AUDIT COMMITTEE

Tuesday, 22 July 2014 (2.00 pm)

Please find the attached reports marked as "TO FOLLOW" on the Audit Committee agenda:

3 **REVIEW OF THE STATEMENT OF ACCOUNTS 2013-14** (Pages 1 - 22)

To present the report of the Interim Head of Function (Resources) and Section 151 Officer. *(REPORT TO FOLLOW)*

4 **GOVERNANCE AND ASSURANCE UPDATE AND DRAFT ANNUAL GOVERNANCE STATEMENT 2013-14** (Pages 23 - 44)

To receive an update on governance and assurance and the initial draft of the Governance Statement 2013-14. *(REPORT TO FOLLOW)*

5 **ANNUAL TREASURY MANAGEMENT REVIEW 2013-14** (Pages 45 - 58)

To present the Annual Treasury Management Review for 2013-14. *(REPORT TO FOLLOW)*

6 **TREASURY MANAGEMENT QUARTER 1 2014/15** (Pages 59 - 70)

To present the Treasury Management Quarter 1 2014/15 update. *(REPORT TO FOLLOW)*

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ISLE OF ANGLESEY COUNTY COUNCIL

COMMITTEE:	**AUDIT COMMITTEE**
DATE:	**22 JULY 2014**
TITLE OF REPORT:	**STATEMENT OF ACCOUNTS 2013/14 MAJOR JUDGEMENTS AND ESTIMATES**
PURPOSE OF REPORT:	**UPDATE AUDIT COMMITTEE MEMBERS ON KEY JUDGEMENTS IN THE 2013/14 STATEMENT OF ACCOUNTS**
PORTFOLIO HOLDER(S):	**COUNCILLOR H E JONES**
REPORT BY:	**RICHARD MICKLEWRIGHT**
CONTACT OFFICER:	**RICHARD G JONES**
ACTION:	**NOTE THE CONTENTS AND DECIDE WHETHER FURTHER TRAINING WOULD BE DESIRABLE ON THE STATEMENT OF ACCOUNTS**

INTRODUCTION

The Council's Draft Statement of Accounts for 2013/14 was signed by the Interim Section 151 Officer on 30 June 2014, within the end of June statutory deadline.

The accounts cover the period from 01/04/2013 - 31/03/2014. They are large, complicated statements which are not always easy for the non-specialist to interpret. They are also prepared at a point in time and, as such, judgements need to be made in applying accounting policies and assumptions made about future and other major sources of estimation uncertainty.

The purpose of this report is to give more clarity to Members and officers on those judgements, and should be read in conjunction with the draft Statement of Accounts. Those accounts were published on the Council's website at the beginning of July.

The accounts are prepared in accordance with proper practices as set out in the CIPFA/ LASAAC Code of Practice on Local Authority Accounting in the United Kingdom.

THE STATEMENT OF ACCOUNTS

A brief explanation of the Statement of Accounts is set out below. As always, Finance Officers would want members of the Audit Committee to focus on certain key areas:-

- The Explanatory Foreword, which links the out-turn back to the budget for the year and the in-year monitoring (Appendix A);
- The Movement in Reserves Statement (Appendix B), which summarises the reserves available to the Council, divided into usable and unusable categories, and the movements during the year.

The main parts of the Statement of Accounts are:-

Contents (pages 1-2)

Summarises the layout of the accounts and better enables the user to find their way around them.

Appendix 1 (pages 96-97) Related Parties – stakeholder Representation.

Glossary (pages 98-101)

The use of abbreviations is often necessary to keep this sizeable document to a minimum. Technical terms are also explained in the Glossary to assist the user of the accounts.

Explanatory Foreword (pages 3-13)

This is an important part of the accounts as it explains in financial terms how the year has gone. It summarises the information contained within the main statements and notes to the accounts. The numbers in the foreword should reflect or mirror the key figures contained within the financial statements.

The main sections of the foreword are as follows:-

Introduction

Explanation of performance and format of the statement, including the statutory framework and changes in accounting treatment.

- **Revenue Expenditure** - Review of the year - contains commentary on the revenue performance of the Council against budget plans and in-year forecasts, with explanations of the reasons for over or under spending; Housing Revenue Account (HRA) - contains commentary on the HRA usable reserve;

- **Capital Expenditure** – contains commentary on capital expenditure comparison between budget and actuals Major Capital Projects and Capital Expenditure and Financing;

- **Borrowing and Investments** – contains commentary on borrowing and investments over the year;

- **Balance Sheet** position as at 31 March 2014 - contains commentary on the movement within the balance sheet Usable and Unusable Reserves and Provisions.

- Commentary on particular significant items within the accounts,

The main financial statements

The Movement in Reserves Statement for the current and comparative year (page 15)

This statement is vertical in presentation in that it should be read down rather than across. It contains two years' worth of movements starting from reserve balances at 1 April 2012 and end at the bottom with reserve balances at 31 March 2014. It shows each of our 'useable' reserves plus a summary of unusable reserves.

Unusable Reserves are really reserves created to contain technical adjustments and they are not available for spending by the Council. For example, the Revaluation Reserve was £38.174m at 31 March 2014. However, this contains 'paper' gains from increases in the value of its Plant, Equipment, Property and Intangible Assets. Money would only be realised and be usable on the sale of these assets.

Usable Reserves are monies that can be expended by the Council. Certain reserves are 'ring fenced' and can only be expended on specific purposes. For example, the School reserves can only be used by schools and the Housing Revenue Account can only be expended on council houses.

Usable Reserves contain the Council Fund and HRA General Reserves, Earmarked Reserves and the Capital Receipts Reserve.

It should be noted that this is only a ‘snap shot’ of balances at 31 March and not all of these balances are ‘available’ to spend. For example, services may have planned to spend some of their earmarked reserves as part of the current year (or coming year/s) budget plans.

The Statement also contains the adjustments necessary to ensure that the charge against the Council Fund is limited to the total that is allowed by law to be charged against the Council Tax. This issue is dealt with in more detail below.

Comprehensive Income and Expenditure Account (CIES - page 16)

This statement shows the accounting cost in the year of providing the Council services in accordance with accounting standards, rather than the amount to be funded from taxation. Accounting standards require certain costs, e.g. depreciation (over £10.645m in 2013/14), to be charged to services, but because this is not a ‘real’ cost, i.e. no money actually changes hands, statutory regulations do not allow it to be charged against the Council Fund. So, although it forms part of the reported net deficit on services, it is removed from the charge against taxation by the adjustments shown in the Movement in Reserves Statement (see above). A full list of all such adjustments appears in Note 7 on page 44.

These technical charges can have quite a dramatic impact on the bottom line balance on the CIES. For example, there is an actual re-measurement charge of the net defined liability of £17.624m in 2013/14 (note 41 page 75-81), which makes up the bulk of the overall deficit shown of £24.116m on page 16. The net taxation position is shown in the Movement in Reserves Statement. This shows a net surplus on the Council Fund of £28k.

Balance Sheet (page 17)

The Balance Sheet for the Council shows the assets and liabilities of the Council as at 31/03/2014. The net assets (assets less liabilities) are matched by the reserves held by the Authority. These are split into usable reserves (subject to conditions) and unusable reserves that are mainly technical adjustments.

Cash Flow Statement (page 18)

The Cash Flow Statement shows the changes on cash and cash equivalents of the Authority during the year. The statement shows how the Council generated and used cash and cash equivalents by classifying cash flows into the following 3 areas:-

Net cash flows from Operating Activities – are funded by way of taxation and grant income or the recipients of services provided by the Authority.

Net cash flows from Investing Activities – represent the extent to which cash flows have been made from resources which are intended to contribute to the Council’s future service delivery.

Net cash flows from Financing Activities – are useful in predicting claims on future cash flows by providers of capital to the Authority, for example borrowing.

Notes to the Accounts including Note 1, Accounting Policies (pages 19- 37)

The notes are to facilitate the user of the accounts’ understanding. These notes set out, in general, what the accounts are measuring and how that measure has been derived. It is also the usual starting point in reading the main statements. If there is a number one doesn’t understand then, hopefully, one can gain more information by referring to the associated note as detailed on the main statement.

Supplementary Financial Statement Housing Revenue Account (pages 92 - 95)

Judgemental Decisions and Estimation Uncertainties (note 4 pages 40 - 41)

Users of the accounts are often concerned about their accuracy. The test of this is usually reflected in the outcomes of the independent external audit that, for this year, commenced on 2 July. It is a statutory requirement for the outcomes of this external audit to be presented to the Audit Committee and for the Final Accounts to be presented for approval by 30th September.

There are certain notes to the accounts that are meant to better explain or summarise the judgemental decisions and estimation uncertainties when the accounts were prepared as shown in Notes 3 and 4, and these are reproduced as Appendices C and CH to this report.

The Committee is invited to consider these aspects of the Statement of Accounts in preparation for the formal presentation of the audited accounts in September. It has also become customary to provide a workshop for members of the Committee in preparation. We would welcome Members' views on the arrangements for this year.

EARMARKED RESERVES

There are a number of reserves shown in the Statement of Accounts that have been set aside for a specific purpose - these are known as earmarked reserves. The amounts held in each and the transfers year on year are shown at Appendix D. A brief description of each and its purpose are shown below:-

Capital Expenditure - to fund capital expenditure in future years. This has been created to ensure committed capital expenditure, including expenditure which has slipped from previous years, is fully financed.

Service Reserves - under the Council's Financial Procedure Rules over and under-spending is carried forward as earmarked reserves to the level set by the Executive.

Restricted Service Reserves - earmarked budgets within service areas which remain unspent at year end.

Equal Pay, Single Status and Job Evaluation - as a result of the 'Single Status' agreement, the Council, in common with most other local authorities, is required to introduce a new pay and grading system with effect from 1 April 2007. The extent to which this may involve an obligation to back pay is uncertain. Negotiations are proceeding on a revised pay and grading structure. A sum has been set aside in the Job Evaluation reserve towards the overall cost of the exercise, including the administrative costs, the cost of new pay scales, any pay protection and any back pay. Although the individual elements cannot be estimated with certainty, the Council is of the view that the sums set aside are adequate.

Recycling - landfill cost savings created by diverting waste to recycling. The reserve will be utilised towards recycling initiatives.

Performance Management Reserve - amounts earmarked towards performance improvement measures from the Outcome Agreement Grant.

Major Repairs Reserve – amounts set aside from HRA balances to fund capital spending on council housing.

Insurance Fund - the Council runs an internal insurance account which pays for self-insured losses and which receives 'premiums' from service accounts. The known losses at year end are provided for. This reserve is the surplus on the internal insurance account plus interest on balances and is intended to cover claims which have been incurred but have not been reported.

Other - this balance comprises the aggregation of the balances of 7 individual reserves, which individually hold balances of less than £0.5m, which are not considered to be material amounts.

PROVISIONS

Provisions are sums of money set aside for known and probable events, i.e. the probability of them occurring is high. The amounts held in each and the transfers year on year are shown at Appendix B. A brief description of each and its purpose is shown below:-

Insurance Claims Provision

The Council's external insurance policies have excesses deductible amounts, which means that the first part of any loss or claim under these policies is self-insured and protected by means of a stop-loss. The Council's general and education properties are not externally insured against the following perils:- escape of water from any tank or pipe, flood, impact, theft, accidental damage, subsidence, ground heave, landslip. With the exception of theft and accidental damage, losses resulting from these perils are normally funded from the insurance reserve. The balance on the insurance provision is the expected liability for the self-insured element of known claims which had not been settled at year end.

Penhesgyn Waste Site

The provision has been provided for the aftercare and reinstatement works of the areas of the site formerly used for landfill. An additional provision has been provided for known future re-engineering work to be carried out to the main culvert / watercourse within the site.

Termination Benefits

Provision for known future liabilities arising from staff reductions following restructure.

Municipal Mutual Insurance (MMI)

In January 1994, the insurer of the Council's predecessor authorities, Municipal Mutual Insurance (MMI), made a scheme of arrangement with its creditors. The Council was notified on 13 November 2012 that the scheme of arrangement has been triggered as a solvent "run-off" was not now expected. The current liability is estimated to be 15% of claims paid on behalf of the Council since January 1994, which equates to £0.17m. The Council is now making a provision for this sum, which will be met initially from the insurance reserve, in order to meet its liabilities under the Scheme of Arrangement.

RECOMMENDATIONS

- That Members consider the key items outlined above; and
- That Members confirm what further preparation is required in advance of the September meeting of this Committee

RICHARD MICKLEWRIGHT
INTERIM HEAD OF FUNCTION (RESOURCES) & SECTION 151 OFFICER

15 JULY 2014

EXPLANATORY FOREWORD

1. INTRODUCTION

The following pages include the Statement of Accounts for the Isle of Anglesey County Council for the year ended 31 March 2014.

Each year the Council must prepare and publish a Statement of Accounts, the purpose of which is to give electors, local taxpayers, Members of the Council, employees and other interested parties clear information about the Council's finances.

The aim is to provide information on:-

- The cost of the services provided in 2013/14;
- Where the money came from;
- What we own and what we owed at the end of the financial year.

The purpose of this foreword is to provide an explanation of the Council's financial position, including the main influences affecting the accounts, and to assist in the interpretation of the accounting statements.

Within the foreword we will set out:-

- What the various elements of the accounts are and what each section tells you;
- Summary of the Council's financial performance during 2013/14;
- An explanation of the main external factors that have influenced the information contained in the accounts in 2013/14;
- A summary of the key information from the accounts alongside an explanation of the reasons for any significant year on year changes.

The Statement of Accounts for 2013/14 has been prepared using best accounting practice set down by the Chartered Institute of Public Finance and Accountancy (CIPFA). The foreword provides an understandable guide to the most significant matters reported in the Accounts and an overview of the Council's overall financial position.

The Council's Accounts for 2013/14 consist of the following:-

- **Statement of Responsibilities for the Statement of Accounts -** which sets out the respective responsibilities of the Council and the Council's Section 151 Officer, the Head of Function (Resources);

- **Annual Governance Statement** – comprises the systems and processes that enable the Authority to monitor the achievement of its strategic objectives. This includes the system of internal control used to manage risk. It sets out the main features of this system and its effectiveness (not available at draft stage).

- **Financial Statements** – the Statement of Accounts includes four core financial statements which are: -

    a) **The Movement in Reserves Statement (MIRS)** – which shows the movement in the year of the different reserves held by the Council analysed between usable and unusable reserves. The surplus (or deficit) on the provision of services line shows the true economic cost of providing the Council services, more details of which are shown in the Comprehensive Income and Expenditure Statement. These are different from the statutory amounts charged to the General Fund Balance and the Housing Revenue Account for council tax setting and dwellings rent setting purposes. The Net Increase/Decrease before transfers to Earmarked Reserves shows the position before any discretionary transfers to/from Earmarked Reserves are undertaken.

b) **The Comprehensive Income and Expenditure Statement (CIES)** – which shows the cost of providing services in the year using accepted accounting practices, rather than the amount to be funded from taxation and general grants in accordance with statutory regulation. Councils raise taxation to cover expenditure in accordance with regulations; this may be different from the accounting cost. The taxation position is shown in the Movement in Reserves Statement.

c) **The Balance Sheet** – which sets out the financial position of the Council at 31 March 2014 as reflected in the level of balances and reserves at the Council's disposal and the level of assets and liabilities held by the Council;

ch) **The Cash Flow Statement** – This summarises the cash inflows and outflows during the year, arising from transactions with third parties for revenue and capital purposes.

d) **The Housing Revenue Account** is a record of revenue expenditure and income relating to the Council's housing stock. Its primary purpose is to ensure that expenditure on managing tenancies and maintaining dwellings is balanced by rents charged to tenants**.** The Housing Revenue account is ring-fenced from the Council's General fund.

dd) **Notes to the Financial Statements –** which are intended to explain the key figures shown in the financial statements. The notes include the Statement of Accounting Policies, which supports and explains the basis of the figures in the Accounts and it sets out the significant accounting policies and estimation techniques used to prepare the Accounts.

2. STATUTORY FRAMEWORK

Regulation 7 of the Accounts and Audit (Wales) Regulations 2005 (SI 2005/368 (W.34), as amended) requires Welsh Local Authorities to prepare a Statement of Accounts in accordance with proper practices.

Regulation 25 of the Local Authorities (Capital Finance and Accounting) (Wales). Regulation 2003 (SI 2003/3239 (W.319), as amended) identifies proper practices for the preparation of the Statement of Accounts. These practices primarily comprise the Code of Practice on Local Authority Accounting in the United Kingdom 2013/14 and the Service Reporting Code of Practice 2013/14 issued by CIPFA, supported by International Financial Reporting Standards (IFRS).

3. CHANGES IN ACCOUNTING TREATMENT

There are no changes to accounting treatment required for 2013/14 and consequently there are no changes to the accounting policies in use at the Council.

4. SUMMARY OF THE YEAR

The Council spends money in two ways; revenue and capital. Revenue spending is on items that are used up within a year and is paid for from Council Tax, government grants, rents and other income. Capital spending generally relates to items of expenditure that will give benefits to the Council for a period of more than one year. The financing of capital expenditure is mainly from capital receipts, capital grants and contributions, or borrowing.

5. The Council produces quarterly reports on the revenue expenditure for the Management Team and Portfolio Holders. On a quarterly basis reports on the financial and performance position are considered by the Executive Committee.

6. REVENUE EXPENDITURE AND INCOME 2013/14

What is Revenue Expenditure and Income?

