



# **Treasury Management**

## **January 2014**

### **Final**

## Contents and Distribution

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### Report Distribution – Final issued on 10th January 2014 to:

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## Executive Summary

### Background

Treasury Management is defined by the Chartered Institute for Public Finance and Accountancy (CIPFA) as the “*management of the local authority’s investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks*”. The Council’s Treasury Management objectives for 2013/14 are as follows:

- Part of the treasury management operation is to use the cash management process to ensure that the Council’s cash flow is adequately planned, and cash is available when needed. The Council has a low risk appetite for investments, therefore available surplus cash is invested in low risk counterparties or instruments providing adequate liquidity initially before considering the investment return.
- The second function of the treasury management service is the longer term cash flow planning, to ensure that the Council can meet its capital spending obligations. This may involve arranging long or short term loans, or using longer term cash flow surpluses.

### Audit Opinion

On 31st March 2013 the Council had approximately £25m of investments, £29.5m of short term borrowing and £235.2m of long term borrowing. The impact and materiality of the system is therefore considered to be **high**. This combined with the Auditor’s opinion that system controls are operating at a **high standard** gives an overall risk to the Council of **moderate**.

### Key Messages

Performance and benchmarking reports viewed during the audit show that the Treasury Management function has achieved higher than average rates for their return on investments and lower than average interest rates on borrowing. It was found that the Treasury Management function continues to be compliant with the CIPFA Code of Practice for Treasury Management and therefore a high standard of opinion on system controls has been given.

One new recommendation has been included in this report for the Treasury Management Strategy to be presented to the Audit Committee for scrutiny prior to the start of the financial year, in order to allow for amendments to be made before it is presented to Cabinet for approval.

### Context

Under the Local Government Act 2003, the Council is required to have due regard to CIPFA's Code of Practice for Treasury Management. The Council has formally adopted the Code of Practice in Schedule 2 of the Financial Regulations. There are three key principals that are set out in the Code of Practice:

- Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.
- Their policies and practices should make clear that the effective management and control of risk are prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and liquidity when investing funds.
- They should acknowledge that the pursuit of value for money in treasury management and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management, their treasury management policies and practices should reflect this.

The Treasury Management Function is a centralised function that is administered by a small team within the Resources directorate. They have direct access to the Co-op Bank Financial Directors system, which allows them to view balances and make transfers via the internet. An external company, SECTOR, is used to provide treasury management consultancy and credit ratings of institutes to inform investment decisions.

At the 31st March 2013 the Council had approximately £25m of investments, £29.5m of short term borrowing and £235.2m of long term borrowing.

### Risk Areas Examined and Findings

In accordance with best practice, a risk-based approach was adopted that identified the key risks to the business objectives and those mitigating actions/controls that should be in place. The auditor then assessed the effectiveness of the mitigating controls through examination of relevant documents, procedures and detailed testing.

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The key risks to the achievement of the business objectives were discussed and agreed with the Board Director: Resources before the commencement of the audit. The table below summarises the Risk Areas examined during the review and provides an assessment of the adequacy of controls in place for each area of risk examined:

<i>Risk Area Examined and Findings</i>	<i>Audit Conclusion</i>
<p><b>Risk: Breach of Financial Regulations and CIPFA Code of Practice for Treasury Management.</b></p> <ul style="list-style-type: none"> <li>• A Treasury Management Strategy was produced by the Head of Finance, Housing, Treasury and Growth. This was approved by Cabinet on 6<sup>th</sup> February 2013.</li> <li>• Although the Treasury Management Strategy was presented to the Audit Committee, this was not until 8<sup>th</sup> April 2013, which does not allow for any amendments to be made, if needed, before the beginning of the financial year.</li> <li>• The mid-year report was being prepared at the time of the review, with the intention to be presented to Cabinet on 11<sup>th</sup> December 2013. It was recommended in the 2012/13 report that the mid-year report be presented to the Audit Committee for scrutiny and challenge before it is presented to Cabinet. This recommendation has not been implemented.</li> </ul>	<p><b>High Standard</b></p>
<p><b>Risk: Counterparties go into liquidation.</b></p> <ul style="list-style-type: none"> <li>• A counterparty limit of £20m has been set for the maximum amount that can be invested with one institution at any time. Testing found that for four dates reviewed this limit had not been exceeded.</li> <li>• The Council uses SECTOR to provide credit ratings for investment institutions. These ratings give an indication of the maximum length of time that investments should be made with individual institutions.</li> <li>• The Treasury Management Strategy sets out criteria for the institutions the Council can invest in. Testing of the outstanding investments on the 1<sup>st</sup> October 2013 found that all counterparties fit the criteria set out in the strategy.</li> <li>• The Council uses three brokers for its borrowings and investments. This is in compliance with the Code of Practice, which advises that business should be spread between no fewer than two.</li> </ul>	<p><b>High Standard</b></p>

