AUDIT COMMITTEE- 5TH MARCH 2014

SUBJECT: THE ROLE OF THE TREASURY MANAGEMENT FUNCTION

REPORT BY: ACTING DIRECTOR OF CORPORATE SERVICES & SECTION 151 OFFICER

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1. PURPOSE OF REPORT

1.1 To present Members of the Audit Committee with details of the Council's treasury management function.

2. SUMMARY

2.1 The report provides detail on the roles undertaken by the Council's treasury management function, the advice sought from external advisors and the reporting requirements under statutory and regulatory guidance.

3. LINKS TO STRATEGY

3.1 Treasury Management Strategy 2013/2014 as agreed by Council on 27th February 2013.

4. THE REPORT

4.1 The Treasury Management Function

4.1.1 The Chartered Institute of Public Finance & Accountancy (CIPFA) has defined treasury management activities as "The management of the organisation'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".

4.1.2 The Council's treasury management team consists of four full-time staff: the Group Accountant (Treasury & Capital); Senior Accountancy Assistant; Accountancy Assistant (Treasury) and Administrative Assistant (Petty Cash). The treasury management team is part of Corporate Finance (Corporate Services Directorate).

4.1.3 The treasury management team is responsible for managing the Council's daily cashflow requirements, banking, money market transactions (lending and borrowing), risk management and income generation.

4.1.4 **Daily cashflow management** - The purpose of cashflow management is to ensure that the Council has sufficient cash available on a daily basis to meet all of its payment obligations. The nature of the Council's cashflow requirements means that on any given day the Council's bank accounts can be overdrawn or in credit. This process is managed by an annual cashflow forecast that is maintained on a daily basis, which details the Council's incoming receipts (grants, capital receipts, maturing cash investments, and council tax/ NNDR receipts), as well as outgoing payments (including salaries, payments to suppliers, HMRC payments, precepts, housing benefit and servicing the Council's debt). This process ensures that sufficient cash balances are available to meet commitments and also avoids excessive surplus cash balances being held in the Council's bank accounts.

4.1.5 **Banking** - The treasury management team is responsible for maintaining the Council's bank accounts, managing the relationship with the Council's bank, undertaking banking transfers and ensuring that the accounts are not overdrawn. The team also administers the petty cash function for the Council.

4.1.6 **Money market transactions** - Lending surplus cash to financially secure institutions that meet the Council's lending criteria as detailed in the Treasury Management Strategy forms part of managing the daily cashflow role. The Treasury Management Strategy is approved annually by Cabinet and Council prior to start of each financial year. At present surplus cash is lent directly to the Debt Management Office (DMO) (part of HM Treasury) and local authorities. In return the Council receives interest payments on the money it lends. Money market transactions also covers the Council's borrowing requirements, whether it is short-term cash to cover a cashflow position, or long-term loans to fund the Capital Programme borrowed from the Public Works Loan Board (PWLB) or banks. As at 13th February 2014, the Council had outstanding cash investments of £95m (DMO £40m and local authorities £55m), and a debt portfolio of £182m (PWLB £142m; Banks £40m).

4.1.7 **Risk management** - Treasury management risks can take many forms arising from the different activities associated with treasury management. It is the role of the treasury management team to highlight and manage such risks and maintain a minimal exposure where possible. The key risks are as follows: -