Before the start of a financial year, the Council prepares its annual revenue budget, which reflects the expenditure and income expected to be needed during the year to provide services. Expenditure relates to running costs such as employee salaries and overheads, repair and maintenance, energy costs, rates and other costs of occupying Council buildings, the cost of running its vehicle fleet and the cost of supplies and services to support the Council's departments. Income relates to receipts from sales of goods and fees and charges from the Council's service users and grants and contributions from the Welsh Government and other external bodies.

What we planned to spend and what we actually spent

The Comprehensive Income and Expenditure Statement and the Movement in Reserves Statement show our financial performance and the net expenditure to be charged against Council Tax. The Council agreed the expenditure budget for 2013/14 in February 2013. This budget has been updated in year to reflect additional funding becoming available and budgets being re-profiled into 2013-14 to result in a final budget of £129m.

This was funded by the Council's Revenue Support Grant from the Welsh Assembly of £78.203m, receipts from the National Non-Domestic Rates Pool of £22.025m and Council Tax receipts of £30.212m.

a) Council Fund Services

The Council's Executive Committee received a provisional out-turn report at its meeting of 10 June 2014, which showed a net underspend of £846k against the Council's approved budget. The revised outturn position shows a net underspend of £1.217m

Generally the underspend has been achieved by

- General restraints on spending by services in response to the forecast financial position of the Council;

However there were a series of significant budget variances across all service areas, details of which are provided in the following paragraphs;

Lifelong Learning

- <u>Central Education</u>
  There is a net underspend of £118k. Within the Service there are a number of areas that are overspent whilst others are below budget. The significant sums are summarised as follows:

- <u>Pupil Transport</u>
  Cost of transport for pupils to schools and colleges was overspent by £177k and Included all sectors i.e. Primary, Secondary, Special as well as Further Education establishments.

- <u>Combined School Meals</u>
  Overspend of £172k and this was partly attributable to a greater take up of free school meals and primary schools meal income has underachieved against the budget target.

- <u>Central Education Administration</u>
  This budget was overspent by £126k. This overspend is spread over a number of areas including supplies and services, but has also been partly offset by underspending on energy costs and over achievement of income/contributions.

- Cynnal
  Overspent by £135k – this was mainly as a result of unbudgeted costs for service level agreement with Cynnal – the service included IT support, Curriculum support and admin management.

- Other Central
  Performance management budget was underspent by £92k and was partly due to underspending on contract costs. The home tuition and sickness budget was also underspent by £96k, mainly due to underspend on staffing. There was also a smaller underspend on Appetite for Life of £24k.

Community Services

Social Care

The Social Care overall outturn position shows a net overspend of £180k. The main variances for Social Care (excluding the provider unit) are as follows:-

- Services for the Elderly
  This area is showing an underspend of £230k. This is partly due to vacant posts within the Service of £84k. However, the Service is also seeing a reduction in spend as a result of a strategy to move away from residential care to home care.

- Learning Disability
  This area is showing an overspend of £142k. This is mainly as a result of unforeseen demand for adult placement in residential care.

- Physical Disability
  These show a service underspend of £90k. This is mainly as a result of the tightened eligibility criteria for adaptations for the home.

- Mental Health
  This shows an overspend of £275k and is as a result of combination of issues relating to a combination of budget pressures relating to residential care.

- Children and Young People Service
  The Service is showing a net underspend of £216k and includes underspend in Family Support of £99k. Likewise, Children with Disability budget is underspent by £73k. However, there are also overspends in other parts of the budget; this includes overspending in legal costs of £32k and out of county placements of £106k.

Non HRA Housing

This Service is showing a net underspend of £248k. Within the Service there has been an additional bad debt provision posted of £53k relating to Private Sector Leasing. The Service also shows a gain of £256k relating to grant reserves monies that have been released from grant reserves. (The figure net of the bad debt and grant reserves adjustments is an under-spend of £45k).

Leisure and Culture

The Culture Services had an overall underspend of £138k, the main variances to this underspend were as follows:-

- Additional running costs at the new archives building has led to an over spend of £25k. Heritage sites were underspent by £15k due to an improved performance at South Stack. Admission fee income was ahead of budget by £21k, but additional running costs of £6k partly offset the increased income performance.

- Museums and galleries were underspent by £5k. Oriel Ynys Môn overspent by £35k due to an under achievement of income, but Beaumaris Gaol and Court generated an underspend of £10k. There was a further underspend of £32k on the museums administration budget.

- The Library Service underspent by £90k mainly due to staff vacancy savings that amount to £60k. There are further underspends on transport and supplies and services that amount to £30k.

The Leisure Services showed an overall underspend of £142k, the main variances were as follows:-

- Park and Outdoor Facilities Services were overspent by £23k. This follows the decision of the Council to make a 'complete withdrawal' from the service provision from April 2012 onwards.

- Indoor sports and recreation facilities are underspent by £158k. Income generation is significantly ahead of budget, amounting to £120k. There are also underspends on premises related budgets of £33k. The historic trend of over spending on the golf course has continued, amounting to £44k.

Sustainable Development

Highways and Transportation

The Service is showing a net overspend of £191k. The main variances are as follows:-

- Works budget (Traffic, Lighting and Maintenance)
  Combined overspend of £198k. This is mainly accounted for by the need to respond to additional emergency works during the winter period.

- Development Control Management
  Underspent by £82k. This was mainly as a result of not achieving budgeted income.

- Other
  School crossing patrol was underspent by £24k. This was mainly due to a significant number of school crossing posts remaining vacant during the year. Car park income was under budget by £36k. This was due to a combination of reduced expenditure on contract payments and additional income over and above budget.

Waste Management.
The total underspend was £265k. The major items were improvements in the Gas Management at Penhesgyn (£159k), and reduced waste going into landfill producing savings of £60k.

Planning
The total overspend was £211k.The major items were:-

- Legal and consultancy costs were £165k over budget due to disputed Planning Committee decisions. The collaboration with Gwynedd Council for the Policy Unit was £23k over budget. Energy Island development was £46k over budget due to additional computer expenditure.

Deputy Chief Executive

- ICT
  This service is underspent by £167k. The majority of this related to the staffing budget being underspent as a result of vacancies.

- <u>Legal and Administration</u>
  This Service is underspent by £174k and is as a result of a combination of various service elements within the budget. Committee Services are underspent by £42k. Legal Services are underspent on staffing due to vacant Solicitor post. The underspend in staffing, net of agency cost and SLA, is £44k.

Housing Revenue Account

The Housing Revenue Account (HRA) identifies costs and income expended and received in respect of the Council's own housing stock. In 2013/14 the account successfully funded all operational expenditure and made capital contributions of £2m towards the long-term maintenance and upgrading of the stock whilst the HRA budget for the year was a surplus of £499k with an outturn surplus of £1.42m. The principal reasons were:-

i) The call on revenue contributions by the capital programme was £1.2m less than anticipated;
ii) Rental receipts were buoyant and performed £500k better than anticipated;
iii) However, £300k cost were higher than anticipated and cuts were incurred on a new computer system implementation;
iv) Upgrades to lifts, fire alarms and sewage facilities costs were £200k higher than budget; and
v) Revenue repairs and maintenance was higher than anticipated.

However, after taking account of an adjustment required by statute to be credited to the HRA, this resulted in an increase of £1.190m to the HRA balance leaving a balance of £1.672m. Further information on the HRA can be found in the Supplementary Statements to the Accounts on page 93.

Use of revenue reserves and balances

Council Fund

At out-turn, the balance on the Council Fund at 31 March 2014 increased by £0.27k from £5.910m to £5.938m. In year movements on the Council Fund can be found in Movement in Reserves Statement on page 15.

Earmarked Reserves
At 1 April 2013, the Council held earmarked reserves of £16.627m. The in year movement of £221k resulted in reduction to balances which now stand at £16.406m (see Note 8 – page 46).

Schools Balances
School reserves are limited to the uses approved by the individual schools and the position varies from school to school. Seven schools had a deficit at the end of the financial year (ten at the end of the previous year) and a number of other schools are projecting deficits in future years.

During the year, net spending by schools has reduced, resulting in an increased reserve balances (in total) of £0.334m, so that the total value of schools reserves at 31 March 2014 stood at £1.518m (£1.184m at 31 March 2013). Details of the breakdown of the value of the reserves by school type can be found in note 9 to the Accounts on page 47.

CAPITAL EXPENDITURE 2013/14

What is Capital Expenditure?
Capital expenditure relates to the cost of providing or enhancing assets or other spending where the benefits last beyond the financial year in question.

What we planned to spend
The Council approved a capital programme of £28.8m for 2013/14. Whilst there were no major project or schemes commenced during the year, there were two major projects that were completed. Firstly, the completion of the improvement works to the Penhesgn site and, secondly, the construction of Canolfan Addysg y Bont.

What we actually spent
The Executive considered a capital out-turn report at its meeting of 9 June 2014, which showed that the Council actually spent £24.1m on capital projects in 2013/14.

Details of spending against individual project budgets are:-

Project	Budget for 2013/14 £000	Actual spend in 2013/14 £000	Variance in Year £000
Housing			
Council Houses	4,948	3,169	(1,779)
Private grants	2,721	1,573	(1,148)
Affordable Housing	513	120	(393)
Education			
Ysgol y Bont	6,368	6,707	339
21st Century Schools - Holyhead	587	10	(577)
Flying Start	535	527	(8)
Learning in Digital Wales	590	614	24
Other	802	603	(199)
Regeneration			
Econ Dev. - Strategic Infrastructure	450	235	(215)
Econ Dev. - Coastal environmental project	80	89	9
Econ Dev. - Other	1,077	356	(721)
Property - Smallholding improvements	(1,369)	683	2,052
Property – Other	1,046	593	(453)
Penhesgyn	6	295	289
Planning - Regeneration (3 towns)	2,000	830	(1,170)
Highways - Borrowing Initiative	1,800	1,785	(15)
Highways - Regional Transport Consortia grant	663	621	(42)
Highways - Safe Routes in Communities Grants	422	438	16
Highways – Other Grants	963	585	(378)
Other			
Equal Pay 2013 /14	3,300	3,300	0
Other Department Schemes	1,310	972	(338)
Total	**28,812**	**24,105**	**(4,707)**

Total capital spending of £24.1m was £4.7m less than the approved budget for the capital programme. This is lower than the previous year's outturn of £25.4m, reconciled as follows: -

There was a reduction in year on year expenditure as a result of:-

(i) reduced activity on some ongoing projects/schemes, including:- (a) HRA works (£5.5m less than 2012/13) mainly due to the WHQS (Welsh Housing Quality Standard) programme of works which was completed in the third quarter of 2012/13, and (b) minor works to schools (£0.6m), Penhesgyn (£0.7m), smallholdings programme of improvements (£0.4m), Anglesey Coastal Environment Project (£0.4m), other schemes (£1.1m).

(ii) schemes completed in 2012/13 such as the Welsh Government (WG) funded Streetscape and Environmental Works 2012/13 (£0.4m), the WG funded upgrade works to leisure centres (costing £0.8m in 2012/13), other schemes (£0.3m).

This was countered, to an extent, by increased expenditure as a result of:-

(i) new items such as equal pay claims (£3.3m) and the WG funded Learning in Digital Wales grant (£0.6m).

(ii) increased activity on ongoing projects and schemes such as:- private sector housing grants (£0.7m), the WG funded relocation of Ysgol y Bont (£2.4m), and other projects and schemes (£1.9m).

There were number of small cost overruns during the year, most of which were funded from service revenue budgets. The two most significant schemes that exceeded the budget allocation were the relocation of Ysgol y Bont, which amounted to £0.3m, and the Penhesgyn Household Waste Recycling Centre improvement works, which were overspent by £0.3m. The overspend on the relocation of Ysgol y Bont was mainly due to the extended construction period and additional unforeseen items. The Penhesgyn overspend was partly as a result of additional costs in the design phase of the project together with additional work commissioned to improve infrastructure assets relating to access roads and car parking; the overspend was funded from service reserves.

Budgeted external resources for the year

Capital Grants
The significant proportion of capital grants were claimed in full.

Capital Receipts
The actual capital receipts on a usable basis amounted to £928k. The budgeted capital receipt was estimated to bring in funds to the value of £1.6m. The shortfall was mainly as a result of HRA anticipated land sales not being achieved, however slippage in the programme compensated for this shortfall.

How the capital programme was paid for
Funding for the Capital Programme is dependent on resources from grants, from anticipated capital receipts and on a level of borrowing close to the level assumed by the Welsh Assembly when calculating revenue support.

	Council Fund £000	Housing Revenue Account £000	Total £000
Grants and Contributions	10,567	2,600	13,167
Revenue Contributions	0	488	488
Capital Receipts	847	81	928
Supported Borrowing	992	0	992
Unsupported Borrowing	7,350	0	7,350
Earmarked Reserves	1,180	0	1,180
Total Financing	**20,936**	**3,169**	**24,105**
Resources available at 31 March 2014			
Capital Expenditure Reserve	565	0	565
Leisure Improvement Reserve	196	0	196
Supported Borrowing carried forward	4,050	0	4,050
Total available	**4,811**	**0**	**4,811**

Capital commitments outstanding at the year-end were £2.07m (2012/13: £6.8m). Capital reserves of £0.56m and an unused approved borrowing capacity of £4.1m, have been set aside to partially meet these commitments. It is anticipated that the remaining balance of the current capital commitments and the cost of new projects that are brought forward in future years will be financed from capital grants, receipts from projected asset sales and borrowing.

MAIN INFLUENCES ON THE 2013/14 ACCOUNTS
There are a number of externally driven factors that have had a significant influence on the 2013-14 accounts and the reported financial position of the Council:- impact of the economy on the Council's borrowing strategy and the impact of the Economy on the pension's deficit.

TREASURY MANAGEMENT STRATEGY
The Council is required to operate a balanced budget, meaning that total revenue due during the financial year must be sufficient to meet expenditure, and also that actual cash inflows must be adequate to cover cash outflows. A key part of the Treasury Management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed.

BORROWING
In line with the approved Treasury Management Strategy, the Council was in an under borrowed (internally borrowed) position at the year end, a position which commenced in 2011/12. This means that the capital borrowing need (the Capital Financing Requirement), was not fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow used as a temporary measure. This approach is prudent as investment returns were low, counterparty risk high and forecast interest rates not expected to rise sharply.

The Council was in an under-borrowed position at the start of the year (£10.3m). During the year, one loan of £6.5m matured and the Council's underlying need to borrow increased by £3.8m, resulting in an under-borrowed position at the year-end of £20.6m. As a result of the continued internalisation of borrowing, the year-end borrowing was £89.6m (31 March 2013: £96.1m), with an average rate of 5.72% (31 March 2013: 5.53%).

Impact of the economy on the Council's borrowing strategy
The prevailing financial climate has continued to influence the Council's approach to its Treasury Management activities. The Council's strategy has been to use existing cash balances to fund capital expenditure rather than raising new long-term loans. This avoids the need to hold financial assets (cash and investments) that were not generating a significant return. The Council still has sufficient cash balances to operate effectively and could access additional funds at short notice with minimal cost should it be required.

INVESTMENTS
The Council operated within its approved Annual Investment Strategy during the year. The investments at the year- end totaled £9.2m (31 March 2013: £13.5m).

BALANCE SHEET POSITION AT 31 MARCH 2014

During 2013/14, the Council's reserves were £126.604m, a reduction of £23.857m from the previous financial year. This decrease was mainly as a result of unusable reserves falling from £125.982m to £101.070, of which the majority of the movement relates to the pension reserve (liability) which has increased by £22.725m. The analysis of the balances of the Unusable reserves can be found in note 11 page 48.

The Balance Sheet shows a slight increase in Long Term Assets valuations, which amounts to an increase of £1.037m. Likewise, there have been reductions in both Current Asset and Current Liabilities balances of £7.301m and £5.776m respectively.

The biggest movement relates to the Long Term Liabilities, which has increased by £23.369m (as documented below). The Balance Sheet can be found on page 17.

PENSIONS

- **TEACHERS PENSION SCHEME**

  Teachers employed by the Council are members of the Teachers' Pension Scheme, administered by the Department for Education. The scheme provides teachers with specified benefits upon their retirement, and the Council contributes towards the costs by making contributions based on a percentage of members' pensionable salaries.

- **LOCAL GOVERNMENT PENSION SCHEME**

  As part of the terms and conditions of employment of its officers and other employees, the Council offers retirement benefits by participating in the Gwynedd Pension Fund administered by Gwynedd County Council. This is a funded scheme, meaning that the Council and employees pay contributions into a fund, calculated at a level intended to balance the pension's liabilities with investment assets. Benefits will not actually be payable until employees retire but the Council has a commitment to make the payments to the Pension Fund that need to be disclosed at the time that the employees earn their future entitlement.

  International Accounting Standard (IAS) 19 – Employee Benefits applies to all local authorities and relates to the Gwynedd Local Government Pension Fund administered by Gwynedd County Council.

  The current economic climate also has a significant impact on the net Pensions Liability. One of the most significant changes on the Balance Sheet relates to the Council's pensions reserve which has increased from £80.034m to £102.759m, an increase £22.725m. It is important to note that the apparent deterioration in the pension position is based on actuarial valuations and does not represent an immediate call on the Council's reserves. The Council's actual payments to the Pension Fund are reviewed every three years as part of the triennial valuation of the Pension Fund. An investment strategy is then determined which aims to recover this deficit over the period as determined by the Pension Fund's Actuary (Hymans Robertson).

