Leeds
CITY COUNCIL

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Report of the DIRECTOR OF RESOURCES

Scrutiny Board (Central and Corporate Functions)
Date: 2nd November 2009
Subject: Review of Treasury Management post Icelandic Reports

Electoral Wards Affected:	**Specific Implications For:**	
	Equality and Diversity	
	Community Cohesion	
	Narrowing the Gap	

Eligible for Call In	√	Not Eligible for Call In (Details contained in the report)	

EXECUTIVE SUMMARY

1. This report updates members on the recommendations of three reports on the Icelandic crisis. These reports were written by the Communities and Local Government Select Committee (CLG), the Audit Commission (AC) and Cipfa as a response to the lessons learnt from the crisis.

2. The treasury function is operating effectively and that many of the recommendations made in the three reports are already incorporated within treasury practice.

3. All three reports highlight that local authorities should have an Audit Committee tasked with specific responsibility for scrutiny of the treasury management function. Members are asked for their views on whether this responsibility should sit with Scrutiny Board (Central and Corporate Functions) or the Corporate Governance and Audit Committee.

4. The three reports also highlighted that members should be adequately trained in order to effectively scrutinize the treasury function.

5. The CLG report asked whether the audit/scrutiny function would be enhanced by the appointment of an external treasury specialist.

6. The AC report concludes that many local authorities acted prudently and within their treasury management strategy guidelines. The over arching treasury management framework is the right one, however they must ensure that the function is properly resourced (both in terms of knowledge and numbers) in order to fully asses the risks involved. There are lessons to be learnt and the AC will provide further guidance and reports.

7. The Cipfa report comments that Councillor involvement should be strengthened and suggested that authorities should consider how they can best involve Members and leading Portfolio Holders in determining treasury management strategies. Cipfa is looking to develop training for councillors in their role.

1.0 Purpose Of This Report

1.1 The Treasury Management annual report 2008/09, presented to Executive Board in July, highlighted to members the recommendations of three reports on the Icelandic crisis. These reports were written by the CLG, the audit commission and CIPFA as a response to the lessons learnt from the crisis.

1.2 The Annual report referred the recommendations from the three reports to the Central and Corporate Functions Scrutiny Board and the Corporate Governance and Audit Committee. This report now provides members with a response to the issues raised.

2.0 Background Information.

2.1 The operation of the Treasury Management function is governed by provisions set out under part 1 of the Local Government Act 2003 whereby the Council is required to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities.

2.2 The treasury management function is responsible for HRA and General Fund long term debt in the region of £1.4bn and investments that currently stand at £60m. It also manages the cash flow requirements of the Council.

2.3 The credit crisis began in 2007 when the French Bank BNP Paribas closed two of its mortgage backed securities fund because they could not value them. As a result credit stopped flowing in the money markets. The following 12 months saw banks suffering huge losses, and national Governments taking coordinated action to intervene in the money markets. This did not stem the problem as in October 2008 Lehman’s Brothers went into administration. Weeks later the Icelandic banks folded. The collapse of the Icelandic banks in 2008 has thrown the treasury management function into the spotlight. Local Authorities collectively had £1bn on deposit with Icelandic banks which immediately became illiquid.

2.4 Since then money and equity market volatility has abated but the economies are still suffering. Early predictions are that most of the deposits held in Icelandic Banks will be returned.

3.0 Main Issues

3.1.1 This section considers the implications of the issues raised in each of the three reports for the Authority’s Treasury Management function. The analysis concentrates on the recommendations that require specific action. These points and the remaining recommendations are shown in Appendix A. The remaining recommendations cover issues that the Authority is in agreement with and/or were already incorporated within the treasury management function.

3.1.2 In general the main points raised in each of the three reports endorse the current working practices and framework of the treasury management function.

3.2 ***CLG Committee report – Local Authority Investments***

3.2.1 This report looks at a number of different areas within treasury management and the wider interested parties. Formal written and oral evidence was taken from a variety of sources before the report was produced. The report focuses on the following key areas of treasury management:

- Local authorities' investments and reserves
- Local authorities' financial teams
- Scrutiny of the treasury management function
- Credit rating agencies
- Treasury management advisors

3.2.2 The report highlights that all local authorities should have an Audit Committee tasked with specific responsibility for scrutiny of the treasury management function. Members are asked for their views on whether this responsibility should sit with Central and Corporate Functions Scrutiny Board or the Corporate Governance and Audit Committee.

