Centre for Public Scrutiny

Camdor GLOBAL ADVISORS
FINDING LASTING SOLUTIONS IN AN UNCERTAIN WORLD

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2nd edition

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CfPS

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FOREWORD: LORD BOB KERSLAKE

We all know that councils are struggling to manage a tough financial challenge at the moment. Pressures on revenue budgets are growing, and will continue to grow in the face of the demands of adult social care, waste management and the myriad other local demands which are making it increasingly difficult to "square the circle" of delivering high quality services within budgets.

For councillors at the centre of this maelstrom it must be difficult to know how best to engage with this. The issues involved seem so huge, and impervious to any attempt to handle them, that it would be understandable to let a sense of fatalism build up – about the future of the local government sector, and of councillors' ability to forge and mould that future.

There are, however, opportunities for councillors to play a part. This publication highlights the benefits of opening up treasury management to scrutiny. Treasury management is often seen as a part of councils' financial responsibilities that is dry and arcane, but in a world of limited resources it is vitally important. How are we prepared, as a sector, to invest our reserves in order to secure a return that allows us to continue to deliver good services? Moreover, how will we manage those reserves in a way that allows us to retain their existing value?

With interest rates at historically low levels, but with inflation creeping up, councils face the real risk of their capital being chipped away by market forces. Does this suggest that we need to start making more calculated risks about how and where money is invested? The implications of these kinds of challenges are significant. If a council has £20 million held in reserves (including reserves earmarked for certain purposes), a combination of interest rate and inflation pressures mean that the council could – if it held these assets in cash, for easy access – lose £400,000 of this figure annually. This is to say nothing of the impact of pension yields – not covered in this document but of vital contextual importance.

Adding further layers of uncertainty is the coming into force of the MIFID II legislation, which will mean significant additional restrictions to the ability of local authorities to invest their assets freely.

The political importance of these big financial decisions, and local responses to changes in national legislation, requires an element of member scrutiny – but scrutiny that is proportionate and that complements the professional advice that the council might receive from third parties, not to mention the expert opinion of the council's s151 officer. This guide provides some practical ways for scrutiny councillors to learn more about the world of treasury management, and then to apply that knowledge to the practical challenge of scrutinising councils' approaches to their assets. In particular, we present some possible questions and lines of inquiry that we think councillors can productively take forward.

Treasury management is a growing challenge for the sector. The time is right for the political skills of councillors to consider, challenge and refine councils' policies and priorities for investment to be recognised by professionals, and capitalised upon.

Lord Kerslake,
Chair of the Centre for Public Scrutiny

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This guide seeks to support CfPS's mission of ensuring accountability and transparency in the key area of public finances, which now as we enter a new post Brexit economic environment more than ever before is in need of close and careful scrutiny

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. Rather it is to reinforce that each local authority is responsible for their own treasury decisions and appetite to risk management. Authorities should ensure compliance with extant regulations and best practice guidance and that they have in place well trained staff and if required utilise treasury management professionals to develop their treasury operations.

INTRODUCTION

All councillors have a duty to ensure that their authority manages public funds in a responsible way. Part of members' oversight of this is provided for through the audit process. But there are complementary responsibilities for councils' overview and scrutiny functions. This paper will set out what those responsibilities are in the specific context of councils' management of their financial assets ("treasury management") and how councillors can fulfil them in a proportionate way.

The world of finance – both public and private – has changed a lot in the decade since the last financial crisis began in 2007 and since local authorities found themselves so exposed to the collapse of the Icelandic banks in October 2008. The policies of austerity which followed on, from 2010 onwards, have led to significant amounts of political and economic volatility, both nationally and locally.

Against this backdrop, some local authorities find themselves sitting on more cash reserves than ever that need to be managed, but in an increasingly uncertain environment. Councils seeking to invest their money are making little to no money from those investments – in fact, when inflation is taken into account, those more traditional investments are likely to lead to a negative return for councils. This has led to big worries for councils, and their future financial position.