  The Movement in Reserves Statement and the Comprehensive Income and Expenditure Statement shows the pensions benefits earned in the year, adjusted as necessary to reflect that part of the pensions costs that are not met from Council taxpayers.

PROVISIONS

Total provisions held by the Council amounted to £7.598m at 1 April 2013. During the year, the balance increased by £2.m to £9.600m, due to the requirement to provide an additional provision to meet liabilities in respect of after-care costs of the Penhesgyn landfill site.

Details of the movements in provisions are shown in note 27 to the Accounts on page 60.

MOVEMENT IN RESERVES STATEMENT
FOR YEAR ENDED 31 MARCH 2014

This Statement shows the movement in the year on the different reserves held by the Council, analysed into 'usable reserves' (i.e. those that can be applied to fund expenditure or reduce local taxation) and other reserves. The 'Surplus/(Deficit) on the provision of services' line shows the true economic cost of providing the Council's services, more details of which are shown in the Comprehensive Income and Expenditure Statement. This is different from the statutory amounts required to be charged to the Council Fund Balance for council tax setting purposes and the Housing Revenue Account for rent setting purposes. The 'Net Increase / (Decrease) before transfers to earmarked other reserves' line shows the in year movement on the Council Fund and Housing Revenue Account balances before any discretionary transfers to or from earmarked reserves are made by the Council.

Restated 2012/13	Council Fund Balance	Earmarked Council Fund Reserves (Note 8)	HRA Balance (Supplementary Financial Statements)	Capital Receipts Reserve (Note 10)	School Balances (Note 9)	Capital Grants Unapplied (Note 14)	HRA Earmarked Reserve	**Total Usable Reserves**	**Total Unusable Reserves**	**Total Reserves of the Council**
	£000	£000	£000	£000	£000	£000	£000	£000	£000	£000
Movement in reserves during the year	5,796	12,882	247	0	1,252	**0**	**0**	**20,177**	**143,419**	**163,596**
(Deficit) on provision of services	4,788	0	(6,776)	0	0	0	0	**(1,988)**	**0**	**(1,988)**
Other Comprehensive Income and Expenditure	0	0	0	0	0	0	0	**0**	**(11,147)**	**(11,147)**
Total Comprehensive Income and Expenditure	**4,788**	**0**	**(6,776)**	**0**	**0**	**0**	**0**	**(1,988)**	**(11,147)**	**(13,135)**
Adjustments between accounting basis and funding basis under regulations (note 7)	(2,015)	0	8,027	14	0	262	0	**6,288**	**(6,288)**	**0**
Net (Decrease) before Transfers to Earmarked Reserves	**2,775**	**0**	**1,251**	**14**	**0**	**262**	**0**	**4,302**	**(17,437)**	**(13,135)**
Transfers to/(from) Earmarked Reserves (note 8)	(2,661)	2,729	(1,016)	0	(68)	0	1,016	**0**	**0**	**0**
Increase/(Decrease) In Year Balance 31 March 2013	**114**	**2,729**	**235**	**14**	**(68)**	**262**	**1,016**	**4,302**	**(17,437)**	**(13,135)**
Movement in reserves during the year	**5,910**	**15,611**	**482**	**14**	**1,184**	**262**	**1,016**	**24,479**	**125,982**	**150,461**
Surplus/(Deficit) on provision of services	(8,642)	0	(456)	0	0	0	0	(9,098)	0	(9,098)
Other Comprehensive Income and Expenditure	0	0	0	0	0	0	0	0	(15,018)	(15,018)
Total Comprehensive Income and Expenditure	**(8,642)**	**0**	**(456)**	**0**	**0**	**0**	**0**	**(9,098)**	**(15,018)**	**(24,116)**
Adjustments between accounting basis and funding basis under regulations (note 7)	8,740	0	1,689	(14)		(262)		10,153	(10,153)	0
Net Increase / (Decrease) before Transfers to Earmarked Reserves	**98**	**0**	**1,233**	**(14)**		**(262)**	**0**	**1,055**	**(25,171)**	**(24,116)**
Transfers to/(from) Earmarked Reserves (note 8)	(70)	(264)	(43)	0	334	0	43	0	0	0
Other transfers									259	**259**
Increase/(Decrease) in Year	**28**	**(264)**	**1,190**	**(14)**	**334**	**(262)**	**43**	**1,055**	**(24,912)**	**(23,857)**
Balance 31 March 2014	**5,938**	**15,347**	**1,672**	**0**	**1,518**	**0**	**1,059**	**25,534**	**101,070**	**126,604**

NOTE 3 – CRITICAL JUDGEMENTS IN APPLYING ACCOUNTING POLICIES

In applying the accounting policies set out in Note 1, the Council has had to make certain judgements about complex transactions or those involving uncertainty about future events. The critical judgements made in the Statement of Accounts are:-

- The Accounts have been prepared on a going concern basis, which assumes that the functions and services provided by the Council will continue in operational existence for the foreseeable future.

- The Council has determined that a number of assets which are used for social or economic development purposes are not solely held for income generation or capital appreciation purposes and, therefore, do not meet the definition of investment properties. As a consequence, these assets are shown as Non-Current Assets - Property, Plant and Equipment within the Balance Sheet.

- In accordance with current guidance regarding the treatment of certain types of school, only the value of the land for voluntary controlled schools is included in the Balance Sheet. As the Council does not own these types of schools and does not have access to them for valuation purposes, the value of the buildings is excluded from the Balance Sheet. In addition to this, Voluntary Aided and Foundation Schools, neither the value of land nor the buildings are included on the Balance Sheet.

- Capital and grants are reviewed regularly to assess if the terms and conditions attached to the respective grants have been met. If the terms and conditions have been met, they will be recognised within the Comprehensive Income and Expenditure Statement in the year. If not, they will be carried within the balance sheet as deferred income until such time as either the terms and conditions associated with the grant are met or the grant is repaid to the grant provider should the terms and conditions not be met. This treatment can result in material balances being carried in the balance sheet as deferred income in the year.

- The group boundaries have been reviewed using the criteria outlined in the relevant accounting standards and Code of Practice, the Council has not identified any companies or organisations that would require it to complete group accounts.

- There is a high degree of uncertainty about future levels of funding for local government. However, the Council has determined that this uncertainty is not yet sufficient to provide an indication that the assets of the Council might be impaired as a result of a need to close facilities and reduce levels of service provision.

NOTE 4 – ASSUMPTIONS MADE ABOUT FUTURE AND OTHER MAJOR SOURCES OF ESTIMATION UNCERTAINTY

The Statement of Accounts contains estimated figures that are based on assumptions made by the Council about the future or that are otherwise uncertain. Estimates are made taking into account historical experience, current trends and other relevant factors. However, because balances cannot be determined with certainty, actual results could be different from the assumptions and estimates.

The following items in the Council's Balance Sheet at 31 March 2014 may be considered to be most vulnerable for estimating error in the forthcoming financial year:-

Non- Current Assets - Property, Plant and Equipment – Assets are depreciated over useful lives in accordance with standard accounting practices. Any difference between the depreciation applied and actual deterioration to assets will, naturally, reflect in future spending patterns. Information relating to Property, Plant and Equipment is contained in Note 15 on page 53.

The accounting policy for the depreciation of Property, Plant and Equipment (page 21) identifies that:-

"Where an item of Property, Plant and Equipment (Non-Current Asset) has major components whose cost is significant in relation to the total cost of the item, the components are depreciated separately."

Applying this in practice requires two judgements to be made, to establish:-

- the proportion of the cost of an asset which is considered to represent a significant part of the asset, and
- the cost threshold, below which the separate calculation of depreciation on part of an asset would not have a significant effect on the amount of depreciation as a whole.

The Council has set these figures at 20% of the total cost of the asset and £2m respectively. As is stated above in respect of depreciation in general, physical deterioration of the individual parts of an asset may, over time, lead to spending patterns which have not been fully reflected in the levels of depreciation previously provided for.

Council Housing - The Council's Housing Stock is valued under a standard methodology, part of which requires the application of an adjustment factor to allow for the difference between rents and yields on private sector and social housing. There is, currently, no published adjustment factor for Wales, and so the Council has selected the most comparable of the English regions and applied the published factor for that, which was 31%. Should a specific factor be published, either for Wales as a whole, or on a regional basis, then this will be applied. Each 1% of any resulting change would increase or decrease the reported value of the stock by approximately £3.4m.

Provisions - The Council has made provision for a series of uncertainties, which could result in significant costs in later years. These principally relate to equal pay, after-care costs for the Penhesgyn landfill site, prospective termination benefits for staff leaving the Council and possible liabilities arising from insurance liabilities. Full details are contained in Note 27. A change in the anticipated value of settlements for legal claims by 10% would increase or decrease the expected value of the liability by approximately £0.4m.

Pensions Liability – The Pension Liability position as contained within the accounts is based on a number of complex assessments and judgments relating to discount rates, projected salary increases, changes in retirement ages, mortality rates and expected returns on pension assets. A firm of consulting actuaries is engaged by the administering Council to provide expert advice on the assumptions to be applied. Further details are contained in Note 41

Doubtful Debts Impairment/Allowance – As at the 31st of March 2014 the Council had a short-term debtor balance of £29.3m. A review of the arrears balance suggested that impairment for doubtful debts of £5.6m was appropriate. Any differences between the impairment level applied and the actual arrears position will naturally reflect in future spending patterns. Doubtful Debts impairments are contained within the figures for Short Term Debtors contained in Note 24 on page 59

NOTE 8 - EARMARK RESERVES

	Balance as at 01 April 2012	Transfers In 2012/13	Transfers Out 2012/13	Balance as at 31 March 2013	Transfers In 2013/14	Transfers Out 2013/14	Balance as at 31 March 2014
	£000	£000	£000	£000	£000	£000	£000
Capital Expenditure	1,000	1,209	(1,209)	1,000	904	(1,339)	565
Penhesgyn Waste Landfill Site Reserve	886	0	(886)	0	0	0	0
Service Reserves	1,507	1,540	(1,156)	1,891	0	(268)	1,623
Restricted Services	1,781	4,036	(754)	5,063	1,997	(754)	6,306
Equal Pay, Single Status and Job Evaluation	1,966	701	0	2,667	0	(311)	2,356
Recycling	1,473	302	(986)	789	108	(667)	230
Performance Management Reserve	1,054	412	(26)	1,440	0	0	1,440
Major Repairs Reserve (HRA)	0	860	0	860	0	0	860
Insurance Fund	2,529	0	(178)	2,351	184	0	2,535
Other	686	1	(121)	566	10	(85)	491
Total	**12,882**	**9,061**	**(5,316)**	**16,627**	**3,203**	**(3,424)**	**16,406**

Purpose of Earmarked Revenue Reserves

Capital Expenditure - to fund capital expenditure in future years. This has been created to ensure committed capital expenditure, including expenditure which has slipped from previous years, is fully financed.

Penhesgyn Waste Landfill Site Reserve - this reserve was created from the net cash assets, less winding up and capping costs, of Cwmni Gwastraff Môn-Arfon Cyf, which has been wound up. The reserve was transferred in the financial year 2012/13 to provisions to meet future after-care liabilities for the site.

Service Reserves - under the Council’s Financial Procedure Rules over and under-spending is carried forward as earmarked reserves to the level set by the Executive.

Restricted Service Reserves - earmarked budgets within service areas which remain unspent at year-end.

Equal Pay, Single Status and Job Evaluation - as a result of the 'Single Status' agreement, the Council, in common with most other local authorities, is required to introduce a new pay and grading system with effect from 1 April 2007. The extent to which this may involve an obligation to back pay is uncertain. Negotiations are proceeding on a revised pay and grading structure. A sum has been set aside in the Job Evaluation reserve towards the overall cost of the exercise, including the administrative costs, the cost of new pay scales, any pay protection and any back pay. Although the individual elements cannot be estimated with certainty, the Council is of the view that the sums set aside are adequate.

Recycling - landfill cost savings created by diverting waste to recycling. The reserve will be utilised towards recycling initiatives.

Performance Management Reserve - amounts earmarked towards performance improvement measures from the Outcome Agreement Grant.

Major Repairs Reserve – amounts set aside from HRA balances to fund capital spending on Council housing.

Insurance Fund - the Council runs an internal insurance account, which pays for self-insured losses, and which receives 'premiums' from service accounts. The known losses at year-end are provided for. This reserve is the surplus on the internal insurance account plus interest on balances and is intended to cover claims, which have been incurred but have not been reported.

Other - this balance comprises the aggregation of the balances of 7 individual reserves, which, individually, hold balances of less than £0.5m, which are not considered to be material amounts.

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ISLE OF ANGLESEY COUNTY COUNCIL	
COMMITTEE:	AUDIT COMMITTEE
DATE:	22 JULY 2014
TITLE OF REPORT:	GOVERNANCE AND ASSURANCE UPDATE AND DRAFT ANNUAL GOVERNANCE STATEMENT 2013-14
PURPOSE OF REPORT:	UPDATE ON GOVERNANCE AND ASSURANCE AND PRESENTING INITIAL DRAFT OF THE GOVERNANCE STATEMENT
REPORT BY:	DEPUTY CHIEF EXECUTIVE
CONTACT:	Einir Wyn Thomas
ACTION:	CHALLENGE AND MAKE COMMENTS

1. Background

1.1 This report updates the committee on aspects of its corporate governance responsibilities. In particular it presents a draft of the Annual Governance Statement for 2013-14 for discussion and comment.

2. Governance and Assurance Update

2.1 In July 2013, the Audit Committee considered a report on the Review of Governance and AGS and requested that the “Deputy Chief Executive ... provide the Audit Committee with regular updates on the Governance Action Plan.” An update of the action plan appears at Appendix A.

3. Corporate Assessment

3.1 Members will be aware that Wales Audit Office has notified the Council that the first corporate assessment under the new regime will be carried out in February 2015. Work is underway to prepare for the Assessment.

4. Corporate Self-assessment

4.1 One of the agreed actions for the year, aimed at improving and streamlining governance arrangements, was to ensure that the main corporate self-assessments are streamlined. In 2013, a Corporate Self-assessment document was published in addition to the Annual Governance Statement and the Performance Report. All three were based on separate assessment activities.

4.2 This year the intention is to hold a workshop on 17 July, which will bring together these streams and ensure a consistent outcome. The results of the self-assessment will be shared with this committee.

5. The Annual Governance Statement

5.1 This section enables discussion of the Draft Annual Governance Statement (AGS) for the last financial year (Appendix B). The current draft is still at a consultation and challenge stage and will be updated as necessary for the result of the corporate self-assessment and any changes up to the date of signing the accounts. It will go on to officers and members for comment before being updated and brought back to this Committee for approval at its meeting in September.

5.2 The Council is required to review at least once in a year of the effectiveness of its system of internal control and governance arrangements and publish a statement reporting on the review at the same time as the Statement of Accounts.

5.3 This requirement is based on the CIPFA/SOLACE Statement from 2007 on Delivering Good Governance in Local Government. It is now a statutory requirement in England and since 2011 has had almost the same status in Wales. The expectation is that each authority adopts a local code of governance based on the principles in the CIPFA/ SOLACE framework then conducts a review against the framework and the local code.

5.4. Role of the Audit Committee: The approval of the Annual Governance Statement (prior to signing by the Leader and the Chief Executive) is in the Terms of Reference of the Audit Committee.

"3.4.8.1.1. (viii) to ensure that the authority has a sound system of internal control which facilitates the effective exercise of functions and which includes arrangements for the management of risk and adequate and effective financial management. To review the effectiveness of internal control at least once a year and approve an Annual Governance Statement for inclusion with the authority's Statement of Accounts."

5.5. Considerations for Audit Committee

- Are there any significant gaps in the description of the governance arrangements and are there any weaknesses in the arrangements?
- Does the conclusion on Significant Governance Issues sound right?
- Do members wish to make any comments on the content?

6. Recommendation

That the Audit Committee:

- Notes the update on governance;
- Considers the draft Annual Governance Statement and makes comments.