3.2.3 The report also notes that the members involved with scrutiny should be adequately trained. Treasury has in the past provided in house training on treasury management and will look to hold further sessions in the future. Members may also consider visiting the treasury management section to gain a practical understanding of how the treasury team operates, should they feel it necessary. The Treasury Management has received similar visits in the past

3.2.4 The report further highlighted that members, in light of the specialised nature of treasury management, should consider whether to involve external specialists to enable a satisfactory level of scrutiny. Should this route be considered then the appointee should have the necessary level of financial experience and governance in the public sector

3.2.5 The Council's treasury management policy upholds the recommendations of the report when making investments. These key points are that deposits/investments are made with current credit ratings and additionally rely upon a range of other information sources available. These have typically covered:

- Live market information in the UK, US, Europe, and emerging markets. This information covers the money markets, commodities and equities.
- Information from the money market brokers and money market fund managers
- Diversification of investments across products and geographical borders
- Sharing of information across Core City and West Yorkshire District groups
- Information provided by the Council's treasury management advisors.

3.2.6 The use of Treasury management advisors is further highlighted in the report. The Council has always viewed that whether treasury management provide information or advice does not matter, when the authority must itself understand the inherent risks with any investment decision taken. The Council's priority for investment has always been security of capital, liquidity and then the return generated.

3.2.7 The report comments on the role of the audit commission in the crisis and notes that the level of auditing should have been higher given the increasingly volatile economic context. The Council's own treasury function is internally audited on an annual basis, with additional external audits on balance sheet items undertaken as part of the audit of the authority's final accounts.

3.2.8 We agree with the amendments to the CIPFA code which the Authority was already complying with.

3.3 ***Audit Commission Report - Risk and Return: English Local Authorities and the Icelandic Banks.***

3.3.1 The report notes that many local authorities acted prudently and within their treasury management strategy guidelines. The over arching treasury management framework is the right one, however they must ensure that the function is properly resourced in order to fully asses the risk involved.

3.3.2 The report commented on what key interested parties should do:

- Central Government
- Cipfa
- Local Authorities
- AC

3.3.3 The AC commented the cost of early repayment of PWLB debt should be re-visited to ensure that the structure introduced in 2007 does not prevent Councils from redeeming debt. Since this report was released a 'Consultation Letter' was published by the PWLB, asking for feedback on proposals to provide intra-day rate updates, which it anticipates would lead to a fall in the cost of repaying debt. We are currently preparing a response to this consultation.

3.3.4 The Treasury management function has sufficient resources, with the appropriate level of experience and qualifications to adequately assess risk inherent within investment decisions undertaken, as recommended by the AC.

3.3.5 The AC further recommend that elected members responsible for treasury management are suitably trained in the stewardship of public monies so they are able to scrutinise effectively and be accountable for the treasury management function.

3.3.6 The AC will aim to work with Cipfa and other to ensure that the lessons are learnt and will provide further guidance and reports.

3.4 ***A CIPFA Treasury Management Panel Bulletin: Treasury Management in Local Authorities – Post Icelandic Banks Collapse (March 2009).***

3.4.1 CIPFA are in the process of issuing a revised code of practice and guidance which will be fully adopted by the Council. The Treasury Management Bulletin provides some interim advice to local authorities on treasury management practices in the light of the Icelandic Banks collapse and the continuing 'credit crunch'.

3.4.2 The advice covers the following areas:

- Revised Treasury Management Code and Guidance
- Treasury Management Objectives
- Treasury Management Governance Arrangements
- Monitoring
- Gross and Net Borrowing
- Skills and Training

- Counterparty Lists
- Use of Treasury Management Advisers
- Benchmarking

3.4.3 In terms of governance arrangements the authority already provides three updates a year on treasury management. The report also highlights issues raised in the CLG report around the level and training of Members (see 3.2.2). This report goes further and poses that Councillor involvement be strengthened and it is suggested that authorities consider how they can best involve Executives and leading Portfolio Holders in determining treasury management strategies. Cipfa is looking to develop training for councillors in their role.

3.4.4 The treasury management team possesses substantial treasury management experience, together with Cipfa qualified and part qualified staff and as such will consider whether the new Cipfa treasury management qualification will further enhance the service.

3.4.5 Cipfa recommend that formal limits on investment in sectors and by country be applied. We already incorporate these views when placing investments but are of the view that a formal limit would be too restrictive and would not necessarily provide a reduced level of risk.

3.4.6 The bulletin makes a series of further recommendations which the Treasury Management function already incorporates in its working practices.

4.0 Implications For Council Policy and Governance

4.1 The operation of the Treasury Management function is governed by provisions set out under part 1 of the Local Government Act 2003 whereby the Council is required to have regard to the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities.

