION CALCULATION

17.1 The Chief Finance Officer introduced the report and outlined the background and accounting regulations for the Minimum Revenue Provision (MRP). MRP is a charge to the revenue account that reflects the cost of borrowing incurred for a capital asset that is delivering services/adding value in a financial year. The report detailed a number of ways by which MRP could be calculated under previous and current accounting regulations. The report outlined the opportunity to change from the current straight line methodology to an annuity basis, which better reflects the use of the asset over time and the changing value of money.

17.2 The views of the Committee were sought and these would be taken into consideration during the RPPR process and whilst refreshing the Treasury Management Strategy. The Committee will have the opportunity to revisit the issue of MRP when the Treasury Management Strategy was considered by the Committee in November 2018.

17.3 The Committee discussed the MRP calculation method and noted that the current repayment method favours future tax payers. If an annuity method is adopted, ultimately the amount paid is the same but the phasing is different. In the earlier years the MRP payment is less, but in the later years the payment is more. The Committee asked if there was a disadvantage in changing to an annuity method.

17.4 The Chief Finance Officer responded that the report illustrates how the repayment may change over time, but it is difficult to say what the repayment will be in the future, as capital needs and financing will change over time. The MRP is an accounting charge and changing to the annuity method would be more reflective of the time value of money (i.e. it reduces over time). The Chief Finance Officer clarified that the application of the MRP calculation happens as part of the annual Statement of Accountants. The external auditors as part of the year end audit process will assess the reasonableness of the MRP policy applied, within the context of the overall accounts.

17.5 The Committee discussed whether to recommend a change in the MRP calculation method in response to recommendation 3 of the report. The Committee supported a change to the annuity method as it is appropriate on an intellectual and practical basis. In doing so, the view of the Committee would be taken into consideration as part of the RPPR process. Any change to the MRP calculation basis would be part of the Treasury Management Strategy, and need approval of Cabinet and Full Council in due course.

17.6 The Committee RESOLVED to recommend a change to the annuity calculation method for MRP, for inclusion in the RPPR process and approval by Cabinet and Full Council.

18 COUNCIL RESERVES REPORT

18.1 The Chief Finance Officer introduced the report. He outlined that the overriding consideration is that the level of reserves are sufficient to mitigate risk, in its various forms, and to allow for transformation and organisational change. The Robustness Statement in appendix 2 outlines the risks that are taken into account as part of the assessment of the level of reserves needed in the RPPR process. Appendix 4 shows the future plans for reserves at this point in time, but these may change as part of RPPR process.

18.2 The Committee asked if the Council has enough reserves to cope with the move from Rate Support Grant (RSG) to business rate retention funding, and the possibility that the amount of revenue from business rate retention is less than expected. The Chief Finance Officer outlined that the Medium Term Financial Plan (MTFP) has been set out on the basis that the Council does not fully know the impact of business rate retention and the withdrawal of RSG, so the reserves reflect this position. The Council has enough reserves to cope with this situation, but cannot be certain what the impact will be in the longer term.

18.3 The Chief Operating Officer added that reserves can only be used once, and the issue of business rate retention will be ongoing. So it is not possible to give an assurance that reserves can cope with this funding change in the longer term.

18.4 The report sets out the amount of useable reserves as a percentage of the net revenue budget that ESCC has in comparison with our South East Seven neighbouring authorities (table 1, paragraph 2.7 of the report). ESCC's useable reserves as percentage of net revenue are 17.4%. This compares with the average County Council 30%; London Boroughs 58%; Outer London Boroughs 44%; and Metropolitan Councils 40%.

18.5 The Committee asked if the move to a Core Offer of statutory services increases risk. The Chief Operating Officer outlined that the move to a Core Offer addresses the increased risks from the reduction in central Government funding and as such de-risks service delivery. The Chief Finance Officer added that the reserves are held to mitigate the impact of change, and there is an assessment of the risk of moving to the Core Offer. Financial, service and transformation risks are embedded in our approach. So under the Core Offer, if departments have identified increased risk as part of transformation, then the Council will take this into account when assessing the level of reserves.

18.6 The Committee asked for clarification on the term 'useable reserves'. The Chief Finance Officer explained that useable reserves is an entry in statement of accounts that incorporates all reserves that have been listed, as well as carry forwards, under regulation IAS20, of underspent departmental grants. The figures in appendix 3 and 4 do not include unspent grants, so the figure for useable reserves in the statement of accounts is slightly higher.

18.7 The Committee considered that the level of contingency and the General Fund was prudent, and that the general level of reserves appeared to be about right. However, the Committee would like further clarity on how the different reserves could be used (e.g. Service Specific and Strategic reserves), and found the term 'earmarked reserves' unhelpful in describing what the reserves were for and how they could be spent. It was suggested that the way the reserves are presented should be reviewed to help the public understand what they are for, and to emphasise that they could only be spent once.

18.8 The Committee acknowledged that it was difficult to get the level of reserves right as the Council will be criticised if it has too many reserves or spends reserves too much. It discussed the difference between Service Specific and Strategic reserves as detailed in appendix 3.

18.9 The Chief Finance Officer outlined what the Council is able to change (i.e. has a level of discretion to review the risk and need for the reserve) the £75m of reserves which are held as strategic and service specific reserves as detailed in appendix 3. These are subject to review as part of the RPPR process in line with the current reserves policy and an assessment of the robustness of the policy. For example, the Waste Reserve in 2014 was £35m. This was reviewed and a judgement made that the Council did not need to hold that amount of reserve, so it was reduced to £12m. The money released by the review was then reallocated to support the capital programme.

18.10 The Chief Operating Officer outlined that the Chief Finance Officer undertakes an ongoing review of the level of reserves required, and whether they can be used as part of RPPR process. Any recommended changes will be reported through the Audit Committee and the RPPR process as part of the Treasury Management Strategy and Reserves Policy update.

18.11 The Committee commented that it would like to see an explanation of use and review of reserves somewhere, perhaps as part of the Reserves Policy. It agreed that the reserve balances that can be taken into account in the RPPR process is everything listed in appendix 3 apart from those balances held on behalf of others (e.g. school balances).

18.12 The Committee RESOLVED to:

1) Note the current approach to reserves and balances; and
2) Agreed that the reserves and balances that can be taken into consideration within the RPPR process, is everything listed in appendix 3, except the balances held on behalf of other people.

19 WORK PROGRAMME

19.1 The Committee discussed the future work programme and noted that the issue of reserves will be considered as part of the RPPR process.

19.2 The Committee asked for an update on ownership of schools between ESCC and the Diocesan authority, which was previously highlighted in the annual statement of accounts. The Chief Finance Officer agreed to provide an update on progress to the Committee via email.

19.3 The Committee confirmed that it was happy with the agenda items planned for the November meeting.

The meeting ended at 11.46 am.

Councillor Colin Swansborough (Chair)
Chair

Report to:	**Audit Committee**
Date:	**22 November 2018**
By:	**Chief Operating Officer**
Title of report:	**Internal Audit Progress Report – Quarter 2 (01/07/18 – 30/09/18)**
Purpose of report:	**To provide Members with an update on all internal audit and counter fraud activity completed during the quarter, including a summary of all key findings. The report also includes details of progress on delivery of the annual audit plan along with an update on the performance of the internal audit service during the period.**

RECOMMENDATIONS

Members are requested to:

1. **consider and agree any action that should be taken in response to the issues raised in any of the audits carried out during Quarter 2;**
2. **identify any new or emerging risks for consideration for inclusion in the internal audit plan.**

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1. Background

1.1 This progress report covers work completed between 1 July 2018 and 30 September 2018.

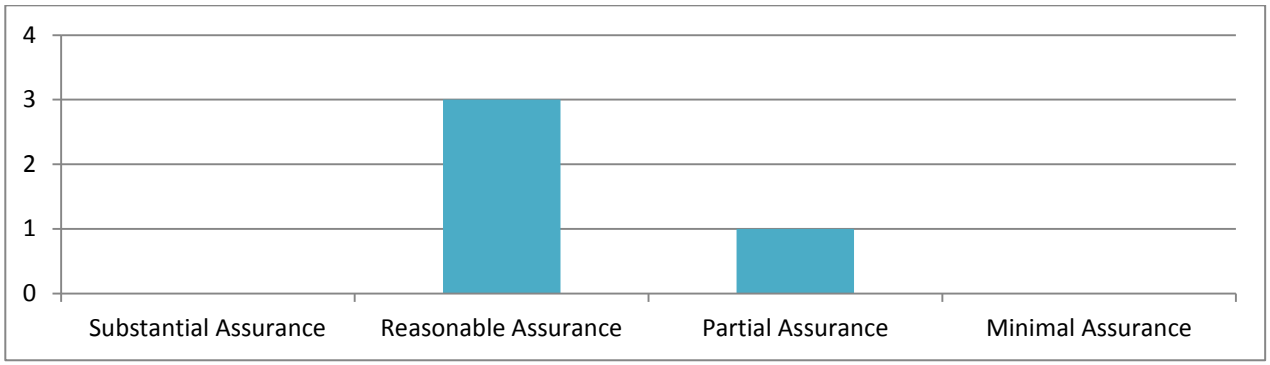
2. Supporting Information

2.1 The current annual plan for internal audit is contained within the Internal Audit Strategy and Annual Plan 2018-19 which was approved by Audit Committee on 22 March 2018.

3. Conclusion and Reasons for Recommendation

3.1 Key audit findings from final reports issued during Quarter 2 are summarised in Appendix A.

3.2 Overall, of the four formal audits finalised during the quarter in which an opinion was given, three received opinions of ‘reasonable assurance’ and one received ‘partial assurance’. There were no opinions of ‘substantial assurance’ or ‘minimal assurance’. The completion to final report stage during the quarter of only four ‘opinion’ audits is low in comparison to previous quarters. This is as a result of audit investigation work and lower levels of production as a result of summer holidays. In addition, other non-opinion audit activity has been undertaken in quarter 2 that includes work relating to Orbis Policies and Atrium, as reported in this report. Also, several audits were at draft report stage at the end of the quarter and will be reported upon in our quarter 3 report. We remain confident that we will achieve our target of 90% completion of the audit plan by 31 March 2019.



3.3 Although the same range of internal audit opinions are issued for all audit assignments, it is necessary to also consider the level of risk associated with each area under review when drawing an opinion on the Council's overall control environment. **Taking into account these considerations, the Chief Internal Auditor continues to be able to provide reasonable assurance that the Council has in place an effective framework of governance, risk management and internal control**.

3.4 The overall conclusion has been drawn based on all audit work completed in the year to date and takes into account the management response to audit findings and the level of progress in subsequent implementation. This is something which will continue to be monitored and reported on by Internal Audit throughout the year.

3.5 Formal follow up reviews continue to be carried out for all audits where 'minimal assurance' opinions have been given and for higher risk areas receiving 'partial assurance'.

3.6 Members will recall that flexibility was built into the audit plan to allow resources to be directed to any new and emerging risks. We continue to liaise with departments to identify these but would also welcome input from this Committee. Details of those reviews added and removed from the plan so far this year are set out at the end of Appendix A.

3.7 Progress against our performance targets (focussing on a range of areas relating to our service) can be found in Appendix A. All targets have been assessed as on target (green).

KEVIN FOSTER
Chief Operating Officer

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Background Documents:

Internal Audit Strategy and Annual Plan 2018-19

Appendix A

Internal Audit and Counter Fraud

Quarter 2 Progress Report 2018/19

CONTENTS

1. Summary of Completed Audits

Orbis Budget Management

1.1. The Orbis Partnership is responsible for delivering services from a joint operating budget, which is shared by the three partnership authorities, in accordance with an Inter Authority Agreement (IAA).

1.2. We carried out an audit of the joint operating budget in 2016/17, when the partnership only included East Sussex County Council (ESCC) and Surrey County Council (SCC) and gave an opinion of substantial assurance; the second highest of the five opinions available at the time.

1.3. The gross Orbis joint operating budget for 2018/19 is £76.4m[1], with income budgeted at £13.8m, leaving a net budget of £62.6m. Each Council contributes to the net budget on a ratio of 55% (Surrey County Council (SCC), 24% East Sussex County Council (ESCC) and 21% Brighton and Hove City Council (BHCC)). This is the agreed contribution ratio (ACR), as defined by the IAA.

1.4. The purpose of this new audit was to provide assurance that:

- governance structures, including roles and responsibilities, are clearly defined, understood and effective;
- adequate and timely management information is available that facilitates effective decision making;
- budget management reports contain materially accurate and timely information to facilitate effective budget management;
- the operating costs of Orbis are identified and apportioned across the three Orbis partners on a consistent basis and are clearly understood. Mechanisms are in place to ensure that all income and expenditure is matched to the correct Orbis partner; and
- mechanisms are in place to ensure that changes to costs for one partner that are material can be measured and reflected fairly in the agreed contribution ratio.

1.5 In undertaking this work, whilst areas of good practice were identified, we found a number of opportunities for improvement in control and we were, therefore, only able to provide an audit opinion of **partial assurance**. The opinion has reduced because managers, who have been managing budgets on an Orbis-wide basis, have had less clarity in their budget reports. This has particularly been the case where their budgets combine both Orbis costs and costs that are managed by Orbis officers, but are specific to sovereign authorities[2].

[1] For the three partner authorities

[2] These costs are known as Managed on Behalf of (MOBO) and include, for example, buildings maintenance, where the budget is managed by Orbis, but belongs to the sovereign authorities, which own the assets.

1.6 The key areas for improvement identified were to ensure that:

- clearer information is available for budget managers who hold budgets allocated on an Orbis-wide basis;
- the new budget monitoring tool includes commitments for non-staffing spend in order to strengthen budget managers' understanding of the overall position; and
- a mechanism is implemented to measure the level of service provided to the constituent authorities which, in turn, will increase opportunities to demonstrate value for money being delivered to each sovereign authority.

1.7 Actions have been agreed with management to address these issues. Significant effort has been put into providing an integrated budget and a unified approach to budget monitoring across the Orbis partnership. With the integration of Brighton & Hove City Council budgets only coming into effect in April 2018, the combined budgets and use of the new monitoring tool are still in their infancy and it is expected that they will continue to develop and improve. A follow-up audit will be carried out in 2019/20 to ascertain that progress has been made.

Apprenticeship Levy

1.8 The Apprenticeship Levy is a Government scheme requiring all employers with annual salary costs of over £3m to pay a levy of 0.5% of the salary cost which is subsequently available to the organisation to spend on apprenticeship training. The government has set a target of 2.3% of the workforce to be apprentices. Current projections indicate 34% of the apprenticeship levy available to ESCC will have been spent by April 2019, with 111 apprenticeships already engaged in apprenticeship training (49% of the target). In line with many other organisations nationally, the Council has accepted that, where the available levy has not been spent, it will be lost. This is because of the cost and adverse impact on service delivery that recruiting more apprentices than we need may have.

1.9 The purpose of this review was to provide assurance that:

- apprenticeship levy calculations and accounting arrangements are correct;
- stakeholder engagement and workforce planning arrangements maximise the value achieved from the scheme; and
- monitoring and reporting arrangements ensure Levy expenditure and performance meet organisational and scheme objectives.

1.10 In completing this work we were able to provide an opinion of **reasonable assurance**. We found that robust levy calculation and accounting arrangements are in place. A clear strategy has been developed to align workforce planning with the Council's approach to the Levy and this has been communicated to senior management and Members. Extensive communication and engagement has raised awareness of apprenticeship opportunities across the organisation, earning recognition from the

Local Government Association. Effective monitoring and reporting of levy expenditure and performance against targets ensure appropriate transparency and inform planning.

1.11 However, a small number of opportunities to improve the control environment were identified. These included the need to:

- record forecasting activity electronically to monitor expenditure and improve financial planning;
- update the communication and engagement plan to include measures to assess the impact of activity undertaken; and
- review access permissions to the digital apprenticeship account to prevent unauthorised access to data held.

1.12 Appropriate action to address the findings of this review was agreed with management within a formal action plan.

Orbis Policy Review

1.13 The nature of the Orbis partnership means that individuals working for Orbis may be employed by any one of the three founding partners and subject to their respective employers' policies. An inconsistent or contradictory policy framework may lead to issues such as confusion for staff and managers, error or omission, inappropriate decision making or HR disputes. With the development of an integrated management structure, there is a greater need for a clear and consistent framework of governance over Orbis activity.

1.14 Because there are likely to be areas where policies and procedures differ between partner organisations, it is important that these differences are clearly identified and understood, especially by staff working across the partnership.

1.15 Our review set out to identify and evaluate a range of key policy documents across partner organisations to identify any inconsistencies.