Appendix A

Governance and Assurance Action Plan July 2014 Audit Committee				
Issue	**Ref**	**Actions Identified**		
Significant Governance Issues				
The need to ensure that the Transformation Programme is delivered as planned while continuing to provide services effectively;	1.1	Establish Transformation Boards; Programme Management Office and Governance arrangements.	✓	
	1.2	Developing internal capacity to support transformation and improvement.	✓	
The need to plan for and deliver the savings required of the Council	2.1	Develop a Medium Term Financial Strategy based on existing plans and projections.		Being implemented - will need to be developed further
	2.2	Establish the Efficiency Strategy as part of the Council's core strategic plans		Being implemented - will need to be developed further
	2.3	Introduce Commissioning and Procurement Policy and Strategy		Procurement Improvement Programme set up
Taking appropriate technical and organisational measures against unauthorised or unlawful processing of personal data and against accidental loss or destruction of, or damage to, personal data	3.1	The Council has accepted a consensual audit by the Information Commissioner.	✓	
	3.2	Establish a project board to implement existing work plans and the recommendations of the Information Commissioner	✓	
Governance Framework and Review Issues				
Arrangements for Monitoring the Governance Framework and Action Plan	4.1	Invite Audit Committee to take regular monitoring reports	✓	
	4.2	Review Terms of Reference of the Audit Committee to ensure that the Annual Governance Statement (AGS) assurance can be gathered throughout the year		Programmed for 2014-15 new guidance published in December 2013
Achieving a Cohesive Governance Framework	5.1	Broaden the framework to include assurance on the Council's vision and outcomes for the public	✓	

	5.2	Document the framework and ensure that all relevant and current policies, strategies, guidelines and reports are easily accessible		Ongoing
	5.3	Provide training to managers and staff		Ongoing
Streamlining the Self-Assessments	6.1	Decide how to streamline the processes for developing the Corporate Self-Assessment, the AGS and the Improvement Report		Workshop July 2014
	6.2	Promote greater consistency across services in the quality of self-evaluation		Good progress in key service areas - now need to roll out to other services
Evaluating the effectiveness of controls	7.1	Map where the Council gets its assurance in all key governance areas and use it to feed the AGS, linking it with the Internal Audit assurance plan and annual corporate self-assessment		Ongoing
	7.2	Decide how to evaluate controls in assurance framework		Ongoing
Development areas				
Ensure coherent and effective senior management	8.1	Complete the Heads of Service review.	✓	
	8.2	Document and embed roles of Heads of Service and relationship with SLT		Action for 2014-15
	8.3	Approve a Protocol for Chief Finance Officer to ensure that the Council can show that it complies with the CFO Statement.		
Member Development	9.1	Achieve "The Wales Charter for Member Support and Development"	✓	
	9.2	Deliver the WLGA funded programme on developing the Executive	✓	

Developing and embedding the Corporate Performance Management system, Programme Management and the Risk Management system, and ensuring appropriate management information	10.1	Approve and implement a new Performance Management Framework	*M*	
	10.2	Review arrangements for a web-based performance management system		National solution not proceeding - potential collaborative procurement
	10.3	Identify current information systems and establish how they integrate with each other, identifying any gaps		Not currently prioritised
	10.4	Embed Risk Management arrangements	*M*	Action for 2014-15
	10.5	Introduce new Programme and Project Management framework		Action for 2014-15
	10.6	Introduce Officer group to review and make recommendations on matters relating to performance, projects, action plans and risks	✓	
Strengthening Financial Management Arrangements	11.1	Complete the implementation of new financial systems		Post implementation review - findings to be implemented
	11.2	Complete new staff structure for Finance		Being reviewed and aiming to conclude by Autumn
	11.3	Update Financial Procedure Rules		Action for 2014-15 - due to be availlable in Autumn
Ensuring that the basic building blocks of governance are in place consistently across departments and ensuring compliance	12.1	Ensure consistent absence and sickness management	*M*	Ongoing
	12.2	Increase the percentage of completed individual performance reviews	*M*	Ongoing
	12.3	Deliver the Development Priorities in the Corporate Communication Strategy		Ongoing

	12.4	Prepare and implement Customer Service Strategy		Customer Charter to be delivered as part of Customer Service Excellence project
The continued need to review, and improve, the governance arrangements for partnership and collaborative working and to raise awareness and ensure compliance by officers	13.1	Identify relevant partnership arrangements		Not currently prioritised
	13.2	Provide guidance to staff and members on setting up and managing partnerships		Not currently prioritised
	13.3	Establish a new Scrutiny Committee focused on Partnerships and Regeneration	✓	
	13.4	Update Financial Procedure Rules, Contract Procedure Rules, Schemes of Delegation		Delegation scheme updated following restructuring: Financial Procedure Rules and Contract Procedure Rules are actions for 2014-15
	13.5	Review and update the Constitution for partnership and collaborative working		Follows from 13.1/13.2
	13.6	Introduce Commissioning Policy and Strategy		Ongoing
The need to manage reports by external audit and other regulators on a corporate basis and ensure appropriate response	14.1	Implement system for identifying regulatory work across the Council		Improvements made recently
	14.2	Implement register of Regulators' recommendations and ensure monitoring of progress in line with internal audit recommendations		Action for 2014-15
	14.3	Introduce Officer group to review and make recommendations on the regulators' programmes and progress against agreed actions		Action for 2014-15

The Council has no complete and formally approved Business Continuity Plan or ICT disaster recovery plan	15.1	Draw up Service Business Continuity Plans		Not prioritised during period of restructuring. Resource now being discussed with North Wales joint service
	15.2	Develop the draft ICT Disaster Recovery Plan for approval		Progress made during year
Need to Strengthen Target Setting	16.1	Ensure that target setting supports the Council's objectives and priorities, is realistically linked to resources, and uses benchmarking and trends data to validate.		Progress made during year - ongoing in 2014-15
Need to strengthen Grant Claim processes	17.1	Complete Grants Action Plan		Progress made during the year but some actions ongoing
WAO's National Scrutiny Report	18.1	Consider result of WAO's National Scrutiny Report and draw up action plan		Action for 2014-15
Capacity and Capability in Corporate Services	19.1	Work to do to strengthen corporate capacity, particularly around ICT, procurement, asset and information management.		Action for 2014-15

ANNUAL GOVERNANCE STATEMENT – 2013-14

1 BACKGROUND

This is the first Governance Statement for the Council elected on new wards in May 2013 at the end of a period of government intervention. It sets out the governance arrangements in place for the year focusing on those current significant governance issues in relation to the authority achieving its vision. It highlights changes made during the year and includes a brief evaluation where weaknesses or significant improvements are identified.

Aspects of the Council's governance arrangements had been strengthened and modernised in recent years across a number of governance themes, and these were then incorporated in the Transformation Plan for the authority which was adopted in January 2013 setting out the agenda for its work up to 2016. It was designed as a programme of change driven by the Council itself.

The Vision for the Council is that by 2016:

"we will be a professional and well-run Council, innovative and outward-looking in our approach, committed to developing people and partnerships in order to deliver efficient and effective services of good quality, that are highly valued by our citizens."

We also emphasise that assurance and governance will be key to ensuring the delivery of corporate plan.

"In doing so, we will –

- provide an integrated performance management framework, linking the Corporate Plan to the Medium Term Financial Strategy down to the annual budget setting process and individual performance development reviews
- collect and use information to monitor our performance and take action to improve where required
- support the evolving strength of the Council's democratic decision making and scrutiny processes
- strengthen our engagement with and involvement of Anglesey citizens in the Council's decision making and accountability processes
- continue to strengthen our processes around finance and workforce reporting and monitoring
- put in place robust arrangements for dealing with our financial challenges, ensuring service transformation and innovative delivery is at the heart of what we do"

The six key themes supporting the vision are:

- **Professional and Well Run**
- **Innovative, Ambitious and Outward Looking**
- **Customer, Citizen and Community Focused**
- **Valuing and Developing our People**
- **Committed to Partnership**
- **Achieving**

The Governance Statement assesses the arrangements against the six principles of governance:

Focusing on the purpose of the authority and on outcomes for the community and creating a vision for the local area
Members and officers working together to achieve a common purpose with clearly defined functions and roles
Promoting values for the authority and demonstrating the value of good governance through upholding high standards of conduct and behaviour
Taking informed transparent decisions which are subject to effective scrutiny and managing risk
Developing the capacity and capability of Members and Officers to be effective
Engaging with local people and other stakeholders to ensure robust accountability

2 SCOPE OF RESPONSIBILITY

The Isle of Anglesey County Council is responsible for ensuring that its 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. The Council also has a duty under the Local Government (Wales) Measure 2009 to make arrangements to secure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness.

In discharging this overall responsibility, the Council is also responsible for putting in place proper arrangements for the governance of its affairs, facilitating the effective exercise of its functions, and which includes arrangements for the management of risk and adequate and effective financial management.

The Council has approved and adopted a local code of corporate governance which is consistent with the principles of the CIPFA/SOLACE Framework, Delivering Good Governance in Local Government. A copy of the local code is on our website at http://www.anglesey.gov.uk/council-and-democracy/governance-and-performance-/corporate-governance/. This statement explains how the Council has complied with the code and it meets the requirements of non-statutory proper practice encouraging the publication of an Annual Governance Statement. It also meets the requirement of regulation 4(2) of the Accounts and Audit (Wales) Regulations 2005 in relation to the publication of a statement on internal control.

3 THE PURPOSE OF THE GOVERNANCE FRAMEWORK

The governance framework comprises the systems and processes, and culture and values, by which the authority is directed and controlled and its activities through which it accounts to, engages with and leads the community. It enables the authority to monitor the achievement of its strategic objectives and to consider whether those objectives have led to the delivery of appropriate and cost effective services.

The system of internal control is a significant part of that framework and is designed to manage risk to a reasonable level. It cannot eliminate all risk of failure to achieve policies, aims and objectives and can only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of the Council's policies, aims and objectives, to evaluate the likelihood and potential impact of those risks being realised, and to manage them efficiently, effectively and economically.

The governance framework has been in place at the Council for the year ended 31 March 2014 and remains applicable up to the date of the approval of the Statement of Accounts. Where new arrangements have been introduced during the year this has been noted.

4 THE GOVERNANCE FRAMEWORK

The current framework as it relates to each of the six Corporate Governance principles is described in the schedules to the Local Code of Governance which is available at http://www.anglesey.gov.uk/council-and-democracy/governance-and-performance-/corporate-governance/ .

The following summary focuses on the areas of weakness and work on development and strengthening of the framework during the 2013-14 financial year.

Principle One: Focusing on the purpose of the authority and on outcomes for the community and creating a vision for the local area

Key Theme: Customer, Citizen and Community Focused
Committed to Partnership; Achieving

The Council's Corporate Plan 2012-15 continued to guide the work of the Council until the Corporate Plan (2013-17) for the new Council was adopted in December 2013. Wales Audit Office (WAO) reported that the Plan describes the Council's priorities succinctly and clearly and explains how the priorities reflect the views of the public as well as those of the Council and other partners. The Transformation Plan, which was key to the governance improvements of 2013, continues to support the transformation of the Authority to achieve its Vision and priorities. Whilst the strategic aspects are embedded in the new Corporate Plan other aspects guide and help prioritise the work of the Authority's Transformation Boards.

The Single Integrated Strategic Plan developed under the oversight of the Local Services Board was in place by 1 April 2013 as required, superseding the Community Strategy and the strategies for Health, Social Care and Wellbeing; Children; and Community Safety. A Joint Local Services Board is now in place for Anglesey and Gwynedd and the Single Integrated Plans of both council areas are being merged to provide renewed focus on the main priorities for joint action.

An annual budget and high level Medium Term Revenue Budget Strategy was approved in March 2013 and updated in February 2014 following public consultation. Budget cuts continue to be applied across the Council's services. The budget process included discussion in the public domain on the adequacy of reserves; robustness of estimates and treasury management arrangements as required. Little progress was made during the year on the Medium Term Financial Strategy, which still needs to be developed. Work has also commenced on an Efficiency Strategy to identify and confirm the savings which are required to achieve a balanced budget. The continuing cuts to funding and increasing demand for services and for increased performance provide a significant challenge to focus on what is really important.

The Statement of Accounts were published with an unqualified audit opinion at the end of September 2013. The auditor's Annual Audit Letter highlighted an error in producing the draft accounts which had led to a material misstatement, subsequently corrected, and proposed improvements for the current year.

An Improvement Plan (Performance Review) report was approved by the County Council in October 2013. The Plan looked back to assess how we performed against the priorities and targets as set out in our 2012-13 Corporate Business Plan. This was assessed by WAO in its Improvement Assessment Letter as the Council having discharged its improvement reporting duties under the Measure and having acted in accordance with Welsh Government guidance. [A Corporate Self-Assessment was undertaken in July 2014.]

Partnership governance arrangements are in place on a case by case basis but there is no overarching partnership framework in place. This has been identified as a weakness as partnering and commissioning becomes more of a priority for the Council and a programme of work is planned. However, governance and scrutiny arrangements are in place for the new Joint Local Services Board and the related Joint Partnership Unit. A transformation plan is being developed to ensure that these arrangements are effective and that the partnership is making a positive contribution to the objectives of the constituent organisations.

Progress is being made on the way service quality standards are set and measured, and the information needs are to be assessed and improved. Target setting was strengthened during the year although there is still room for improvement. Weaknesses in performance management and accountability had contributed to failings in both the Education and Children Services in recent years but it is now acknowledged that improvements in planning and accountability have improved the prospects for these key services. The good practices in these services will be extended to other areas of the Council.

A Performance Management Framework was in place throughout the year including quarterly score cards, half yearly challenges to Services and regular reports to the Executive and to Scrutiny. The framework continues to be developed to focus on self-assessment by Heads of Service, and on the key areas of risk and transformation. It is also focusing on improvements to reporting of workforce and financial information. During the autumn of 2013, a series of Service Reviews was undertaken which covered budgets and performance and which informed the budget process.

Financial Management arrangements were in place throughout the year, although there were recognised weaknesses in the old financial ledger and related systems which were used to close the 2012-13 accounts. The implementation of a new financial system which went live in April 2013 was intended to resolve these weaknesses but the implementation of the system led to delays and inaccuracies in the making and recording of some transactions. The effect was that there were gaps in financial controls and some non-compliance with system controls. Addition resource has been brought in to address the issues identified, the situation is being kept under review and an Action Plan is in place to resolve any outstanding issues.

The planned work on developing a commissioning strategy and updating procurement policies and procedures has been delayed. There are weaknesses of compliance and Value for Money relating to Procurement and a critical consultant's report was received during the year. An Improvement Programme for Procurement is underway.

Internal Audit review and report on processes that support the achieving of the Council's objectives and their annual report is an important part of the review of effectiveness described at Section 5 of this Statement.

Managing grant claims [draft received very recently - does this need to be highlighted?]

Principle Two: Members and officers working together to achieve a common purpose with clearly defined functions and roles

Key Theme: Professional and Well Run

The Council has adopted an Executive system with a Leader elected by the Council and an Executive of up to six members appointed by the Leader. The Executive makes decisions on key strategic issues and is responsible for implementing the agreed policies of the Council. Each Executive Member has a portfolio for a particular council function. Two scrutiny committees hold the Executive to account, these are made up of councillors not on the Executive. There are also regulatory committees including Planning, Licensing, Appeals and Audit, together with a number of other committees set up for specific purposes.

Arrangements for committees and a scheme of delegation to officers and members are included in the Council's constitution. Significant changes have been made to the committee structure and to the scrutiny function over recent years, especially so in the run-up to the May 2013 elections to cater for the reduction in the number of members from forty to thirty and for multi member wards.

There is a new Relationship Protocol for Members and Officers and during 2013 a programme of work supported by the Welsh Local Government Association (WLGA) was implemented to help develop the Executive and the way members and senior officers work together; this includes the key roles of Leader and Chief Executive, and a protocol for the Shadow Executive.

The Council's new senior management structure was completed during 2012. A review of the next tier of Head of Service was undertaken in 2013-14 and this led to a reduction of six posts at this level. The exercise was substantially complete in December 2013.

The approved senior management structure includes a Chief Executive who is the designated Head of Paid Service; a Deputy Chief Executive who is responsible for leading the internal functions of the Council and for ensuring good corporate governance; and three Directors who lead the agenda for their group of services, taking responsibility for the policy, planning and performance of those functions. These five officers form the Authority's Senior Leadership Team (SLT).

Heads of Function for Resources and for Council Business are respectively the authority's designated Chief Financial Officer (CFO) and Monitoring Officer. They both report to the Deputy Chief Executive who is responsible for the management of their performance and for coordinating their governance roles within the wider corporate governance and performance and change management framework.

The approved management model is that the SLT leads on developing the vision and strategic direction of the Council and is held to account in that role; and that the extended management team has an implementation role. The CFO and Monitoring Officer attend SLT meetings as required and are key members of the Heads of Service management team. They have ready access to the Chief Executive and the SLT and its individual members.

It is a requirement that local authorities assess their arrangements on an annual basis against the CIPFA Statement on the Role of the Chief Financial Officer in Local Government and report on compliance or explain any alternative arrangements. Since January 2013, the approved management model has been in place which is a different model to that envisaged by CIPFA but which is intended to have an equivalent impact to that envisaged by the CIPFA Statement. A protocol has been drawn up, to ensure that the Council's arrangements deliver an equivalent impact; this includes access to SLT meetings and papers and other safeguards. The protocol will be considered by the full Council, in October 2014. The effectiveness of the protocol for committee papers has been reviewed, and was amended and implemented in February 2014.The effectiveness of these arrangements is being reviewed by management in Autumn 2014.

The Council implemented the Public Service Internal Audit Standards in April 2013. There is also an expectation that local authorities are compliant with the CIPFA Statement on The Role of the Head of Internal Audit in Public Service Organisations: the Council’s arrangements are consistent with the principles set out in the statement. A review of effectiveness of Internal Audit will be conducted.

Some corporate services were strengthened as part of the response to the Corporate Governance Inspection in 2009. During the year, as a result of the budget cuts, and difficulties in recruitment, a number of corporate services are now looking at ways of managing client demand to front line functions and is currently the subject of review by the Deputy Chief Executive.

Allowances are paid to members in accordance with a local scheme based on the decisions of the Independent Remuneration Panel for Wales. The Panel published specific reports for this Council in respect of the year. Decisions on discretionary matters are taken by the Full Council and both the schemes, and the payments made to members under the scheme, are published on the Council’s website.

A Pay Policy Statement has been adopted as required and this was reviewed and updated in March 2013 and 2014.

Principle Three: Promoting values for the authority and demonstrating the value of good governance through upholding high standards of conduct and behaviour

Key Theme: Professional and Well Run

The Corporate Plan for 2012-15 set out the Council’s values and these became embedded in the Vision of the Transformation Plan and the Transformation Culture. The Six Key Themes underpin the corporate way of working and the importance of good governance is emphasised in the new Corporate Plan.

The Local Code of Corporate Governance was updated in September 2013.