4.2 Any changes to the requirements to the code will be adopted and reported to Council at the earliest opportunity.

4.3 This report also highlights whether specific scrutiny of the treasury management function should sit with the Central and Corporate Functions Scrutiny Board or the Corporate Governance and Audit Committee.

5.0 Legal and Resource Implications

5.1 The adoption of recommendations of the three reports that have resource implications which will be contained within existing resource levels.

6.0 Conclusions

6.1 The credit crunch and the collapse of the Icelandic banks have resulted in the treasury management function receiving a greater level of scrutiny. Three reports by the CLG, the Audit Commission and Cipfa have been written. These reports conclude that there is nothing fundamentally wrong with the framework under which treasury management operates. However there are some concerns with some authorities in the way investments are made and the mechanism for how investment strategies are scrutinised.

6.2 There are also concerns over the level of scrutiny and whether Members are adequately trained to assess the treasury management function.

7.0 Recommendations

That Members:

7.1 Note that the treasury function is operating effectively and that many of the recommendations made in the three reports are already incorporated within treasury practice.

7.2 Determine whether the scrutiny of the treasury management function should sit with the Scrutiny Board (Central and Corporate Functions) or the Corporate Governance and Audit Committee.

7.3 The nominated committee responsible for scrutiny should consider whether it is adequately trained to discharge its responsibilities.

7.4 The nominated committee responsible for scrutiny should also consider whether to appoint an external specialist to enable it to adequately and effectively scrutinise the treasury function.

<u>Associated documents:</u>

a) Treasury Management Strategy 2008/09 - Executive Board 8th February 2008.
b) Treasury Management Strategy 2009/10 – Executive Board 13th February 2009.
c) Local Authority Investments CLG Select Committee 11th June 2009
d) Treasury Management in Local Authorities – Post Icelandic Banks Collapse – CIPFA Treasury Management Panel Bulletin March 2009.
e) Risk and Return – English Local Authorities and the Icelandic Banks – Audit Commission March 2009.

Appendix A

Seventh Report From The Communities And Local Government Committee: Local Authority Investments: Session 2008-09: HC 164-1

Conclusions and recommendations

Local authorities' investments and reserves

1. We conclude that it would be inappropriate to seek to restrict local authorities' investment options. Although interest rates are now at historically low levels, returns on investments are usually an important source of local authorities' revenues and investment by local authorities is an element in the health of the UK financial sector. The primary consideration of local authority investment, as emphasised by CIPFA, should remain security and liquidity; but yield should not be neglected. The risk involved in seeking yield should be mitigated by robust and responsive Codes, guidelines and best practice. (Paragraph 37)

We agree that investment options should not be limited further – the scope of local government is already quite constrained. Our main investment priority, as demonstrated in the TMPS, is the security of capital.

Local authorities' financial teams

2. We endorse the Audit Commission's censure of these rudimentary mistakes in organisations responsible for investing large amounts of public money. However, as the Commission's research has found, those seven authorities were not necessarily the only local authorities at fault. (Paragraph 42)

Noted

3. It is obvious from our written evidence, and from the research carried out by the Audit Commission, that there are some local authorities with excellent treasury management services, but there are also local authorities with a less effective service. One of the objectives of the CIPFA Codes and Codes of Practice should be to ensure that all local authorities are aware of the level of expertise which is necessary to run a successful treasury management operation, and have all the checks and balances in place to ensure adequate monitoring, on an ongoing basis, of both the framework within which its treasury management team operates and the individual decisions which are made on a day-to-day basis. (Paragraph 49)

We concur.

4. We recommend that the Government, CIPFA and the LGA study ways in which local authorities, particularly smaller ones, could join together to share expertise and pool treasury management resources. The sharing of information and expertise, such as identifying banks that are in the same financial group, might have lessened the failures that occurred during the Icelandic crisis. (Paragraph 56)

We agree that effective Treasury Management requires adequate levels of resources, and ways to provide these to smaller authorities should be explored. We already participate in information sharing forums (e.g. Core Cities and West Yorkshire Districts) and have taken on the TM function for WYITA, providing the resources necessary for it to be effective.

Scrutiny of the treasury management function

5. We endorse the Minister's suggestion and recommendations by CIPFA and the Audit Commission that all local authorities should have an Audit Committee with specific responsibility for the scrutiny of the treasury management function.

Guidance to local authorities to that effect should be given through appropriate amendment to the CIPFA Codes. (Paragraph 68)

We have an audit committee and scrutiny board, both of which cover Treasury Management Strategy and pick up any issues.