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Risk Area Examined and Findings	Audit Conclusion
<p><b>Risk: Market conditions and changes in the economic environment</b></p> <ul style="list-style-type: none"> <li>• Three Treasury Management reports are produced annually and reported to Cabinet. These reports include details of the general economic climate and the Council's performance.</li> <li>• Benchmarking is carried out, by the Treasury Management Assistant, throughout the year, which compares the LIBOR lending and borrowing rates to the Council's own average rates achieved. The report produced for November 2013 showed the Council had an average short term investment rate of 0.70% against 0.52% benchmark figure, and short term borrowing average rate of 0.28% against a benchmark rate of 0.36%.</li> <li>• The Council's Treasury Management performance is compared annually to other local authorities through CIPFA benchmarking, although at the time of audit the figures for 2012/13 had not yet been published.</li> </ul>	<p><b>High Standard</b></p>
<p><b>Risk: Inadequate cash flow management</b></p> <ul style="list-style-type: none"> <li>• The Logotech cash flow management system is updated with details of payments and receipts for the Council for the full financial year. Before the end of the financial year further details are added for the beginning of the next financial year.</li> <li>• Each day the Cash Flow system is updated with the actual balances taken from the Council's online banking system (Finance Director). This gives an actual end of day balance for the previous day and opening balance for the current day, so that decisions are based on the most accurate information.</li> <li>• Testing on one example of an investment and one short term borrowing found that their details had been accurately entered on Logotech by the Treasury Management Assistant. This ensures that the future daily balances reflect the repayments, and interest payments that are due.</li> </ul>	<p><b>High Standard</b></p>

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Risk Area Examined and Findings	Audit Conclusion
<p><b>Risk: Error, fraud and corruption</b></p> <ul style="list-style-type: none"> <li>• The Financial Director system enforces all transactions to be set up by one officer and approved by another, in order to maintain segregation of duties in the process. This is in addition to the manual CHAPS payments forms that are required to be signed by three officers in addition to the one raising the payment request.</li> <li>• Treasury Management Daily Dealing Notes have been prepared so that the treasury management process can continue in the absence of the Treasury Management Assistant. These have been updated to include the date they were last reviewed and who by, as recommended in the 2012/13 audit report.</li> <li>• The balances on the Logotech system are reconciled to the General Ledger on a monthly basis and were found to be up-to-date at the time of audit. The Treasury Management Assistant was in the process of producing a summarised report that could be sent to the Head of Housing Treasury and Growth for quarterly reviews, as was recommended in the 2012/13 audit.</li> </ul>	<p><b>High Standard</b></p>

### Overall Opinion

**Materiality and Impact: High.** On 31<sup>st</sup> March 2013 the Council had a net borrowing position of £239m materiality is therefore **high**. The purpose of the Treasury Management function is to maintain the Council's cash flow to enable it to continue with its day-to-day activities. A failure of the system would therefore have a significant impact on the Council.

**Changes since the last audit:** The table below is a summary of the progress made in implementing the recommendations made in the 2012/13 report. One low priority recommendation was made relating to the user access rights on the Financial Director system. Progress against this recommendation will be reviewed as part of a separate Treasury Management System Control and Integrity Audit.

**Swindon Internal Audit Services: Treasury Management 2013/14**

	Implemented	Partially Implemented	Not Implemented	Superseded	TOTAL
High	0	0	0	0	0
Medium	1	0	1	0	2
Low	1	0	0	0	1
<b>TOTAL</b>	2	0	1	0	3

**Opinion on system controls: High standard** (see Appendix A) i.e. the auditor completing the review concluded the significant controls are in place and operating effectively and only minor recommendations have been made.