There are a number of codes of conduct and protocols in place as part of the Constitution to ensure high standards of conduct and behaviour. There is a Policy for the Prevention of Fraud and Corruption in the Constitution with subsidiary plans in place.

An active and effective Standards Committee is in place and it reported on its work in an annual report at the end of the year. There has been a history of complaints against council members, often by other members. The number of these complaints has reduced very significantly with no complaints upheld during the year, and the Chair of the Standards Committee refers to a huge improvement in standards within the council which has naturally lead to a reduction in conduct issues and complaints being raised.

Principle Four: Taking informed transparent decisions which are subject to effective scrutiny and managing risk

Key Theme: Innovative, Ambitious and Outward Looking

The arrangements for delegation of Executive decisions to individual Members are becoming better understood across the Authority and guidance was reissued in August 2013 and its effectiveness will be reviewed by management in the Autumn.

In 2012, the Council introduced new systems to ensure easy access to the Council's agendas, papers and minutes and from May 2013 members and the public have had the full benefit of access to committee papers and supporting information. Members have direct access to this electronic system during meetings.

The role of Scrutiny was strengthened as part of the Commissioners' programme of work and an Annual Report was published in May setting out the work done by the Committees during the year. Scrutiny was also the subject of a national WAO Improvement Study in early 2013 and the Council conducted a self-evaluation as part of the study. The results of the self-evaluation show a perception that scrutiny is not yet positively supporting the Council and its Services. The results of the self-evaluation will be considered in the context of changes made since May 2013 and the national report and guidance and an improvement plan is being put in place. From June 2013 the number of scrutiny committees has been reduced from five to two and the effectiveness of this change is being reviewed. The Deputy Chief Executive is working with Scrutiny to bring in a more corporate way of working, with a view to Scrutiny effectively adding value to service performance and to the Council achieving its objectives. A Working Group has been established to review the terms of reference of the Scrutiny Committees. Draft changes have been made and are currently the subject of consultation. They are due to go to the full Council in October 2014.

Risk Management arrangements have been developing over the last two years and the policies and guidance were reaffirmed and formally adopted in 2012. Arrangements continue to be embedded in services and corporately but progress is slow. Additional resources have been identified to support progress.

The management of change had been weak within the authority and project management not embedded. During the year, significant steps have been taken to develop a new programme and project management framework and to provide capacity to support the Transformation Plan. The effectiveness of the framework is being reviewed.

An effective Audit Committee is in place. The committee conducted a self-assessment during the year and reported on its work at the end of the year.

There are transparent and accessible arrangements for dealing with complaints and a new Concerns and Complaints Policy came into force in April 2013 based on the Model Policy developed with the Public Services Ombudsman for Wales. Internal Audit has undertaken sample testing of compliance and a report has been produced. There are two areas of service non-compliance which are now being addressed corporately through an agreed Action Plan. The number of complaints to the Ombudsman were again relatively low with only one complaint reaching the investigation threshold; that complaint was upheld.

The Council has recently updated and re-launched its Policy on Whistleblowing to comply with the new statutory legal test. The Policy has been given more prominence on the Council's website. However, it is acknowledged that there are deficiencies, namely a documented procedure is required, there is a need to increase awareness/training and to develop a centralised corporate database to capture the information and ensure that it is analysed and appropriately reported. It is proposed that there will shortly be training for middle managers through the Middle Managers Conference and that dealing with whistleblowing complaints will form part of the investigation skills training which is currently being arranged.

Principle Five: Developing the capacity and capability of Members and Officers to be effective

KeyTheme: Valuing and Developing our People

During the year, the Council achieved the Welsh Charter for Member Support and Development which has been developed by the WLGA and authorities to provide a guide, some impetus and recognition for authorities wishing to provide high standards of support for their members. Member job descriptions have been in place since 2012. Most members have completed personal development reviews. The Member Development Plan takes account of these reviews. An induction programme for new members was undertaken in June 2013 onwards. The Democratic Services Committee oversees these areas and its Chair serves as Member Development Champion. Job descriptions/person specifications and personal development reviews for elected Members have now been extended to include the seven coopted members of the Standards Committee. From 2014, members also prepare individual annual reports which are published on the Council website.

A Democratic Renewal Strategy was completed in preparation for the elections held in May 2013. This strategy contributed to increased participation and increased voter turnout. There are still concerns about lack of diversity of candidates and membership.

We have a People Strategy and Strategies for Workforce Development, Talent and Succession Planning and the Council has Investors in People accreditation. There was an induction programme in place for staff and managers throughout the year.

The Corporate Personal Development Review was further embedded and developed in the year. The scheme covers all staff including senior managers. [report outcome here]. A target of 70% has been set to ensure a higher rate during 2014-15. Arrangements are being made to target training and development on a more consistent and focused basis, linked to appraisal, as budgets are reduced.

As a consequence of the priority afforded to completing the corporate Job Evaluation project, there has been less progress on developing the strategic HR plans. These strategies will be updated to incorporate the needs of the Transformation Plan and outcomes of the staff survey.

There is a lively Middle Managers forum and the Ignite Club provides inspirational learning sessions which are open to all staff. As part of the activity on the Transformation Plan and staff engagement activity, individuals across the authority have been given an opportunity to work on corporate projects and strategies.

Principle Six: Engaging with local people and other stakeholders to ensure robust accountability

Key Theme: Customer, Citizen and Community Focused

The Community Engagement Strategy produced in 2011 was still in place during the year and was supported by Good Practice Consultation and Engagement Guidelines for staff. This strategy is now dated and is to be replaced by a Customer Care Charter and by the Corporate Communication Strategy. Effective public consultation was achieved as part of the corporate planning and budget setting processes as well as in developing strategies for future delivery of key services. As a result of public engagement activity over the last few years, there is a pool of citizens who have volunteered to assist the Council as consultees in the future. The Council is working closely with Menter Mon via the Local Voices project to optimise consultation opportunities.

Arrangements for engagement with groups of stakeholders are in place and include a Community Council Charter and a Voluntary Sector Compact.

The Council conducted a surveys of its residents in 2012 but is now using the results of the National Survey for Wales to obtain feedback on a comparable basis annually across Welsh authorities. The 2014 survey shows that 59% of Anglesey respondents agree that the Council provides high quality services. This rate is higher than the average for Wales and is a significant improvement on last year (48%). The Survey also showed that slightly more respondents agree than disagree that the Council is good at letting people know how it is performing – also better than average and a significant increase on last year.

Arrangements are in place to engage with Welsh Government, External Audit and other regulators and WLGA. These have been strengthened during the recent periods of intervention and need to be sustained as part of the continuing governance arrangements.

A Communication Strategy is in place for the year. The strategy has four strands: Citizen and Community Engagement; Media; the Council Brand; and Internal Communication. Internal Communication is a key area for development in the Transformation Plan.

Annual reports on their work were published by Scrutiny as well as the Standards and Audit Committees. From June 2014, individual members also publish annual reports.

The Council's first staff survey for some years attracted a response rate of 32% and results were encouraging. Of those staff who responded, most (71%) are proud to work for the Council and 75% are satisfied with the Council as an employer. 89% of staff enjoy their work most of the time and 85% are satisfied with their job.. The survey has highlighted that work needs to be done at all levels to make staff feel valued, to communicate and consult better on major issues affecting staff and to inform them about decisions taken which affect Anglesey as a whole.

There are longstanding arrangements for engaging with employees: with Trade Unions through the Local Joint Consultative Committee and less formal meetings, and communication with staff generally through e.g. monthly staff bulletins. Managers and staff are being consulted and involved in decision making as part of the Transformation Programme.

5 REVIEW OF EFFECTIVENESS

The Isle of Anglesey County Council has responsibility for conducting, at least annually, a review of the effectiveness of its governance framework including the system of internal control. The review of effectiveness is informed by the work of managers within the authority who have responsibility for the development and maintenance of the governance environment, the Head of Internal Audit's annual report, and also by comments made by the external auditors and other review agencies and inspectorates.

The effectiveness of the governance framework has been evaluated by a combination of:

- the results of the regular in-year review and monitoring by officers and committees;
- a review of relevant documents prepared during the year or relating to the year;
- the review of progress against the Transformation Plan;
- a review of the six themes which underpin the authority's values
- reviews of feedback from Estyn and CSSIW and the related recovery boards on the improvement work in relation to Education and Children's Services;
- a series of interviews with key officers;
- discussion with, and receiving comments from, groups of officers and members including the SLT and the Executive.

Regular in-year review and monitoring includes:

- formal risk management activity, including specific consideration of those risks linked to governance processes;
- Internal Audit, whose work takes account of identified risks through regular audits of the major systems, establishments, major projects and major governance processes; including risk management, in accordance with the annual internal audit plan, and which includes 'follow-up' work to ensure that senior officers implement agreed recommendations;
- the annual assessment of Internal Audit by the Council's external auditors;
- the work of the Council's Scrutiny and other Committees, including its Audit and Standards committees;
- the opinions and recommendations of the Council's external auditors and other review agencies and inspectorates;
- the regular monitoring of improvement and performance against the Corporate Plan and its supporting plans and strategies by members and senior managers.

Key policies, and any amendments to them, are approved by the Executive and where appropriate, formally adopted by the County Council.

[In July, a Corporate Self-Assessment was conducted by Senior Members and Officers, based on the evidence collected for this Governance Statement and the Annual Performance Report and other information. The results of the self-assessment [will be] consulted on and made available to staff and stakeholders. It [will] also inform this Statement and the related Action Plan.]

The Audit Committee was asked for views on the effectiveness and completeness of the assurance and governance framework and comments on a draft version of this AGS before final draft was taken back to the Committee for approval.

6 SIGNIFICANT GOVERNANCE ISSUES

Good progress was made across a number of governance themes during the year leading to an Annual Improvement Report (AIR) from Wales Audit Office concluding "that the Council is likely to make arrangements to secure continuous improvement for 2014-15. [they] found that:

- "the Council made steady progress in delivering improvements in most of its priority areas for 2012-13 but further improvements are required in some key services.";
- "more thorough and consistent procedures and developing governance arrangements have strengthened the Council's ability to evaluate and improve services."; and
- "if delivered effectively, the Council's plans for improvement and its arrangements to support improvement should help it to meet the financial and other challenges that lie ahead.."

They also made a proposal that "To make progress and achieve the objectives of the Transformational Plan, the Council should:

- secure sufficient capacity, capability and stability in its corporate finance service; and
- identify and improve weaknesses in the management of the financial ledger system."

The report of the Head of Internal Audit gives assurance on the framework for internal control. It identifies one review carried out during the year which received a "red" assurance opinion. This review related to Creditor Payments made through the new CIVICA system which went live at the beginning of the year, and identified some control gaps and some non-compliance with system controls. Reports on another two financial systems based on CIVICA (debtors and ledger) were given a red/amber assurance for similar reasons. The report of the Head of Internal Audit also identifies five areas where significant weaknesses in control would prevent the Council placing reasonable reliance on the systems of internal control in respect of those systems reviewed during the year. These areas were:

- Business Continuity;
- Risk Management;
- Governance: compliance with key corporate policies and procedures;
- Information Management; and
- System Implementations, especially with regard to replacement of key financial systems.

Good progress was made on a number of the actions identified in the 2012-13 Annual Governance Statement as Significant Issues:

- We established Transformation Programme Boards; a Corporate Programme Management Office and related governance arrangements;
- Progress has been made in the management of data security and information assets, but there is still more to do;

but progress was slower on planning for and delivering the savings required of the Council although progress is being made now.

Progress is also slower on some of the other areas in the Governance and Assurance Action Plan:

- Risk Management,
- Business Continuity;
- Compliance with key corporate policies;
- Information Systems;
- [add after completing review of action plan]

These items are reflected in the report of the Head of Internal Audit; in the Self-assessment; or in the AIR and are included in the governance action plan for 2014-15.

Based on the review outlined above, and in particular, the annual report of the Head of Internal Audit; the corporate self-assessment, and the Annual Improvement Report by the Wales Audit Office, the following issues have been identified as the current significant governance issues in relation to the authority achieving its vision:

Significant Governance Issues	
Issue	**Actions Identified**
The need to plan for and deliver the savings required of the Council	*Develop a Medium Term Budget Strategy based on existing plans and projections* *Establish the Efficiency Strategy as part of the Council's core strategic plans* *Introduce Commissioning and Procurement Policy and Strategy*
Taking appropriate technical and organisational measures against unauthorised or unlawful processing of personal data and against accidental loss or destruction of, or damage to, personal data	*The Council has accepted a consensual audit by the Information Commissioner and the Action Plan arising therefrom.* *Establish a project board to implement existing work plans and the recommendations of the Information Commissioner*
Corporate Services Capacity *To include Finance, ICT, Legal, HR and Scrutiny*	*Services are drafting the corporate service "offer" for discussion in order to ensure resourcing of corporate and service priorities.*
Financial Systems, especially the ledger system	*Action Plan being implemented following a post implementation review*
Risk Management	*Programme of work due in the Autumn*
Procurement	*Procurement Improvement Programme being put in place*
[may need to add more after self-assessment]	

7 CERTIFYING THE ANNUAL GOVERNANCE STATEMENT

We have been advised on the implications of the result of the **review of the effectiveness of the governance framework** by the Audit Committee and that the arrangements **continue to be regarded as fit for purpose in accordance with the governance framework**. The areas already addressed and those to be specifically addressed with new actions planned are outlined in the document.

We propose to take appropriate steps to address these and the other weaknesses identified in the Annual Governance Statement and to further enhance our governance and assurance arrangements in the forthcoming year. We will monitor the implementation and operation of improvements through the Audit Committee and as part of our next annual review.

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Leader of the Council	**Chief Executive**
Date:	**Date:**

On behalf of the Isle of Anglesey County Council

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ISLE OF ANGLESEY COUNTY COUNCIL	
REPORT TO:	**AUDIT COMMITTEE**
DATE:	**22 JULY 2014**
SUBJECT:	**ANNUAL TREASURY MANAGEMENT REVIEW FOR 2013/14**
PORTFOLIO HOLDER(S):	**COUNCILLOR H E JONES**
LEAD OFFICER(S):	**RICHARD MICKLEWRIGHT**
CONTACT OFFICER:	**BEN DAVIES (EXT. 2610)**

Nature and reason for reporting

To comply with regulations issued under the Local Government Act 2003 and with the Council's Treasury Management Scheme of Delegation for 2014/15 (Appendix 8).

In accordance with the Treasury Management Scheme of Delegation for 2014/15 (Appendix 8 of the Treasury Management Strategy Statement 2014/15) this report is due to be presented to the Executive and then the full Council once it has been scrutinised by this committee.

Summary

The Council is required by regulations issued under the Local Government Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2013/14. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management (the Code) and the CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code).

Under the Prudential Code it is a requirement that all local authorities set Prudential Indicators for borrowing and investing among other factors each year. The Council confirmed its limits for 2013/14 on 5 March 2013 and outturn information is provided in this report.

During 2013/14 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (received on 5 March 2013);
- a mid year (minimum) treasury update report (received on 27 March 2014);
- an annual review following the year describing the activity compared to the strategy (this report).

The regulatory environment places responsibility on Members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by Members.

This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit Committee before they were reported to the full Council.

In order to support the scrutiny role of the members of the Audit Committee Member training on treasury management issues was undertaken during July 2013 as part of the induction training after the May 2013 elections. Further training took place this July.

During 2013/14, the Council complied with its legistlative and regulatory requirments. The key data for actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:-

Data for actual prudential and treasury indicators	2012/13 Actual £000	2013/14 Original £000	2013/14 Actual £000
Capital expenditure			
• Non-HRA	16,677	19,000	20,936
• HRA	8,751	4,900	3,169
• Total	25,428	23,900	24,105
Total Capital Financing Requirement:			
• Non-HRA	81,346	88,500	86,286
• HRA	25,062	23,700	23,903
• Total	106,408	112,200	110,189
Gross borrowing	96,097	122,000	89,590
External debt	96,097	124,000	89,590
Investments			
• Longer than 1 year	-		-
• Under 1 year	13,468		9,196
• Total	13,468		9,196

Other prudential and treasury indicators are to be found in the main body of this report. The S151 Officer also confirms that borrowing was only undertaken for a capital purpose and the statutory borrowing limit (the authorised limit), was not breached.

The financial year 2013/14 continued the challenging investment environment of previous years, namely low investment returns and continuing heightened counterparty risk.

RECOMMENDATIONS

The Committee is recommended to:-

(i) Note the actual 2013/14 prudential and treasury indicators in this report;
(ii) Consider the annual treasury management report for 2013/14 and pass on to the next meeting of the Executive with any comments.

Appendices:

Appendix 1 - Summary Portfolio Valuation as at 31 March 2014
Appendix 2 - Credit ratings of investment counterparties and deposits held with each as at 31 March 2014
Appendix 3 - Equivalent Credit Ratings
Appendix 4 - The Economy and Interest Rates – A Commentary by Capita Asset Services

Background papers

Treasury Management Strategy Statement 2013/14
Prudential and Treasury Indicators 2013/14.

1. INTRODUCTION

This report summarises the following functions / activities / outcomes in financial year 2013/14:-

- Capital activity;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- The actual prudential and treasury indicators;
- Overall treasury position identifying how the Council has borrowed in relation to this indebtedness, and the impact on investment balances;
- Interest rate movements in the year;
- Detailed debt activity; and
- Detailed investment activity.

