Treasure Your Assets

Centre for Governance and Scrutiny

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About the Centre for Governance and Scrutiny

CfGS exists to promote better governance and scrutiny, both in policy and in practice. We support local government, the public, corporate and voluntary sectors in ensuring transparency, accountability and greater involvement in their governance processes.

Governance and scrutiny are essential for the successful working of any organisation. Now, more than ever, trusted decisions are needed. We believe that decisions are better made when they are open to challenge and involve others – whether that's democratically elected representatives, those affected by decisions, or other key stakeholders.

At the heart of better governance and scrutiny are the right behaviours and culture. Our work champions these relational aspects and designs the structures to support them, leading to more effective decision-making and improved outcomes for organisations and people.

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Introduction

This guide is designed to provide advice to councillors, and the officers who support them, on how the way that councils manage and control their financial assets. This work, usually known as "treasury management", is key to councils' ability to manage public funds in a responsible way.

This guide explores the basics of treasury management in local authorities and suggests how such issues might be scrutinised. It covers how you might approach ongoing scrutiny of the council's treasury management policies and practices, in the context of focusing on those areas where scrutiny might add most value in what is a complex regulatory environment.

This guide is designed to complement CIPFA's "Effective scrutiny of treasury management" self-assessment tool. This guide introduces some of the core concepts, and possible areas of focus, sitting behind scrutiny of treasury management.

There are two caveats to the use of this guide.

Firstly, it does not consider the investment of pension fund assets, which are subject to different regulation and governance regimes.

Secondly it is not intended to provide any specific advice to individual authorities on investment and other treasury management activity.

Acknowledgments

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Explaining treasury management

The key components of treasury management

The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as:

"The management of the organisation's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

(Treasury Management in the Public Services, Code of Practice and Cross-Sectoral Guidance Notes: CIPFA, 2021 p5)

Treasury management (TM) activity includes managing the council's cash flow and then making decisions on whether to invest and/or borrow money to support the council's overall policy objectives. Treasury management is undertaken by every council, though some will have some shared functions, such as in London, for example.

<u>Managing cash flow</u>

Local authorities deal with large cash transactions on a daily basis. Cash flow management is the process by which the council monitors the overall liquidity of the council's finances (i.e., making sure money is available when needed) and calculates the amount of cash that may be surplus at any point in time. This surplus cash is then invested to enable the authority to earn interest, which, in turn, increases the available funding to support its policies and business plans. Cash flow management will also ensure that the council has the required cash available to fund the council's capital expenditure plans, including the decision on whether to borrow money to cover temporary cash needs or to support capital expenditure.

Cash is generated from a variety of sources – council tax, business rates, specific grants, fees and charges being the most common. The need to spend money may not coincide with the receipt of the funds, thus leading to instances where the authority has a temporary excess of cash, which it can invest short-term or a deficit, which can be covered by temporary borrowing or a bank overdraft.

<u>Managing reserves</u>

Most councils have funds accumulated over previous years in various reserves and balances, such as self-insurance reserves, repairs and renewals reserves, and general balances. All such reserves and balances will be invested to provide a return to the council. This may include internal investment, whereby cash reserves may be utilised temporarily to finance capital spending instead of borrowing from external sources.

Managing capital receipts and grants, and capital borrowing

Capital receipts and grants may be available to the authority but are yet to be applied (used) to fund planned capital expenditure.

While authorities cannot borrow money purely for speculative investment, they can take advantage of prevailing market conditions and borrow in advance of planned capital expenditure, for example, where interest rates are expected to rise in the future, providing they are not doing this purely to profit from the investment of borrowed sums.

The revised CIPFA Prudential Code for Capital Finance[1] provides more detail on things such as prudential borrowing, the financing of capital expenditure, and the management of risks associated from commercial investments. The Code, in particular, recommends regular review of commercial investments made primarily to produce yield for the authority. Revised guidance now discourages councils from borrowing to invest in assets primarily for commercial return.

The objectives of treasury management

Treasury management has both investment and borrowing objectives – both of which should be seen in the context of councils' duties to consider and act on risk:

Investment Objectives: councils are obliged to produce an Annual Investment Strategy to encourage the "prudent" investment of funds that the authorities hold on behalf of their communities. The need for prudence reflects the fact that all investment decisions need to balance relative risk and reward and this is particularly important for local authorities, given that they are dealing with public funds.

The Prudential Code defines a prudent investment policy as having two objectives: achieving both security (protecting the capital sum from loss) and liquidity (ensuring the money is available when needed).

Once proper levels of security and liquidity are determined, it will then be reasonable to consider what return (yield) can be obtained within those priorities.

Treasury management will also consider the overall availability of funds should there be an unforeseen need to spend, e.g. in an emergency such as a flood, or due to an unanticipated increased in demand for a service. It should also consider the council's liquidity needs over time and ensure that these are aligned with the liquidity profile of the treasury investment portfolio.