1.16 The review found that policies are broadly similar across all three authorities. However, there are some differences. The most significant of these relate to the Codes of Conduct, where there are clear differences in:

- how declarations and acceptance of gifts and hospitality and personal relationships are treated; and
- where the onus of responsibility to declare conflicts of interest lies, because East Sussex is the only authority to require all employees to make a declaration in the register of interests irrespective of whether one exists (i.e. nil returns required).

1.17 The aligning of existing arrangements across the partnership would strengthen employees' compliance with Code of Conduct policies and provide support to managers applying a consistent delivery of line management responsibilities in accordance with the "Joint Protocol for the Management of Staff in Orbis" policy.

1.18 Management has agreed to consider the issues highlighted in our review and in particular the implications for employees working across more than one partner. The main differences will be communicated to those affected to raise awareness and ensure that employees are following the relevant policies.

Pensions Processes and Systems

1.19 East Sussex County Council is the designated statutory administering authority for the East Sussex Pension Fund (the Fund). The Council has a statutory responsibility to administer and manage the Fund in accordance with the rules of the Local Government Pension Scheme.

1.20 As at 31 March 2018, the Fund comprised 132 scheme employers with approximately 70,000 members. The most recent actuarial valuation of the Fund was in October 2016 and found that the funding level has improved from 81% (in 2013) to 92%.

1.21 The purpose of the audit was to provide assurance that controls are in place to meet the following objectives:

- Process controls in the system are effective and any transactions, data and outputs from the system are complete and accurate.
- The governance processes that are in place are both effective and clear and help the efficient running of the service. Performance of pensions administration by Orbis Business Operations is monitored.
- Deficits for the admitted bodies are fully supported by a bond or guarantee; and
- The employer portal (PensionWeb) is used in a secure environment.

1.22 We were able to provide **Reasonable Assurance** over controls operating within this area. Systems are in place to manage the accuracy of data entry to pension systems, the calculation of pension benefit entitlements and to ensure that income expected from employers is received intact. An actuarial assessment is undertaken for all new employers and performance targets, for the pension administration service provider, have been set and are monitored on a regular basis.

1.23 Whilst slippage was found in the Annual Benefit Statement production plan, the Administrator was working to a revised production plan at the time of the audit to help ensure that the statutory deadline of 31st of August was met. As a result, no formal management action in this area was raised within our review. It should be noted, however, that the deadline was subsequently not met following

an error in compiling the Statements, which was not identified until after the deadline had expired and the audit had been completed. Internal Audit has carried out additional work to ascertain the reason for this error and findings have been presented to management and appropriate mitigating actions agreed. This work will be reported upon in our quarter 3 progress report.

1.24 Although we gave an opinion of reasonable assurance, a number of opportunities for improvement were identified, relating to:

- the need to ensure data errors and warnings [3] highlighted in a routine data cleansing exercise in December 2017 are investigated and, if necessary, corrected to reduce the likelihood of errors in actuarial valuations or the calculation of benefit entitlements;
- the need to supplement statutory data requirements with scheme-specific requirements to strengthen data quality;
- the provision of assurance that year-end activities are completed in a timely manner by developing a schedule of key activities; and
- the strengthening of system access controls, by carrying out an annual access review of the administration system, Altair.

1.25 A formal action plan incorporating the findings of our review was agreed with management.

Disaster Recovery

1.26 Disaster recovery is the process by which essential Council systems are brought back on line following a natural disaster or a technological failure. It involves the backing up of data, to enable its recovery, the provision of alternative locations and/or ICT infrastructure and appropriate policies and procedures.

1.27 The future migration of the St. Mary's disaster recovery site to the Orbis data centre will include an overhaul of current disaster recovery processes and documentation in line with Orbis standards. However, this review considered the current provision of disaster recovery prior to the migration, across the following three systems hosted by the Council:

- Exchange;
- Active Directory; and
- Liquid Logic.

1.28 The audit also considered the extent to which the recovery provision was understood and documented and the adequacy of staff training provided to support it.

[3] These may include data that is correct but that falls outside expected ranges, or potentially empty data fields.

1.29 As a result of our work, we were able to provide **Reasonable Assurance** that controls were operating as intended. A small number of areas for improvement were identified. These include the need to:

- remove inconsistencies in formal documentation and definition of the overarching and individual disaster recovery processes;
- review and update policies and overarching documents that support the council's critical systems and disaster recovery to reflect changes to critical requirements of the authority; and
- strengthen the documentation of risks and event responses to reduce the risk of error or loss of critical data, when recovering key systems, and the speed at which recovery can occur.

1.30 These areas have been discussed with management and a formal action plan agreed to address them.

Atrium - Accounts Payable and Accounts Receivable Modules

1.31 In 2013, a business case was submitted for the procurement of a new property asset management system (PAMS) as the system then in use was no longer considered to be fit for purpose. The option selected was the procurement of an integrated PAMS through the South-East 7 partnership and the Atrium system was subsequently procured. This system has separate modules to control orders and payments for planned and reactive maintenance, capital works, rental income and expenditure, and disposals and acquisitions.

1.32 Following the implementation previously of the Works Delivery module of the Atrium system, the Property Division within the Business Services Department is looking to implement a further two modules covering property rental payments (the Accounts Payable module) and the receipt of property rental income (the Accounts Receivable module).

1.33 The purpose of our work in this area was to provide assurance on whether risks associated with key aspects of the implementation of these two modules were being properly managed, prior to any go-live decision being made by the project board. Our work focussed on:

- System controls
- User acceptance testing
- Interface (with SAP) controls

1.34 In completing this work, we identified a number of areas where controls required strengthening prior to the system going live. These included the need to:

- Ensure lease data is accurate and up-to-date, including improving controls over the input of data to the system;

- Document procedural guidance in relation to the use of the AP and AR modules to ensure consistency in how tasks are carried-out within the system;
- Ensure adequate training has been provided to all relevant staff;
- Perform adequate user acceptance testing, with the appropriate oversight of the project board; and
- Confirm and document roles and responsibilities in relation to the reconciliation of interface files between Atrium and SAP to ensure appropriate scrutiny of payments.

1.35 All of the findings of our review were discussed with the project team and subsequently with the project board which is committed to ensuring appropriate controls are in place prior to go-live.

Troubled Families

1.36 The Troubled Families (TF2) programme has been running in East Sussex since January 2015 and is an extension of the original TF1 scheme that began in 2012/13. The programme is intended to support families who experience problems in certain areas, with funding for the local authority received from the Department for Communities and Local Government (DCLG), based on the level of engagement and evidence of appropriate progress and improvement.

1.37 Children's Services submit periodic claims to the DCLG to claim grant funding under its 'payment by results' scheme. The DCLG requires Internal Audit to verify 10% of claims prior to the Local Authority's submission of its claim. We therefore reviewed 27 of the 267 families included in the April/July 2018 grant.

1.38 In completing this work, we found that valid 'payment by results' (PBR) claims had been made and outcome plans had been achieved and evidenced. All of the families in the sample of claims reviewed had firstly met the criteria to be eligible for the TF2 programme and had either achieved significant and sustained progress and/or had moved from out of work benefits into continuous employment. We therefore concluded that the conditions attached to the TF2 grant determination programme had been complied with.

2. Counter Fraud and Investigation Activities

Proactive Counter Fraud Work

2.1 A programme of proactive counter fraud work remains ongoing with updates provided to members as part of separate reports.

Summary of Completed Investigations

Conflicts of Interest

2.2 An audit investigation was undertaken following an anonymous allegation that a manager within the Council had friendships with contractors that he was responsible for employing and had personally benefited from using their services.

2.3 Our investigation confirmed the existence of personal relationships with contractors that went beyond that considered appropriate by an officer in this role, including socialising and receipt of hospitality. The manager had not declared this in accordance with the Council's Code of Conduct and Conflict of Interest policy, despite regular reminders to do so, and therefore no measures to manage the conflict had been put in place. In addition, the manager had also not declared hospitality received from a potential contractor relating to a large contract due to be let by the Council.

2.4 During the course of this investigation, the officer concerned left the Council. In response to these issues, an internal control review has been undertaken to learn lessons from this issue and ensure that appropriate management controls are put in place to help avoid future repetition. In addition, management are undertaking a review of the relevant contracts in this area to ensure robust and transparent arrangements are in place.

3. Action Tracking

3.1 All high priority actions agreed with management as part of individual audit reviews are subject to action tracking. As at the end of quarter 2, 100% of high priority actions due had been implemented.

4. Amendments to the Audit Plan

4.1 In accordance with proper professional practice, the internal audit plan for the year remains under regular review to ensure that the service continues to focus its resources in the highest priority areas based on an assessment of risk. Through discussions with management, the following reviews have been added to the audit plan during the year:

- Cultural Compliance – Business Operations
- Property Disposals
- Pension – Annual benefit Statements
- Non-Household Waste Charging Scheme
- Surveillance Cameras
- Orbis Customer Access Portal
- Pension Annual Benefit Statements
- Pension Fund Strategy
- Purchase To Pay Change Programme
- Procurement - Lessons Learned from Investigations
- SAP Upgrade

4.2 Through the same process, the following audits have been removed or deferred from the audit plan and, where appropriate, will be considered for inclusion in the 2019/20 plan as part of the overall risk assessment completed during the annual audit planning process:

- Debt Management within Deferred Payment Arrangements

4.3 Given the additional audit work above, we are currently reviewing the remainder of the audit plan to assess the impact of this.

5. Internal Audit Performance

5.1 In addition to the annual assessment of internal audit effectiveness against Public Sector Internal Audit Standards (PSIAS), the performance of the service is monitored on an ongoing basis against a set up agreed key performance indicators as set out in the following table:

Aspect of Service	Orbis IA Performance Indicator	Target	RAG Score	Actual Performance
Quality	Annual Audit Plan agreed by Audit Committee	By end April	G	Approved by Audit Committee on 22 March 2018
	Annual Audit Report and Opinion	By end July	G	2018/19 Annual Report and Opinion approved by Audit Committee on 13 July 2018
	Customer Satisfaction Levels	90% satisfied	G	100%
Productivity and Process Efficiency	Audit Plan – completion to draft report stage	90%	G	59% completed to draft report stage by end of Q2 (against a Q2 target of 45%)
Compliance with Professional Standards	Public Sector Internal Audit Standards	Conforms	G	January 2018 – External assessment by the South West Audit Partnership gave an opinion of 'Generally Conforms' – the highest of three possible rankings
	Relevant legislation such as the Police and Criminal Evidence Act, Criminal Procedures and Investigations Act	Conforms	G	No evidence of non-compliance identified
Outcome and degree of influence	Implementation of management actions agreed in response to audit findings	95% for high priority agreed actions	G	100%
Our staff	Professionally Qualified/Accredited	80%	G	85%[4]

[4] Includes part-qualified staff

Appendix B

Audit Opinions and Definitions

Opinion	Definition
Substantial Assurance	Controls are in place and are operating as expected to manage key risks to the achievement of system or service objectives.
Reasonable Assurance	Most controls are in place and are operating as expected to manage key risks to the achievement of system or service objectives.
Partial Assurance	There are weaknesses in the system of control and/or the level of non-compliance is such as to put the achievement of the system or service objectives at risk.
Minimal Assurance	Controls are generally weak or non-existent, leaving the system open to the risk of significant error or fraud. There is a high risk to the ability of the system/service to meet its objectives.

Report to:	**Audit Committee**
Date:	**22 November 2018**
By:	**Chief Operating Officer**
Title of report:	**Counter Fraud Update and Work Plan, (including the proposed updated Anti-Money Laundering Policy)**
Purpose of report:	**To provide Members with an update on the work of the integrated Counter Fraud Service**

RECOMMENDATIONS

Members are requested to note:
1. **the report and consider the priorities raised;**
2. **note the updated Anti-Money Laundering policy (Appendix A) prior to submission to Governance Committee for approval**

1. Background

1.1 The Orbis Internal Audit structure came into effect from 1st April 2018. The integrated structure was designed to deliver the following benefits:

- Resilience, flexibility and quality;
- Specialisms;
- Sustain strong sovereign focus.

1.2 A key strand of the structure was the formation of a counter fraud team that would deliver specialist fraud resource across the partnership.

2. Supporting Information

2.1 The counter fraud team is resourced through an Audit Manager, Principal Auditor and Senior Auditor. In addition, two investigators are based at Brighton to deliver Housing fraud work to Bright and Hove City Council (BHCC).

2.2 Work to date has focussed on the following areas:

Priority	Progress to date
Reactive Investigations	The counter fraud team is responsible for assessing and evaluating fraud referrals received by each sovereign partner, and then leading on subsequent investigations. The team have implemented a coordinated approach to assessing and logging referrals and adopted consistent procedures for recording investigations. During the 6-month period to date, there have been several investigations across the partnership, some of which have been resourced through sovereign audit teams supported by advice and direction from the counter fraud team. The results of these investigations are reported at their conclusion to each separate authority within the quarterly Internal Audit progress reports.
National Fraud Initiative (NFI)	The datasets for the biennial NFI exercise were submitted in October 2018. The counter fraud team have taken on responsibility for the coordination and submission of these at each authority. Results from the matching exercise are due in late January 2019 at which point the counter fraud team will liaise with partner authorities to review and investigate flagged matches.

Priority	Progress to date
Counter Fraud Policies	Each Orbis partner has in place a counter fraud strategy that sets out their commitment to preventing, detecting and deterring fraud. The counter fraud team will review the sovereign strategies and align with best practice to ensure a robust and consistent approach to tackling fraud. As a priority, the Anti-Money Laundering policies have been reviewed and updated to reflect recent changes in legislation. The updated East Sussex County Council (ESCC) Anti-Money Laundering policy can be found in Appendix A. Approval for this will be sought at Governance Committee in January.
Fraud Risk Assessments	Fraud risk assessments have been updated to ensure that the current fraud threat facing each partner authority has been considered and mitigating actions identified.
Fraud Response Plans	The fraud response plans take into consideration the fraud risk assessments and emerging trends across the public sector and provide a proactive counter fraud programme. These are being reviewed and aligned to deliver an efficient and effective programme of work across the Orbis partners. This will include an increased emphasis on data analytics.
Fraud Awareness	The team have been rolling out a programme of targeted fraud awareness workshops to help services identify the risk of fraud and vulnerabilities in their process and procedures. Workshops have been delivered to several teams across the partners from a mix of services.
Coordinate Counter Fraud Activities with District & Borough Partners	Recent initiatives have taken place with District and Borough (D&B) council partners that have delivered increased collection of council tax and business rates across Surrey. Benefits from this approach will be shared with ESCC and BHCC to promote closer working.

2.3 The following areas have been identified as priorities for the second-half of the year:

- Continued refresh of fraud risk assessments;
- Roll out of proactive programmes and data analytics (shaped by fraud response plans);
- Continue fraud awareness workshops to raise awareness to the risk of fraud and to promote the work of the counter fraud team;
- Launch of an Orbis wide fraud survey to coincide with Fraud Awareness Week;
- Joint working with District and Borough councils to target increased council tax and business rates collection.

2.4 From the reactive investigation work completed in recent months, the following can be drawn out as emerging threats:

- Conflicts of interest – there have been several cases across the Orbis partners where external interests have conflicted with officers' paid employment and been either undeclared or inadequately managed.
- Procurement controls – internal audit have identified a number of cases where procurement controls have operated poorly.

2.5 In all cases, the outcomes from investigations and associated trends are used to inform future internal audit planning.

3. Conclusion and Reasons for Recommendation

3.1 The developments set out above are driven by a desire to implement a coordinated counter fraud response across Orbis partners that delivers a professional and expert fraud service. The team will continue to provide both proactive and reactive counter fraud services and will periodically report on the outcomes from this to Members at all Orbis partner authorities.

KEVIN FOSTER
Chief Operating Officer

Contact Officers:	Russell Banks, Orbis Chief Internal Auditor	Tel No. 01273 481447
	Simon White, Audit Manager (Counter Fraud)	Tel No. 020 85419191

Background Documents

None.

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Anti-Money Laundering Policy

Date: October 2018

Document summary

This policy sets out the procedures that must be followed to enable the Council to comply with its legal obligations to prevent criminal activity through Money Laundering.

Contents

About this document:

Enquiries: Internal Audit and Counter Fraud **Author:** Internal Audit and Counter Fraud Telephone: 020 8541 9191 Email: simon.white@surreycc.gov.uk **Download this document** From: http://intranet.escc.gov.uk/helping/financepurchasing/finance/Documents/antimoneylaundering.doc	**Version number:** 05 **Related information** Anti-Fraud and Corruption Strategy Code of Conduct and Conflict of Interest Policy Disciplinary Policy and Procedures Whistleblowing policy – Raising concerns

Accessibility help

Zoom in or out by holding down the Control key and turning the mouse wheel.

CTRL and click on the table of contents to navigate.

Press CTRL and Home key to return to the top of the document

Press Alt-left arrow to return to your previous location.