**Overall Assessment of Risk:** The combination of the high impact of the system, along with the opinion on the system controls gives an overall risk assessment to the Council as being **moderate**:

		MATERIALITY AND IMPACT		
SYSTEM CONTROL		High	Medium	Low
1	High Standard	Moderate	Minimal	Minimal
2	Satisfactory	Moderate	Moderate	Minimal
3	Significant Improvements Required	Of Concern	Moderate	Moderate
4	Fundamental Weaknesses Identified	Significant	Of Concern	Moderate



## Action Plan

The purpose of this action plan is to provide a summary of the matters arising during the audit of the Treasury Management, together with the recommendations to mitigate risks, the manager's response to the recommendations, along with the officer responsible and timescale for implementation. In order for you to identify the most significant matters arising, which affect the reliance that can be placed on the controls reviewed, the recommendations have been prioritised.

Ref.	Finding	Recommendation	Responsible Officer and Timescale	Management Response
<b>1</b>	<b><i>Risk: Breach of Financial Regulations and CIPFA Code of Practice for Treasury Management</i></b>			
1.1	<p>The CIPFA Code of Practice recommends that the Council delegate the role of scrutiny of Treasury Management strategy and policy to a specific body and performance and policy setting should be subjected to prior scrutiny. In February 2010 Cabinet approved Audit Committee to be the scrutiny body.</p> <p>The Treasury Management Strategy was not presented to the Audit Committee before the beginning of the Financial year or before it was approved by Cabinet.</p> <p>There is a risk that if changes are required as a result of the Audit Committee's scrutiny and challenge, amendments cannot be made prior to the beginning of the financial year or before it is approved by Cabinet.</p> <p>In addition, although in draft format at the time of the audit review, the mid-year performance report was due to be presented to Cabinet on the 11<sup>th</sup> December with no prior scrutiny by Audit Committee due to the timing of meetings.</p>	<p>The Treasury Management Strategy should be presented for scrutiny by the Audit Committee before it is presented to Cabinet for approval.</p> <p>In accordance with the Audit Committee's Terms of Reference there should be annual scrutiny of Treasury Management performance. Therefore the Audit Committee should be presented with either the mid-year or end of year performance report, ideally before they are presented to Cabinet.</p> <p><b><i>Similar recommendation made in the 2012/13 audit.</i></b></p> <p><b>Priority: Medium</b></p>	<p>Head of Finance, Housing, Treasury and Growth</p> <p>April 2014</p>	<p>Agreed, subject to Audit Committee dates falling in line with Cabinet dates.</p>

Standard Audit Opinions	Standard Audit Opinion System Control
<p>The audit opinion is based on two different criteria the first is materiality of the system and its impact on the Council if there was a system failure. This has been split into High, Medium or Low.</p> <p>The second criteria is the standard of control found within the system audited. This has been categorised into 4 different levels i.e. high; satisfactory; significant improvements required and fundamental weaknesses identified. Each of these categories has a standard opinion (see below).</p> <p>The combination of these two factors gives an overall risk assessment to the Council of one of four scores i.e. significant, of concern, moderate or minimal (see Overall Opinion section in the main report).</p>	<p><b>Audit Opinion 1. <i>High standard</i></b></p> <p>The auditor completing the review concluded the significant controls are in place and operating effectively and only minor recommendations have been made.</p>
	<p><b>Audit Opinion 2. <i>Satisfactory standard</i></b></p> <p>The auditor completing the review concluded that most of the significant controls are in place and operating satisfactorily although some non-compliance was identified and therefore there is scope for improvement.</p>
	<p><b>Audit Opinion 3. <i>Significant improvements required</i></b></p> <p>The auditor completing the review concluded that existing procedures needed to be improved to ensure that they are fully reliable. A number of significant recommendations have been made to improve missing or failing controls.</p>
	<p><b>Audit Opinion 4. <i>Fundamental weaknesses identified</i></b></p> <p>The auditor completing the review concluded that the matters arising from the review are sufficiently significant to place doubt on the reliability of the procedures reviewed. Implementation of the recommendations made is a priority to ensure that reliance can be placed on the system.</p>

## Acknowledgements

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<b>Name</b>	<b>Job Title</b>
Keir Garnham	Treasury Management Assistant
Paul Smith	Head of Finance, Housing, Treasury and Growth