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[1] Accessible at https://www.cipfa.org/policy-and-guidance/publications/t/the-prudential-code-for-capital-finance-in-local-authorities-2021-edition#:~:text=The%20objectives%20of%20the%20Prudential,are%20affordable%2C%20prudent%20and%20sustainable (£). While the Code is not publicly available without payment, councillors should find that chief finance officers will be able to explain, and make available, its key contents.

Borrowing Objectives: The Prudential Framework for Capital Finance, supported by CIPFA's Prudential Code, enables authorities to borrow money for capital purposes, should they consider it to be affordable and prudent.

Councils are free to borrow from government itself. A number of mechanisms exist for doing this, the most common of which is through the 'Public Works Loans Board' (PWLB) which is part of HM Treasury. For example, the UK Municipal Bond Agency (Local Capital Finance Company) was established to reduce council's capital cost by rising money on the capital markets through issuing bonds. Councils may also borrow from and lend to each other, though mostly this is short-term borrowing. For authorities which are not "debt free", the treasury management function will seek to ensure that borrowing costs are minimised, and also that the structure of the council's overall borrowing will not leave it overly vulnerable to market conditions, e.g. if a large proportion of the council's debt is maturing and requires renegotiation at one particular point in time, the council is potentially vulnerable to prevailing market interest rates.

Member and officer oversight of treasury management

There is a defined regulatory framework that all local authorities are required to comply with. Guidance is issued by the Chartered Institute of Public Finance (CIPFA) and by Government. Compliance with this framework results in a range of policies, systems and procedures that will enable a council to invest and borrow appropriately.

The CIPFA Treasury Management Code[2] sets requirements for how councils must fulfil their legal duties concerning treasury management. This includes control and monitoring arrangements. These requirements will need to be set out in councils' constitutions, and other governance documents (for example, the Annual Governance Statement).

These requirements include:

- That a policy statement and suitable treasury management practices (TMPs), setting out how those policies will be delivered, be agreed. Section 6 of the TM Code sets out some specific recommended wording to be used in the policy statement. This wording highlights the criterion of risk as the principal means by which the effectiveness of TM should be judged. CIPFA recommends twelve specific TMPs, which are the controls and procedures that provide the working practices and parameters of the treasury management function at the authority;
- That full council receives regular reports on treasury management activities;
- Delegation of treasury management to a particular committee with delegation of administration of TM to a specified officer;
- Nomination of a specific body to have responsibility for scrutinising TM.

[2] Accessible at https://www.cipfa.org/policy-and-guidance/publications/t/treasury-management-in-the-public-services-code-of-practice-and-crosssectoral-guidance-notes-2021-edition (£)

Decision-making on treasury management

A range of individuals are involved in making treasury management decisions. This section goes into more detail about who those individuals are, and how they work together.

<u>Prudence and the prudential person</u>

All of those playing an active part in treasury management – including people sitting on overview and scrutiny committees – need to act in accordance with the "prudent person" principle.

The key issue in prudence and risk is not whether investment decisions were successful or not (although this is of course important), but whether the process followed in reaching the decisions was reasonable in its assessment of the risks and rewards.

Prudence is the process by which the treasury management strategy and risks are assessed, in light of the council's principal investment and cashflow aims and needs. Therefore, an aggressive strategy can meet this standard if a sound process is followed while a simple conservative strategy could fail if the process of assessing risks is not sound.

In the broader context of overall governance of risk, particularly in treasury management, a crucial element involves the active role of the Audit Committee. The 'prudent person' principle, central to treasury management, aligns with the council's broader corporate governance system, as overseen by the Audit Committee. This committee therefore plays an important role in ensuring that the environment that supports the treasury management strategy and associated risks are robust and adhere to prudent standards. However, it is important to note that the Audit Committee does not have a leadership or decision-making role when it comes to treasury management.

The role of officers

<u>The role of the Section 151 Officer</u>

The person with overall responsibility for ensuring the effective operation, and oversight, of the treasury management function is the Section 151 Officer[3]. Responsibility for the function is part of their wider statutory responsibility for a council's finances. The core elements of the Section 151 Officer's role will be set out in the council's Constitution – usually in the Financial Regulations, and in the part of the Scheme of Delegation that covers financial management.

Whilst many authorities will have staff who undertake day-to-day treasury management activities, the Section 151 Officer will be responsible for the management and overview of the treasury management function, including ensuring that it is adequately resourced and elected members and staff are suitably trained. Section 151 Officer will also ensure that the treasury management staff have adequate authority to undertake treasury management

[3] This is the person designated under s151 of the Local Government Act 1972 as being the designated "responsible financial officer", who "shall make arrangements for the proper administration [the council's] affairs".

activity within the agreed risk environment i.e. authority to lend and borrow within agreed parameters. They will also be responsible for ensuring that the authority has adopted the required treasury management codes and strategies outlined above and for ensuring that the authority, including its elected members, are kept appraised of the activities and performance of treasury management activities.