- ***Cashflow management*** - The risk arising from insufficient cash to pay obligations (liquidity risk) and reputational risk as a result of paying creditors late. The treasury management team manage this risk by ensuring that sufficient surplus cash is available in the short-term.
- ***Lending activities*** - The risk of the institution to which the Council has lent money being downgraded by credit rating agencies due to a weakness in its business operating environment (counterparty risk). The Council at present only lends to the DMO and local authorities, which have the same credit rating as the UK Government and are considered to be the safest counterparties available to the Council.
- ***Money market risk*** - The risk arising from money markets not operating fluidly as a result of a fear in a financial institution defaulting, leading to a liquidity problem in the wholesale funding of financial institutions and corporate organisations. This was the case at the start of the financial crises in 2008 that resulted in Northern Rock, Bradford & Bingley and Icelandic banks all defaulting due to their dependence on wholesale funding.
- ***Interest rate risk*** - The risk of interest rates rising or falling. When interest rates rise, the cost of borrowing also rises resulting in higher borrowing costs on new loans or existing variable loans. When interest rates fall, the Council's investment income reduces. The Council manages the risk of rates increasing by fixing its interest rates on long-term debt.
- ***Banking risk*** - The risk of the Council's banker being severely downgraded, defaulting or entering resolution; the consequence of this being the knock on effect on the Council's operations (failure to pay creditors and housing benefit claimants, inability to collect income). The Council recently experienced this with the Co-Operative Bank in late 2013 when the bank was on the verge of collapsing and had to be bailed out by its investors. The Council put interim measures in place to mitigate the risk and undertook a procurement process to source a new bank supplier, resulting in Barclays being appointed on an interim basis.

4.2 Treasury Management Advisors

4.2.1 The Council currently engages the services of two external treasury management advisors (Arlingclose and Sector). The role of the treasury management advisors is to support the treasury management team with technical information and views on the economy and to provide advice on regulatory and technical matters. Typically, treasury management advisors will provide: -

- Daily and weekly market and economic commentary including the release of economic data;
- An annual balance sheet review and a review of the strategic use of cash resources;
- Annual Elected Member training and periodic meetings with Council Officers;
- A review of debt rescheduling opportunities and supporting the Council in undertaking the refinancing of debt;
- Supporting the Council's preparation of its statutory accounts;
- Engaging with the Government, Welsh Government, audit and accounting bodies with regards to regulatory and technical issues.

4.2.2 The current treasury management contract expires on 31st March 2014, and a procurement exercise is taking place with the view to offering a new contract. Only one advisor will be appointed in light of the Council's budget savings target.

4.3 Treasury Management Reporting Requirements

4.3.1 The Council has adopted CIPFA's Code of Practice on Treasury Management, and a requirement of the Code is to present to Elected Members a minimum of three reports; The Annual Strategy (at the start of the financial year), a mid-year report and the Outturn Report. The Council currently submits the minimum required reports as well as monitoring reports covering period 4 (April - July) and period 9 (April - December). Appendix 1 provides an example of a monitoring report, which typically covers the following: -

- The Council's borrowing position in the reported period covering loans raised and repaid and debt rescheduled.
- The Council's cash investment portfolio as at the reported period including the average rate of return and the make-up of the portfolio.
- Specific treasury management issues, for example banking tender, Icelandic Banks, Treasury Advisors contract etc.
- Prudential indicators for the reported period in accordance with CIPFA's Treasury Management Code of Practice and the Prudential Code.

5. EQUALITIES IMPLICATIONS

5.1 This report is for information purposes, so the Council's Equalities Impact Assessment (EqIA) process does not need to be applied.

6. FINANCIAL IMPLICATIONS

6.1 There are no direct financial implications arising from this report.

7. PERSONNEL IMPLICATIONS

7.1 There are no direct personnel implications arising from this report.

8. CONSULTATIONS

8.1 There are no consultation responses that have not been reflected in this report.

9. RECOMMENDATIONS

9.1 Members of the Audit Committee are asked to note the contents of this report.

10. REASONS FOR THE RECOMMENDATIONS

10.1 To ensure that Members of the Audit Committee have an awareness of treasury management activities.

11. STATUTORY POWER

11.1 Local Government Acts 1972 and 2003.

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Background Papers:

Appendices:
Appendix 1 Policy & Resources Scrutiny Committee Report (4th March 2014) - Treasury Management & Capital Financing Prudential Indicators Monitoring Report (1st April 2013 to 31st December 2013).