Where does scrutiny come in?

To help scrutiny members and officers tackle this very complex and technical subject, this guide explores the basics of treasury management in local authorities and suggests how such issues might be scrutinised. It seeks to explain both the principles and objectives behind good treasury management - the term governing how councils manage their money and cash flows - and also the key pieces of legislation, guidance and regulations with which councils must comply. It covers how you might approach a scrutiny review of the council's treasury management policies and practices.

As a minimum, a council's s151 officer will be obliged to report to the Audit Committee on two issues – treasury management performance, and the treasury management strategy for the following year. A "midyear review" may also be carried out. These duties derive in part from the Local Government 2003 and CIPFA guidance.

In the light of the deterioration of the economic forecast for the UK following the Brexit referendum in June 2016, and ongoing changes to the finances of local government following reductions in revenue support grant it is inevitable that councils will and should examine whether that level of scrutiny is sufficient and ensure that their treasury operations are fit for purpose. This is where scrutiny may come in.

WHAT IS 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, 2011 p11)

Therefore, treasury management 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, and will be locally defined, controlled and monitored by a series of policies, strategies and controls.

The Objectives of Cash Flow Management

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 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 support capital expenditure.

Cash is generated from a variety of sources. The need to spend money may not coincide with the receipt of the funds, thus leading to instances where the authority has a temporary deficit or excess of cash, which can be smoothed out with temporary borrowing.

Some of the key sources include:

- **Council Tax and Business Rates collected.** With the localisation of business rates, councils' reliance on this form of income is expected to increase.
- **Other income such as Revenue Support Grant, specific grants and fees and charges.** The level of the RSG will steadily decrease between now and 2020, being partially replaced with the localisation of business rates.
- **Reserves and balances.** Most councils have funds which have been accumulated over previous years in a wide variety of reserves and balances. For example, 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.
- **Capital receipts and grants.** Capital receipts and grants may be available to the authority but are yet to be applied (used) to fund planned capital expenditure.
- **Capital borrowing taken out in advance to fund planned capital expenditure.** Whilst 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.

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.

To that end the guidance defines a prudent investment policy as having two objectives: achieving first of all the security (protecting the capital sum from loss) and the 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 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.

Borrowing Objectives: The Prudential Framework for Capital Finance, supported by CIPFA's Prudential Code, enables authorities to borrow money for capital purposes, should it consider it to be affordable and prudent. Not all councils borrow money, and some are completely "debt free".

Councils are free to borrow from government itself. A number of mechanisms exist for doing this. 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. For authorities who 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.

TREASURY MANAGEMENT POLICIES, CONTROLS AND PRACTICES AT INDIVIDUAL COUNCILS

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 the Department for Communities and Local Government (DCLG). Compliance with this framework results in a number of policies, systems and procedures that will enable a council to invest and borrow appropriately.

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 with legal audit (which is not the same as scrutiny, but which carries out a complementary task);
- 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 than underpins investment decisions***

This is something on which we commented in depth in "Risk and resilience" (2016)

- ***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?'

- ***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.

Prudence and the prudential person

Those playing an active part in treasury management – including scrutineers – need to act in accordance with the "prudent person" principle. This principle is discussed in more detail in section below.

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

Developing one step further, 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.

Members have a critical role to play in this assessment. As we have noted in "Risk and resilience" (2016), politicians are central to assessing an authority's appetite to 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.

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.

Recommendations on standard approaches on oversight and governance of Treasury Management

The CIPFA Treasury Management Code sets out a series of recommendations as to how councils should fulfil their legal duties on treasury management – in particular, how these should be addressed in standing orders and associated governance material.

Councils' treasury management functions must be effectively controlled and monitored. In brief these controls comprise:

- Requirement 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. They can be found listed as an appendix;
- Requirement for full council to receive 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.

Key aspects of treasury management in more detail

Risk management and credit rating

CfPS produced a paper on scrutiny's approach to risk and resilience in summer 2016.