The Role of the Treasury Management Function

Most authorities will have staff who are responsible for day-to-day treasury management activities, reporting to the Section 151 Officer either directly or indirectly. The Treasury Management Practices adopted by the Council should clearly set out the roles and responsibility and level of authority delegated to treasury staff to ensure that all the responsible officer's delegations are undertaken and that the operations take place within an agreed risk-controlled environment. Whilst there is no requirement for these officers to be qualified accountants, the CIPFA Treasury Management (TM) Code[4] requires the authority to ensure that they are suitably trained and qualified to undertake their duties.

The role of members

Ultimately, the Section 151 Officer is accountable to members – like any other officer – for the delivery of a Treasury Management Strategy that is agreed by councillors at full Council on the recommendation of the Executive. Full Council is also responsible for agreeing the mid-year review and annual report, and supporting schedules as outlined in the Code.

Elected members (the Full Council on the recommendation of the Executive) should approve an annual Treasury Management Strategy, mid- year review and annual report as well as supporting schedules as outlined within the Code. Responsibility for oversight of the treasury function is often undertaken by the finance or audit committee.

Regular reports on the performance of treasury management against the strategy should be provided to the Council's Executive. The Executive should ensure that the treasury management strategy is meeting its objectives and supporting the delivery of council policy.

The Audit Committee, and scrutiny committees, have separate but complementary roles in respect of oversight of treasury management. In brief, these are:

- For the Audit Committee, oversight of risk and governance. An understanding of risk is critical to effective treasury management, and the Audit Committee's oversight on risk means it has an important role to play here. It is not the role of the Audit Committee to actively monitor treasury management, or to comment on policy – although Audit does oversee those tasks where they are carried out by others;
- For scrutiny committees (or, more specifically, the scrutiny committee holding specific oversight duties with regard to corporate finance) there is a wider remit – scrutiny can look at the policy (i.e. political) decisions which underpin aspects of the treasury

[4] Supra, n4

management strategy, including the council's appetite for risk and the extent to which those risks have been meaningfully understood and mitigated, where they occur. This is explained in more detail in the section below.

Areas for scrutiny to act

In "The good scrutiny guide" (2019)[5] we set out some overall features for effective scrutiny. In relation to treasury management, we need to be more specific about these features. The complexity of the subject area, and the fact that scrutiny will be operating in a regulatory environment where other individuals and groups have formal roles, mean that particular focus and rigour are needed.

In their guidance, "Supporting scrutiny of treasury management"[6] CIPFA provide a tool for councils to evaluate their scrutiny arrangements – councillors and officers are likely to want to use this tool (which complies with the CIPFA Treasury Management Code) to ensure that their arrangements are operating effectively.

This section sets out those main areas on which members might wish to focus their scrutiny. We will explain the formal role of scrutiny in more detail in the following section, but this section should be read in the context of the understanding that members' overriding role here is to oversee:

- the way that advice is provided to the council by treasury management experts, or the way that those experts take decisions on the council's behalf;
- the role played by the Cabinet Member for Finance and the s151 officer, and other members and officers, in setting the risk tolerance of the authority's approach to investment;
- the intersection between the Audit Committee and that of overview and scrutiny;
- the implications of the council's treasury management decisions on its balance sheet and the delivery of its substantive policy priorities for the benefit of local people.

This section supports the arguments that scrutiny has a role:

- ***To engage actively with the risk culture that underpins investment decisions***

In practice, this means scrutinising the council's understanding of the major strategic risks that it faces (not just risks related specifically to treasury management, or to finance)and seeking to understand the council's tolerance to / appetite for risks. On the basis of this councillors can understand where and how mitigations are being planned, and actively delivered, that reflect this appetite. Importantly, this requires that an

[5] Accessible at https://www.cfgs.org.uk/?publication=the-good-scrutiny-guide
[6] Accessible at https://www.cipfa.org/services/networks/better-governance-forum/corporate-governance-documentation/supporting-scrutiny-of-treasury-management#:~:text=Effective%20scrutiny%20of%20treasury%20management%20is%20an%20important%20requirement%20of,require%20support%2C%20training%20and%20guidance.

understanding of risk (and its implications) be shared by members and officers, and that risk be a meaningful component of discussion around decision-making;

- ***To engage local people on what TM is***
Elected members and officers can be tempted into thinking that they are talking about 'the council's money'; citizens know it's their money and expect you to be their trustee. You will need to explain why TM is essential and important and answer their questions about 'Why have you got all that money?', 'Why was it being invested rather than spent on services?', 'Why wasn't it just put in the local building society?'. Importantly, this may involve the need to understand and explain aspects of treasury management that may seem counterintuitive – including the need to retain and build up reserves when the council is in a challenging financial position.