References shown in blue text are available on the Intranet/Czone

References shown in underlined blue text are links to other areas of this document

Anti-money laundering policy

Policy statement

East Sussex County Council will do all it can to:

- Prevent any attempts to use the Council and its staff to launder money;
- Identify potential areas where money laundering may occur; and
- Comply with all legal and statutory requirements, especially with regard to the reporting of actual or suspected cases of money laundering.

1. Introduction

1.1 The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017, the Proceeds of Crime Act 2002 and the Terrorism Act 2000 (and all relevant amending legislation) place obligations on the council, including its members and employees, with respect to suspected money laundering.

1.2 While most money laundering activity in the UK occurs outside of the public sector, vigilance by Council members and officers can help identify those who are, or may be, perpetrating crimes relating to the financing of terrorism and money laundering.

1.3 This policy forms part of the Council's counter fraud framework and sets out:

- Definitions and legal background in respect of money laundering;
- The Council's approach to money laundering including the responsibility of members and officers to report suspicions promptly; and
- Guidance and procedures for members and officers.

2. Scope of the policy

2.1 This policy applies to all members and officers of the Council and aims to maintain the high standards of conduct that the public is entitled to expect from the Council.

2.2 It is vital that all members and officers are aware of their responsibilities and remain vigilant; criminal sanctions may be imposed for breaches of legislation.

2.3 Failure to comply with the procedures set out in this policy will result in action being considered under the Sanctions Policy. This may include disciplinary action in line with the Officer, or Member, Code of Conduct.

3. Definitions and legal background

3.1 Money laundering is the process of converting illegally obtained money or assets into 'clean' money or assets with no obvious link to their criminal origin.

3.2 There are three primary money laundering offences set out in legislation:

- Concealing, disguising, converting, transferring, or removing from the UK any criminal property (Section 327 of the Proceeds of Crime Act 2002);
- Entering into or becoming concerned in an arrangement which you know or suspect facilitates the acquisition, retention, use or control of criminal property by or on behalf of another person (Section 328); and

- Acquiring, using or possessing criminal property (Section 329).

3.3 There are also two secondary offences:

- Failure to disclose any of the three primary offences; and
- Tipping off (the act of informing a person suspected of money laundering in such a way as to prejudice an investigation).

3.4 Any member or employee of the Council may potentially be implicated in money laundering if they suspect money laundering and either become involved with it in some way and/or do nothing about it. The key requirement is to promptly report any suspected money laundering activity to the Money Laundering Reporting Officer.

4. The Money Laundering Reporting Officer (MLRO)

4.1 The officer nominated to receive disclosures about money laundering activities within the Council and its Orbis partners is the Auditor Manager for Counter Fraud:

Simon White Audit Manager (Counter Fraud)	Room 318, County Hall Penrhyn Road Kingston upon Thames Surrey, KT1 2DN
Telephone: 0208 541 9191 / 07779 455501 Email: simon.white@surreycc.gov.uk	

4.2 In the absence of the MLRO, the Principal Auditor (Counter Fraud) is authorised to deputise:

Alex McLaren Principal Auditor	Brighton Town Hall Bartholomew Square Brighton BN1 1JP
Telephone: 01273 292573 / 07592 103574 Email: Alex.Mclaren@brighton-hove.gov.uk	

5. Procedures

Cash

5.1 The Council will not accept any cash payment in excess of £5,000 irrespective of whether this is through a single payment or series of linked payments. ‘Cash’ includes notes, coins, banker’s drafts and travellers cheques.

5.2 This does not necessarily mean that cash transactions below this value are legitimate and legal. Professional scepticism is encouraged at all times and any suspicions must be reported to the MLRO or their deputy.

Responsibilities of members and officers

5.3 Any member or officer who suspects money laundering activity must report their suspicion promptly (as soon as practicable) to the MLRO or their deputy if appropriate. If you prefer, you can discuss your suspicions with your line manager first.

5.4 Your disclosure must be made at the earliest opportunity following the information coming to your attention, not weeks or months later, and should be made to the MLRO or deputy using the form attached at the end of this policy.

5.5 You must follow any subsequent directions from the MLRO or deputy. You must not:

- Make any further enquiries into the matter;
- Take any further steps in any related transaction without authorisation from the MLRO or deputy;
- Disclose or otherwise indicate your suspicions to the person suspected of money laundering; or
- Discuss the matter with others or make a note on file that a report to the MLRO or deputy has been made unless there is a risk that other officers may progress the matter or a related transaction, as this may alert the suspected perpetrator.

Responsibilities of the MLRO

5.6 The MLRO or deputy must promptly evaluate any disclosure to determine whether it should be reported to the National Crime Agency (NCA). Any decision not to submit a report to the NCA must be recorded.

5.7 If they so determine, the MLRO or deputy must promptly submit an online Suspicious Activity Report (SAR) to the NCA. Alternatively, a SAR may be manually reported to the NCA. Both online and up to date manual reporting forms are available on the NCA's website.

5.8 If a disclosure provides the MLRO or deputy with knowledge or reasonable grounds to suspect that a person is engaged in money laundering, and they do not disclose this to the NCA as soon as practicable, the MLRO or deputy will have committed a criminal offence.

Risk based approach, customer due diligence and record retention

5.9 Under MLR 2017, the Council is obliged to adopt a risk-based approach towards anti-money laundering regulations and how they approach due diligence.

5.10 MLR 2017 stipulate risk mitigation policies must be in writing and be proportionate to the risks identified. They must include internal controls over money-laundering and terrorist financing risks. They must also include revised customer due diligence procedures as well as reporting, record keeping and monitoring requirements.

5.11 Regulation 18 of MLR 2017 requires a written risk assessment to identify and assess the risk of money laundering and terrorist financing that the Council faces. This will:

- Assist in developing policies, procedures and controls to mitigate the risk of money laundering and terrorist financing;
- Help in applying a risk-based approach to detecting and preventing money laundering terrorist financing Inform an assessment of the level of risk associated with particular business relationships and transactions and enable appropriate risk-based decisions about clients and retainers;

- Inform an assessment of the level of risk associated with particular business relationships and transactions and enable appropriate risk-based decisions about clients and retainers.

5.12 In carrying out risk assessments we will take into account information on money-laundering and terrorist financing risks made available by the Law Society and/or SRA, and risk factors relating to:

- Customers;
- Geographic areas where the Council operates;
- Products and services;
- Transactions;
- Delivery Channels.

5.13 Under MLR 2017, there ceases to be "automatic" simplified due diligence requirements for any transactions. Instead, a relevant person needs to consider both customer and geographical risk factors in deciding whether simplified due diligence is appropriate. There are various levels of due diligence as follows:

- Simplified due diligence is only permitted where it is determined that the business relationship or transaction presents a low risk of money laundering or terrorist funding, taking into account the risk assessment;
- Enhanced due diligence' (Regulation 33) for those with a high-risk status, for example remote transactions where the customer is not physically present to be identified would require additional appropriate documents to be requested;
- The 'beneficial owner', the individual that ultimately owns or controls the customer or on whose behalf a transaction or activity is being conducted, should be identified;
- The business relationship should be scrutinised throughout its existence and not just at the beginning.

5.14 In all cases, the evidence of the customer identification and record of the relationship/transaction should be retained for at least five years from the end of the business relationship of transaction(s). The records that must be kept are:

- A copy of, or references to, the evidence of the identity obtained under the customer due diligence requirements in the Regulations;
- The supporting evidence and records in respect of the business relationships and occasional transactions which are the subject of customer due diligence measures or ongoing monitoring;
- A copy of the identification documents accepted and verification evidence obtained;
- References to the evidence of identity.

5.15 If satisfactory evidence of identity is not obtained at the outset of the matter then the business relationship or one off transaction(s) cannot proceed any further.

5.16 The customer identification procedure must be carried out when the Council is undertaking business in relation to accountancy, procurement, asset management, audit and legal services with a financial or real estate transaction and:

- Forms a business partnership with a customer;
- Undertakes a one-off transaction (including a property transaction or payment of a debt) involving payment by or to a customer of £5,000 or more;
- Undertakes a series of linked one-off transactions involving total payment by or to the customer(s) of £5,000 or more;
- It is known or suspected that a one-off transaction, or a series of them, involves money laundering;
- This must be completed before any business is undertaken for that customer..

5.15 In the above circumstances, employees must:

- Identify the person seeking to form the business relationship or conduct the transaction (an individual or company);
- Verify their identity using reliable, independent sources of information, Identify who benefits from the transaction;
- Monitor transactions to make sure they are consistent with what you understand about that person or country;
- Understand the source of their funds;
- Ensure there is a logical reason why they would want to do business with the Council.

5.17 Transaction and business relationship records should be maintained in a form from which a satisfactory audit trail may be compiled, and which may establish a financial profile of any suspect account or customer.

5.18 The steps that will be followed to continuously mitigate the risks associated with money laundering are:

- Applying customer due diligence measures to verify the identity of customers and any beneficial owners obtaining additional information on customers;
- Conducting ongoing monitoring of the transactions and activity of customers with whom there is a business relationship;
- Having systems to identify and scrutinise unusual transactions and activity to determine whether there are reasonable grounds for knowing or suspecting that money laundering or terrorist financing may be taking place.

5.19 Risks will be reviewed continuously as part of the annual review of the Council Risk Register.

6. Guidance and training

6.1 The Council will:

- Make members and officers aware of the requirements and obligations placed on the Council, and on themselves as individuals, by anti-money laundering legislation; and
- Give targeted training to those considered to be the most likely to encounter money laundering.

6.2 Further information can be obtained from the MLRO and the following sources:

- Anti-money laundering responsibilities from gov.uk: https://www.gov.uk/guidance/money-laundering-regulations-your-responsibilities
- Anti-money laundering guidance from the Law Society: http://www.lawsociety.org.uk/support-services/advice/articles/quick-guide-to-the-money-laundering-regulations-2017/
- CIPFA: www.cipfa.org/members/members-in-practice/anti-money-laundering
- The National Crime Agency: www.nationalcrimeagency.gov.uk

OFFICIAL – SENSITIVE]

Confidential report to the Money Laundering Reporting Officer

To: Money Laundering Reporting Officer

From: _____ *[insert your name]*

Title/Service: _____ *[insert your post title and service]*

Telephone: _____

Date of report: _____

Response needed by: _____ *[e.g. transaction due date]*

Name(s) and address(es) of person(s) involved:

[If a company/public body please include details of nature of business]

Nature, value and timing of activity involved:

[Please give full details e.g. what, when, where, how. Continue on a separate sheet if necessary]

	Yes	No	
Has any investigation been undertaken?	☐	☐	If 'yes' please provide

Have you discussed your suspicions with anyone else? ☐ ☐ details below

Details of investigation undertaken and/or discussions held:

THIS REPORT TO BE RETAINED FOR AT LEAST FIVE YEARS

[OFFICIAL – SENSITIVE]

To be completed by the Money Laundering Reporting Officer

Date report received:

Date acknowledged:

Evaluation	
What action is to be taken?	
Are there reasonable grounds to suspect money laundering activity? If so, please provide details	

Reporting		
If there are reasonable grounds for suspicion, will a report be made to the NCA?	☐ Yes	☐ No
If 'no', reasons for non-disclosure		
If 'yes', date of report to NCA		Online / Manual [delete as appropriate]

Consent

Is NCA consent required for any ongoing or imminent transactions?	☐ Yes ☐ No
If 'yes', please confirm details	
Date consent received from NCA	
Date consent passed on to officer	

Other relevant information

Signed _____ Date: _____

THIS REPORT TO BE RETAINED FOR AT LEAST FIVE YEARS

Report to:	**Audit Committee**
Date of meeting:	**22 November 2018**
By:	**Chief Operating Officer**
Title:	**Brexit risk discussion**
Purpose:	**To provide information and assurance on the issues that the Council has already considered in relation to potential Brexit risks, and engage the Committee in developing the thinking around the Brexit risk.**

RECOMMENDATIONS

1) Note the work that has taken place to review the potential impacts of Brexit.
2) Provide comments and input around incorporating a Brexit risk in to the Strategic risk register.

1 Background

1.1 As the Committee will be aware, the government is currently in negotiating the UK's future relationship with the European Union (EU), following the vote to leave.

1.2 At the Audit Committee on 20 September 2018, the Committee commented that Brexit and the potential 'disorderly exit' is not mentioned on strategic risk register. The Committee commented that there is a risk from an adverse currency fluctuation and higher inflation, plus an impact on ports. Therefore, a disorderly Brexit should be on the strategic risk register. The Chief Operating Officer responded that the Brexit risk had been considered but further review was required to define the risk and mitigations. At present it is difficult to put in place mitigations when the actual impacts remain unknown. The Committee's comments were noted and it was agreed that this risk will be will revisited in November (which is the purpose of this report).

1.3 This report will provide an update on the issues that the Council has already considered, in order to inform and provide assurance. It also seeks to engage the Committee in developing the thinking around the Brexit risk and how it could be captured in the context of the information provided and the current risk register. This can be fed into the quarter 3 risk register (scheduled for Audit Committee in March 2018).

2 Supporting information

20 September Audit Committee

2.1 As part of the discussions on 20 September, the Committee suggested that it might to helpful to focus on specific areas of risk such as:

1. A break down in the supply chain for the Council's suppliers and local businesses;
2. Blockages to the transport system especially at ports (e.g. Newhaven).
3. The cost inflation impact on staffing and suppliers of a currency fluctuation and higher inflation.

2.2 These areas will be covered in the sections below.

Government preparations and communications

2.3 Information from the Association of County Chief Executives (ACCE) indicates that the Government are currently looking at Brexit preparations down the following work streams:

- Citizens' rights (including whether EU residents can vote in next year's borough and district elections).
- Workforce
- Trading Standards (particularly in relation to weights and measures at ports)
- Structural Funds
- Ports and Borders
- Community Cohesion
- Economy

At this stage local government have not been engaged with on these preparations.

2.4 The Local Government Association (LGA) 'Brexit "No Deal" briefing for councils' (5 October 2018) includes information on the Withdrawal Act 2018 and its application in a No Deal scenario:

> *EU law and regulation underpins many council services (such as waste and environmental standards). The Withdrawal Act 2018 provided for all EU law to be brought into UK law to ensure that there was legal certainty for businesses and residents. The Withdrawal Act is now law and this legal certainty remains in place under No Deal.*
>
> *However, many UK laws refer to EU regulations or to EU agencies. The Withdrawal Act gives ministers the ability to amend such laws where EU institutions or processes are mentioned. We have been assured that the principle that the Government is working to is that of continuity (at least in short-medium term) and naming UK successor agencies to EU regulators.*
>
> *Under No Deal, all these legal changes to UK law need to be in place by March 2019 and relevant information communicated to the sector by Government. Given the number of Statutory Instruments that are required it is not clear at the moment whether all changes will be communicated via the "no deal" technical papers or through direct communications by a number of Government departments to relevant professional bodies or directly to councils.*

Current risk register and sharing best practice with other local authorities

2.5 The Council's Strategic risk register (circulated to the Committee at quarter 1) is attached as Appendix 1. A consideration for the Committee is whether it is a better approach to have Brexit as a separate risk or a component part of risks on the register.

2.6 The Council's Business Continuity approach is a well-established and embedded framework where (depending on the services impacted by a scenario) the Corporate and/or relevant Departmental Business Continuity Team would respond to the incident. Council activities have been prioritised using a robust Business Impact Analysis process, and any unforeseen impacts to the business continuity of our prioritised activities, will be initially addressed through this approach.

2.7 The South East Risk Managers Group (consisting of 10 local authorities) shares information every 6 months on their strategic risks. The Members of the group are East Sussex, Surrey, Kent, Essex, West Sussex, Hertfordshire and Buckinghamshire County Councils, Brighton & Hove City Council, Medway Council and City of London Council.

2.8 At the point of the most recent information exchange (July 2018), two Councils had a specific Brexit related risk; one referenced place specific infrastructure risk; and the other was very high level with no mitigation at this stage. In the majority of cases, Brexit is being treated as an issue that is being monitored; rather than a risk with associated mitigations.

Workforce

2.9 The Council records employee's nationality as part of the pre-employment checking process, to ensure that new recruits are eligible to work in the UK. In addition, we ask existing employees to state their nationality as part of our voluntary staff equalities survey. This information is stored on our central employment database, which means we can be reasonably certain of the number of EU citizens currently employed by the Council. As of August 2018, a total of 234 EU citizens are directly employed by ESCC.

2.10 Based on the number of employees likely to be affected, and the likely outcomes of the negotiations, the short-term impact on the Council's overall workforce is likely to be limited. Nonetheless, the Council is taking some steps to ensure that all employees are kept informed, and that those who are directly affected are supported to ensure they can keep working in the UK. As some Council job roles include a higher proportion of EU citizens, taking action now will help protect service delivery in future.

2.11 At present, there is no advice on residency and employment rights of non UK EEA (European Economic Area) residents under a no deal scenario.