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 now 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.

Investment in private markets

A further key evolution since the last report was written 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

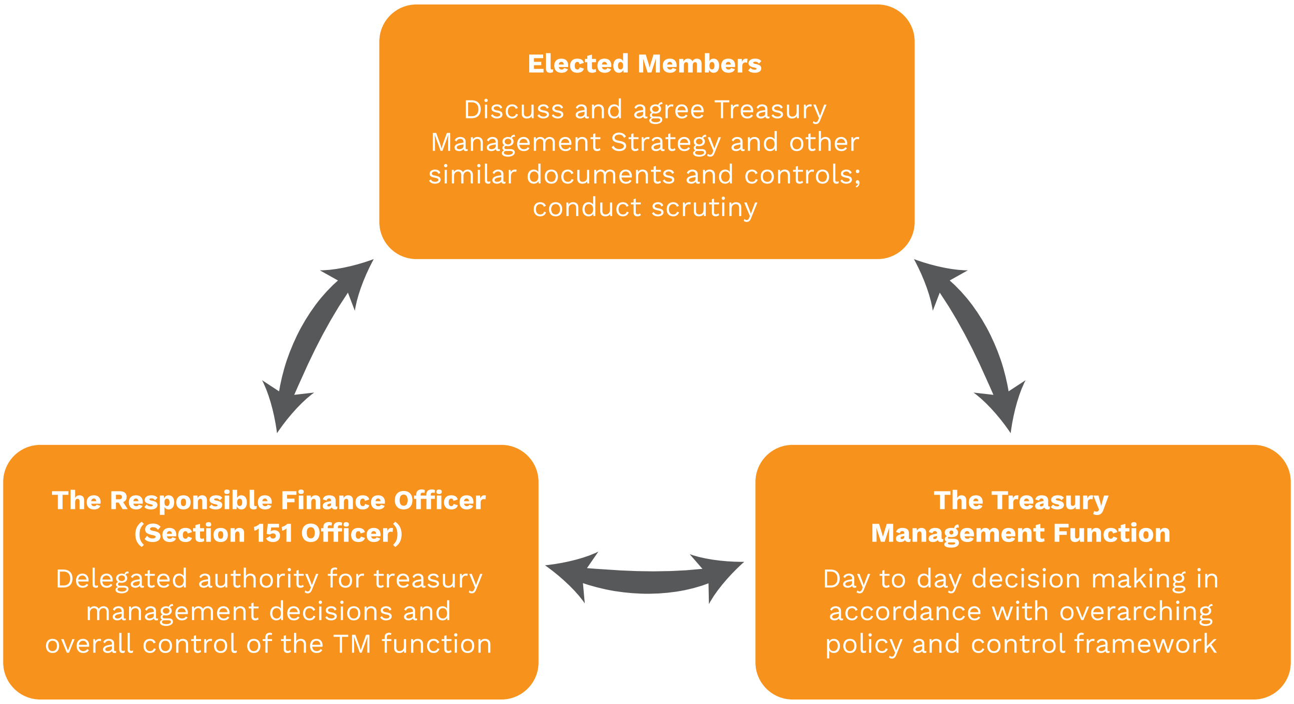
As each local authority will be responsible for its own appetite for risk, as defined within the annual treasury management strategy, direct comparison with peers can be misleading. CIPFA does however conduct a benchmarking service which is useful for high level comparison and review.

The CIPFA Prudential Code specifies a series of indicators designed to agree 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.

Individual councils are also free to supplement the Prudential Indicators with local performance indicators to provide further information on the success or otherwise of its treasury management activities.

Treasury Management Decision Making Roles and Responsibilities

A range of individuals are involved in making decisions. This section goes into more detail about who those individuals are, and how they work together. In many ways, treasury management decisions are made in a similar manner to other decisions at the authority. This can be illustrated by the following diagram.