- ***To demonstrate transparency and accountability***
The council should be prepared to explain publicly the reasons for its investment policies and decisions

- ***To demonstrate that elected members take their responsibilities seriously***
Investment and borrowing decisions are undertaken following thorough option appraisal; the supporting processes are reviewed and approved. If the council's investments are safe, demonstrate the level of performance. If some of the council's investment is at risk, you are examining in detail 'what went wrong' and you are determined to learn and apply lessons from the investigation.

- ***To show that elected members and officers make informed decisions***
Show that councillors have gone out of their way to understand risk management and the complexities of the market, and those officers have brought high-quality professional judgement to their advice and decisions.

- ***To demonstrate that the council's treasury management strategy is forward looking and fit for purpose***
Show that councillors have undertaken a full review of the economic environment, operations, decision making, and use of external providers to ensure a robust and appropriate approach to scrutiny.

- ***To implement new training and professional development for officers and members***
Training can assist the responsible officer in achieving the required standards of professional expertise within the authority; training and development can also help members to play a more active role, especially on risk.

Members have a critical role to play in this assessment. As we have noted in "Risk and resilience" (2021), politicians are central to assessing an authority's appetite for risk and have a key role in constructively challenging a council's approach to this issue. This requires an active engagement by members in treasury management, not an abrogation of responsibility in favour of "experts" or officers.

What are the key features of effective scrutiny of treasury management?

Effective scrutiny of this subject will require:

- ***A well-scoped and manageable scrutiny process***
  Particular thought will need to be given to the skills and competencies of scrutiny officers and advisers in both scoping any review of treasury management and in providing continuing advice to councillors during the conduct of the review and in making any recommendations. A full-fledged "review of treasury management" – looking at the issue in depth, and in isolation – might not be the best way to undertake work. Review of treasury management might more usefully form a part of wider work on the development of the Medium-Term Financial Strategy, or the broader "watching brief", or ongoing oversight, that scrutiny may want to take on the management of risk (in co-ordination with the work of the Audit Committee). This approach – proportionate, and aligned where possible with existing work – is likely to be the most sustainable;

- ***The right timing***
  Thought needs to be given as to the timing of scrutiny's interventions, particularly in light of prevailing market and economic conditions. This is a reason why it may be most useful to look at treasury management plans alongside the wider MTFS, during the scrutiny of the council's budget (on which we comment in more detail in the "Financial scrutiny practice guide" (2021).

- ***The right level of detail***
  Councillors may feel a need to prepare and learn in advance about investment policies and financial instruments in order to be able to meaningfully scrutinise these issues. While some understanding of these details is likely to be useful, the intention should not be to provide a technical check on advice with regard to individual investment decisions – or to look at everything. It is most likely that members will find it useful to look behind individual decisions to the strategy, and the appetite to risk underpinning it. An iterative approach to training, development and discussion with officers – developing skills, knowledge and expertise over time - will give members and officers alike a much clearer understanding of what niche scrutiny can fill.

- ***Before beginning, having a clear understanding of the various roles and responsibilities of individuals and organisations involved in the TM process***
  These will include council officers, TM advisers, external fund managers, and TM brokers – both as set out earlier in this guidance, and as reflected by local practice.

- ***Thinking about and engaging the public***
  There may be an opportunity to make a public explanation of TM performance and activities and how the function will contribute to the council's corporate objectives over the coming years in a way which local citizens can understand. Public interest in this may seem a niche pursuit, but in a financially straitened environment ensuring that information providing assurance about the council's approach is out in the public domain is a useful discipline to keep.

Overall, scrutiny activity in this area is likely to need to be focused. This is because there will be a range of individuals and sets of people tasked with researching and advising on the council's assets – scrutiny will need to understand how it complement that process, and not interfere with the exercise by managers and advisers of the formal legal duties in this area.

As we have noted above, it is most likely that a form of proportionate **ongoing oversight** is the most productive way to proceed – scrutiny using periodic access and review to key information in order to keep a watching brief over the issues involved.

For some time now we have recommended to councils that they consider this approach for work programming generally – continually reviewing information about council's business in order to decide what matters might be "escalated" to scrutiny for more serious attention. In the next section we explore in more detail what this escalation would look like – what would happen when an issue might be considering sufficiently important to justify time being set aside at committee for more detailed conversation.

Councils are likely to find this approach significantly more productive than attempting to expect a scrutiny committee to review policies and procedures on a general basis six-monthly or annually – or undertaking a more detailed standalone review of treasury management on a more irregular basis.

Members planning how to exercise this watching brief will be able to clarify:

- what scrutiny's role here might be (in co-ordination with the audit committee)
- what information scrutiny might need, on an ongoing basis, to carry out this role;
- who might provide this information;
- who might provide support in interpreting this information (presumably the s151 officer, although councillors might consider that a form of independent advice is sensible);
- how scrutiny might use this information practically;
- how scrutiny will evaluate the impact it's having and tweak its performance accordingly.