6. Members of audit committees need to take their responsibilities for that scrutiny seriously and need to ensure that they are properly trained. The CIPFA Treasury Management Code of Practice should make explicit the need for specific training in treasury management to be undertaken by those councillors with responsibility for overseeing treasury management arrangements, and the Audit committee should be charged with ensuring that it is available and with monitoring its adequacy. (Paragraph 69)

Training has been offered to councillors in the past, both structured and by request. Once we have established which board is responsible for TM scrutiny, further training will be offered.

7. Guidance from CIPFA notes that it is open to an authority to appoint someone other than an elected member and from outside the authority either to serve on or to chair the audit committee. The co-option of external members to audit committees in this manner offers an additional opportunity to local authorities to enhance the expertise available to the authority in the scrutiny of its treasury management function, and we encourage all local authorities to consider taking advantage of it. (Paragraph 70)

Due to the specialised nature of local authority treasury management, the potential pool of external individuals who would add value is quite small. However we will keep this under review.

8. Whether a local authority has an Audit Committee or not, elected members should ensure that they pay proper attention to scrutiny of the Annual Investment Strategy (AIS), and of the decisions which are taken under it. We recommend that CIPFA, in reviewing its Codes, consider what further guidance is necessary to local authorities to ensure that elected members are given—and take—appropriate opportunities to scrutinise their AIS. We also recommend that CIPFA develop and include in its revised Codes more rigorous requirements for reporting to elected members on decisions taken by officials under the AIS. (Paragraph 71)

Noted.

Credit rating agencies

9. The lack of information about the appropriate use of credit ratings in the Government guidance and in the CIPFA Codes is an omission. Some local authorities have relied too heavily on credit ratings, without appreciating that they should be viewed within the context of other financial and economic information and advice. We welcome the new guidance from the CIPFA Treasury Management Panel, but believe that there is room to go further. We recommend that the Government revise the informal commentary on its statutory guidance, to include information about the appropriate use of credit ratings. We also recommend that the CIPFA Codes include guidance to local authorities on the nature of credit ratings, highlighting the risks of over-reliance on them. Credit ratings should not be used in isolation as a justification for the soundness of an investment and local authorities should be made aware of the fact that credit ratings should be viewed within the context of wider financial and economic information and advice. (Paragraph 81)

We concur that the guidance should be updated with relation to the status of credit agencies. However we already only use them as part of a range of information sources when making investment decisions.

Treasury management advisors

10. Responsibility for local authorities’ investment decisions lies, and must continue to lie, with the local authorities themselves. However, the claim by some treasury management advisers that they give information only, not advice, on investment counterparty creditworthiness to local authorities is, in our view, misleading. (Paragraph 99)

The services provided by Treasury Advisors can be interpreted as either as advice or information. However, we recognise that full responsibility for investment decisions rests with the Treasury Management function itself.

11. The involvement of treasury management advisers in local authority treasury management will only be valuable if local authorities understand the level of service they require, and if the advisers themselves are clear about the level of service they are providing. Treasury management advisers must decide, define and communicate what services they are providing clients, particularly in relation to the provision of "information" and/or "advice". The local authority itself nevertheless remains ultimately responsible for any investment made, and CIPFA should warn local authorities about over-reliance on treasury management advisers, whose services have been shown to be variable and, in some cases, inadequate. (Paragraph 100)

We already only use treasury advisers as one of a range of market information sources that we take into account when making Treasury Management decisions. We will continue to monitor our reliance on, and the quality of our Treasury Advice.

12. We recommend that the Audit Commission carry out a value for money study of the services that local authorities have received from treasury management advisers, with a view to advising local government on the value that they offer in the differing circumstances applying to individual authorities. (Paragraph 101)
We concur that such a review would be useful for local authorities in general, but having recently undertaken a tender for the provision of Treasury Services, we are satisfied that our current Treasury Advisor arrangements provide value for money to the Council.

13. We recommend that the CIPFA Codes give more detailed advice to local authorities on the services which they may expect to receive from treasury management advisers, and how to use them effectively. The guidance should make clear that such advisers may give varying types and levels of information or advice. (Paragraph 105)

We concur that the Codes should be updated accordingly.