The Role of Elected Members

The role of elected members in the oversight of the treasury management operations within their local authorities was significantly enhanced following the Icelandic banking crisis and subsequent revision of CIPFA's Treasury Management Code. Elected members 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.

The council's overview and scrutiny function will also play an important role, but this will depend on its relationship with audit, and the mutual decision made by the members of both bodies about the roles they will perform. Traditionally, oversight and ongoing scrutiny of treasury management policy is carried out by audit, but in the sections below we will demonstrate why overview and scrutiny's perspective can add another dimension – particularly on risk.

The Prudential Indicators, including the treasury management indicators, must be approved by the body responsible for setting the budget, i.e. full Council. The indicators for the forthcoming year and following years must be approved before the start of the financial year, and, in most authorities, form part of the overall budget and council tax setting report. The Prudential Indicators can be revised at any point during the year, but all such revisions require to be approved by full Council, following due process as set out in the council's Constitution.

The Role of the Responsible Finance Officer ("Section 151 Officer")

The Local Government Act 1972, Section 151, requires that every authority has a designated "Responsible Financial Officer", who "shall make arrangements for the proper administration of their financial affairs". As such, the Section 151 Officer will have overall responsibility for the council's approach to treasury 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 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 that 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 of 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 TM Code requires the authority to ensure that they are suitably trained and qualified to undertake their duties.

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. CIPFA published a self-assessment guide of effective scrutiny in 2014. It can be found at appendix 1.

OVERVIEW AND SCRUTINY OF TREASURY MANAGEMENT

The above sections have provided an introduction to treasury management as it is practised in local government – this section explains in more detail exactly how councillors can carry out effective, proportionate scrutiny of the issue.

This starts by considering scrutiny's overall role. What is scrutiny here to do?

In considering how to undertake scrutiny of TM, it is worth thinking about the **key features** of what effective scrutiny will look like.

Key features of effective scrutiny

- ***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

- ***The right timing***

Thought needs to be given as to the timing of a detailed TM scrutiny review, particularly in light of prevailing market and economic conditions. Consider the review as a chance to supplement the annual treasury management strategy approval process; alternatively, it may be better for scrutiny to engage by taking a "watching brief" over TM activity.

- ***The right level of detail***

Councillors will need to prepare and learn in advance about investment policies and financial instruments, although there is no need to attempt to become an instant expert. A lack of expertise can also lead to a tendency to want to look at everything – an iterative approach to training, development and discussion with officers 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. Some of that information was provided earlier in this report, but the local circumstances need to be understood by everyone to ensure that scrutiny works appropriately.

- ***Thinking about and engaging the public***

This is an opportunity to make a public explanation of TM performance and activities in a way which local citizens can understand, how the function will contribute to the council's corporate objectives over the coming years.

In "The change game" (2015) we highlighted the possibility that scrutiny might choose certain focus areas – issues to narrow the scope of a review or investigation and make it more likely that impact will come about. In treasury management, such narrowing of focus is likely to be of particular importance. 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.

There are a number of different ways of undertaking this kind of scrutiny. A traditional scrutiny task and finish review is an attractive option – but a "review of treasury management" is likely to be too broad, and may not focus on the right issues. It is more likely that ongoing oversight is the most productive way to proceed.

By "ongoing oversight", we mean scrutiny receiving regular information which allows it to remain aware of the council's approach to treasury management. 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.

Members undertaking longer term oversight through the scrutiny function will be able to clarify:

- what scrutiny's role here might be (to focus on risk? Something else?)
- 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 an adviser, but moderated by some officer advice as well);
- 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 work of audit.

It may be, for example, that scrutiny's interventions will be driven "by exception" – that audit and scrutiny will retain oversight of different elements of TM, with scrutiny taking on more substantive scrutiny of a particular element if it is causing concern to either body.

The kinds of data that councillors might wish to use for such "ongoing oversight" might be:

- Audit reports (see below);
- 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.

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.