The first point – scrutiny's role – is critical here, as without that clarity, ongoing oversight of treasury management will end up overwhelming the scrutiny function and overlapping unnecessarily with the oversight carried out by the s151 officer, Cabinet and the Audit Committee.

How scrutiny can undertake its work

Scoping

Identifying issues for review

As part of its ongoing oversight/watching brief of the treasury management process, members consider that an issue has arisen which is sufficiently important to justify being escalated to a committee for substantive discussion. What happens next?

Such escalation would need to be justified, and the issue would need to be something scrutiny could do something about. Members would be supported by the following kinds of information:

- Audit reports;
- Reports to Cabinet and full Council on the authority's assets and approach to treasury management;
- Corporate risk registers (to understand where the risks with greatest financial impact lie, which might have an impact on the council's approach to how it invests its money);
- Formal, internal reports produced by the s151 officer on financial issues;
- Guidance and information provided by fund managers or advisers.

Rather than considering this information formally, and regularly, in committee, we think it most sensible that members consider it as part of the wider basket of information that they have access to on an ongoing basis, and which they might use to support their broader work programming. This is part of an approach to information management that we suggest in "The good scrutiny guide" (2019) and that we have since expanded on in our members' guide to access to information (2023).

If scrutiny is to maintain a watching brief over treasury management issues, it will need to plan to intervene more formally when issues of concern emerge, "by exception". We explore this in more detail in the next section.

Some of these documents will need to be kept private for legal and professional reasons. For this – and other – reasons it is likely to make most sense for this ongoing oversight, and access to this information, to happen between meetings, rather than for detailed information to be submitted regularly to committee.

This could be augmented by regular (perhaps quarterly) informal meetings between a relevant scrutiny chair and the s151 officer, at which treasury management might be discussed alongside other financial issues. This will ensure that formal, public-facing scrutiny work on this subject can be focused on meaningful questioning and challenge, rather than exploration of broad topics and information-sharing.

Possible areas of focus where an issue is escalated to scrutiny:

- There is concern that the council may be overexposed to risk arising from a particular investment or investments (for example, in commercial activity);
- There is concern that the council's level of reserves is low, considered against the level of risk faced;
- Changing local and national political priorities (and/or major local or national events) change the risk profile attached to treasury management decisions (an extreme example being the impact of the pandemic).

Preparation and scoping work

The initial scoping of work will need to work in much the same way as the scoping of a task and finish review. Council officers – the s151 and others – will need to be prepared to support this work at the planning stage.

This is likely to involve further review of the information we highlighted in the last section.

Based on this information, members will be able to make informed judgments about:

- the identification of any ***witnesses*** who are to be asked to give evidence or answer questions (see below)
- whether any opportunity is to be given to ***citizens*** to contribute to the review (e.g. by being invited to submit questions or comments they want to be addressed in the review process)
- the ***timescale*** for the review
- the management of internal and external ***communications***
- the ***preparation and learning requirements*** of elected members, scrutiny officers and advisers who are to be involved in the review

On the basis of this, members considering an issue relating to treasury management in committee will be able to formulate a plan and some objectives.

Witnesses

Bearing in mind that we do not suggest a fully-fledged review of TM, we would suggest a limited range of internal and external witnesses. The relevant Cabinet Member, the Section 151 Officer and a manager with specific responsibility for treasury management are likely to provide useful internal expertise. There are some circumstances where scrutiny may want to call on external partners – treasury management advisers or fund managers, for example.

Effective questioning

In both scoping the review and in preparing panel members, particular attention needs to be given to:

Establishing whether there any other investigations being carried out

- Are any contractual proceedings in course or anticipated with the council's external advisers and fund managers?
- If such proceedings are in course or anticipated, advice will need to be taken from the council's legal adviser on the opportunities and constraints that might apply to the scrutiny process.

Identifying the key lines of enquiry

The list below is necessarily generic and will differ depending on the specific treasury matter under discussion.

- Confirming the TM decision-making processes
- Confirming roles and responsibilities of the key stakeholders
- How does this council compare to other comparable authorities and what are the reasons for any significant difference in performance?
- What has been successful in this council's TM?
- What has been unsuccessful in this council's TM?
- How could this council do better?

Establishing the facts and the evidence

- What are the questions that need to be asked?
- Who is to be asked?
- Who is going to ask?
- How are we going to ensure that un-evidenced assertions are followed through?

Ensuring that questions and comments establish facts and are not used to try to determine responsibility or blame

- The scrutiny review should always be trying to establish facts, performance comparisons and make recommendations about performance improvement.

Questions to ask

Some of these questions are general in nature and can be posed informally to help scrutiny understand where to focus its attention.

Some are quite detailed and are designed to help scrutiny to assure itself on matters of technical detail.

We think that some of these questions can also be used as prompts for officers in writing officer reports intended for a member audience.