14. The Financial Services Authority (FSA) should take a more active role in the regulation of treasury management advisers. The evidence which we have examined has raised concerns about potential conflicts of interest and questions as to whether there are any financial transactions between treasury management advisers and brokers that might compromise the independence of advice being given to local authorities. There is a strong case for a full investigation by the FSA of the services provided by local authority treasury management advisers. We recommend that such an investigation be carried out as soon as possible. (Paragraph 120)

We concur

15. Our examination of the role of treasury management advisers in the Icelandic debacle has raised wider questions about their influence on local authorities' treasury management practice. First, there is confusion, and perhaps some deliberate ambiguity, about what services they offer. It is clear to us that some local authorities believed that they could place reliance on their treasury management advisers in a way that some of the treasury management advisers themselves now seek to argue was misguided. Second, there is concern about the independence of treasury management advisers that may be part of companies that will benefit from the investment decisions of the local authorities that they advise. Third, there is a lack of clarity about the extent to which local authorities can assume that treasury management advisers are properly regulated. While local authorities must ultimately take responsibility for their investment decisions, a range of regulatory and advisory bodies appear to us to have been complacent in their approach to the role of treasury management advisers. The Audit Commission, CIPFA and the FSA must all re-examine the role and reliability of treasury management advisors and their discharge of duties of care for local authorities in managing this aspect of treasury management. (Paragraph 121)

We concur

The Audit Commission

16. Notwithstanding the Audit Commission's disclaimers about what auditors can and cannot do, the guidance issued after the Icelandic banking collapse shows that there *were* questions that auditors could properly have asked to ensure that local authorities were following agreed treasury management procedures. If the Audit Commission's auditors had followed this guidance as normal practice before the Icelandic banking collapse, local authorities might have been alerted to some of the failures in treasury management procedure which, in some cases, led to funds being put at risk. (Paragraph 132)

Noted – however it was the responsibility of the local authorities, not the Audit Commission, to ensure their procedures were fit for purpose.

17. The Audit Commission took it for granted that treasury management was a well managed function, and, consequently, was not an area of concern for auditors. Even if it could not reasonably have been expected to foresee the collapse of a country's entire banking system, the Audit Commission should have been aware of the greater risk to treasury management as a result of the prevailing financial climate and should have adjusted its practice accordingly. The Audit Commission failed to realise that treasury management was becoming an increasingly risky area and, in that respect, it must share some of the blame for the potential loss of funds in the Icelandic banks. If it had viewed treasury management within the increasingly volatile economic context, it would have put treasury management higher in its auditing procedures, and if it had done that, it is possible that less public money would no be at risk. We recommend that the Audit Commission review its own auditing procedure and prioritisation of the areas of local authority activity it chooses to audit, in order to ensure that such complacency does not happen in future. (Paragraph 135)

We concur.

The CIPFA Codes

18. We recommend that CIPFA add to the issues that need to be covered in a local authority's annual investment strategy (AIS) the use, or not, of an external advisor; schemes of delegation and the role of the Section 151 officer; and the use of and procedures regarding credit rating agencies. The guidance need not be prescriptive about the way in which the AIS should address these issues, but it should ensure that proper attention is paid to these previously under-scrutinised areas. (Paragraph 141)

Noted – the above issues are central to good governance, and we already ensure that our arrangements in these areas are reviewed regularly.

Central Government and local authority treasury management

19. We welcome the Government's willingness, as expressed by the Minister for Local Government in evidence to us, to revise its approach to investment guidance, and we trust that it will look closely again at that guidance in the light of the conclusions of this Report, especially at the issues surrounding the use of credit ratings. However, the failures in treasury management identified by our inquiry and by the Audit Commission's work have for the most part occurred not because of CLG's guidance, but because of local authorities not following the guidance properly. (Paragraph 145)

Noted

20. We agree with the Government's approach to assisting those local authorities that have funds at risk in the failed Icelandic banks, which we consider to be an appropriate way of protecting the council tax payer whilst avoiding the "moral hazard" inherent in an unconditional, open-ended guarantee of local authorities' investments. The Government will have to monitor closely the amount of money that local authorities eventually get back from Iceland to ensure that any actual losses do not seriously disadvantage either local council tax payers or local service uses. However, democratically accountable local authorities are ultimately responsible for their investments and it is they who should take the consequences—whether in the budget or at the ballot box—of their investment decisions. (Paragraph 152)

Noted.

21. We seek reassurance that regular meetings at an appropriately senior level are held between the Audit Commission, the local authority associations, CIPFA and CLG to ensure that the treasury management system is kept under review. We also recommend that these meetings include links with the financial regulatory bodies—the Financial Services Authority and the Bank of England—to ensure consistent and up-to-date information is passed onto these bodies. (Paragraph 156)

We concur

22. The majority of stakeholders in treasury management agree that the cost of early repayment of debt to the PWLB needs to be reviewed. We add our voice to those recommending that the Government carry out an urgent review of the arrangements for early repayment of debt to the PWLB. (Paragraph 166)

Since this report was released a ‘Consultation Letter’ was published by the PWLB, asking for feedback on proposals to provide intra-day rate updates, which it anticipates would lead to a fall in the cost of repaying debt. We are currently preparing a response to this consultation.