Procurement

2.12 In relation to Procurement, the EU Withdrawal Act brings all relevant legislation into UK Law unchanged, and there is already UK legislation covering public procurement which also remains unchanged. In the longer term, the position will depend on what form of Brexit we take and we will monitor this.

2.13 We will continue to work with our suppliers and their supply chains to monitor the impact of Brexit and their ability to deliver and maintain services to the Council. Given the uncertainty around the final outcome of the negotiation, it is difficult to predict the impact, however current skill shortages in the construction and care industries are likely to remain one of the key areas of focus for discussions. Work currently undertaken by the Council's Economic Development and Skills Team will continue to help to mitigate some of the current skills shortages.

Communities, Economy and Transport

2.14 The Communities, Economy and Transport department are currently working to:

- Develop contingency plans for the transport system as a result of increased congestion which may result from a 'no deal' Brexit scenario.
- Consider any potential changes to environmental regulation (such as the common agricultural policy and fisheries policy) and trading standards, along with any implications for local authorities (both in terms of the regulation and the Council's regulatory role).

3. Conclusion and reasons for recommendations

3.1 The report provides an update on the issues that the Council has been considering in relation to potential outcomes of Brexit.

3.2 It also highlights that the Council is not 'behind the curve' on planning, as Government engagement has not yet begun, and other local authorities are taking the approach of monitoring developments rather than treating Brexit as a risk to mitigate.

3.3 The Committee is therefore recommended to:

1) Note the work that has taken place to review the potential impacts of Brexit; and
2) Provide comments and input around incorporating a Brexit risk in to the Strategic risk register.

KEVIN FOSTER
Chief Operating Officer

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APPENDIX 1

Strategic Risk Register – Q1 2018/19			
Ref	**Strategic Risks**	**Risk Control / Response and Post Mitigation RAG score**	
12	**CYBER ATTACK** The National Cyber Security Centre (NCSC) has highlighted the substantial risk to British web infrastructure with elevated levels of Cyber Crime being reported against all areas of government. Cyber-attacks often include multi vector attacks featuring internet based, social engineering and targeted exploits against hardware, software and personnel. The remote nature of the internet makes this an international issue and an inevitable risk. Examples of the impact of a Cyber Attack include: • Financial fraud related to phishing of executives and finance staff; • Loss of Personally Identifiable Information and subsequent fines from Information Commissioner's Office (4% of global revenue under the new General Data Protection Regulations); • Total loss of access to systems that could lead to threat to life. A successful cyber-attack can shut down operations - not just for a few hours, but rather for multiple days and weeks. The collateral damage, such as information leaks and reputational damage can continue for much longer. Added to that, backup systems, applications and data may also be infected and therefore, of little usable value during response and recovery operations - they may need to be cleansed before they can be used for recovery. This takes time and consumes skilled resources reducing capacity available to operate the usual services that keep the Council working.	Most attacks leverage software flaws and gaps in boundary defences. Keeping software up to date with regular patching regimes; continually monitoring evolving threats and re-evaluating the ability of our toolset to provide adequate defence'. Ongoing discussion and communication with the Info Sec industry to find the most suitable tools and systems to secure our infrastructure. Expanding Security Information and Event Management (SIEM) system capabilities to align with SCC and leverage latest standards of automation, detection and prevention. Development of “Security Advocates”. Trained staff that can cascade and share cyber security insights and highlight potential issues into the workforce. Promoting a visible approachable business based security team; Enhancing user awareness - Expanding E-Learning and policy delivery mechanisms to cover Cyber threat, educating staff around the techniques and methods used by active threats. With 77% of all malware installed via email, users to be given learning experiences of phishing at point of use in a safe and secure environment; Providing GDPR training and workshops to cascade vital skills and information to those affected by new Data Protection laws; ESCC servers moved to the Orbis Primary Data Centre for resilience – An accredited Tier 3 environment certified to these standards: • ISO 27001 - IT Governance and Information Security Management • ISO 9001 - Quality Standard in Customer Service, Customer Processes, Product Process and Service, Efficiency and Continuous Improvement • ISO 14001 - Environmental Management and Best Practices for Corporate Environmental Responsibility. Disaster Recovery services now to similarly be relocated to a Tier 3 Data Centre environment (Orbis Secondary Data Centre in Guildford).	**R**

APPENDIX 1

Strategic Risk Register – Q1 2018/19			
Ref	**Strategic Risks**	**Risk Control / Response and Post Mitigation RAG score**	
4	**HEALTH** Failure to secure maximum value from partnership working with the NHS. If not achieved, there will be impact on social care, public health and health outcomes and increased social care cost pressures. This would add pressures on the Council's budget and/or risks to other Council objectives.	Implementation of East Sussex Better Together Programme by ESCC and Hastings and Rother CCG and Eastbourne, Hailsham and Seaford CCGs to transform health and social care in the county and deliver the Better Care Fund plan to improve outcomes for East Sussex residents, with robust governance arrangements reporting to County Council and Health and Wellbeing Board. In High Weald Lewes Havens the Connecting 4 You Programme has now been established to improve health and social care outcomes for residents. NHS England has applied formal directions to both NHS Hastings and Rother CCG and NHS Eastbourne, Hailsham and Seaford CCG which require them to develop and implement a financial recovery plan that contributes to achieving financial balance across the whole East Sussex system and ensures services are clinically sustainable as well as financially so. Leadership capacity, governance and wider capacity and capability of the CCGs will also be reviewed. Financial recovery will therefore be the focus of CCG and partnership attention for the rest of the financial year. The ambition of ESBT remains the same, however the pace of change will inevitably slow due to the need to achieve financial balance.	**R**
7	**SCHOOLS** Failure to manage the expected significant reduction in resources for school improvement from 2017/18 and the potential impacts of changing government policy on education, leading to reduced outcomes for children, poor Ofsted reports and reputational damage	• Work closely with schools to build a sustainable system across East Sussex, in order to ensure that the capacity and expertise is available to provide oversight of educational performance and to offer appropriate support and challenge where it is required. • Provide an opportunity for every school to be part of a local Education Improvement Partnership to support their ongoing improvement and for all partnerships to develop to the point where they provide a sustainable network through which all schools and other providers take responsibility for improvement in their local area. • Continue to develop commissioning model of school improvement including reviewing the level of trading by SLES to ascertain what is sustainable within reducing capacity and to identify core services that can be traded. • Continue to build relationships with academies and sponsors, including the Diocese of Chichester; ensure a dialogue about school performance, including data sharing. • Work with academies and maintained schools through the Education Improvement Partnerships to develop system leadership, school to school support and to broker partnerships to reduce pressure on SLES services. • Broker support to academies to address any performance concerns and investigate the feasibility of trading some LA school improvement services with all schools on a full cost recovery basis. • Where academies do not appear to be accessing appropriate support, bring this to the attention of the DfES, who may exercise their intervention powers. • Work with the Regional Schools Commissioner to ensure the work of the RSC and the LA is aligned and that schools have the support they need. • Review SLES activity in relation to our statutory responsibilities.	**R**

APPENDIX 1

Strategic Risk Register – Q1 2018/19			
Ref	**Strategic Risks**	**Risk Control / Response and Post Mitigation RAG score**	
1	**ROADS** Wet winter weather, over recent years has caused significant damage to many of the county's roads, adding to the backlog of maintenance in the County Council's Asset Plan, and increasing the risk to the Council's ability to stem the rate of deterioration and maintain road condition.	The additional capital maintenance funding approved by Cabinet in recent years has enabled us to stabilise the rate of deterioration in the carriageway network and improve the condition of our principle road network. However a large backlog of maintenance still exists and is addressed on a priority basis. The County Council's asset management approach to highway maintenance is maintaining the overall condition of roads, despite recent year's winter weather. However, severe winter weather continues to be a significant risk with the potential to have significant impact on the highway network. The recently approved five year capital programme for carriageways 2018/19 to 2022/23, and the six year additional capital programme for drainage and footways 2017/18 to 2022/23 provide the ability to continue to improve condition and build resilience into the network for future winter events. The past winter (2017/18) has been more severe than previous years. We gritted 52,584 km last year and gritted over 98,000 km this year. There were also two periods of snowfall this year. Whilst this was manged well it has led to an increase in carriageway potholes, which will put some additional pressure on the revenue budget as a result. Changes to the grass cutting policy could have an impact on the efficiency of the drainage system, with more material in the drains if it is not managed effectively.	**A**
5	**RECONCILING POLICY, PERFORMANCE & RESOURCE** Failure to plan and implement a strategic corporate response to resource reductions, demographic change, and regional economic challenges in order to ensure continued delivery of services to the local community.	We employ a robust Reconciling Policy, Performance and Resources (RPPR) process for business planning. We have adopted a commissioning approach which means evaluating need and considering all methods of service delivery, which includes working with partner organisations to deliver services and manage demand. The Council Plan sets out targets for a 'One Council' approach to deliver our priorities and is monitored quarterly. The plans take account of known risks and pressures, including demographic changes and financial risks, to design mechanisms to deliver the Council's priorities. Central Government's plans for the future funding of local government services remain undeveloped. It is prudent therefore to continue to plan on the basis of current assumptions.	**A**
13	**DEDICATED SCHOOLS GRANT** Failure to manage the loss of flexibility in the allocation of the Dedicated Schools Grant and High Needs (HN) Block funding and the potential increased risk to the Council's budget.	The County Council has agreed an approach to mitigate and fund DSG reductions. Through the RPPR process, and building on previous work to offset DSG reductions, funding to offset expected reductions to the highest risk areas has been planned over the next 3 years. For HN block in particular, a significant amount of work has been undertaken, working with schools, to reduce the pressure in this area. The funding of DSG reductions as described above will also help with this. The on-going RPPR process will continue to part-mitigate this risk.	**A**

APPENDIX 1

Strategic Risk Register – Q1 2018/19			
Ref	**Strategic Risks**	**Risk Control / Response and Post Mitigation RAG score**	
8	**CAPITAL PROGRAMME** As a result of current austerity, the capital programme has been produced to support basic need only and as a result of this there is no resource for other investment that may benefit the County e.g. that may generate economic growth. Additionally there is a risk, due to the complexity of formulas and factors that impact upon them, or changes in these, that the estimated Government Grants, which fund part of the programme, are significantly reduced. There is also a risk that the move from S106 contributions to Community Infrastructure Levy will mean that Council has reduced funding from this source as bids have to be made to Districts and Boroughs. Slippage continues to occur within the programme, which has an impact on the effective use of limited resources.	Governance arrangements have been reviewed and developed with Property for the delivery of Schools Basic Need and capital property works in support of the robust programme delivery of the basic need programme. The Education Sub Board, which in part focuses on future need for schools places, continues to inform the Capital Strategic Asset Board of key risks and issues within the School Basic Need Programme. Regular scrutiny by the Capital Strategic Asset Board, of programme and project profiles (both in year and across the life of the programme) occurs on a quarterly basis. Financial regulations have been updated to reflect the revised governance arrangements. The Board also proactively supports the seeking and management of all sources of capital funding, including; grants, S106, CIL, Local Growth Fund and European grants. A working group has been set up to develop the process for bidding for CIL and work continues with Districts and Boroughs to maximise the Council's receipt of this limited resource. Finance continues to work with CET colleagues to strengthen the governance and reporting across their capital programme and the CET Capital Board now includes Finance support, as well as Finance representation at the cross departmental Local Growth Fund Oversight group.	**A**
9	**WORKFORCE** Stress and mental health are currently the top two reasons for sickness absence across the Council, potentially leading to reduced staff wellbeing, reduced service resilience, inability to deliver efficient service and / or reputational issues.	The 2018/19 Q1 sickness absence outturn for the whole authority (excluding schools) is 1.89 days lost per FTE, a decrease of 2.7% since the same period last year. Although stress/mental health remains the primary reason for absence during Q1, time lost due to stress/mental health during this period fell by 9.3% compared to Q1 last year. A range of initiatives to address stress/mental health absences have been implemented, including: • hosting wellbeing roadshows and raising awareness through Yammer campaigns and newsletters • managers' 'Mental Health Awareness' workshops have now been introduced as part of the corporate training programme. • increased measures are being put in place to support the resilience of our employees, including the introduction of a managers 'Mental Health Awareness workshop' as well as Mental Health First Aiders across the organisation. • finally, the evaluation of the online mindfulness pilot programme (through LGA funding) has now been completed and this will be used to inform future commissioning of mindfulness activities	**A**

APPENDIX 1

Strategic Risk Register – Q1 2018/19			
Ref	**Strategic Risks**	**Risk Control / Response and Post Mitigation RAG score**	
10	**RECRUITMENT** Inability to attract high calibre candidates, leading to limited recruitment choices and therefore lack of the expertise, capacity, leadership and/or innovation required to deliver services and service transformation.	Work is underway to understand the specific recruitment and retention issues across the workforce and identify appropriate solutions to these. This includes: • identifying relevant attraction and engagement channels; • a review of the Council's market position in terms of salary levels; • consideration of the broader employee offer; • re-procurement of the Council's benefits provision, due to launch July 2018; •consideration of the workforce for the future in the context of the council's 'core offer', and • a review of our recruitment incentive arrangements such as the Relocation Scheme, Market Supplements etc.	**A**
6	**LOCAL ECONOMIC GROWTH** Failure to deliver local economic growth, and failure to maximise opportunities afforded by Government proposal to allocate Local Growth Funding to South East Local Enterprise Partnership, creating adverse reputational and financial impacts.	The County Council and its partners have been successful in securing significant amounts of growth funding totalling £110m, via both the South East and Coast 2 Capital Local Enterprise Partnerships, to deliver a wide range of infrastructure projects in East Sussex. We have also secured outgoing EU funding for complementary economic development programmes supporting businesses to grow, including South East Business Boost, LoCASE, SECCADS and inward investment services for the county. The County Council is working with Wealden DC and developing a business case to secure Housing Infrastructure Funding (HIF) of approximately £30m. It will be submitted by March 2019. The aim is to accelerate housing development in Wealden, with the proposal if successful helping to unlock significant funding for county transport and school infrastructure improvements in one of our key Growth Corridors. The business case will also include an environmental mitigation package in recognition of the impact on the Ashdown Forest. Government is working on a new Shared Prosperity Fund, which seeks to combine growth funding and outgoing EU funding into one, and as a consequence we are working with partners to develop a pipeline of projects to ensure we are well-placed to capitalise when the fund is released, and calls for projects are issued. Government has also instigated a review of LEPs across the country, and we await the outcome with interest.	**G**

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Report to:	**Audit Committee**
Date:	**22 November 2018**
By:	**Chief Finance Officer**
Title of report:	**Annual Audit Letter and fee update 2017/18**
Purpose of report:	**To inform the Committee of the Annual Audit Letter and fee outturn for 2017/18.**

RECOMMENDATION – The Committee is recommended to note the Annual Audit Letter and the fee update for 2017/18.

1. Background

1.1 The external audit fees for 2017/18 was £110,179 (County Council of £83,572 and the Pension Fund of £26,607) for the core audit in line with the planned fee. The grant certification work is still ongoing; the final fee will be confirmed upon the conclusion of this work, with costs of these additional services funded from existing budgets. In addition, the fees incurred by the Auditors for the work on the elector objections relating to 2016/17, are yet to be confirmed.

1.2 During the audit, KPMG were asked by some auditors of the Pension Fund's admitted and scheduled bodies to undertake an enhanced suite of testing, which they are required to complete under the terms of the Public Sector Audit Appointments (PSAA) contract. This fee will be agreed through the PSAA fee variation process, and the Pension Fund is able to recharge onto the admitted bodies to which the work relates.

2. Supporting Information

2.1 The Annual Audit Letter (AAL) attached as Appendix A summarises key issues arising from the work carried out during the year. This report contains no new findings or recommendations, and reflects issues already reported within the 2017/18 External Audit Report to the Governance Committee, including the objection from local elector, which is currently being finalised.

2.2 KPMG issued an unqualified opinion on the Council's financial statements on 30 July 2018. This means that KPMG believe the financial statements give a true and fair view of the financial position of the Council and of its expenditure and income for the year. The financial statements also include those of the East Sussex Pension Fund (ESPF).

2.3 The AAL has been circulated to all Councillors and published on the Council's website. The report will be presented to the Cabinet for approval at its 11 December 2018 meeting.

3. Appointment of External Auditor from the Financial Year 2018/19

3.1 The Council contract with the KPMG has ended following the audit of 2017/18 Statement of Accounts and the Council would like to extend its thanks to KPMG for their support during the 2017/18 audit.

3.2 For the financial year 2018/19, the Council has used the PSAA to source the appointment of Grant Thornton LLP to audit the Council and ESPF accounts from 2018/19 to 2022/23. This appointment was made under regulation 13 of the Local Audit (Appointing Person) Regulations 2015, and approved by the PSAA Board.