Once scrutiny has used these questions to understand the context and nature of TM issues in the authority, members can then use their general skills to unpick specific problems or issues that arise.

<u>In preparation</u>

Who are the Council's advisers on TM; who are the Council's fund managers?

- When were these contracts last renewed?
- How long have these advisers/managers been in place for?
- Have these contracts led to any performance issues and if so, have they been resolved?
- Are advisers (in particular) financially liable for the advice they provide?
- What benchmarks are used for performance?
- Are there any other suitable advisers?
- What are we expecting these advisers/managers to deliver; is this one of their strengths?

<u>Getting a picture of where investments are now</u>

Immediately prior to the Council's adoption of its TM strategy, what was the schedule of investments maturing in 30 days / 3 / 6 / 12 months?

Do these match the council's liquidity requirements (what are those requirements)? How liquid are these investments? Does this liquidity keep static? If there is any mismatch, why is this?

How long into the future does the council forecast cash flow requirements, and does the investment outlook stretch this far?

What is the council's perception of investment in private assets – securities and debt in companies which are not publicly listed?

What is the amount / percentage of investment in each asset class? How correlated are these asset classes, and the underlying investments? What are the associated risks?

How often does the council carry out a health check of its portfolio (at least half year, quarterly recommended

Has the council ever decided to adopt a more cautious approach to investment decisions that strictly requires by the council's strategy and policy? Has the council ever taken a riskier approach? If so, why? Can the reasons be evidenced, and what were the implications?

What evidence is considered when evaluating the credit quality of a counterparty (credit ratings along are likely to be insufficient)? Is there are an approved list of credit ratings agencies?

How does the council monitor its investments and associated risks? How do "macro" changes feed into this analysis?

<u>More formal questions</u>

(These questions might be asked when members have a clear idea of an issue they might want to look at. These are drafted to reflect possible scrutiny of an investment or portfolio of investments that might be causing concern).

In the case of an investment/investments causing concern:

- What were those investments?
- When did the concern arise?
- Was it reflected in changes in the credit ratings of those investments?
- When was the concern spotted?
- Were any investments under the control of Fund Managers?
- What advice was taken, by whom, and what was the nature of that advice?
- What action was taken as a result, and what is the current position?

In the case of the council's general approach to risk and investment:

- How, and why, do we calculate and evaluate risk in the way we do?
- Has the council's TM policy been successful in the last year?
- What KPIs are used to quantify success?
- What lessons can be learned to inform future practice?
- How does local investment (given the importance of social value) influence the council's decision-making?

Conclusions and recommendations

Having established the facts about the council's actual and potential performance, the panel will wish to produce a report which is robust, provides an evidence-based account of actual performance, reaches fair and supported conclusions, and makes clear recommendations.

Recommendations are likely to include:

- Proposals that the council should consider and/or implement to improve performance
- Issues for the Section 151 Officer to address, and for Cabinet and the Council to pick up in the next planned review of the current treasury management strategy;
- Identification – and mitigation – of risks which may have been impacted by any issues under investigation;
- A timescale for reporting back on the consideration that has been given to and action taken on the recommendations.

Appendices

Appendix 1: Key aspects of treasury management in more detail

Risk management and credit rating

The identification and control of risk is essential in all aspects of the council's activities. However, risk management in the treasury management function has unique factors to be taken into consideration. As part of their Treasury Management Practices, all authorities will consider their approach to a number of key risks. These include:

- Ensuring the authority has enough cash assets to meet its liabilities (liquidity) – that the council is investing the right amount, given its overall cashflow;
- Exposure to certain investment risks. There will be a need to set limits to how much the authority invests in certain things – mindful of the need to be able to realise assets quickly where needed;
- Diversifying. Essentially, this is about ensuring that there is a spread in its portfolio enough to deal with any likely economic or financial shocks;

In order to decide with whom, and in what, to invest, the council will have to have regard to that organisation's credit rating. The theory is much the same to that applied in personal banking, when a bank makes a decision whether to lend to an individual (for example, on a mortgage) on the basis of their credit rating. CIPFA recommends that local authorities use more than one source of information to determine credit quality, and ratings are not a definitive guide to where risk will and won't lie in the future.

The approach that councils take here is important because it goes to the heart of their appetite for risk – particularly given that the ratings of certain investments can oscillate.

Investments, and organisations, are given a rating by agencies. This rating helps potential investors to identify the risks associated with investment.

There is also a close link between the prudent person rule and what might be termed the twin principle of proportionality. For any treasury function and oversight, the prudent assessment and consideration of the treasury management strategy and associated risks should be:

i) Proportional to the size of the pool and the cashflow needs of the council

ii) Proportional to the complexity of the proposed investment strategy

Simple risks (for example, the risk of money laundering) place a lower burden of care and skill than more complex risks. As the majority of risks will predominantly be found in economic conditions and therefore, in the investment strategy, the level of care and skill required needs to be proportional to the complexity of the investment strategy proposed or undertaken.