Audit Commission Report – Risk and Return: English local authorities and the Icelandic Banks

Conclusions

115 The chaos in the financial system that led to the collapse of the Icelandic banks had no recent precedent. But the collapse has revealed much about the way that local authorities look after their money.

Noted.

116 Many authorities have acted prudently, used advice and information wisely and balanced their risks. Others have been less cautious, by following ratings exclusively and perhaps striving to achieve a high yield without due regard to the risks involved. And a small group of authorities that made deposits in Icelandic banks after the credit ratings had been downgraded did not, in the Commission's view, take adequate steps to ensure that they were using up-to date information when making deposits at a time of great financial instability, and when the fragility of the Icelandic banking system had been widely reported and was common knowledge

We concur – it was known for some time that the Icelandic economy was unstable, which we had picked up from financial news sources. This led to our placing an internal ban on investments with Icelandic banks.

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117 The consequence of this lack of caution has been the potential loss of large sums of public money. Had all authorities stopped depositing in Icelandic institutions after April 2008, then the amount of money at risk would have been over £500 million lower than is the case.

Noted.

118 The overarching treasury management framework is the right one. Authorities should remain in control of their own funds within a national prescribed structure. The current structure has gaps, but the system can be adjusted rather than replaced. But if authorities are going to deposit in the commercial sector to benefit from the higher rates of interest available, they must ensure that their treasury management is properly resourced, managed and scrutinised. The full range of risks needs to be recognised and managed.

Noted.

119 There is always the risk that a commercial bank will collapse. Local authorities may, as a consequence, lose money. But with a better approach to managing their deposits, the chances of suffering such a loss can be reduced.

We concur

Recommendations

Central government should:

Review and revise the weaker aspects of the national framework highlighted in this report, especially the weight given to credit rating;
Noted

Enable and require the Debt Management Office (DMO) to provide deposit accounts to public bodies if those bodies cannot achieve the security they require in the market; and
Noted again DMO should be encouraged to pay market rates not ¼% below as they currently are

Review the cost of early repayment of debt to the Public Works Loans Board to ensure that the structure introduced in November 2007 is not acting against the wider public interest by encouraging authorities to hold unnecessarily large deposits.

Local Authorities are discouraged from repaying debt because of its cost in terms of premia and are therefore holding higher levels of deposits.

CIPFA should:

Revise and tighten its code of practice for treasury management to take account of the findings in this report;
Noted

Make more explicit the element of the prudential code that allows loans to be drawn down ahead of actually spending the money. Loans should be drawn down only after risks are fully assessed;
Noted

Continue to work with the Association of Corporate Treasurers to develop appropriate training and qualification for those working in treasury management in local authorities; and
Noted Courses should be appropriate to Local Government i.e. no derivatives or currency elements

Coordinate information sharing between local authorities to enable them to learn from one another. Any benchmarking activities should, as a minimum, highlight measures of security and liquidity of funds as well as yield.
Agreed but issues around benchmarking becoming performance measures and are sometimes counterproductive. Benchmarking occurs with other Metropolitan Districts and on a more detailed level with core cities. These exercises provide guidance on general levels of performance. You cannot however say that one authority is better than another because its return on investments is higher.

Local authorities should:

Set the treasury management framework so that the organisation is explicit about the level of risk it accepts and the balance between security and liquidity and the yield to be achieved. At the highest level, the organisation should decide whether it has:

- Appetite and capability to be able to manage risk by placing funds with financial institutions; or
- no appetite and/or insufficient capability to manage the risk of placing funds in the market, and should instead place funds with the UK government's Debt Management Office;

Agreed – This responsibility is discharged through quarterly strategy meetings, monthly finance meetings and formal reports to Executive Board.

Ensure that treasury management policies:

- follow the revised CIPFA code of practice;
- are scrutinised in detail by a specialist committee, usually the audit committee, before being accepted by the authority; and
- are monitored regularly;

Agreed

Ensure elected members receive regular updates on the full range of risks being run;
Agreed

Ensure that the treasury management function is appropriately resourced, commensurate with the risks involved. Staff should have the right skills and have access to information and external advice;
Agreed and consideration should be given to the levels of experience within the team

Train those elected members of authorities who have accountability for the stewardship of public money so that they are able to scrutinise effectively and be accountable for the treasury management function;
Agreed

Ensure that the full range of options for managing funds is considered, and note that early repayment of loans, or not borrowing money ahead of need, may reduce risks;
Agreed however current PWLB methodology does work against this

Use the fullest range of information before deciding where to deposit funds;
Agreed but need to note time sensitive nature of money dealing in usual circumstances we need to be practical, perfect information will never be available and so a balance should be struck between information and speed.