4. Conclusion and reasons for recommendations

4.1 The report is intended to communicate audit issues and VFM conclusion to key external stakeholders, including members of the public.

IAN GUTSELL
Chief Finance Officer

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Local Members

All

Background Documents

1. 2017/18 Independent Auditor's (KPMG) Annual Governance Report on ESCC Accounts and Value for Money conclusion report

2. 2017/18 Independent Auditor's (KPMG) Annual Governance Report on Pension Fund Accounts

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KPMG

Annual Audit Letter 2017/18

East Sussex County Council

—

August 2018

Contents

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This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. Public Sector Audit Appointments issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies summarising where the responsibilities of auditors begin and end and what is expected from audited bodies. We draw your attention to this document which is available on Public Sector Audit Appointment's website (www.psaa.co.uk).

External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

We are committed to providing you with a high quality service. If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Joanne Lees, the engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact the national lead partner for all of KPMG's work under our contract with Public Sector Audit Appointments Limited, Andrew Sayers (andrew.sayers@kpmg.co.uk). After this, if you are still dissatisfied with how your complaint has been handled you can access PSAA's complaints procedure by emailing generalenquiries@psaa.co.uk, by telephoning 020 7072 7445 or by writing to Public Sector Audit Appointments Limited, 3rd Floor, Local Government House, Smith Square, London, SW1P 3HZ.

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This Annual Audit Letter summarises the outcome from our audit work at East Sussex County Council (the Authority) in relation to the 2017/18 audit year, which is the final year that KPMG is the auditor of the Authority and its pension fund.

Although it is addressed to Members of the Authority, it is also intended to communicate these key messages to key external stakeholders, including members of the public, and will be placed on the Authority's website.

Audit opinion	We issued an unqualified opinion on the Authority's financial statements on 30 July 2018. This means that we believe the financial statements give a true and fair view of the financial position of the Authority and of its expenditure and income for the year. The financial statements include those of the pension fund.
Financial statements audit	Our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole. Materiality for the Authority's accounts was set at £9.9 million which equates to around 1% of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision. Materiality for the Pension Fund was set at £33 million which is approximately 1% of assets. We report to the Audit Committee any misstatements of lesser amounts, other than those that are "clearly trivial", to the extent that these are identified by our audit work. In the context of the Authority, an individual difference is considered to be clearly trivial if it is less than £495k for the Authority and (£1.65 million for the Pension Fund). We did not identify any audit adjustments with just a small number of presentational amendments which have been made by the Authority. Our audit work was designed to specifically address the following significant risks in relation to the Authority accounts: — Management Override of Controls – Our audit methodology incorporates the risk of management override as a default significant risk. No issues were identified; — Valuation of PPE – The Authority has adopted a rolling revaluation model which sees all land and buildings revalued over a three year cycle. As a result of this, however, individual assets may not be revalued for two years. This creates a risk that the carrying value of those assets not revalued in year differs materially from the year end fair value. We have raised a recommendation regarding the treatment of the contingency provision going forward in light of the new guidance due to be published – see appendix one for detail; — Pensions Liabilities – Valuation of the Local Government Pension Scheme relies on a number of assumptions, most notably around the actuarial assumptions, and actuarial methodology which results in the Authority's overall valuation. No issues were identified. One further significant risk was identified relating specifically to the Pension Fund: — Valuation of hard to price investments – our audit approach incorporated specific audit procedures in relation to investments in the pension fund that are inherently harder to value or do not have publicly available quoted prices, requiring professional judgement or assumptions to be made at year end. We did not identify any issues.

Headlines

APPENDIX A

Other information accompanying the financial statements	Whilst not explicitly covered by our audit opinion, we review other information that accompanies the financial statements to consider its material consistency with the audited accounts. This year we reviewed the Annual Governance Statement and Narrative Report. We concluded that they were consistent with our understanding and did not identify any issues.
Pension Fund audit	There were no significant issues arising from our audit of the pension fund and we issued an unqualified opinion on the pension fund financial statements as part of our audit report.
Whole of Government Accounts	We reviewed the consolidation pack which the Authority prepared to support the production of Whole of Government Accounts by HM Treasury. We reported that the Authority's pack was consistent with the audited financial statements.
Value for Money conclusion	We issued an unqualified conclusion on the Authority's arrangements to secure value for money (VFM conclusion) for 2017-18 on 31 July 2018. This means we are satisfied that during the year the Authority had appropriate arrangements for securing economy, efficiency and effectiveness in the use of its resources. To arrive at our conclusion we looked at the Authority's arrangements to make informed decision making, sustainable resource deployment and working with partners and third parties.
Value for Money risk areas	We undertook a risk assessment as part of our VFM audit work to identify the key areas impacting on our VFM conclusion and considered the arrangements you have put in place to mitigate these risks. Our work did not identify any significant matters.
High priority recommendations	We raised no high priority recommendations as a result of our 2017-18 work.
Certificate	The audit cannot be formally concluded and an audit certificate issued as we are considering an elector query relating to 2016/17. Until we have completed our consideration of this we are unable to certify that we have completed the audit of the accounts in accordance with the requirements of the Local Audit and Accountability Act 2014.
Audit fee	Our fee for 2017-18 was £83,572, excluding VAT (2016/17: £83,572). Our fee for the audit of the Pension Fund was £26,607 excluding VAT (2016/17: £26,607). The fee is consistent with the planned fees for the year. This year we have been requested to undertaken enhanced procedures on behalf of a number of the admitted and scheduled bodies to the Pension Fund. The fee for this will be agreed with the Authority and the PSAA through the PSAA fee variation process, which can be recharged on to those bodies. Further detail is contained in Appendix 3.
Exercising of audit powers	We have a duty to consider whether to issue a report in the public interest about something we believe the Authority should consider, or if the public should know about. We have not identified any matters that would require us to issue a public interest report. In addition, we have not had to exercise any other audit powers under the Local Audit & Accountability Act 2014.

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Appendix 1: Key issues and recommendations

We detail here the one medium priority recommendation arising from our 2017/18 financial statements audit. We note there were no recommendations arising during our 2016/17 audit which required follow up.

No.	Issue and recommendation	Management response / responsible officer / due date
1	**Use of a contingency provision within the land and buildings valuation** During our review of the Council's land and buildings valuation, it was identified that the valuer has included a contingency provision of 5% of each revalued specialised asset, of a total value of £13.6m. Whilst current guidance on the subject does not expressly prohibit the use of a contingency provision for such assets, a number of valuers have moved away from using such provisions now as they are considered inconsistent with the instant build approach. Moreover, there is currently a RICs consultation ongoing regarding the guidance for specialised asset valuations, which states that a contingency provision should not be used where the instant build method is deployed. We recommend therefore that the Council review its need for a contingency provision in light of the new guidance as it is published, to ascertain if a contingency provision is appropriate and allowable in future years.	**Accepted** Pre the 2018/19 closure of account closure process, the Council (in consultation with our valuer) will review its need for a contingency provision as soon as the new Royal Institute of Chartered Surveyors (RICs) guidance is published. **Responsible officer** Ola Owolabi, Head of Pensions **Due date** 31 May 2019

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Appendix 2: Summary of reports issued

This appendix summarises the reports we issued since our last Annual Audit Letter.

These reports can be accessed via the Audit Committee pages on the Authority's website at www.eastsussex.gov.uk.

External Audit Plan (March 2018)

The External Audit Plan set out our approach to the audit of the Authority's financial statements and to work to support the VFM conclusion.

Auditor's Report (July 2018)

The Auditor's Report included our audit opinion on the financial statements including the pension fund accounts along with our VFM conclusion.

Annual Audit Letter (August 2018)

This Annual Audit Letter provides a summary of the results of our audit for 2017/18.

2018

January

February

March

April

May

June

July

August

September

October

November

Certification of Grants and Returns (January 2018)

This letter summarised the outcome of our certification work on the Authority's 2016-17 grants and returns.

Report to Those Charged with Governance (July 2018)

The Report to Those Charged with Governance summarised the results of our audit work for 2017/18 including key issues and recommendations raised as a result of our observations. We issued a separate report for the audit of the pension fund.

We also provided the mandatory declarations required under auditing standards as part of this report.

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Appendix 3: Audit fees

This appendix provides information on our final fees for the 2017/18 audit.

To ensure transparency about the extent of our fee relationship with the Authority we have summarised below the outturn against the 2017/18 planned audit fee.

External audit

Our final fee for the 2017/18 audit of the Authority was £83,572, which is in line with the planned fee. Fees have not yet been agreed with the Authority for the work on the elector objections relating to 2016/17.

Our final fee for the 2017/18 audit of the Pension Fund was in line with the planned fee of £26,607. In addition, during the year we were asked by auditors of the Pension Fund's admitted and scheduled bodies to undertake an enhanced suite of testing, which we are required to complete under the terms of the PSAA contract. This fee will be agreed with the Authority and the PSAA through the PSAA fee variation process, which the Pension Fund is able to recharge on to the admitted bodies to which the work relates.

Certification of grants and returns

In addition to the statutory external audit, we also undertake the certification of two grant claims, the NCTL (National College of Teaching and Leadership) and the TPA (Teachers' Pensions Agency) returns. Work on these is ongoing and the final fee will be confirmed upon the conclusion of this work.

Other services

We did not charge any additional fees for other services.

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Report to: **Audit Committee**

Date: **22 November 2018**

By: **Chief Finance Officer**

Title of report: **Treasury Management – Stewardship Report 2017/18**

Purpose of report: **To present a review of the Council's performance on treasury management for the year 2017/18 and Mid Year review for 2018/19.**

RECOMMENDATION: The Audit Committee is recommended to note the Treasury Management performance in 2017/18 incorporating the Mid Year review for the first half of 2018/19.

1. Background

1.1 The annual stewardship report reviews the Council's treasury management performance and Mid Year report is required by the Code of Practice for Treasury Management.

2. Supporting Information

2.1 The Council's treasury management activities are regulated by a variety of professional codes, statutes and guidance. The Council has adopted the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice for Treasury Management in the Public Sector and operates treasury management service in compliance with this Code. These require that the prime objective of the treasury management activity is the effective management of risk, and that its borrowing activities are undertaken in a prudent, affordable and sustainable basis and treasury management practices demonstrate a low risk approach. The Code requires the regular reporting of treasury management activities to:

- Forecast the likely activity for the forthcoming year (in the Annual Treasury Strategy Report); and
- Review actual activity for the preceding year (this Stewardship report).
- A mid year review.

2.2 This report sets out:

- A summary of the original strategy agreed for 2017/18 and the economic factors affecting this strategy (Appendix A).
- The treasury management activity during the year (Appendix B);
- The treasury management mid year activity for 2018/19 (Appendix C);
- The Prudential Indicators, which relate to the Treasury function, Minimum Revenue Policy (MRP) and compliance with limits (Appendix D).

3. The economic conditions compared to our Strategy for 2017/18

3.1 The strategy and the economic conditions prevailing in 2017/18 are set out in Appendix A which is attached to this report. 2017/18 continued the challenging environment of the previous years, with concerns over the states of the UK economy and of European countries.

4. The Treasury activity during the year on short term investments and borrowing

<u>The Treasury Management Strategy</u>

4.1 The strategy for 2017/18, agreed in January 2017, continued the prudent approach and ensured that all investments were only to the highest quality rated institutions. For banks the maximum investment period was one year and for other local authority lending two years. For the 2017/18 strategy Enhanced Money Market / Cash funds were included to manage liquidity and improve yield where possible.

<u>Short term lending</u>

4.2 At the Monetary Policy Committee (MPC) meeting 2 November 2017, the MPC by vote of 7-2 increased the Bank of England base rate from 0.25% to 0.50%.

4.3 The total amount received in short term interest for 2017/18 was £1.3m at an average rate of 0.53%. This was above the average base rates in the same period (0.35%) and against a backdrop of ensuring, so far as possible in the current financial climate, the security of principal and the minimisation of risk. This Council has continued to follow a prudent approach with security and liquidity as the main criteria before yield.

Long term borrowing

4.4 Details of long term borrowing are included in Appendix B of the report. The important points are:

- No new borrowing was undertaken in 2017/18.
- The average interest rate of all debt at 31 March 2018 (£270.8m) was 4.80%.
- Public Works Loan Board (PWLB) Debt maturing during 2017/18 totalled £4.8m and was at an average rate of 8.00%.
- Although a proactive approach has been taken to repayment and restructuring of debt, no cost effective opportunities arose during the year, because there has been a considerable widening of the difference between new borrowing and repayment rates, which has made PWLB debt restructuring now much less attractive.

Minimum Revenue Provision (MRP)

4.5 Full details of the 2017/18 MRP policy are set out in appendix D, no changes were made to the MRP policy during 2017/18.

5. Treasury Management Mid Year Review 2018/19

5.1 The Treasury Management and Annual Investment Strategy for 2018/19 were approved by the Cabinet on 23 January 2018 reflecting a revised approach to investment options. This introduced new approved instruments into the strategy with the intention of improving yield and diversification. On the 2 August 2018 the MPC increased the Bank of England base rate from 0.50% to 0.75% the average rate of return for investments to 30 September 2018 was 0.75%.

5.2 As part of the revised approach to investments in August 2018, the council invested £5m in the CCLA Property Fund, a pooled property fund. Further options to invest within the remit of the strategy will be investigated during the year.

5.3 No further PWLB borrowing was undertaken in the period and cost effective opportunities to restructure debt are currently being reviewed with our Treasury Management advisors Link Asset Services. During 2018/19 PWLB debt to mature totals £4.6m, this historic debt is at an average rate of 8%.

6. Prudential Indicators which relate to the Treasury function and compliance with limits

6.1 The Council is required by the CIPFA Prudential Code to report the actual prudential indicators after the end of each year. There are eight indicators which relate to treasury management and they are set out in Appendix D. The Council is fully compliant with these indicators.

7. Conclusion and reason for recommendation

7.1 This report updates the Committee and fulfils the requirement to submit an annual/half yearly report in the form prescribed in the Treasury Management Code of Practice. Short term lending throughout the period covered achieved returns between 0.46% and 0.92%. The key principles of security, liquidity and yield are still relevant. Officers are currently investigating further opportunities within the strategy to minimise costs and increase investment income.

IAN GUTSELL
Chief Finance Officer
Contact Officer: Richard Grass Tel No. 01273 481926

BACKGROUND DOCUMENTS

Cabinet 24 January 2017 Treasury Management Strategy for 2017/18
23 January 2018 Treasury Management Strategy for 2018/19
CIPFA Prudential Code and Treasury Management in the Public Services- Code of practice
Local Government Act 2003 Local Government Investments guidance.

Appendix A

A summary of the strategy agreed for 2017/18 and the economic factors affecting this strategy

1. Background information

1.1 Cabinet received an annual Treasury Management Strategy report in January 2017, which sets out the proposed strategy for the year ahead. This strategy includes the limits and criteria for organisations to be used for the investment of cash surpluses and has to be approved by the Council.

1.2 This Council has always adopted a prudent approach to its investment strategy and in the last few years, there have been regular changes to the list of the approved organisations used for investment of short term surpluses. This list is regularly reviewed to ensure that the Council is able to invest in the best available rates consistent with low risk; the organisations are regularly monitored to ensure that their financial strength and low risk has been maintained.

1.3 The original strategy for 2017/18 was drawn up in January 2017 at a time of global political uncertainty and a potential resurgence of EU sovereign debt crisis. In this climate, ensuring the security of investments continues to be paramount and caution has to be taken on where surplus funds can be invested.

1.4 At the same time, the Treasury Management Policy Statement was agreed as unchanged for 2017/18.

East Sussex County Council defined its treasury management activities as:

"The management of the organisation's cash flows, its banking, money market and Capital market transactions (other than those of the Pension Fund) the effective management of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

The Council regards the successful identification, monitoring and management of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.

This authority acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving best value in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management".

2. Investment

2.1 When the strategy was agreed in January 2017, it emphasised the continued importance of credit quality. The Treasury Management advisors Link Asset Services commented on short term interest rates, the UK economy, inflation, the outlook for long term interest rates and these factors were taken into account when setting the strategy.

2.2 Officers regularly review the investment portfolio, counterparty risk and construction, and use market data, information on government support for banks and the credit ratings of that government support. Latest market information is arrived at by reading the financial press and through city contacts as well as access to the key brokers involved in the London money markets.

2.3 This Council in addition to other tools uses the creditworthiness service provided by Link Asset Services. 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;
- credit default swap (CDS) spreads to give early warning of likely changes in credit ratings; and
- sovereign ratings to select counterparties from only the most creditworthy countries.

2.4 The strategy going forward was to continue with the policy of ensuring minimum risk, but was also intended to deliver secure investment income of at least bank rate on the Councils cash balances.