Investment in private markets

A further key evolution in recent years has been the rise of the private and unrated markets. This includes corporate loans, real estate lending, and eventually long dated social housing and infrastructure financing. The notion that they are private should not be necessarily confused with poorer quality, however.

But there are also challenges, as many of these private assets may not be formally rated and also require fundamental credit analysis to understand the actual risks embedded within them due to their bespoke nature. If these fall within the purview of the treasury management strategy, it is likely that the local authority in question will need to rely on external advisors to navigate this landscape.

Getting advice

Local authorities can and do make their own investment decisions, but, given the potentially specialised knowledge and skill required to deliver an effective treasury management service many employ an external firm of advisers to support them. Such advisers will give regular advice on the compliance with the Code, technical accounting issues, counterparty analysis and views on the direction of interest rates and assistance in formulating and monitoring treasury management strategies etc.

External fund managers, conversely, go beyond the provision of advice and directly manage investments on behalf of the authority. Authorities with larger investment portfolios might employ more than one external fund manager, and/or manage part of their treasury management activities in-house in order to diversify their treasury management activity, prevent potential over-reliance on one company and provide information on relative performance for internal benchmarking and comparison purposes. The use of external fund managers requires a robust approach to monitoring and oversight.

All of these arrangements involve the involvement of external partners to either assist the council in making investment decisions – or making decisions on the council's behalf. These people require strong direction to ensure that the council's best interests are being served. This direction – in terms of risk appetite and the overall profile of investment that the council wishes to take – ultimately comes from the council's political leadership. It therefore needs to be subject to scrutiny by politicians.

Benchmarking and Performance Measurement

As each local authority is responsible for its own appetite for risk, as defined within the annual treasury management strategy, direct comparison with peers can be misleading.

The CIPFA Prudential Code[7] specifies a series of indicators which set parameters for the treasury management activity at the authority, assisting in the management of risk and the assessment of performance. These indicators are approved by full Council, usually annually at the same time as the annual budget and council tax level are approved and can be amended during the year subject to approval by the full Council. The same indicators are also reported to the council at the end of the year. They can provide a good starting point for councillors seeking to get to grips with the basics, before more detailed questions are asked of officers.

In addition to the Prudential Indicators, individual councils have the flexibility to augment their treasury management assessments with the inclusion of local performance indicators. These local performance indicators offer a means to provide more comprehensive insights into the effectiveness and outcomes of their treasury management activities, including the utilisation of capital metrics.

By incorporating capital metrics into their treasury management evaluations, councils can gain a deeper understanding of their capital position and its impact on financial stability and risk management. These metrics may encompass key financial indicators related to capital allocation, debt sustainability, liquidity, and asset-liability management. Utilising capital

[7] The Code is not publicly available. Individual Councils will have access to it, and s151 officers should be able to make it available to councillors for review.

metrics in conjunction with the Prudential Indicators allows councils to assess how their treasury management practices align with their broader capital finance strategies, facilitating a more holistic and data-driven approach to decision-making and performance assessment.

Compliance and Assurance

As we have seen treasury management is extremely complex and a resource intensive operation, appropriately so given the management of large sums of public money. There are several resources available to elected members to support their scrutiny function: these include internal and external audit, independent treasury management advisors all of whom can be called upon for to undertake specific checks or a health check type of review.

An internal audit of treasury management will be scoped to focus on key areas of risk. Management's and the audit committee's need for assurance will be taken into account when planning the audit. Treasury management can be a complex operation in some councils and presents a number of risks, both operational and strategic so a planned internal audit may not seek to provide assurance over them all at once. Four main themes are:

- The alignment of the treasury strategy to organisational objectives and adequacy of treasury risk management arrangements
- Adequacy of governance arrangements & compliance with regulations
- The satisfactory management control of financial & operational risks
- Adequacy of performance management arrangements.

Internal audit reports will provide an invaluable resource for a scrutiny review of treasury management.

Appendix 2: Glossary of financial instruments and terminology

Capital receipts

A capital receipt is the proceeds of sale from an asset. Capital receipts generated from the sale of General Fund assets are fully available for use by the local authority, whereas capital receipts from Housing Revenue Account assets, and, in particular, Right to buy sales, are subject to nationally determined "pooling" arrangements. Available capital receipts can either be immediately used to fund capital projects or invested to gain a return via the treasury management function. As a result of the now repealed Local Government and Housing Act 1989, up until 1998, councils were required to specifically "set-aside" a percentage of generated capital receipts to make provision for the repayment of debt (debt free authorities were exempted from this requirement as they had no debt to repay). Some council still hold such set aside capital receipts as part of their overall reserves and balances.

Cash flow

The movement of cash into and out of a local authority.