The role of audit

CIPFA has published a range of documents for audit committees – guidance issued in 2013, and a self-assessment tool titled "Effective Scrutiny of Treasury Management".

Different councils' audit committees take different focuses on treasury management. Some adopt a compliance-based approach – some go much further. Early contact with audit to understand the local role of the committee is important to present unnecessary overlap and to highlight opportunities to work together.

Scoping a 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. The issue would need to be something scrutiny could do something about. Scrutiny could look at a range of issues as part of its oversight of treasury management. Particularly if scrutiny decided to conduct a task and finish-style inquiry into such an issue, careful scoping would be required to ensure that scrutiny's role fits with that of other individuals and bodies. This planning stage will benefit from external expertise – a co-optee or technical adviser may be able to provide productive, and independent, advice and assistance.

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.

If an independent adviser has been appointed to assist members, it will be important for the support officer and that adviser to work together with members on that scope.

Particular attention in the preparation and scoping process will need to be given to:

- the council's ***background papers*** required to be considered (e.g. Treasury Management Strategy and Performance papers)
- the ***legislative framework*** and ***external policy guidance*** (e.g. CIPFA codes)
- ***good practice information*** (e.g. from high-performing authorities)
- the nature of any ***other reports to be commissioned*** from the s151 officer or Chief Executive about the authority's actual practice and performance

- identifying and understanding the ***Treasury Management options*** that are available to the council – examining the reasons and justifications for choices that have been made
- ***learning from the experiences of other councils*** who have conducted TM reviews.

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 undertaking a standalone scrutiny review will be able to formulate a plan and some objectives.

Witnesses

Depending on the particular circumstances and TM history of the authority, and the scope of the scrutiny review, witnesses could include:

- Cabinet Member with responsibility for TM
- Director of Finance (S.151 Officer)
- Chief Executive
- Head of Audit
- Head of Risk Management
- TM officer
- External auditor
- External Treasury Management Advisers
- External Fund Managers
- External witnesses from any of the above categories who come from, for example, an authority with a high-performing TM function

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

- Confirming the decision-making processes
- Confirming roles and responsibilities of the players
- How does this council compare to the others 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?

The questions that need to be asked to establish the facts and the evidence

- What are the questions?
- 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.

CfPS's Practice Guide on effective questioning expands on some of these points; readers should also refer to "Optimising scrutiny" (2017).

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 Cabinet, or Audit Committee, or Scrutiny Committee, or Member Development Committee, or s151 officer to address
- Identification of other unglamorous, but risk significant, activities that ought to be the subject of a similar scrutiny review process
- How the council can inform citizens about TM activities and performance
- A timescale for reporting back on the consideration that has been given to and action taken on the recommendations
- Proposals for future TM scrutiny review and arrangements

QUESTIONS FOR OVERVIEW AND SCRUTINY PANELS TO ASK

Many of these questions are general in nature, and should be posed informally to help scrutiny understand where to focus its attention. The answers will help scrutiny to define this focus, and can also be used by members to clarify where they need to receive more, and more detailed, information.

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.

In preparation

Has the council undertaken CIPFA's "effective scrutiny self-assessment"?

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?

Getting a picture of where investments are now

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 (this should be annually)?

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?

More formal questions

(These questions might be asked when members have a clear idea of an issue they might want to look at. These in particular 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?

APPENDIX 1 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 local authorities' 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 2 - REFERENCES

Relevant Legislation

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

Local Government Act 2003

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

Other Relevant Documents

The Prudential Code for Capital Finance in Local Authorities. CIPFA 2011

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 2011

Treasury Management in the Public Services Guidance Notes for Local Authorities including Police and Fire Authorities (Fully revised Second Edition). CIPFA 2011

Treasury Management Statement of Professional Practice. CIPFA 2002

Useful websites

www.cfps.org.uk

www.cipfa.org

www.fitchratings.com

www.moodys.com

www.standardandpoors.com

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