2.5 As was clear from the events globally and nationally since 2008, it is impossible in practical terms to eliminate all credit risk.

2.6 The strategy aimed to ensure that in the economic climate it was essential that a prudent approach was maintained. This would be achieved through investing with selected banks and funds which met the Council's rating criteria. The emphasis would continue on security (protection of the capital sum invested) and liquidity (keeping money readily available for expenditure when needed) rather than yield.

2.7 The Council's investment policy has regard to the Ministry of Housing, Communities & Local Government's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Link Asset Services Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, and then return.

2.8 Investment instruments identified for use in the financial year are listed in section 3.2 and 3.4 under the 'Specified and Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

2.9 The weighted scoring system produces an end product of 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, i.e., using counterparties within the following durational bands provided they have a minimum AA+ sovereign rating from three rating agencies:

- Yellow 2 years
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months
- No Colour, not to be used

Y	*P*	*B*	*O*	*R*	*G*	*N/C*
Up to 2yrs	*Up to 2yrs*	*Up to 1yr*	*Up to 1yrs*	*Up to 6 mths*	*Up to 100days*	*No Colour*

2.10 The Link Asset Services credit worthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue influence to just one agency's ratings.

2.11 Typically the minimum credit ratings criteria the Authority use, will be a short term rating (Fitch or equivalents) of short term rating F1, long term rating A-, viability rating of A-, and a support rating of 1. 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 daily. The Authority is alerted to changes to ratings of all three agencies through its use of the Link Asset Services credit worthiness service.

- if a downgrade results in the counterparty or investment scheme no longer meeting the Authority's minimum criteria, its further use as a new investment will be withdrawn immediately.

- in addition to the use of credit ratings the Authority will be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Authority's lending list.

2.12 The Link Asset Services methodology was revised in October 2015 and determines the maximum investment duration under the credit rating criteria. Key features of Link Asset Services credit rating policy are:

- a mathematical based scoring system is used taking ratings from all three credit rating agencies;
- negative and positive watches and outlooks used by the credit rating agencies form part of the input to determine a counterparty's time band (i.e. 3, 6, 9, 12 months etc.).
- CDS spreads are used in Link Asset Services creditworthiness service as it is accepted that credit rating agencies lag market events and thus do not provide investors with the most instantaneous and "up to date" picture of the credit quality of a particular institution. CDS spreads provide perceived market sentiment regarding the credit quality of an institution.
- After a score is generated from the inputs a maximum time limit (duration) is assigned and this is known as the Link Asset Services colour which is associated with a maximum suggested time boundary.

2.13 All of the investments were classified as Specified (i.e., investment is sterling denominated and has a maximum maturity of 1 year) and non-Specified Investments (i.e., any other type of investment not defined as Specified). These investments were sterling investments for up to two years maturity with institutions deemed to be high credit quality or with the UK Government (Debt Management Account Deposit Facility). These were considered low risk assets where the possibility of loss of principal or investment income was small.

2.14 If investment instruments identified in the financial year under the 'Non-Specified and Specified' Investments categories were used, the Council funds would be invested as follows:

3. Specified Investments

3.1 An investment is a specified investment if all of the following apply:

- the investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling;
- the investment is not a long term investment (i.e. up to 1 year);
- the making of the investment is not defined as Capital expenditure by virtue of regulation 25(1)(d) of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [SI 3146 as amended];
- the investment is made with a body or in an investment scheme of high credit quality (see below) or with one of the following public-sector bodies:
    - The United Kingdom Government;
    - A local authority in England or Wales (as defined under section 23 of the 2003 Act) or a similar body in Scotland or Northern Ireland; and
    - High credit quality is defined as a minimum credit rating as outlined in section 4.2 of this strategy.

3.2 The use of Specified Investments

Investment instruments identified for use in the financial year are as follows:

- The Table below set out the types of investments that fall into each category, counterparties available to the Council, and the limits placed on each of these. A detailed list of each investment type is available in the Treasury Management Practices guidance notes;
- all investments will be within the UK or AAA sovereign rated countries.
- The Council's investment in Lloyds Banking Group were based on the fact that this group is part-nationalised by UK Government, and any changes to their credit ratings will impact on the duration of the Council investment with the Group.

Criteria for specified Investments:

Counterparty	**Country/ Domicile**	**Instrument**	**Maximum investments**	**Max. maturity period**
Debt Management and Depost Facilities (DMADF)	UK	Term Deposits (TD)	unlimited	1 yr
Government Treasury bills	UK	TD	unlimited	1 yr
Local Authorities	UK	TD	unlimited	1 yr
Lloyds Banking Group • *Lloyds Bank* • *Bank of Scotland*	UK	TD (including callable deposits), Certificate of Deposits (CD's)	£60m	1 yr
RBS/NatWest Group • *Royal Bank of Scotland* • *NatWest*	UK		£60m	1 yr
HSBC	UK		£60m	1 yr
Barclays	UK		£60m	1 yr
Santander	UK		£60m	1 yr
Goldman Sachs Investment Bank	UK		£60m	1 yr
Standard Chartered Bank	UK		£60m	1 yr
Individual Money Market Funds (MMF)	UK/Ireland/ domiciled	AAA rated Money Market Funds	£60m	Liquidity/instant access
Enhanced Money Market / Cash Funds (EMMFs)	UK/Ireland/ domiciled	AAA Bond Fund Rating	£60m	Liquidity
Counterparties in select countries (non-UK) with a Sovereign Rating of at least AA+				
Australia & New Zealand Banking Group	Australia	TD / CD's	£60m	1 yr
Commonwealth Bank of Australia	Australia	TD / CD's	£60m	1 yr
National Australia Bank	Australia	TD / CD's	£60m	1 yr
Westpac Banking Corporation	Australia	TD / CD's	£60m	1 yr
Royal Bank of Canada	Canada	TD / CD's	£60m	1 yr
Toronto Dominion	Canada	TD / CD's	£60m	1 yr
Development Bank of Singapore	Singapore	TD / CD's	£60m	1 yr
Overseas Chinese Banking Corp	Singapore	TD / CD's	£60m	1 yr
United Overseas Bank	Singapore	TD / CD's	£60m	1 yr

Counterparty	Country/ Domicile	Instrument	Maximum investments	Max. maturity period
Svenska Handelsbanken	Sweden	TD / CD's	£60m	1 yr
Nordea Bank AB	Sweden	TD / CD's	£60m	1 yr
ABN Amro Bank	Netherlands	TD / CD's	£60m	1 yr
Rabobank	Netherlands	TD / CD's	£60m	1 yr
ING Bank NV	Netherlands	TD / CD's	£60m	1 yr
DZ Bank	Germany	TD / CD's	£60m	1 yr
UBS	Switzerland	TD / CD's	£60m	1 yr
Credit Suisse	Switzerland	TD / CD's	£60m	1 yr
Danske Bank	Denmark	TD / CD's	£60m	1 yr
Nordea Bank	Finland	TD / CD's	£60m	1 yr
JP Morgan Chase	U.S.A	TD / CD's	£60m	1 yr

*Enhanced Money Market / Cash Funds were added to the 2017/18 strategy to diversify investment options.

3.3 All Money Market Funds used are monitored and chosen by the size of fund, rating agency recommendation, exposure to other Countries (Sovereign debt), weighted average maturity and weighted average life of fund investment and counterparty quality. Enhanced Money Market / Cash Funds were added to the 2017/18 strategy to diversify investment options.

4. Non Specified Investments

4.1 Non-Specified investments are any other types of investment that are not defined as specified. The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below.

Non-Specified Investment	Minimum credit criteria	Maximum investments	Max. maturity period
UK Local Authorities	Government Backed	£60m	2 years
Local Capital Finance Company Limited	Local Governement Agency Backed	£100k	N/A

4.2 Non specified investments would include any sterling investments and the purchase of shares in the Municipal Bonds Agency (Local Capital Finance Company Limited). The Council will make an investment in the form of shares in the Municipal Bond Agency (Local Capital Finance Company Limited) where the primary purpose is to support the Council's priorities rather than to speculate on the capital sum invested. With the exception of the municipal bonds agency investment, only investments where there is no contractual risk to the capital invested and where the rate of return justifies their use will be entered into.

4.3 The council had no exposure in Non-Specified investments during the 2017/18.

5. The economy in 2017/18 – Commentary from Link Asset Services in April 2018.

5.1 During the calendar year of 2017, there was a major shift in expectations in financial markets in terms of how soon Bank Rate would start on a rising trend. After the UK economy surprised on the upside with strong growth in the second half of 2016, growth in 2017 was disappointingly weak in the first half of the year which meant that growth was the slowest for the first half of any year since 2012.

5.2 The main reason for this was the sharp increase in inflation caused by the devaluation of sterling after the EU referendum, feeding increases into the cost of imports into the economy. This caused a reduction in consumer disposable income and spending power as inflation exceeded average wage increases. Consequently, the services sector of the economy, accounting for around 75% of GDP, saw weak growth as consumers responded by cutting back on their expenditure. However, growth did pick up modestly in the second half of 2017. Consequently, market expectations during the autumn, rose significantly that the MPC would be heading in the direction of imminently raising Bank Rate.

5.3 The minutes of the MPC meeting of 14 September indicated that the MPC was likely to raise Bank Rate very soon. The 2 November MPC quarterly Inflation Report meeting duly delivered by raising Bank Rate from 0.25% to 0.50%. The 8 February MPC meeting minutes then revealed another sharp hardening in MPC warnings on a more imminent and faster pace of increases in Bank Rate than had previously been expected. Market expectations for increases in Bank Rate, therefore, shifted considerably during the second half of 2017-18 and resulted in investment rates from 3 – 12 months increasing sharply during the spring quarter.

5.4 PWLB borrowing rates increased correspondingly to the above developments with the shorter term rates increasing more sharply than longer term rates. In addition, UK gilts have moved in a relatively narrow band this year, (within 25 bps for much of the year), compared to US treasuries. During the second half of the year, there was a noticeable trend in treasury yields being on a rising trend with the Fed raising rates by 0.25% in June, December and March, making six increases in all from the floor. The effect of these three increases was greater in shorter terms around 5 years, rather than longer term yields.

5.5 The major UK landmark event of the year was the inconclusive result of the general election on 8 June 2017. However, this had relatively little impact on financial markets.

Appendix B

The Treasury Management activity during the year 2017/18

1. Short term lending interest rates

1.1 Base interest rate was increased in November 2017 to 0.50%. The average rate for the year was 0.35%.

1.2 There have been continued uncertainties in the markets during the year as set out in Section 4 of Appendix A.

1.3 The strategy for 2017/18, agreed in January 2017, continued the prudent approach and ensured that all investments were only to the highest quality rated banks and funds using Link's colour coded credit methodology.

1.4 The total amount received in short term interest for 2017/18 was £1.3m at an average rate of 0.53%. This was above the average of base rates in the same period (0.35%) and against a backdrop of ensuring, so far as possible in the financial climate, the security of principal and the minimisation of risk.

2. Long term borrowing

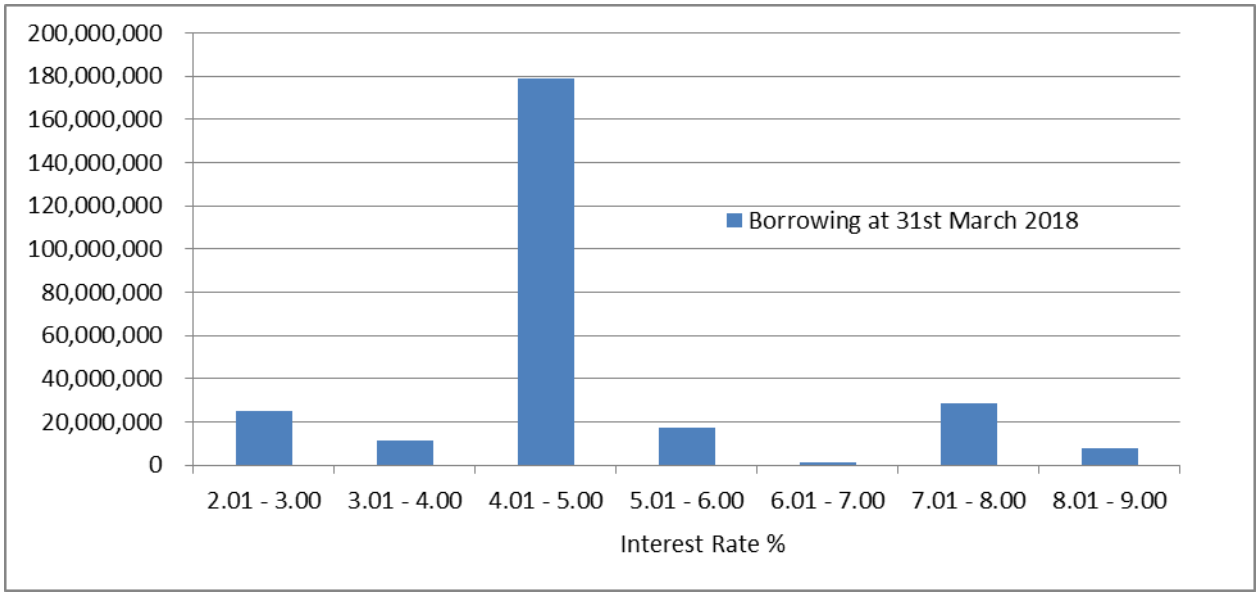
2.1 Officers constantly reviewed the need to borrow taking into consideration the potential increases in borrrowing costs, the need to finance new Capital expenditure, refinancing maturing debt, and the cost of carry that might incur a revenue loss between borrowing costs and investment returns.

2.2 During 2017/18 £4.6m of PWLB debt matured at a coupon rate of 8%. This historic maturing debt was not replaced with additional in year new borrowing.

2.3 The average interest rate of all debt at 31 March 2018 of £270.8m was 4.80%. No beneficial rescheduling of debt has been available, due to a considerable widening of the difference between new borrowing and repayment rates, which has made PWLB debt restructuring now much less attractive. Consideration would have to be given to the large premiums (cash payments) which would be incurred by prematurely repaying existing PWLB loans. It is very unlikely that these could be justified on value for money grounds if using replacement PWLB refinancing.

2.4 The opportunity to restructure our debt has been significantly reduced since October 2010 as a result of the PWLB increasing all of its lending rates by 1% as part of the Government's Comprehensive Spending Review. However, it did not increase the rate of interest used for repaying debt so that not only the cost of future borrowing has increased but the opportunity to restructure debt when market conditions allow has been significantly reduced.

2.5 The range of interest rates payable in all of the loans is illustrated in the graph below:



3. Short term borrowing

3.1 No borrowing was undertaken on a short-term basis during 2017/18 to date to cover temporary overdraft situations.

4. Treasury Management Advisers

4.1 The Strategy for 2017/18 explained that the Council uses Link Asset Services as its treasury management consultant on a range of services which include:

- Technical support on treasury matters, Capital finance issues and advice on reporting;
- Economic and interest rate analysis;
- Debt services which includes advice on the timing of borrowing;
- Debt rescheduling advice surrounding the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments;
- Credit ratings from the three main credit rating agencies and other market information;
- Assistance with training on treasury matters

4.2 Whilst the advisers provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice the final decision on treasury matters remained with the Council. This service remains subject to regular review.

4.3 Link Asset Services is the largest provider of Treasury Management advice services to local authorities in the UK and they claim to be the market leading treasury management service provider to their clients. The advice has been and will continue to be monitored regularly to ensure a continued excellent advisory service.

Appendix C

The Treasury Management Activity Mid-Year Report - 2018/19

1. Background

1.1 The Treasury Management and Annual Investment Strategy for 2018/19 were approved by the Cabinet 23 January 2018. The 2018/19 strategy broadened the approved instruments to improve yield and diversify the investment portfolio. Changes to the strategy are summarised below.

Investment option	2017/18	2018/19
Money Market Funds (Including LVNAV)	✓	✓
Bank Notice Accounts	✓	✓
Fixed Term Bank Deposits	✓	✓
UK Local Authorities	✓	✓
Enhanced Money Market Funds (VNAV)	✓	✓
Building Societies	✗	✓
Pooled Property Funds	✗	✓
Corporate Bond Funds	✗	✓
Multi Asset Funds	✗	✓
Equity Funds	✗	✗

1.2 This report considers treasury management activity over six months of the financial year.

2. Summary of financial implications

2.1 During the first half year investments have been held in bank notice accounts, money market funds and other local authorities. Counterparty credit quality remains a primary concern for the treasury team, with security, liquidity and yield in that order a priority. Measures have been taken to reduce the level of liquidity (prudently) to improve returns.

2.2 The Bank of England's Monetary Policy Committee increased the official Bank Rate on 2 August 2018 from 0.50% to 0.75%

2.3 In line with the revised annual investment strategy, in August 2019 the council invested £5m in the CCLA Local Authority Property Fund, a pooled property vehicle. Net yield on this fund for the quarter to 30 September 2018 was 3.09% which equates to £32k of income. This compares to an average rate of 0.75% for 6 months on the remainder of the councils investment portfolio.