CIPFA

Chartered Institute of Public Finance and Accountancy

CIPFA is one of the leading professional accountancy bodies in the UK and the only one which specialises in the public sector. It is responsible for the education and training of professional accountants and for their regulation through the setting and monitoring of professional standards, set out in a series of Statements of Professional Practice (SoPPs). CIPFA also produces various codes of practice and guidance relevant to local authority financial management, including the Treasury Management Code of Practice and the Prudential Code for Capital Finance.

Credit ratings agencies

Private companies who, amongst other services, provide an analysis and assessment of the creditworthiness of debt issuers such as banks. Further information about the work of credit rating agencies can be found from the company websites; www.fitchratings.com, www.standardandpoors.com and www.moodys.com.

Counterparty

A bank, company or other such body that the council invests with or borrows from.

External Fund managers

External companies that may be contracted by local councils to manage parts of their overall treasury management activities.

Liquidity

Liquidity is the need to ensure that the council has sufficient cash to meet its immediate expenditure requirements. Liquidity is also a relative term to indicate the ease in terms of potential time delay and financial loss at which an investment can be converted back into cash.

Maturity

The length of time before a loan or investment is due to be paid back

MIFID II

The Markets in Financial Instruments Directive, a piece of EU legislation that governs the provision of investment services in financial instruments by banks and investment firms and the operation of traditional stock exchanges and alternative trading venues. The original Directive was introduced in 2007 and followed up by a revision in the aftermath of the financial crisis. Importantly, MIFID II classifies local authorities as retail, rather than professional, clients – this has implications for the advice that local authorities need to take in order to invest.

Non-Specified Investments

All investments that do not meet the requirements of specified investments (see below) i.e. they mature over 365 days or offer higher risk

Prudential Code

Basis for the system of self-regulation of local authority investment activity introduced by the 2003 Local Government Act, which requires local authorities to 'have regard to' the Prudential Code. Requirements include but go beyond issues of treasury management

Prudential Indicators

Minimum set of required information on capital expenditure, external debt and treasury management for the next three financial years. Must be reported to the full Council

Public Works Loans Board

A statutory body based in the UK Debt Management Office, an executive agency of HM Treasury. It lends money from the National Loans Fund to local authorities and other prescribed bodies and collects repayments.

Redemption premium

Some investments and borrowings are offered by financial institutions over a fixed term. Should the council seek to end the agreement early, compensation may be payable the financial institution in the form of a redemption premium. This is similar to the early redemption penalty present in many fixed rate domestic mortgages.

Reserves and Balances

Reserves and balances are both monies that have been put aside in a particular year to cover future expenditure plans. More specifically, reserves tend to be used to cover specific types of expenditure, but where the specific amount and timing is uncertain. For example, councils might have an insurance reserve to cover it for the cost of loss and damage not covered by its external insurance policies. Balances are less specific and usually arise from under spends. There is no specific guidance on the size of reserves and balances that a council should have, but every council must itself agree a minimum level of balances as part of its financial planning process. Reserves and balances are invested as part of the treasury management process, with consequent returns available to allocate as part of the budgeting process.

Risk management

Risk management is the process by which potential risks are identified and controlled. Treasury management activities expose councils' risks such as the loss of funds invested, and so specific controls and procedures are required to ensure that the exposure to such risk is minimised.

Section 151 Officer

The statutory role of each local authority's Responsible Financial Officer prescribed in Section 151 of the 1972 Local Government Act with responsibility for making "arrangements for the proper administration of their financial affairs". Usually, the Borough Treasurer or Director of Finance.

Specified Investments

Investments defined in the 2004 Local Government Investment regulations as offering both high security and high liquidity, they must be made in sterling and mature within one year

Treasury Management

The management of an organisation's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks

Treasury Management brokers

Brokers act on behalf of investors and/or borrowers and undertake the necessary transactions to purchase financial instruments on behalf of their clients. They differ from fund managers as they act on instructions rather than being involved themselves in the decision to buy or sell.

Treasury Management Practices

12 controls or procedures that are recommended by CIPFA to be adopted by local authorities to guide and set the parameters of the treasury management function

Appendix 3: Relevant Legislation

Local Authorities (Capital Finance and Accounting) (England) regulations 2003 (SI3146) and subsequent amendments

Local Government Act 2003

Local Government Investments. Guidance under Section 15(1)(a) of the Local Government Act 2003. ODPM March 2004

Appendix 4: Other Relevant Documents

The Prudential Code for Capital Finance in Local Authorities. CIPFA 2021

Treasury and Civil Service Committee Second Report of Session 1991-92 *Banking supervision and BCCI, the role of local authorities and money brokers.* HC paras 1-3 Q838

Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes. CIPFA 2021

Treasury Management in the Public Services Guidance Notes for Local Authorities including Police and Fire Authorities (Fully revised Second Edition). CIPFA 2021

Treasury Management Statement of Professional Practice. CIPFA 2002