Be clear about the role of external advisers, and recognise that local authorities remain accountable for decisions made; and
Agreed. The Council is accountable for the decisions it takes.

Look for economies of scale by sharing resources between authorities or with pension funds, while maintaining separation of those funds.
Agreed. Leeds provides a treasury management service for the West Yorkshire Integrated Passenger Transport Authority. In the provision of this service it is essential to understand the cash flow requirements of the service.

The Audit Commission will:

Ask auditors to follow up this report as part of their use of resources work for 2008/09 and future years;
Noted.

Work with CIPFA to ensure that the lessons in this report and the research on which they are based are included in the revised treasury management guidance; and
Noted see above practicality should also be considered. No mention in this that the area usually involves time sensitive workloads and how these may be affected.

Work with others to produce guidance and tools for those in councils with a need to understand the treasury management function.
Noted

CIPFA Treasury Management Panel Bulletin: Treasury Management In Local Authorities – Post Icelandic Banks Collapse (March 2009)

Following the collapse of the Icelandic Banks, Local Authority treasury management has come under the spotlight. The Audit Commission has just published its report "Risk and Return" on local authority treasury management and the Communities and Local Government Select Committee has carried out a review of local authority investments and will report shortly. **CIPFA intends to revise both the Treasury Management Code and Guidance Notes** in light of the lessons to be learnt. This Treasury Management Bulletin provides some interim advice to local authorities on treasury management practices in the light of the Icelandic Banks collapse and the continuing 'credit crunch'.

It should be noted that this bulletin constitutes advice only. It does not have the status of formal guidance under legislation. Formal guidance will be published following consultation in the form of a revised Treasury Management Code and Guidance Notes for Local Authorities.

Revised Treasury Management Code and Guidance

The reports from the Communities and Local Government Select Committee and the Audit Commission will help to inform the revised code and guidance. This interim advice covers some of the key areas likely to be covered in the revised guidance. Comments are sought from practitioners on the interim guidance and any additional areas that should be covered. Comments should be emailed to alison.scott@cipfa.org by 29 May 2009. It is intended to issue a revised code and guidance notes in summer 2009.

Noted.

Treasury Management Objectives

It is important that treasury management policies adequately reflect risk and in particular security, liquidity and yield risk, in that order of importance. No treasury management transaction is without risk and management of risks is the key purpose of the treasury management strategy.

Noted.

Diversification should be a key consideration in setting treasury management objectives. This includes not just diversification between counterparties but also, diversification between countries, sectors and instruments. Authorities should ensure that the instruments they are using are appropriate to their portfolio and skills and understanding.

We ensure that diversification is taken into account in all investment decisions, whenever appropriate. However we do not agree that it should, in itself, form a treasury management objective. It is instead something to consider in order to achieve the security of our investment portfolio.

Treasury Management Governance Arrangements

The introduction of the Treasury Management Code, Prudential Code and Annual Investment Strategy, improved the involvement of elected councillors in treasury management decision making. The Treasury Management Strategy is approved annually by full Council, this is clearly a strength of current arrangements.

We concur but only if Council fully understand what it is that they are approving

Best practice authorities are supporting this decision making with improved information and regular review by councillors in both executive and scrutiny functions. Councillors are not treasury management professionals and the key to councillor involvement is developing their understanding of treasury risks and the need to place risk above reward.

Noted.

In order to further strengthen councillor involvement, it is suggested that authorities consider how they can best involve Executives and leading Portfolio Holders in determining treasury management strategies and whether Audit Committees should be given an explicit responsibility to keep treasury management arrangements under review. It is clear that councillor involvement should not be at the level of individual transactions but in terms of policies and procedures with special emphasis on risk management. In order to support Audit Committees in this role, CIPFA will be looking to develop training for councillors in this role.

We are looking into whether one of our scrutiny bodies has specific responsibility for Treasury Management. Training has been offered to councillors in the past, both structured and by request. We would look at CIPFA's training offer when more details of it are released.

The role of the Director of Finance in Treasury Management will be developed as part of the Statement on the Role of the Finance Director for Local Government but it is clear that he or she is ultimately responsible for ensuring that Treasury Management policies and practices are in place and are properly adhered to. The role of internal audit in providing these assurances should be reviewed on a regular basis.

Noted. At Leeds City Council we are audited both internally and externally on an annual basis.

Monitoring

It is recognised that many authorities formally report on treasury management more regularly than the annual report required by the Treasury Management Code. In order to enshrine best practice it is suggested that authorities report formally on treasury management activities at least twice a year and preferably quarterly. Other than the annual report the additional monitoring reports could be taken to executive committees as long as they are public reports available to all councillors and audit and scrutiny committees.