2.4 The use of Multi Asset Funds will be explored with our treasury advisors Link Asset Services.

2.5 The average investment balance to September 2018 was £250m and generated investment income of £935k. The forecast for 2018/19 is £2.0m.

2.6 The level of Council debt at 30 September 2018 was £269m with two loans totalling £3.3m maturing with the PWLB in the next 6 months to 31st March 2019. The forecast for interest paid on long-term debt in 2018/19 is approximately £12.83m and is within the budgeted provision.

2.7 Opportunities to reduce the cost of carry (interest paid against interest received) are being explored as and when options arise. A new opportunity to reduce the cost of carry by restructuring £23.5m of the council's LOBO loans has arisen, which is currently being explored.

3. Treasury Management Strategy

3.1 The Council approved the 2018/19 treasury management strategy at its meeting on 23 January 2018. The Council's stated investment strategy is to prudently manage an investment policy achieving first of all, security (protecting the Capital sum from loss), liquidity (keeping money readily available for expenditure when needed), and to consider what yield can be obtained consistent with those priorities.

3.2 The Council's exposure to security and interest rate risk have been monitored closely. No further external borrowing has been undertaken in the period. Rescheduling any existing loans under the current economic conditions the costs of doing so in terms of interest and premium payable would be prohibitive.

3.3 The Chief Finance Officer is pleased to report that all treasury management activity undertaken from April 2018 to September 2018 period complied with the approved strategy, the CIPFA Code of Practice, and the relevant legislative provisions.

4. Economic Review (provided by Link Asset Services, October 2018)

4.1 The first half of 2018/19 has seen UK economic growth post a modest performance, but sufficiently robust for the Monetary Policy Committee, (MPC), to unanimously (9-0) vote to increase Bank Rate on 2nd August from 0.5% to 0.75%. Although growth looks as if it will only be modest at around 1.5% in 2018, the Bank of England's August Quarterly Inflation Report suggested that growth will pick up to 1.8% in 2019, albeit there were several caveats – mainly related to whether or not the UK achieves an orderly withdrawal from the European Union in March 2019.

4.2 Some MPC members have expressed concerns about a build-up of inflationary pressures, particularly with the pound falling in value again against both the US dollar and the Euro. The Consumer Price Index (CPI) measure of inflation is currently running at 2.5% but is expected to fall back towards the 2% inflation target over the next two years given a scenario of minimal increases in Bank Rate. The MPC has indicated Bank Rate would need to be in the region of 1.5% by March 2021 for inflation to stay on track. Financial markets are currently pricing in the next increase in Bank Rate for the second half of 2019.

4.3 Unemployment is now at a 43 year low of 4% on the Independent Labour Organisation measure, but despite that, wage inflation is currently not overly-strong at 2.6% (including bonuses). This is a global theme for the major economies of the world. Indeed, with UK wages running in line with the CPI measure of inflation, real earnings are, in effect, neutral. Given the UK economy is very much services sector driven, any weakness in household spending power is likely to feed through into tepid economic growth.

4.4 The MPC will need to tread cautiously before increasing Bank Rate again, especially given all the uncertainties around Brexit. Additionally, business sentiment surveys, such as the Purchasing Managers Index collated by Markit, suggest the UK is set for only modest GDP growth in the second half of 2018 with the monthly updated figure for annual growth being 1.5% as at the end of July. The housing market is going through a weak phase – with UK-wide house price growth averaging 2 to 3%, but with London and the south-east experiencing price falls.

5.0 Link Asset Services (LAS) forecasts

5.1 The flow of generally positive economic statistics after the end of the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, to 0.75%. However, the MPC emphasised again, that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years' time but they declined to give a medium term forecast.

5.2 LAS do not think that the MPC will increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. We also feel that the MPC is more likely to wait until August 2019, than May 2019, before the next increase, to be followed by further increases of 0.25% in May and November 2020 to reach 1.5%. However, the cautious pace of even these limited increases is dependent on a reasonably orderly Brexit.

5.3 LAS, has provided the following forecast:

	Link Asset Services Interest Rate View										
	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate View	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%
3 Month LIBID	0.75%	0.80%	0.80%	0.90%	1.10%	1.10%	1.20%	1.40%	1.50%	1.60%	1.60%
6 Month LIBID	0.85%	0.90%	0.90%	1.00%	1.20%	1.20%	1.30%	1.50%	1.60%	1.70%	1.70%
12 Month LIBID	1.00%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%	1.60%	1.70%	1.80%	1.80%
5yr PWLB Rate	2.00%	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%
10yr PWLB Rate	2.40%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%

6. Borrowing advice:

6.1 Although yields have risen from their low points, yields are still around historic lows and borrowing should be considered if appropriate to Council's strategy. LAS still see value in the 40yr to 50yr range at present but that view would be negated if Bank Rate does not climb to at least 2.5% over the coming years. Accordingly, councils will need to review and assess their risk appetite in terms of any underlying borrowing requirement they may have, and also project forward their position in respect of cash backed resources. Any new borrowing should also take into account the continuing cost of carry, the difference between investment earnings and borrowing rates, especially as LAS forecasts indicate that Bank Rate may rise to only 1.50% by March 2021.

Appendix D

1. Prudential Indicators which relate to the Treasury function and compliance with limits

1.1 The Council is required by the Prudential Code to report the actual prudential indicators after the end of each year. There are eight indicators which relate to treasury management and they are set on an annual basis and monitored, they comprise:-:

- Operational and authorised borrowing limits which includes short term borrowing (paragraph 2.1 below)
- Interest rate exposure (paragraph 3.1 below)
- Interest rate on long term borrowing (paragraph 4.1 below)
- Maturity structure of investments (paragraph 5.1 below)
- Compliance with the Treasury Management Code of Practice (paragraph 6.1 below)
- Interest on investments (paragraph 7.1 below)
- Capital Financing Requirement and Minimum Revenue Provision (paragraph 8.1 below)

2. Operational and authorised borrowing limits.

2.1 The tables below sets out the estimate and projected Capital financing requirement and long-term borrowing in 2017/18

	Capital Financing Requirement	**2017/18 Estimate**	**2017/18 Actual**
		£m	**£m**
	Capital Financing Requirement at 1 April 2017	**352**	**335**
add	Financing of new assets	26	12
less	Provision for repayment of debt	(12)	(12)
less	Long term Capital loan*	-	1
	Capital Financing Requirement at 31 March 2018	**366**	**336**
add	Short Term Borrowing Provision	10	
	Operational Boundary	**376**	
add	Short Term Borrowing Provision	20	
	Authorised Limit	**396**	

	Actual Borrowing	**2017/18 Actual**
		£m
	Long Term Borrowing at 1 April 2017	**275**
less	Loan redemptions	(4)
add	New Borrowing	-
	Long Term Borrowing at 31 March 2018	**271**

*The Capital loan relates to an outstanding loan with other local authority.

2.2 The Capital Financing Requirement includes PFI Schemes and Finance Leases totalling £90m resulting in an underlying need to borrow of £246m.

2.3 The Operational Boundary was consistent with the Council's current commitments, existing plans and the proposals for Capital expenditure and financing, and with its approved treasury management policy statement and practices. It was based on the estimate of most likely, prudent but not worst case scenario. Risk analysis and risk management strategies were taken into account as were plans for Capital expenditure, estimates of the Capital financing requirement and estimates of cash flow requirements for all purposes. The Operational boundary represents a key management tool for in year monitoring and long term borrowing control.

2.4 The Authorised Limit for borrowing was based on the same estimates as the Operational Boundary but includes additional headroom for a short term borrowing to allow, for example, for unusual cash movements or late receipt of income.

2.5 The Authorised limit is the "Affordable Borrowing Limit" required by S3 of the Local Government Act 2003 and must not be breached. The Long Term borrowing at 31st March 2018 of £270.8m is under the Operational boundary and Authorised limit set for 2017/18. The Operational boundary and Authorised limit have not been exceeded during the year.

3. Interest rate exposure

3.1 The Council continued the practice of seeking to secure competitive fixed interest rate exposure for 2017/18. 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 or improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments;
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- 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.

	2017/18	**2018/19**	**2019/20**
Interest rate exposure	**Upper**	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	15%	15%	15%
Maturity structure of fixed interest rate borrowing 2017/18			
	Lower	**Upper**	**Actual 2017/18**
Under 12 months	0%	25%	4%
12 months and within 24 months	0%	40%	2%
24 months and within 5 years	0%	60%	13%
5 years and within 10 years	0%	80%	9%
10 years and within 20 years	0%	80%	22%
20 years and within 30 years	0%	80%	18%
30 years and within 40 years	0%	80%	29%
40 years and above	0%	80%	2%

3.2 The Council has not exceeded the limits set in 2017/18. Not more than £20m of debt should mature in any financial year and not more than 15% to mature in any two consecutive financial years. Borrowing has been undertaken giving due consideration to the debt maturity profile, ensuring that an acceptable amount of debt is due to mature in any one financial year. This helps to minimise the authority's exposure to the risk of having to replace a large amount of debt in any one year or period when interest rates may be unfavourable. The bar chart in the attached Annex 1 shows the maturity profile.

4. Interest rate on long term borrowing

4.1 The rate of interest taken on any new long term borrowing has been defined with the assistance of Link Asset Services. The Accounts and Pensions Team have set up a recording process to monitor set trigger rates and work to an agreed protocol for potential future borrowing activity to fund the Capital programme.

5. Maturity structure of investments

5.1 The Investment Guidance issued by the government, allowed local authorities the freedom to invest for more than for one year. All investments over one year were to be classified as Non-Specified Investments. The Council had taken advantage of this freedom and non-Specified Investments are allowed to be held within our overall portfolio of investments and in line with our prudent approach in our strategy.

6. Compliance with the Treasury Management Code of Practice

6.1 East Sussex County Council has adopted the Chartered Institute of Public Finance and Accountancy (CIPFA), Code of Practice for Treasury Management in the Public Services. In December 2017, CIPFA, issued a revised Treasury Management Code and Cross Sectoral Guidance Notes, and a revised Prudential Code.
A particular focus of these revised codes was how to deal with local authority investments which are not treasury type investments e.g. by investing in purchasing property in order to generate income for the Authority at a much higher level than can be attained by treasury investments. The outcome is a new Capital Strategy document which will be presented to Cabinet as part of the 2019/20 budget papers.

7. Interest on investments

7.1 The table below sets out the average monthly rate received on our investments and compares it to the Bank of England Base rate to reflect both the interest rates available in the market and limitation in the use of counterparties.

Month	Amount £'000	Monthly rate	Margin against Base Rate
April	110	0.52%	0.27%
May	112	0.53%	0.28%
June	95	0.47%	0.22%
July	103	0.46%	0.21%
August	103	0.47%	0.22%
September	99	0.47%	0.22%
October	106	0.47%	0.22%
November	120	0.55%	0.06%
December	123	0.59%	0.09%
January	126	0.61%	0.11%
February	111	0.60%	0.10%
March	124	0.61%	0.11%
Total for 2017/18	**1,332**	**0.53%**	**0.18%**

7.2 The total amount received in short term interest for the year was £1.3m at an average rate of 0.53%. This was above the average of base rates in the same period (0.35%) but ensuring, so far as possible in the financial climate, the security of principal and the minimisation of risk. This Council has continued to follow a prudent approach with security and liquidity as the main criteria before yield.

8. Capital Financing Requirement and Minimum Revenue Provision (MRP)

8.1 The Council's underlying need to borrow for Capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the Capital activity of the Council and resources used to pay for the Capital spend. It represents the 2017/18 unfinanced Capital expenditure (see below table), and prior years' net or unfinanced Capital expenditure which has not yet been paid for by revenue or other resources.

8.2 Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the Capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the Capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the

Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

8.3 Reducing the CFR – the Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that Capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet Capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

8.4 The total CFR can also be reduced by:

- the application of additional Capital financing resources (such as unapplied Capital receipts); or
- charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

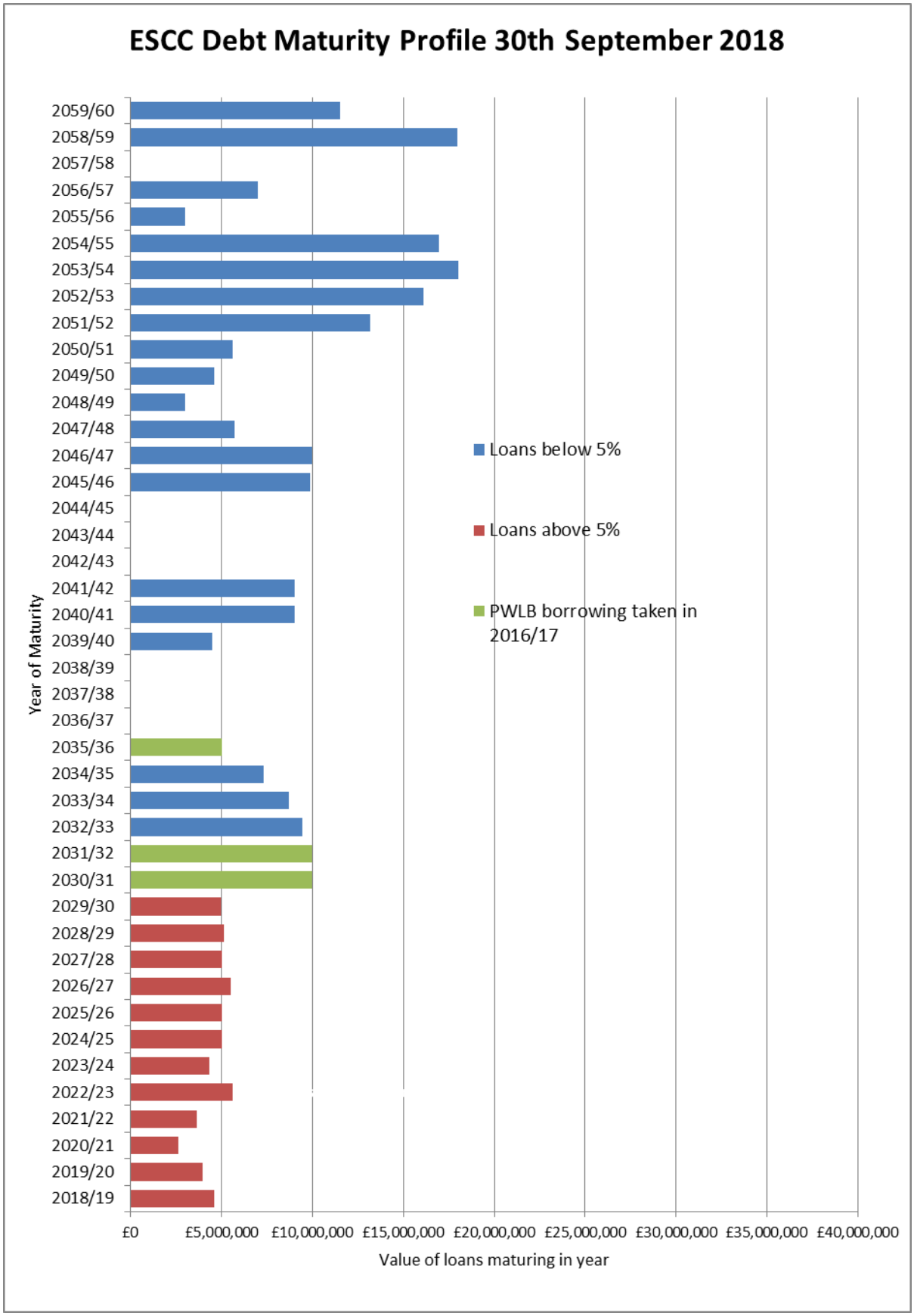
8.5 The Council's 2017/18 MRP Policy (as required by Ministry of Housing, Communities & Local Government Guidance) was approved as part of the Treasury Management Strategy Report for 2018/19 on 23 January 2018.

8.6 The Council's CFR for the year is shown below, and represents a key prudential indicator. It includes PFI and leasing schemes on the balance sheet, which increase the Council's borrowing need. No borrowing is actually required against these schemes as a borrowing facility is included in the contract.

CFR including appropriate balances and MRP charges for PFI Schemes and Finance Leases.