2. THE COUNCIL'S CAPITAL EXPENDITURE AND FINANCING 2013/14

2.1 The Council undertakes capital expenditure on long-term assets. These activities may either be:-

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or

- Financed from borrowing; this may be through planned borrowing or otherwise. If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

2.2 The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

£m	2012/13 Actual (£m)	2013/14 Estimate (£m)	2013/14 Actual (£m)
Non-HRA capital expenditure	17	19	21
HRA capital expenditure	9	5	3
Total capital expenditure	**26**	**24**	**24**
Non-HRA financed in year	11	8	9
HRA financed in year	5	5	3
Non-HRA unfinanced capital expenditure	**6**	**11**	**12**
HRA unfinanced capital expenditure	**4**	**0**	**0**

3. THE COUNCIL'S OVERALL BORROWING NEED

3.1 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 debt position. The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend. It represents the 2013/14 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

3.2 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 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.

3.3 Reducing the CFR

3.3.1 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.

3.3.2 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).

3.3.3 The Council's 2013/14 MRP Policy (as required by WG Guidance) was approved as part of the Treasury Management Strategy Report for 2013/14 on 5 March 2013.

3.3.4 The Council's CFR for the year is shown below, and represents a key prudential indicator. This would include any PFI and leasing schemes on the balance sheet, which would increase the Council's borrowing need, the CFR. There were no such schemes during the year.

CFR: Council Fund	2012/ 13 Actual (£m)	2013/ 14 Budget (£m)	2013/ 14 Actual (£m)
Opening balance	79	81	81
Add unfinanced capital expenditure (as above)	6	11	8
Less MRP/VRP*	(4)	(3)	(3)
Closing balance	81	89	86

CFR: HRA	2012/ 13 Actual (£m)	2013/ 14 Budget (£m)	2013/ 14 Actual (£m)
Opening balance	22	25	25
Add unfinanced capital expenditure (as above)	4	0	-
Less MRP/VRP*	(1)	(1)	(1)
Closing balance	25	24	24

** Includes voluntary application of capital receipts*

3.3.5 The borrowing activity is constrained by prudential indicators for gross borrowing and the CFR, and by the authorised limit.

3.4 Gross borrowing and the CFR

In order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

	31 March 2013 Actual (£m)	31 March 2014 Budget (£m)	31 March 2014 Actual (£m)
Gross borrowing position	96.1	112.2	89.6
CFR	106.4	112.2	110.2

3.4.1 As part of the financing of capital expenditure for 2013/14 borrowing was used to finance the gap between available resources (capital receipts, capital grants, capital contributions and revenue contributions) and the capital expenditure. It was decided, in light of current and projected market interest rates and counterparty credit risks, to continue internalising borrowing, in the short term at least. This strategy has now been implemented throughout each of the last three years. As a result of continuing with this strategy, the gap between CFR and external borrowing increased during 2013/14 to £20.6m. The gross borrowing at 31 March 2014 is less than the forecast CFR for the following 2 years.

3.5 The other debt related indicators are:

3.5.1 **The authorised limit** - the authorised limit is the "affordable borrowing limit" required by section 3 of the Local Government Act 2003. Once this has been set, the Council does not have the power to borrow above this level. The table below demonstrates that during 2013/14 the Council maintained gross borrowing within its authorised limit.

3.5.2 **The operational boundary** – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary are acceptable subject to the authorised limit not being breached.

3.5.3 **Actual financing costs as a proportion of net revenue stream** - this indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2013/14
Authorised limit	£122.0m
Maximum gross borrowing position	£96.1m
Operational boundary	£117.0m
Average gross borrowing position	£94.0m
Financing costs as a proportion of net revenue stream - CF	5.43%
Financing costs as a proportion of net revenue stream - HRA	16.62%

The reason for the Council Fund financing costs being a marginally higher percentage of the net revenue stream than estimated was due to higher than anticipated financing costs, combined with lower than expected investment income but countered to some extent by higher than expected net revenue stream. A second set of limits of £2m was approved for other long term liabilities; no such liabilities existed during the year.

4. TREASURY POSITION AS AT 31 MARCH 2014

4.1 The borrowing and investment figures for the Council as at the end of the 2013/14 and 2012/13 financial years are as follows:-

	31 MARCH 2013			31 MARCTH 2014		
	£'000	Average Rate (%)	Average Maturity (yrs)	£'000	Average Rate (%)	Av erage Maturity (yrs)
Debt: All Public Works Loans Board	96,096	5.53	26.5	89,590	5.72	26.2
CFR	106,408			110,189		
Over / (under) borrowed	(10,312)			(20,599)		
	10,000	1.63		5,005	0.80	
Fixed term investments (all < 1 year, managed in house and fixed rate)	3,468	0.79		4,191		
No notice investments (all managed in house)	13,468	1.41		9,196	0.58	
Total Investments					0.70	

See a more detailed analysis in Appendix 1. The upper limits for fixed rate and variable rate exposures were not breached during the year.

4.2 Borrowing is further broken down by maturity as:-

	31 MARCH 2013		31 MARCH 2014		2012/13 and 2013/14 Limits	
	£m	% of total	£m	% of total	% of total (upper)	% of total (lower)
Total borrowing	96.1	100	89.6	100		
Under 12 months	6.5	7	0.0	0.0	20	0
12 months and within 24 months	0.0	0	0.0	0.0	20	0
24 months and within 5 years	5.5	6	10.5	11.8	50	0
5 years and within 10 years	16.8	17	13.7	15.3	75	0
10 years and above	67.3	70	65.4	72.9	100	0

4.3 The average borrowing rate of the loan portfolio increased during the year as a loan of £6.5m with a rate of 2.95% matured. There was no debt rescheduling and no new external borrowing. No debt rescheduling took place during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

4.4 Part of the Council's deposits are held in no notice deposit accounts which pay interest at rates near the prevailing base rate (£4.2m at 0.58% (31 March 2013: £3.5m at 0.79%). Of the remaining deposits, £5m was being held for a period of less than 1 year at a rate of 0.80% (31 March 2013: £10m at 1.63%).

5. TREASURY STRATEGY FOR 2013/14

5.1 The expectation for interest rates within the strategy for 2013/14 anticipated low but rising Bank Rate (starting in quarter 1 of 2015), and gradual rises in medium and longer term fixed borrowing rates during 2013/14. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

5.2 In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and to reduce counterparty risk.

5.3 The actual movement in gilt yields meant that PWLB rates were on a sharply rising trend during 2013 as markets anticipated the start of tapering of asset purchases by the Fed. This duly started in December 2013 and the US FOMC (the Fed.), adopted a future course of monthly reductions of $10bn (from a starting position of $85bn), meaning that asset purchases were likely to stop by the end of 2014. However, volatility set in during the first quarter of 2014 as fears around emerging markets, various vulnerabilities in the Chinese economy, the increasing danger for the Eurozone to drop into a deflationary spiral, and the situation in the Ukraine, caused rates to dip down, reflecting a flight to quality into UK gilts.

5.3 The economic position and PWLB and investment rates were as shown in Appendix 4.

6. INVESTMENT OUTTURN FOR 2013/14

6.1 The base rate remained at its historic low of 0.5% throughout the year; it has now remained unchanged for five years. Market expectations of the start of monetary tightening ended up almost unchanged at around the end of 2014 / start of 2015. The Funding for Lending Scheme resulted in deposit rates remaining depressed throughout the year although the part of the scheme supporting provision of credit for mortgages came to an end in the first quarter of 2014.

6.2 The expected investment strategy was to keep to shorter term deposits (up to 364 days) although the ability to invest out to longer periods was retained (although not used). Available cash balances were expected to be up to £30m, ranging between £15m and £35m. The budget was set at 0.92% or £332k after adjusting for the higher rates on existing investments. As it turned out, average balances of £23.1m returned £185k (0.80%). The lower than budgeted average cash balance was partly the result of continuing to internalise borrowing. The lower than budgeted return was due to worse than anticipated rates of return on investments, with rates continuing to fall throughout the year.

7. INVESTMENT SECURITY AND CREDIT QUALITY

7.1 No institutions in which we had made investments had any difficulty in repaying investments and interest on time and in full during the year.

7.2 During 2013/14, credit ratings remained poor across the range of our usual counterparties. Since late 2008 it has been challenging to place deposits with appropriate counterparties. In December 2008, the Council's approval was obtained to extend flexibility with counterparties to deal with market changes; this included the ability to invest all our surplus funds with central government if necessary. The list was further widened in April 2010 to include nationalised and partly nationalised institutions and this list was clarified in March 2013 in relation to nationalised and part nationalised UK banks for the 2013/14 criteria. Previous decisions had extended flexibility for investing with local authorities.

7.3 The practical effect of these policies was as follows: during the year we continued to use no notice accounts with major high street institutions (Santander, HSBC, RBS and Bank of Scotland) for day to day cash flow.

7.4 The two fixed term investments (both with the Royal Bank of Scotland (RBS), each being £5.0m) at the start of the year, matured during the year (in May 2013 and November 2013). The investment that matured in May 2013 was at a rate of 1.68% and this was reinvested in full with RBS for a further 6 months at a rate of 0.95% and upon maturing in November 2013 it was reinvested in full with RBS for a further 3 months at a rate of 0.8% and again for another 3 months at 0.8% upon maturing in February 2014. The investment from the previous year that matured in November 2013 was at a rate of 1.58% and this was reinvested with RBS on a no notice basis; this was in order to maintain flexibility and minimise risk and given the continued low level interest rate. The decisions to invest with RBS were made primarily due to them being one of the few creditworthy institutions given their UK government backing.

7.5 During 2013/14 the credit rating issues with Santander continued and the suggested investment duration for Santander UK were at times below the minimum acceptable level. As previously reported investment, on a call basis only, continued with Santander UK on the basis of market analysis and advice from our treasury advisors. Santander's position strengthened through the year and the suggested investment durations from Capita increased to and stabilised at 100 days.

RICHARD MICKLEWRIGHT
INTERIM HEAD OF FUNCTION (RESOURCES) &
SECTION 151 OFFICER **14 JULY 2014**

Summary Portfolio Valutaion
As at 31 March 2014

FINANCIAL ASSETS	**Nominal / Principal (£)**	**Fair Value (£)**
Cash (interest bearing accounts) (1)	4,190,538	4,240,429
Fixed Term Desposits (2)	5,005,042	5,012,467
FINANCIAL LIABILITIES		
PWLB loan – Maturity	89,315,764	109,721,038
PWLB loan – Annuity	274,315	417,031

Counterparties

(1)	Cash (interest bearing accounts)	
	Santander	198
	Bank of Scotland	3,174
	HSBC	243,670
	RBS	3,943,496
		4,190,538
(2)	Fixed Term Deposits	
	Royal Bank of Scotland	5,005,042

Graddfeydd Credyd Gwrthbartion buddsoddi a'r adneuon a ddelir gyda phob un ar 31 Marwth 2014 *
Credit ratings of investment counterparties and deposits held with each as at 31 March 2014*

Grŵp Bancio/ Banking Group	Sefydliad/ Institution	Adneuon / Deposit £'000	Hyd (Galw tymor sefydlog) / Duration (Call / Fixed Term**)	Cyfnod (O/I)/ Period (From - To)	Graddfa Dychweliad/ Rate of Return %	Graddfa Tymor Hir Fitch Long Term Rating ****	Graddfa Tymor Byr Fitch Short Term Rating ****	Graddfa Tymor Hir Moody's Long Term Rating ****	Graddfa Tymor Byr Moody's Short Term Rating ****	Graddfa Tymor Hir Standard & Poor's (S&P) Long Term Rating ****	Graddfa Tymor Byr Standard & Poor's (S&P) Short Term Rating ****	Lliw Sector/Hyd Awgrymiedig/ Sector Colour / Suggested Duration
Lloyds Banking Group plc	Bank of Scotland plc	**3**	**Galw/ Call**	**n/a**	**0.40**	**A**	**F1**	**A2**	**P-1**	**A**	**A-1**	**Glas - 12 mis/ Blue - 12 months**
HSBC Holdings plc	HSBC Bank plc	**244**	**Galw/ Call**	**n/a**	**0.25**	**AA-**	**F1+**	**Aa3**	**P-1**	**AA-**	**A-1+**	**Oren – 12 mis / Orange – 12months**
Santander Group plc****	Santander UK plc	**-**	**Galw/ Call**	**n/a**	**0.40**	**A**	**F1**	**A2**	**P-1**	**A**	**A-1**	**Gwyrdd – 100 diwrnod/ Green - 100 days**
The Royal Bank of Scotland Group plc	The Royal Bank of Scotland plc	**3,943**	**Galw/ Call**	**n/a**	**0.60**	**A**	**F1**	**Baa1**	**P-2**	**A-**	**A-2**	**Glas - 12 mis / Blue - 12 months**
The Royal Bank of Scotland Group plc	The Royal Bank of Scotland plc	**5,005**	**Tymor Sefydlog/ Fixed Term (3 mis/months)**	**Chwefrord /February 2014 - Mai/ May 2014**	**0.80**	**A**	**F1**	**Baa1**	**P-2**	**A-**	**A-2**	**Glas – 12 mis / Blue - 12 months**

* Ceir y Rhestr Benthyca Cymeradwyedig yn Atodiad 5 o'r Datganiad Strategaeth Rheoli Trysorlys 2013/14/Strategaeth Buddsoddi Blynyddol / The Approved Lending List can be found at Appendix 5 of the 2013/14 Treasury Management Strategy Statement / Annual Investment Strategy

** Sef tymor ar pwynt y buddsoddi/Being term at the point of investment.

*** The long term credit rating of RBS was downgraded in March 2014. Given the part nationalised status of this institution the credit rating of the bank are not the determinant of whether to invest.

**** Yn Atodiad 3 ceir y graddfeydd credyd cyfatebol ar gyfer y 3 asiantaeth graddio y cyfeirir atynt uchod./The equivalent credit ratings for the 3 rating agencies referred to above can be found at Appendix 3.

Graddfeydd Credyd Cyfatebol/

Equivalent Credit Ratings (Fitch, Moodys, S&P)

Tymor Hir Fitch Long Term	Tymor Hir Moodys Long Term	Tymor Hir S&P Long Term
AAA	Aaa	AAA
AA+	Aa1	AA+
AA	Aa2	AA
AA-	Aa3	AA-
A+	A1	A+
A	A2	A
A-	A3	A-
BBB+	Baa1	BBB+
BBB	Baa2	BBB
BBB-	Baa3	BBB-
Tymor Byr Fitch Short Term	**Tymor Byr Moodys Short Term**	**Tymor Byr S&P Short Term**
F1+	d/b / n/a	A-1+
F1	P-1	A-1
F2	P-2	A-2
F3	P-3	A-3

THE ECONOMY AND INTEREST RATES

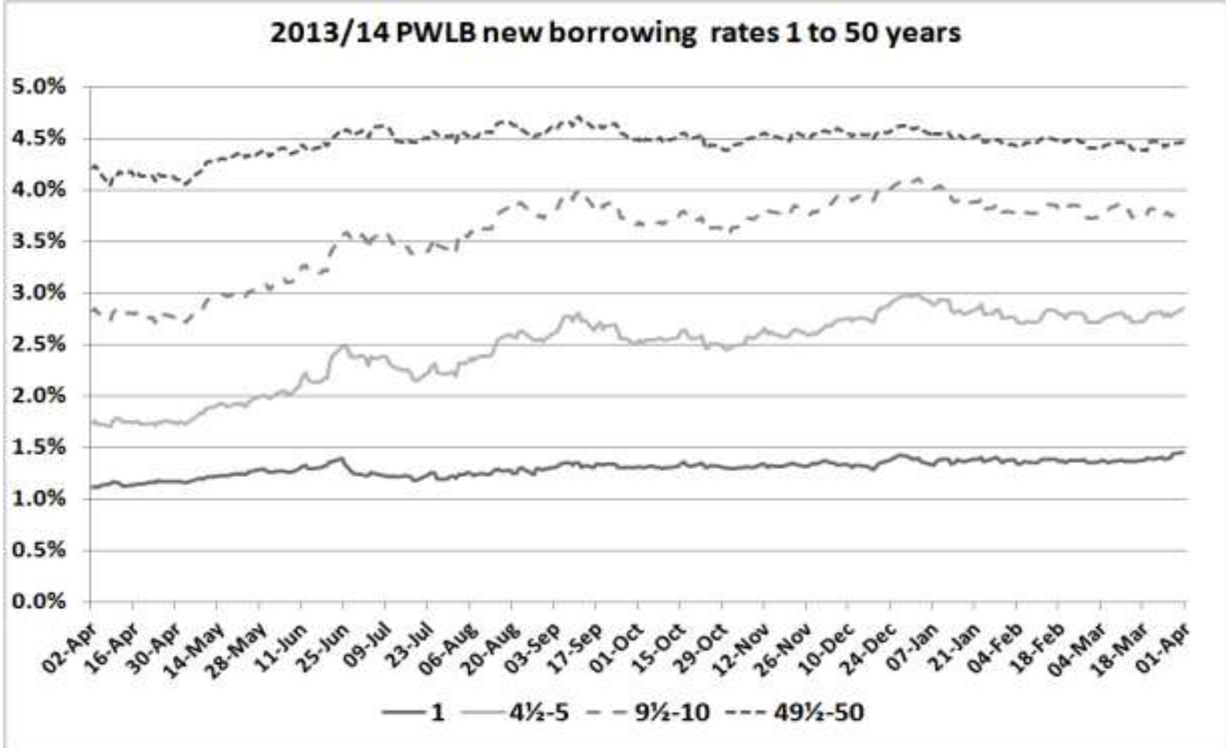
The original expectation for 2013/14 was that Bank Rate would not rise during the year and for it only to start gently rising from quarter 1 2015. This forecast rise has now been pushed back to a start in quarter 3 2015. Economic growth (GDP) in the UK was virtually flat during 2012/13 but surged strongly during the year. Consequently there was no additional quantitative easing during 2013/14 and Bank Rate ended the year unchanged at 0.5% for the fifth successive year. While CPI inflation had remained stubbornly high and substantially above the 2% target during 2012, by January 2014 it had, at last, fallen below the target rate to 1.9% and then fell further to 1.7% in February. It is also expected to remain slightly below the target rate for most of the two years ahead.