We currently provide three Treasury Reports to Exec Board / Full Council each year. One establishes our Treasury Strategy for the year ahead, another provides a mid year update, and the third provides a retrospective look at Treasury activity over the past year. We do not believe that moving to quarterly reporting would add any value, but will keep the situation under review. Overlaid on this we have quarterly formal strategy meeting involving the director as well as monthly update reports to a financial performance group won which the director sits.

Gross and Net Borrowing

Authorities may have a gross borrowing level that exceeds their capital financing requirement for a number of reasons including historical differences between capital receipts and debt repayment profiles and borrowing in advance of need. Authorities should satisfy themselves that, where gross and net debt levels vary substantially, they have taken account of all the risks associated with this strategy and that the reasons underpinning it are sound.

In the interests of transparency and to improve decision making, it is suggested that both the reasons for any significant difference between gross and net debt and the risks and benefits associated with the strategy are clearly placed before councillors as part of their agreement of the annual strategy.

All investment decisions involve a risk assessment. Our Strategy reports provide a gross to net debt reconciliation, and mentions the risks involved in investing any balances.

Local authorities are reminded that borrowing for the explicit purpose of re-investment is ultra vires.

Noted – this is already acknowledged in our TMPS.

Skills and Training

Local authorities should recognise the importance of their treasury management functions and ensure that they are adequately resourced to manage and safeguard the authority's cash resources. Training of staff should address all of the procedures, practices and processes which are relevant to the authority's treasury management arrangements. It is important that staff are only dealing with treasury management transactions where they fully understand the inherent risks.

The Treasury Management function has recently expanded to 4 members of staff, with some grades being increased. Training is provided on the job by experienced managers, with a long training period before any staff member is allowed to make investment decisions.

CIPFA and the Association of Corporate Treasurers will be launching a joint treasury management qualification aimed at public sector organisations in June 2009. CIPFA has also launched a risk management consultation paper and will look to develop practical guidance and toolkits for local authorities for management of treasury risk.

The Treasury Management function is currently assessing the new CIPFA qualification in Treasury Management, with a view to using it if it proves worthwhile. At present the TM function consists of a CIPFA member a very experienced qualified AAT and a part qualified CIPFA trainee.

Counterparty Lists

There has been much debate about the role of credit ratings and their use by local authorities. Credit ratings remain a key source of information but it is important to recognise that they do have limitations. Authorities are advised to have regard to the ratings issued by all three main agencies, Fitch, Moodys and Standard and Poor, and to make their decisions on the basis of the lowest rating. Ratings should be kept under regular review and 'ratings watch' notices acted upon.

We already base our investment decisions on all three credit agencies' ratings, and continually maintain our counterparty list in line with ratings watch notices.

Other sources of information should also be systematically reviewed by authorities. These include the quality financial press, market data and information on government support for banks and the credit ratings of that government support.

We collate information from a wide range of financial sources – these include the Financial Times, Reuters news streams and daily economics briefings from a range of banks and broking houses.

Current best practice by authorities includes setting limits on both the principal amounts invested and duration dependant on the financial standing of institutions and applying sector and country limits in line with their financial strength. It is recommended that authorities in addition to applying limits to individual institutions also apply clear country and sector limits.

We currently deal in only two sectors – banks and other local authorities, so do not feel a sector limit would be useful. We already consider our exposure to other countries when making investment decisions, but feel that a formal limit would be too restrictive.

Use of Treasury Management Advisers

There has also been significant debate about the role and use by authorities of Treasury Management Advisers. One of the key issues appears to have been over-reliance by some authorities on their advisers. Responsibility for investments and borrowing remains with the authority. Authorities should be clear on the status of the service they are receiving from their advisers and satisfy themselves of its appropriateness for their needs.

We recognise that responsibility for investment decisions rests with the Authority, and only use Treasury Advisers as part of a wide range of information used in making investment decisions. We ensure that the service we receive is appropriate as part of the annual procurement of the TA contract.

Authorities should also regularly review their decisions on the use of external investment managers to ensure that these remain appropriate in the light of a changing investment climate.

We do not currently use external managers, but retain the right to do so in the TMPS. This policy is reviewed as part of the annual Treasury Strategy Report.

Benchmarking

Benchmarking has a role in treasury management but benchmarks should not only refer to yield but also reflect the risk inherent in treasury management activities. At a minimum they should include information on security, liquidity and yield.

We currently do some benchmarking as part of the Core Cities group. These benchmarks look at both yield and risk, among other measures.