	2017/18 Actual	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**
	£m	**£m**	**£m**	**£m**
Total CFR	**336**	**347**	**364**	**378**
Movement in CFR	-	11	17	14

Annex 1


ESCC Debt Maturity Profile 30th September 2018
Year of Maturity
2059/60
2058/59
2057/58
2056/57
2055/56
2054/55
2053/54
2052/53
2051/52
2050/51
2049/50
2048/49
2047/48
2046/47
2045/46
2044/45
2043/44
2042/43
2041/42
2040/41
2039/40
2038/39
2037/38
2036/37
2035/36
2034/35
2033/34
2032/33
2031/32
2030/31
2029/30
2028/29
2027/28
2026/27
2025/26
2024/25
2023/24
2022/23
2021/22
2020/21
2019/20
2018/19
Loans below 5%
Loans above 5%
PWLB borrowing taken in 2016/17
£0
£5,000,000
£10,000,000
£15,000,000
£20,000,000
£25,000,000
£30,000,000
£35,000,000
£40,000,000
Value of loans maturing in year

Audit Committee – Work Programme

List of Suggested Potential Future Work Topics		
Issue	**Detail**	**Meeting Date**
Audit Committee Working Groups		
Working Group Title	**Subject area**	**Meeting Dates**
Training and Development		
Title of Training/Briefing	**Detail**	**Date**
Internal Audit Strategy and Plan	A briefing and consultation on the development and content of the Internal Audit Strategy and Plan for 2019/20, prior to the Committee endorsing the Strategy prior to agreement by Cabinet.	January 2019

Future Committee Agenda Items		Author
All meetings		
Internal Audit Progress Report	Quarterly report which provides a summary of the audits and opinions carried out in that quarter; counter fraud and investigations, follow up work on audits and high risk recommendations and performance monitoring against the Internal Audit Plan	Nigel Chilcott / Russell Banks
Strategic Risk Monitoring	Quarterly monitoring report of the Council's Strategic Risk Register	Rawdon Phillips
Committee Work Programme	Discussion of the future reports, agenda items and other work to be undertaken by the Committee.	Senior Democratic Services Advisor
25 March 2019		
Internal Audit Progress Report	Internal Audit Progress report – Quarter 3, 2018/19 (01/10/18 – 31/12/18)	Nigel Chilcott, Audit Manager/Russell Banks, Chief Internal Auditor
Strategic Risk Monitoring	Strategic risk monitoring report – Quarter 2/3, 2018/19	Cath Edwards, Service Improvement and Risk Manager
Internal Audit Strategy and Plan	Consideration of the Internal Audit Strategy and Plan for 2019/20	Russell Banks, Chief Internal Auditor/ Nigel Chilcott, Audit Manager
External Audit Plan 2018/19	This report sets out in detail the work to be carried out by the Council's External Auditors on the Council's accounts for the financial year 2018/19.	Ian Gutsell, Chief Finance Officer & External Auditors
External Audit Plan for East Sussex Pension Fund 2018/19	To consider and comment upon the External Audit Plan for the East Sussex Pension Fund for the financial year 2018/19.	Ian Gutsell, Chief Finance Officer & External Auditors/ Ola Owolabi, Head of Pensions

12 July 2019		
Internal Audit Services Annual Report and Opinion 2018/19	An overall opinion on the Council's framework of internal control, summarises the main audit findings and performance against key indicators (includes Internal Audit Progress report – Quarter 4, 2018/19, (01/01/19 – 31/03/19).	Nigel Chilcott, Audit Manager/Russell Banks, Chief Internal Auditor
Strategic Risk Monitoring	Strategic risk monitoring report – Quarter 4, 2018/19 (01/01/19 – 31/03/19)	Cath Edwards, Service Improvement and Risk Manager
Review of Annual Governance Report & 2018/19 Statement of Accounts	Report of the external auditors following their audit of the Council's statutory accounts. It allows the committee to review the issues raised and assess the management response.	External Auditors/ Ian Gutsell, Chief Finance Officer
Review of Pension Fund Annual Governance Report and 2018/19 Statement of Accounts	Report of the external auditors following their audit of the Pension Fund. It allows the committee to review the issues raised and assess the management response.	External Auditors/ Ian Gutsell, Chief Finance Officer
Monitoring Officer's Annual Review of the Corporate Governance Framework	Sets out an assessment of the effectiveness of the Council's governance arrangements and includes an improvement plan for the coming year, and the corporate assurance statement which will form part of the statement of accounts.	Philip Baker, Assistant Chief Executive

13 September 2019		
Internal Audit Progress Report	Internal Audit Progress report – Quarter 1, 2019/20 (01/04/19 – 30/06/19)	Nigel Chilcott, Audit Manager/Russell Banks, Chief Internal Auditor
Strategic Risk Management	Strategic risk monitoring report – Quarter 1, 2019/20 (01/04/19 – 30/06/19)	Rawdon Phillips, Risk & Insurance Manager
22 November 2019		
Internal Audit Progress Report	Internal Audit Progress report – Quarter 2, 2019/20 (01/07/19 – 30/09/19)	Nigel Chilcott, Audit Manager/Russell Banks, Chief Internal Auditor
Strategic Risk Management	Strategic risk monitoring report – Quarter 2, 2019/20 (01/07/19 – 30/09/19)	Rawdon Phillips, Risk & Insurance Manager
Annual Audit Letter	To consider the Annual Audit letter and fee update from the External Auditor	Ian Gutsell, Chief Finance Officer
Treasury Management	To consider a report on the review of Treasury Management performance for 2018/19 and for outturn for the first six months of 2019/20, including the economic factors affecting performance, the Prudential Indicators and compliance with the limits set within the Treasury Management Strategy.	Ian Gutsell, Chief Finance Officer
Property Asset Disposal and Investment Strategy	Consideration of an annual report on the implementation of the Property Asset Disposal and Investment Strategy.	Tina Glen / Graham Glenn

Report to: **Audit Committee**

Date of meeting: **22 November 2018**

By: **Chief Operating Officer**

Title: **Property Asset Disposal and Investment Strategy –update report**

Purpose: **To provide Audit Committee with an update on activities supporting delivery of the Property Asset and Investment Strategy.**

RECOMMENDATIONS

1. **The Committee notes this Report covering the period April to September 2018.**
2. **The Committee is requested to consider and recommend any actions that should be taken in response to the contents of this Report**
3. **Identify any new or emerging items for consideration**

Background

1.1 On 24th April 2018 Cabinet resolved to approve a Property Asset Disposal & Investment Strategy, and noted key principles around governance and resource arrangements required.

1.2 This Report provides an update on activities for the first 6 months of the Strategy and provides high level models/principles used to support activities underway.

1.3 The key purpose of the Strategy is to deliver an ongoing net income stream to the Council with investment defined as allocating money in the expectation of some benefit in the future. This covers investment in legal interests in land or property assets which enable income streams, and which may include those arising through development opportunities.

1.4 The approved Strategy seeks to address key priorities that i) support the Council's financial resilience in the longer term, ii) support the Council in continuing to deliver its essential services to residents, and iii) act as a catalyst for improved economic outcomes for the County.

1.5 Aligned to these key priorities are several themes around optimising the current estate portfolio, challenging service utilisation, defining growth or locality based strategies, joining up public service delivery, managing a corporate landlord model, and integration of asset management activities with wider regeneration agendas.

1.6 The strategy looks at a combination of investment and development opportunities, with the Council making investments alone or in partnership with either authorities in their local administrative area or with a third party.

1.7 The emphasis remains on the optimisation of East Sussex County Council's (ESCC's) existing asset base and a cautious approach to direct property investment for commercial return, which is identified as a distinct and separate second phase.

1.8 The Strategy, as a reminder, is outlined by the four "quadrant" approach as shown in the table below, noting that some property activities are common or available to each quadrant:

	Activity	Activity
Operational Assets	Optimise Receipt / Revenue from Disposal	Development for Corporate Priorities / Service Need
Investment Assets	Phase 2 Direct acquisitions of up and let investments	Direct development or provision of Equity or Debt finance

2. Supporting Information

Sites Information and Reviews

2.1 As part of the evolving review, it has been necessary to identify initial assets that are planned, or which could form the initial core of a programme. The capital receipts programme has been the source to date and further details of the top dozen sites, together with an outline of high level options are provided in a separate report under item 14 on the agenda.

2.2 Whilst some sites continue to be taken forward through feasibility and /or onto planning stages, further reviews of assets across the Estate will continue as part of the wider Core Offer agenda.

2.3 The process of site and asset reviews /challenge is a continual process and needs to be set against Corporate priorities, which themselves can change over time. It is important for the Council to establish the likely benefits, and track the outcomes it expects to deliver from any asset review /investment process. Where the outcomes sought have a higher level of social value benefit over and above a targeted financial return, it provides the opportunity to identify assets that may form part of an opportunity for a Community Asset Transfer.

2.4 The County Councils' Community Asset Transfer Policy (March 2016) sets out our principles and approach to Community Asset Transfers. It also includes more detailed information such as the process and the assessment criteria. It is important to recognise the difference between our Policy (that supports a transfer of one of our assets to the community aligned to a specific outcome sought), as against a process under the Localism Act 2010 which enables a community to seek an option to bid for an asset (known as a listing an Asset of Community Value) where the nominating party would secure a 6 month period to raise funds to bid for an asset if the owner decided to dispose of same.

2.5 The process behind asset reviews being undertaken can be summarised in Appendix 1 and 2, and is closely aligned to finance assessment noted in paragraphs 2.6 and 2.7 (below).

Governance

2.6 Programme and Project governance around new investment will be managed primarily through the Capital Board which already involves officers across the Council together with supporting consultants. This Board remains an important gateway review mechanism for any evolving business cases, and further consideration may be given to sub boards needed to provide programme management support as activity increases.

Finance assessments

2.7 In developing any business case it is necessary to undertake a full assessment of an opportunity to support a recommended delivery option. In support of feasibility and options appraisal stages, a resource of up to £200,000 has been identified to support the small team of officers involved in the programme.

2.8 Modelling within business cases is anticipated to include:

- An appraisal of the Councils' sites (that potentially form an initial phase of activity)
- A baseline assessment of values and costs to provide identified outcomes or benefits
- An assessment of returns on capital (or revenue) available from identified options.
- Specific financial modelling to consider the cash flow of sites through any delivery stage
- Overall cash flow requirements illustrating the financial returns to the Council from the wider programme
- Developing a value capture model which can identify secondary benefits that might flow to the Council, (such as additional business rates, new homes bonus, Community Infrastructure Levy - CIL etc.)

Model

2.9 Encapsulated in Appendix 2 is a high level model that seeks to underpin our current thinking and deliverability challenge on the re-use of particular assets, and which will inform business cases.

2.10 Those assets already declared surplus, or identified as potentially available through service reviews and which may be thus noted as poor performing (due to current condition and suitability) offer a number of options for re use or investment as against sale.

Potential Benefits

2.11 The balance sheet value of the ESCC estates portfolio is currently recorded at £543m. Although much of the value is held in relatively illiquid assets (i.e. schools), there are still a number of sites that offer development and/or outcome based returns. A summary analysis of an initial list of core sites provides an indication of options available to support the investment strategy, and is outlined in a separate report under item 14 on the agenda.

2.12 Over and above our land valuation assessments (sales values normally taken as capital receipts), returns from onward development would be expected to offer minimum target returns on capital employed, and/or benchmarked returns of between 15% and 20% against full development value of a scheme. Additional income returns can be secured through the County providing development finance at a margin over its current borrowing rates. At this stage it is only possible to give a high level assessment of the timeframes within which project work can progress.

Legal implications

2.13 There are no specific legal implications arising in the context of this report. Consideration is given to relevant legal issues (Title, ownerships, covenant, grant clawbacks) within each property project at the time and is addressed accordingly. Where a joint venture arrangement might be appropriate further consideration of legal structures would be notable.

Financial implications

2.14 The Corporate Management Team (CMT) has supported the request for revenue funding to support certain projects (feasibility and business case development) from the Transitional Fund. At this stage no specific financial targets or outcomes have been sought but non-financial returns can also be highlighted or targeted through activities that support wider economic and community benefits (i.e. examples include support for the creative sector in the Rye Centre).

Risk management

2.15 A focus on asset and investment activities may lead to a review of the wider capital receipts programme, particularly where assets are retained for either a longer period as business cases evolve, or capital receipts are "exchanged" for income generating opportunities from revised investment or delivery vehicles (e.g. transferring a low value but strategically located land asset for an equity stake in the development or joint venture vehicle).

HR implications

2.16 The Strategy highlighted the need for the Council to ensure appropriate capacity and capability is available to ensure delivery, and this has a number of strands across investment, development and operational estate portfolio activities.

2.17 The extent and nature of increased activity and focus on asset management work has already highlighted the need for some realignment of resource. At this stage this is primarily through provision of additional programme management support to the small property team involved, and proposals for short term and longer term arrangements are being considered.

2.18 The level of resourcing and use of external specialist consultants will need to be kept under review and contract managed appropriately, and promptly, in order that implementation of the strategy is not adversely affected.

2.19 The potential scale of asset projects has identified the need for resource and capabilities that cover, or extend across a number of activities such as:

- Formation of the overall delivery strategy;
- Assessment of In-house skills and capacity;
- Stakeholder engagement and communications plan;
- Establishment and oversight of quality assured project processes i.e. business cases, gateway reviews, sign off procedures etc.;
- Coordination of data for validation of project scenarios;
- Oversight of the preparation of project briefs;
- Oversight of the preparation of budgets, business plans;
- Management of the appointment of consultants and contractors to projects;
- Management of risk assessments and mitigation plans
- Monitoring and reporting on progress of overall delivery of programmes and budgets.

3. Conclusion and recommendations

3.1 The current asset base of the County Council offers opportunities to resource active development of sites whether for ongoing service use or wider market development returns.

3.2 Switching from a capital receipts led programme to one that enables retention of land for development (to secure either additional benefits for service use or returns on capital invested) is a key theme of the Property Asset Disposal & Investment Strategy.

3.3 The Core Offer which seeks to support provision of core statutory services enables the Council to undertake further review of its wider asset base for consolidation, rationalisation and reinvestment where appropriate.

3.4 Audit Committee are asked to note and comment upon the core principles and activities noted in this Report

Kevin Foster
Chief Operating Officer

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Appendix 1 – Asset Review Process

Property Review

Location, Suitability, Sufficiency, Costs, Condition

Non Operational

- Why does the Council own it
- Could the capital be better employed

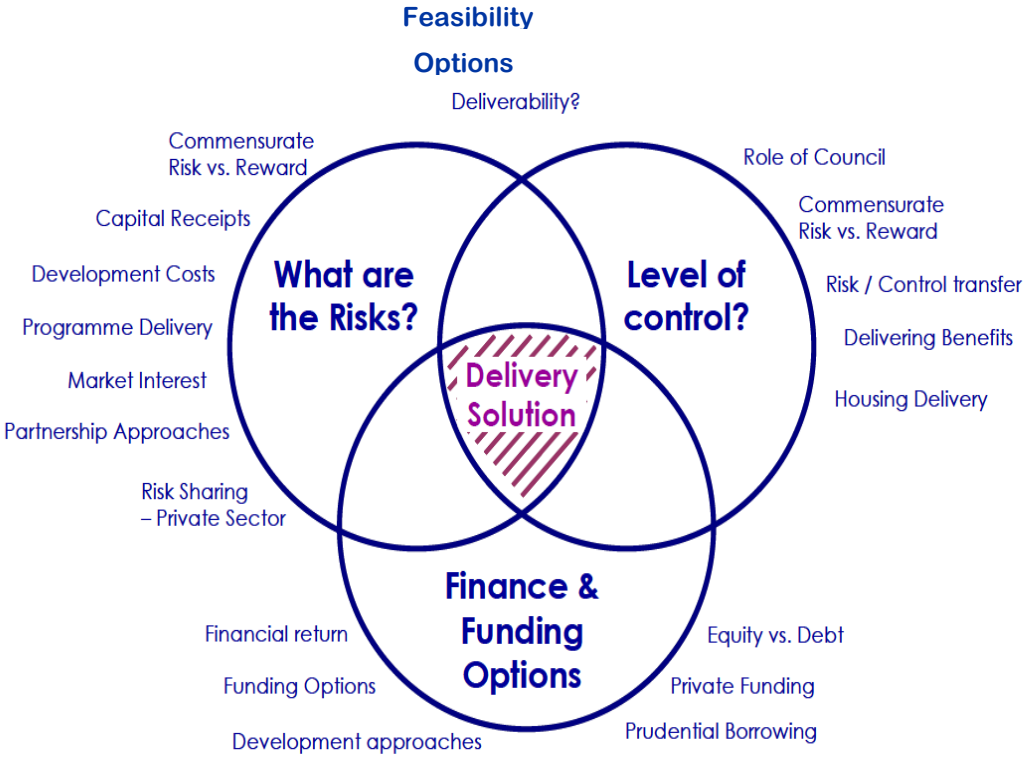
Admin property

- Can we make do with less
- Could we relocate
- Can we share space with public partners

Service Asset

- Is building sustainable
- Would the service be better located elsewhere
- Are there other (better) means of provision?

Appendix 2 – Feasibility Options model



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