Gilt yields were on a sharply rising trend during 2013 but volatility returned in the first quarter of 2014 as various fears sparked a flight to quality (see paragraph 4.) The Funding for Lending Scheme, announced in July 2012, resulted in a flood of cheap credit being made available to banks which then resulted in money market investment rates falling drastically in the second half of that year and continuing into 2013/14. That part of the Scheme which supported the provision of credit for mortgages was terminated in the first quarter of 2014 as concerns rose over resurging house prices.

The UK coalition Government maintained its tight fiscal policy stance but recent strong economic growth has led to a cumulative, (in the Autumn Statement and the March Budget), reduction in the forecasts for total borrowing, of £97bn over the next five years, culminating in a £5bn surplus in 2018-19.

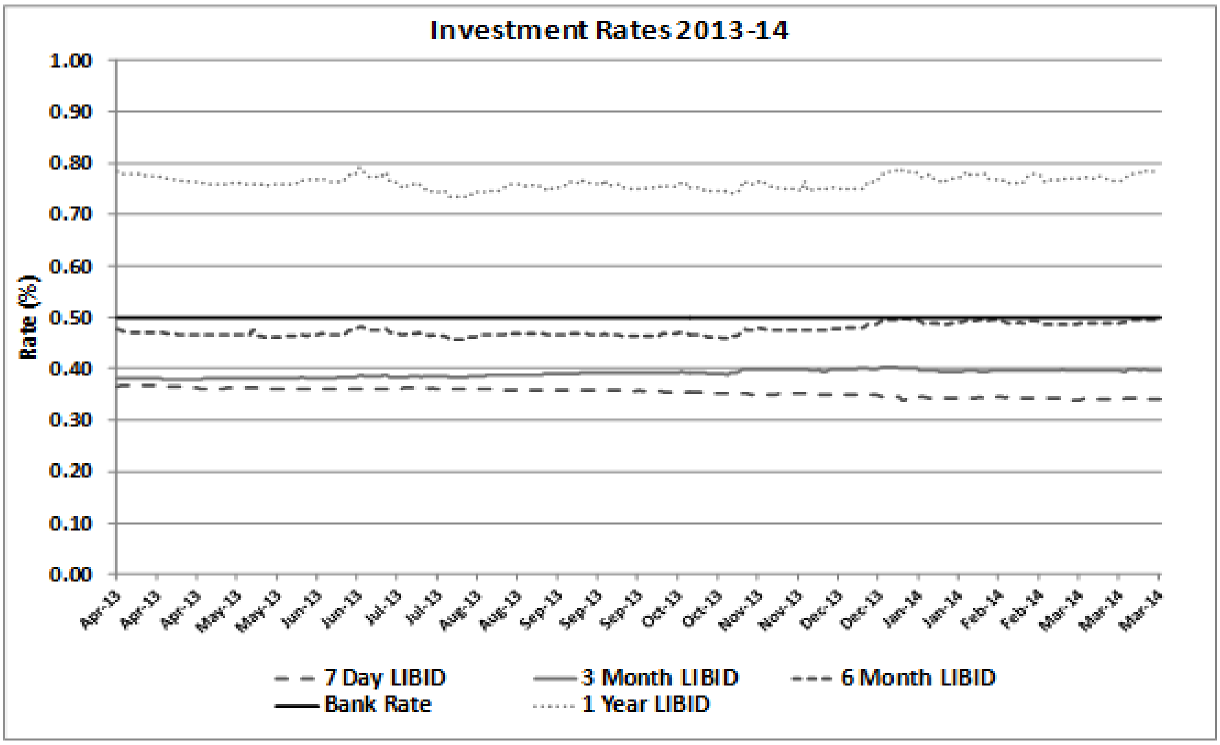
The EU sovereign debt crisis subsided during the year and confidence in the ability of the Eurozone to remain intact increased substantially. Perceptions of counterparty risk improved after the ECB statement in July 2012 that it would do “whatever it takes” to support struggling Eurozone countries; this led to a return of confidence in its banking system which has continued into 2013/14 and led to a move away from only very short term investing. However, this is not to say that the problems of the Eurozone, or its banks, have ended as the zone faces the likelihood of weak growth over the next few years at a time when the total size of government debt for some nations is likely to continue rising. Upcoming stress tests of Eurozone banks could also reveal some areas of concern.

Chart 1: Borrowing Rates 2013-14



PWLB borrowing rates 2013/14 for 1 to 50 years									
	1	1-1.5	2.5-3	3.5-4	4.5-5	9.5-10	24.5-25	49.5-50	1month variable
2/4/13	1.120%	1.150%	1.350%	1.530%	1.750%	2.840%	4.080%	4.230%	1.470%
31/3/14	1.300%	1.420%	1.870%	2.190%	2.500%	3.660%	4.450%	4.480%	1.470%
High	1.450%	1.630%	2.230%	2.620%	2.970%	4.100%	4.670%	4.700%	1.480%
Low	1.110%	1.120%	1.250%	1.410%	1.610%	2.580%	3.780%	4.070%	1.450%
Average	1.305%	1.421%	1.853%	2.164%	2.469%	3.584%	4.427%	4.467%	1.466%
Spread	0.340%	0.510%	0.980%	1.210%	1.360%	1.520%	0.890%	0.630%	0.030%
High date	31/3/14	31/3/14	27/12/13	27/12/13	27/12/13	2/1/14	10/9/13	10/9/13	9/4/13
Low date	5/4/13	15/4/13	15/4/13	15/4/13	15/4/13	19/4/13	19/4/13	3/5/13	10/5/13

Chart 2: Investment Rates 2013-14



Allan gan / From: CAPITA ASSET SERVICES – TREASURY SOLUTIONS

ISLE OF ANGLESEY COUNTY COUNCIL	
REPORT TO	**AUDIT COMMITTEE**
DATE	**22 JULY 2014**
SUBJECT	**TREASURY MANAGEMENT – FIRST QUARTER 2014/15**
LEAD OFFICER(S)	**RICHARD MICKLEWRIGHT**
CONTACT OFFICER	**BEN DAVIES (TEL: 2610)**

Nature and reason for reporting

To comply with regulations issued under the Local Government Act 2003 and with the Council's Treasury Management Scheme of Delegation for 2014/15 (Appendix 8 of the Treasury Management Strategy Statement 2014/15). This committee is responsible for scrutiny of treasury management matters.

1. This report is presented to ensure that the Council complies with the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice for Treasury Management which recommends that Members should be updated on treasury management activities at least twice a year, but preferably quarterly.

2. The Council's treasury advisers (Capita) have provided a summary of the economic background and the economic outlook (Appendices 1 & 2) and have also recently provided the following forecast.

	Sept-14	Dec-14	Mar-15	June 15	Sept-15	Dec-15	Mar-16	June 16	Sept-16	Dec-16	Mar-17	June 17
Bank Rate	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	2.00%	2.00%
5yr PWLB rate	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.60%
10yr PWLB rate	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.20%	4.20%	4.30%	4.40%	4.40%
25yr PWLB rate	4.40%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	4.90%	5.00%
50yr PWLB rate	4.40%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%	4.80%	4.90%	4.90%	4.90%	5.00%

2.1 Capita Asset Services undertook a review of its interest rate forecasts in May, after the Bank of England's Inflation Report. However, more recent developments to the Bank of England's forward guidance have necessitated a second updating in this quarter carried out on 30 June. This latest forecast now includes a first increase in Bank Rate in quarter 1 of 2015 (previously quarter 4 of 2015).

3. At the beginning of the year, the Council's borrowing portfolio was all from PWLB and was £20.6m below the Capital Financing Requirement (CFR) (i.e. part of the borrowing has been internalised). The Treasury Management Strategy Statement for 2014/15 (Section 3.4.1) states that a flexible approach will been adopted with regards to the choice between internal and external borrowing. This has been, and will continue to be, the case, with consideration to all the factors listed in that section. The decision to continue to internalise has been driven mainly due to 2 factors: (1) To limit the Authority's exposure to credit risk (2) to limit the cost of carry. These are set against the backdrop of PWLB and investment rates continuing to remain at historically low levels with only a steady increase forecast into the medium term. The appointed treasury advisors (Capita Asset Services) have also supported the decision to continue to internalise borrowing at this time. Any changes to the current approach will be reported as appropriate.

4. The table shows the positions at the beginning and end of the quarter.

	30 June 2014		31 March 2014	
	£m	%	£m	%
Borrowing (all fixed rate)	89.6	5.72	89.6	5.72
Deposits – No notice	19.1	0.40	4.2	0.58
Deposits – Fixed Term (all < 1 year)	0.0	n/a	5.0	0.80
Total Deposits	19.1	0.40	9.2	0.70
Average Deposits in the Quarter	20.3	0.50	18.2	0.56

4.1 Details of the institutions holding the deposits can be found at Appendix 3.

4.2 During the period no new external borrowing was taken up, no loans matured and no debt rescheduling took place.

4.3 On the investments side, a fixed term deposit with the Royal Bank of Scotland (RBS) (£5m, 0.80%, 3 month duration) matured in May and this was then invested on a no notice basis only; this was in order to maintain flexibility and minimise risk and given the continued low level of interest rates.

There are two points worthy of note:-

- The list of creditworthy counterparties continued to be highly restricted, with very few counterparties standing up to the approved credit criteria; and
- Investment rates available in the market have continued at historically low levels.

4.4 In terms of continuing investments, it has previously been reported that there have been credit rating issues with Santander UK plc and suggested investment durations had been below the acceptable level for investment but that the bank's position had stabilised and improved over the year. Capita's suggested investment duration for Santander has not at any point during the quarter been below 100 days and at the time of preparing this report it stands at 6 months and our treasury advisors advice is that the bank is creditworthy enough to be invested in for far beyond our no notice commitment. The credit ratings and suggested investment duration for Santander during enabled it to be invested in for up to 6 months, with an investment limit of £7.5m and this has been adhered to during the quarter.

4.5 Given the continued challenges faced in investing funds in secure, creditworthy institutions, offering a reasonable rate of return for the risk, options are being investigated to diversify the investment portfolio (in terms of both types, and geographic locations of investments). Any developments will be reported back to the relevant committees as they as appropriate.

5. During the quarter the Council remained within its Prudential and Treasury Limits. The 'Mid-year Review Report' will provide an update and analysis of performance against the treasury and prudential indicators, with any amendments to the figures as appropriate.

6. There has not been any activity since the end of the quarter to note.

7. The plans for the rest of the year are:

- To continue to invest surplus balances in a way that ensures security as well as liquidity and yield;
- To continue to internalise borrowing whilst regularly monitoring market conditions;
- To monitor the market so that rescheduling can be undertaken at an appropriate time if opportunities are available;
- To respond to possible initiatives for using unsupported borrowing or one-off borrowing support.

8. RECOMMENDATION

To consider the content of the report.

RICHARD MICKLEWRIGHT **15 JULY 2014**
INTERIM HEAD OF FUNCTION (RESOURCES) & S151 OFFICER

Cefndir Economaidd / Economic Background

- During the quarter ended 30 June 2014:

  - Indicators suggested that the economic recovery accelerated;
  - Household spending rose again;
  - Inflation fell to its lowest level since September 2009;
  - The ILO measure of unemployment fell further to 6.6%;
  - The MPC suggested that the economy might warrant higher interest rates before the end of the year;
  - Low tax receipts put the fiscal tightening slightly off track; and
  - The European Central Bank (ECB) made announcements designed to boost bank lending and counter the risk of deflation.

- After a healthy quarterly expansion in UK GDP of 0.8% in Q1, some of the early indicators point to growth accelerating in the second quarter. On the basis of past form, the CIPS/Markit business activity surveys point to quarterly GDP growth of around 1.5% in Q2. Admittedly, the composite PMI has tended to overstate the pace of the recovery over the past year. However, survey data was also encouraging on the strength of the recovery in Q2. All of the headline figures in April's industrial production release were encouraging. Indeed, even if production only manages to hold steady in the remaining two months of the quarter, it would still be 0.7% higher in Q2 overall than in Q1. That said, the £2.5bn trade deficit in April, compared to £1.7bn last year, highlights that the recovery is still struggling to rebalance towards exports.

- Meanwhile, household spending looks to have supported further GDP growth in Q2. While retail sales volumes fell by 0.5% on the previous month in May, following strong growth in April, the underlying trend remains strong as a combination of rapid jobs growth and falling prices continues to fuel a recovery in consumer spending. In addition, the more forward-looking survey balances of expected sales also point to solid growth in consumer spending in the near-term. Furthermore, non-high street spending remained robust too. Annual growth in new car registrations averaged around 5% in April and May and the Bank of England's Agents' Survey recorded the measure of consumer services turnover at its joint highest level in May since 1998. So it still seems likely that overall household spending strengthened in the second quarter.

- The labour market has continued its strong recovery. Employment rose by a huge 345,000 in the three months to April, by far the biggest increase since records began in 1971. Despite an increase in the workforce, employment growth was enough to bring the headline (three-month average) unemployment rate down to 6.6% in April. In addition, the timelier claimant count measure of unemployment fell by 27,400 in May, potentially pointing to further falls in the broader ILO measure of unemployment. Nonetheless, pay growth has remained subdued, with headline annual growth (three month average) in average earnings (including bonuses) falling to 0.7% in April, well below inflation of 1.8%. Since real earnings have yet to rise, some consumers may be overstretching their finances in order to spend more.

- Meanwhile, after sending dovish messages through the May Inflation Report, the MPC's communications have now gone full circle, from trying to prevent interest rate expectations from rising too quickly via the introduction of forward guidance last summer, to trying to *raise* them now. A number of Committee members, including Governor Mark Carney, have warned of not-too-distant policy tightening.

- Indeed, the main factor that could dissuade the MPC from starting on an earlier path for increasing Bank Rate is inflation. CPI inflation fell to 1.5% in May, the lowest rate since late 2009. Recent developments, including sterling's further appreciation, falls in producer price inflation and very weak wages growth, suggest that CPI inflation could fall to as low as 1% later this year.

- Meanwhile, May's public borrowing figures contained tentative signs that the coalition is struggling to bring down the deficit in line with fiscal plans this year. The underlying measure of borrowing (PSNB ex. excluding APF and Royal Mail pension fund transfers) was £13.3bn in May, exceeding the consensus forecast of £12.2bn. The increase was largely driven by a drop in tax receipts, rather than strong increases in spending. Spending in April and May is around 9% higher than it was in the same period last year. However, it is still too early in the fiscal year to draw conclusions from these figures.

- One risk which continues to linger is an overheating housing market. Fears that a nationwide bubble is building will not have been assuaged by the Financial Policy Committee's (FPC) relatively timid action announced alongside June's Financial Stability Report. Indeed, the 15% limit on the proportion of the volume of new mortgages that can be advanced at a multiple of 4.5 times income or more is unlikely to prevent a further rise in high loan-to-income ratio lending, given that the limit is a fair way above the actual current proportion of 10%. Furthermore, the tweaks to the existing stress tests used to assess mortgage applicants seem unlikely to make a material difference either. Admittedly, the housing market has already shown some signs of slowing of its own accord. Indeed, approvals for new mortgages fell to an eleven-month low in May, and the new buyer enquiries balance of the RICS Housing Market Survey has continued to moderate. However, with supply remaining tight, further strong increases in house prices in the near-term look likely. Although the FPC could announce further measures at a later date, the timidity of its actions so far may have slightly increased the chances that the MPC could raise Bank Rate in the not too distant future.

- Internationally, the robust 217,000 increase in US non-farm payrolls in May is another encouraging sign that the economy is getting back on the right track after the weather-related weakness during the winter. The 0.6% m/m rise in US industrial production in May also suggests that activity is bouncing back. Meanwhile, the US Federal Reserve continued tapering its asset purchases by a further $10bn in June's policy meeting and highlighted that the benign outlook for inflation means monetary policy will remain loose for some time. The Fed lowered its forecasts for GDP growth and unemployment, but the FOMC's policy statement made no reference to the recent build up of price pressures.

- Activity indicators for the Eurozone suggest that the recovery only gained a little momentum in Q2. Moreover, the spectre of deflation continues to hang over the region. HICP inflation fell from 0.7% to 0.5% in May, the joint weakest rate since 2009 and far beneath the ECB's 2% price stability ceiling. Furthermore, unit labour costs have risen by just 0.1% in the past year. As developments in wages tend to affect wider measures of inflation after a short lag, the latest data suggests that consumer price inflation could fall even further. Accordingly, the ECB made a number of announcements in June designed to boost bank lending and counter deflationary risks, including rate cuts and potential asset purchases. However, the policies involved are not as bold as they might seem. The interest rate cuts were very small and the decision not to sterilise bond purchases made under the Securities Markets Programme amounts to just 1.7% of GDP.

- In the UK, equities continued to underperform, despite improving expectations for the strength and sustainability of the UK's recovery. Indeed, they have continued to underperform US equities, even though the consensus expects the UK to grow faster than the US in 2014. Meanwhile, gilt yields edged up – particularly at the short-end of the curve – following the MPC's communications in June, which were more hawkish than May's Inflation Report. In contrast, forward rates at the long end of the curve fell further, although it is not clear whether this is a result of pessimism about the UK's growth prospects in the long run, or a decline in the term premium which reflects uncertainty about the future path of interest rates.

Allan gan / From: CAPITA ASSET SERVICES – TREASURY SOLUTIONS

ATODIAD / APPENDIX 2

Rhagolygon Economaidd / Economic Outlook

1. THE UK

1a. May Bank of England Quarterly Inflation Report

Over the last four quarters, we have had a continuing run of strong economic news which has consolidated confidence that the UK economy is recovering strongly. However, please note that the Governor said the economy "has only just begun to head back towards normal" after the slowest ever recovery from a recession. Widespread disbelief that unemployment would take nearly three years to fall to 7%, as the Bank forecast at the time of the August Inflation Report, has indeed proved to be well founded as the rate fell to 6.8% in Q1 2014 and then to 6.6% in quarter 2. Accordingly, this latest Inflation Report has seen the Bank provide a view of the economy as moving from a recovery supported by household spending to a more broadly based expansion sustained by:-

- Growth in business investment;
- A change from falling to rising real wages (average wage increases started to exceed the rate of CPI inflation over the last quarter but more recently, this situation has reversed back again);
- Increasing employment;
- Productivity growth to support those real wage increases and improve export competitiveness – expected to reach 2.5% by the end of 2014.

Key economic statistics in the Inflation Report were as follows: -

1. GDP has grown at an annual rate of 3.1% over the last four quarters;
2. Bank of England GDP forecasts: 2014 unchanged at 3.4%, 2015 upped from 2.7% to 2.9%, and for 2016 unchanged at 2.8%;
3. Inflation to be well behaved over the next two years: rising to 2.0% in two years' time from 1.7% in Q2 2015;
4. Growth of productivity has only started to marginally improve, although it is expected to gradually rise back to its average historical rate.

We have reservations that the Bank's current forecasts for GDP growth may be over optimistic and that strong economic growth could weaken as the main impetus has come from consumer spending and an uplift in borrowing to buy property. Whilst the release of this burst of pent up demand to buy property is having a very welcome effect on the economy, this surge is likely to fade in time and will then leave a question mark over where growth is going to come from. Basically, there are four main areas of demand in the UK economy: -

1. Consumers – but most consumers are maxed out on borrowing and trying to pay down debt. In addition, although <u>average</u> wage inflation is now higher than CPI inflation, many consumers are still experiencing declining disposable income as their wage increases are continuing to be less than inflation. This will not reverse until productivity and business investment improve, so as to warrant paying higher wages than are being paid currently. It is mainly higher wages that could provide a solid stimulus to an increase in consumer expenditure which would then underpin strong growth. There are also concerns that a significant number of mortgage holders are going to find it very difficult to manage increases in Bank Rate, and so in mortgage rates, when they do start.

2. Government – again, maxed out on borrowing and committed to austerity programmes to reduce its expenditure. Further austerity measures are still to come.

3. **3.** Foreigners buying our exports – but the EU, our major export market, is likely to experience tepid growth, at best, for the next few years. Also the rise in the value of Sterling means that imports are becoming cheaper which will cause UK consumers to increase purchases of cheaper imported goods in preference to UK produced competing products, so depressing UK GDP growth.

4. **4.** Business investment in fixed capital formation; but this has fallen from 13.5% to 10.4% of GDP over 2008 - 2013. However, there are encouraging signs that businesses are catching the upturn in optimism and are beginning to increase investment and exports into new markets in emerging countries. However, it will take a significant length of time for this start to make a material impact on total UK GDP growth rates and to take over the baton from consumers.

1b. The evolution of forward guidance

If you have been following the comments flying around through late June and early July, you may have ended up with the impression that Carney and other MPC members have been giving rather confused signals as to what the MPC's thoughts are when making "forward guidance" comments on what is going to happen to Bank Rate and when. Here is a quick recap of how forward guidance has evolved: -

1. **August 2013.** The MPC would not consider raising Bank Rate until the unemployment rate falls to 7%; this was deemed unlikely to occur until late 2016.

2. **February 2014 Quarterly Inflation Report.** Forward guidance mark 1 was abolished as the unemployment rate fell rapidly (the 7% threshold was breached in April 2014). Mark 2 'fuzzy guidance' was to be based on a range of about eighteen indicators but was still to be driven, ultimately, by the fundamental concept of how quickly the amount of slack in the economy after the recession, was used up. However, there were a wide range of views in the MPC as to how much slack there was and also around how quickly it would be used up, as there is no definitive and objective way of measuring this concept of slack. However, the Bank, and Carney, both commented that market views of likely increases in Bank Rate were in the right ball park (i.e. late 2014 / early 2015).

3. **14 May: 2014 Quarterly Inflation Report.** By this time, we had hard data that the UK economic recovery was going full steam ahead in 2014, i.e. this pointed to it being more likely that Bank Rate would have to go up sooner than had been expected previously. Instead of which, Carney went out on a limb and made comments to the effect that the possibility of any Bank Rate increase in 2014 and, arguably, even as soon as Q1 2015 was minimal. No other MPC member contradicted these comments, so the logical inference was that his comments must also have been a reflection of the view of the MPC.

4. **12 June: Carney Mansion House speech.** Carney expressed surprise that financial markets had not factored in a higher probability that Bank Rate could go up in 2014. To say that the financial markets were flabbergasted by this dramatic change of tack since a month ago was a bit of an understatement!

5. **18 June: MPC minutes.** The MPC said, (for a second time), that the decision on rates was becoming more balanced. It also said that the low probability (15%) attached in the markets to a rise in 2014 was "somewhat surprising". So Carney's comments at the Mansion House were not a Suarez moment of madness but rather comments that the whole MPC agreed with. So the financial markets now had to go back to where they started from; that they WERE right that a Bank Rate increase was likely in 2014, probably towards the end of the year (November 2014 would be the quarterly Inflation Report month when the MPC would be most likely to take action in

Q4). However, to be fair to Carney and the MPC, saying that 15% was too low leaves wide open just how too low this was, i.e. should it have been a 30% risk; or 70%? Do those comments really mean the financial markets are now right to pencil in a first increase in Q4 2014?

6. **24 June: Select Committee Carney comments.** An MP accused Carney of being an 'unreliable boyfriend' i.e. blowing hot one day and cold the next day. Overall, MPs felt that Carney's attempts at communicating forward guidance had been muddled and left the financial markets, and others, confused in as much as the various attempts at forward guidance had pointed in different directions. Carney attempted to dig himself out of this onslaught by emphasising that the timing for the FIRST increase in Bank Rate would be data driven i.e. no one could say for certain when that would occur. However, what he placed the most emphasis on was the medium term, i.e. the timing of the first increase was of a lesser degree of importance. So, in the medium term, increases would be **"limited and gradual".** Also, rates would not get back to around 5% as before the financial crisis. He also criticised the financial markets for not responding to the strength of recent economic data and commented that the MPC would change its views according to how data evolved. This evoked a response from one MP to say that in that case, forward guidance was redundant and we had returned to the days of "old fashioned smoke and mirrors"!

1c. So where are we now?

Let's make an attempt at trying to blow away the smoke of battle to see clearly where we are now: -

a. Since our previous interest rate forecast on 19 May, short Sterling rates (a good indicator for when financial markets expect the first increase in Bank Rate), have shifted significantly from indicating an early 2015 first increase to Q4 2014.

b. The one piece of guidance which appears to have emerged from the fray of battle unscathed is that in the medium term increases in Bank Rate will be **"LIMITED AND GRADUAL".** Also, rates would not get back to around 5% as before the financial crisis.

c. The MPC have also indicated their concerns that an earlier increase in Bank Rate could help them later with implementing a slower pace of increases in Bank Rate and keeping Bank Rate lower, than if there was a later timing for the first increase. It, therefore, becomes a matter of debate as to how rigidly they will be driven by actual data and what their 2 to 3 year forecasts for inflation (and on the other side of the same coin - slack), indicate, and instead how much weight they will put on their judgement to decide on the optimum time to vote for the first increase given their medium term concerns. Another way of putting this is 'should forecasters now be placing more weight on what they think the MPC will do, rather than what they think inflation, and other data, would warrant on their own in terms of the timing of the first increase in Bank Rate?'

ch. Many forecasters have, therefore, brought forward their forecast for the first increase in Bank Rate to take account of the various comments that have been made by the MPC and Carney and the fact that economic recovery in 2014 is likely to be very robust. (27.6.14 June Q1 GDP figure came in at an annual rate of 3.0%. Surveys and other economic data are now pointing to Q2 building further momentum to around an annual rate of 3.4%.) We agree with this movement and have moved forward our first increase in Bank Rate from Q4 2015 to Q1 2015.

d. But…and this little word BUT can have such a powerful effect! What would happen in the medium term if economic data were to take a nasty turn? Suppose the MPC over estimate the amount of slack in the economy and under estimate the speed with which it is used up? Or, to put it another way, suppose they get their forecasts for inflation over the next 2-3 years too low and inflation builds up quickly and threatens to become a significant risk. Could the commitment to "limited and gradual" increases in Bank Rate melt and disappear like snow on a balmy spring day? One wonders.

Accordingly, in our revised interest rate forecast, this earlier start to the timing of the first increase in Bank Rate has resulted in slight increases in Bank Rate in the two subsequent years compared to our previous forecast. However, we have slowed down the pace at which increases occur in line with the 'slow and gradual' forward guidance which has been emphasised recently.

2. THE GLOBAL ECONOMY

We can only repeat our previous warnings that we are in times when events can precipitate major volatility in markets. During this year we have seen a flight to safe havens resulting from investment flows out of emerging countries back to western economies as the prospects for higher growth in these economies has improved. This has been triggered by the Fed's start to tapering and successive months of reducing QE purchases by $10bn per month.
As for the EZ, while Ireland and Portugal have made very good progress and have been able to exit from their bail out programmes, there remains the prospect that Greece could require a third bailout package, though not one on the same scale as the first two.
A further concern over the EZ is the potential "Japanification" of the economy as some countries are now experiencing, or are very near to, deflation. Deflation causes a real increase in the value of debt. This is dangerous in itself for already heavily indebted countries but even more so where countries are still running up annual deficits of 3% or more. We are, therefore, concerned that some EZ countries experiencing low growth, will, over the next few years, see a significant increase in total government debt to GDP ratios. There is a potential danger for these ratios to rise to the point where markets lose confidence in the financial viability of one, or more, countries. However, it is impossible to forecast whether any individual country will lose such confidence, or when, and so precipitate a resurgence of the EZ debt crisis. While the ECB has adequate resources to manage a debt crisis in a small EZ country, if one, or more, of the larger countries were to experience a major crisis of market confidence, this would present a serious challenge to the ECB and to EZ politicians. All eyes are currently on the ECB in terms of whether they will provide further policy support, having resorted to negative interest rates in June in an effort to encourage financial institutions to lend into the "real economy".

3. CAPITA ASSET SERVICES FORWARD VIEW

We would remind clients of the view that we expressed in our previous interest rate revision newsflashes of just how unpredictable PWLB rates and bond yields are as we are experiencing volatility which is highly correlated to geo-political developments.

As there remain the threat of potential risks from a number of sources caution must be exercised in respect of all interest rate forecasts at the current time. The general expectation for an eventual trend of gently rising gilt yields and PWLB rates is predicted to remain unchanged, as market fundamentals will focus on the improved UK economic performance as well as issues such as the sheer volume of UK gilt issuance (and also US Treasury issuance) and the price of those new debt issues. Negative (or positive) developments on the geo-political front as well as any fresh issues regarding an EZ-related sovereign debt crisis could significantly impact safe-haven flows of investor money into UK, US and German bonds and produce shorter term movements away from our central forecasts.

Our interest rate forecast is based on an initial assumption that we will not be heading into a major resurgence of the EZ debt crisis, or a break-up of the EZ, but rather that there will be a managed, albeit painful and tortuous, resolution of the debt crisis where EZ institutions and governments eventually do what is necessary - but only when all else has been tried and failed. Under this assumed scenario, growth within the EZ will be tepid for the next couple of years and, therefore, has the potential to dampen UK growth, as the EU is our biggest export market.

Our PWLB forecasts are based around a balance of risks. However, we would flag up the potential for upside risks, especially for longer term PWLB rates, as follows:-

- A further surge in investor confidence that robust world economic growth is firmly expected, causing a greater flow of funds out of bonds and into equities.
- UK inflation being significantly higher than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

Downside risks currently include:-

- The situation over Ukraine poses a major threat to EZ and world growth if it was to deteriorate into "economic warfare" between the West and Russia, where Russia resorted to using its control over gas supplies to Europe. Heightened political risks in the Middle East and East Asia could also trigger safe haven flows back into bonds.
- A failure to rebalance UK growth towards exporting and business investment causing a weakening of overall economic growth beyond 2014.
- A resurgence of the EZ sovereign debt crisis caused by ongoing deterioration in government debt to GDP ratios.
- Recapitalising of European banks requiring more government financial support.
- Lack of support by populaces in Eurozone countries for austerity programmes, especially in countries with very high unemployment rates e.g. Greece and Spain, which still face huge challenges in engineering economic growth to correct their budget deficits on a sustainable basis.
- Monetary policy action failing to stimulate sustainable growth in western economies, especially the Eurozone and Japan.
- There are also increasing concerns that the reluctance of western economies to raise interest rates significantly for some years. This plus the huge QE measures which remain in place (and may be added to by the ECB in the near future), has created potentially unstable flows of liquidity searching for yield and therefore heightened the potential for an increase in risks in order to get higher returns. This is a return of the same environment which led to the 2008 financial crisis.

Graddfeydd Credyd Gwrthbartion buddsoddi a'r adneuon a ddelir gyda phob un ar Mehefin 2014 *
Credit ratings of investment counterparties and deposits held with each as at 30 June 2014*

Grŵp Bancio/ Banking Group	Sefydliad/ Institution	Adneuon / Deposit £'000	Hyd (Galw tymor sefydlog) / Duration (Call / Fixed Term**)	Cyfnod (O/I)/ Period (From - To)	Graddfa Dychweliad/ Rate of Return %	Graddfa Tymor Hir Fitch Long Term Rating ****	Graddfa Tymor Byr Fitch Short Term Rating ****	Graddfa Tymor Hir Moody's Long Term Rating ****	Graddfa Tymor Byr Moody's Short Term Rating ****	Graddfa Tymor Hir Standard & Poor's (S&P) Long Term Rating ****	Graddfa Tymor Byr Standard & Poor's (S&P) Short Term Rating ****	Lliw Sector/Hyd Awgrymiedig/ Sector Colour / Suggested Duration
Lloyds Banking Group plc	Bank of Scotland plc	**8,513**	**Galw/ Call**	**n/a**	**0.40**	**A**	**F1**	**A1**	**P-1**	**A**	**A-1**	**Glas - 12 mis/ Blue - 12 months**
HSBC Holdings plc	HSBC Bank plc	**501**	**Galw/ Call**	**n/a**	**0.25**	**AA-**	**F1+**	**Aa3**	**P-1**	**AA-**	**A-1+**	**Oren – 12 mis / Orange – 12 months**
Santander Group plc	Santander UK plc	**49**	**Galw/ Call**	**n/a**	**0.40**	**A**	**F1**	**A2**	**P-1**	**A**	**A-1**	**Coch – 6 mis/ Red - 6 months**
The Royal Bank of Scotland Group plc	The Royal Bank of Scotland plc	**10,000**	**Galw/ Call**	**n/a**	**0.40**	**A**	**F1**	**Baa1**	**P-2**	**A-**	**A-2**	**Glas - 12 mis / Blue - 12 months**

* Ceir y Rhestr Benthyca Cymeradwyedig yn Atodiad 5 o'r Datganiad Strategaeth Rheoli Trysorlys 2014/15 Strategaeth Buddsoddi Blynyddol / The Counterparty Criteria can be found at Appendix 6 of the 2014/15 Treasury Management Strategy Statement / Annual Investment Strategy

** Sef tymor ar pwynt y buddsoddi/Being term at the point of investment.

*** During the quarter the Moody's Long Term rating for the Bank of Scotland pls was upgraded to A1 from A2. The bank is part nationalised and so this did not have a bearing on the investment criteria during the quarter.

******** Yn Atodiad 4 ceir y graddfeydd credyd cyfatebol ar gyfer y 3 asiantaeth graddio y cyfeirir atynt uchod./The equivalent credit ratings for the 3 rating agencies referred to above can be found at Appendix 4.

Graddfeydd Credyd Cyfartebol/
Equivalent Credit Ratings (Fitch, Moodys, S&P)

Tymor Hir Fitch Long Term	**Tymor Hir Moodys Long Term**	**Tymor Hir S&P Long Term**
AAA	Aaa	AAA
AA+	Aa1	AA+
AA	Aa2	AA
AA-	Aa3	AA-
A+	A1	A+
A	A2	A
A-	A3	A-
BBB+	Baa1	BBB+
BBB	Baa2	BBB
BBB-	Baa3	BBB-
Tymor Byr Fitch Short Term	**Tymor Byr Moodys Short Term**	**Tymor Byr S&P Short Term**
F1+	n/a	A-1+
F1	P-1	A-1
F2	P-2	A-2
F3	P-3	A-3