EXE 250809
Item

TREASURY MANAGEMENT ANNUAL REPORT 2008/09

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LEAD OFFICER: Julie Crellin, Head of Finance and Management Information Systems
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Summary:

The Treasury Management Annual Report is a requirement of the Council's reporting procedures as set out in the Financial Regulations. It covers the treasury activity during 2008/09, and the actual Prudential Indicators for 2008/09.

The report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Council is required to comply with both Codes through Regulations issued under the Local Government Act 2003.

The paper also provides an update of the Council's Investment Strategy for 2009/10.

Recommendations:

Members are recommended to:

A. Approve the actual 2008/09 prudential indicators within the report.
B. Note the treasury management stewardship report for 2008/09.
C. Note the update of the Council's Investment Strategy for 2009/10 and the extension of the maximum lending limit from £3 Million to £5 Million for specific institutions as set out in paragraph 4.6 to reflect the limited options currently available as financial ratings fluctuate.

1. INTRODUCTION

1.1 The Local Government Act 2003 introduced a new borrowing system for local authorities known as the Prudential Code (the Code). The Code began on 1st April 2004 and introduced a greater freedom for the Council's capital expenditure. Part of the requirements of the Code, require reporting procedures to be implemented to monitor the progress and status of the capital expenditure plans. Furthermore, the Council's Financial Regulations require an Annual Report on Treasury Management to be presented to Executive prior to 30th September each year. This report fulfils these requirements.

1.2 The Code also requires that Councils use a set of Prudential Indicators in order to ensure that the capital investment plans of the Council are affordable, 1.3 The Council's Financial Regulations also require a Treasury Management Strategy covering the future three financial years to be reported to Council on an annual basis. This was reported to full Council on 24th February 2009, for 2009/10. While the principles of the Strategy remain fundamentally sound, some aspects of the present Strategy are causing difficulties, in the current economic climate, in enabling the Council to successfully place investments to it best advantage. This report therefore seeks to update the 2009/10 strategy to address this issue – see section 4 for further details.

1.4 This report will also be presented to the Audit Committee at its next meeting for information. The Audit Committee is charged with considering the appropriateness of the Council's risk management strategy and given the experience of 2008/09 and the current economic climate, the management of the Treasury Management function is a key risk area. In addition, the Audit Commission produced a national report at the end of March which sought to draw lessons from the Icelandic banking failure and its implications for Treasury Management by public bodies. The Audit Committee will review this report at the same time and consider Copeland's Treasury Management activity. A summary of the report is attached at Appendix D.

2. ECONOMIC SITUATION 2008/09 – A SUMMARY

2.1 The 2008/09 financial year featured one of the most testing and difficult economic and investment environments since the 1930s, involving a number of very significant changes in the performance of the UK, as well as global, economy. And beneath this has been the undercurrent of uncertainty in the financial markets. This was not an easy backdrop against which to manage an investment portfolio.

2.2 The year opened on an uncertain note. The ongoing effects of the "credit crunch" which had started in 2007, prompted monetary policy easing in early April when the Bank of England cut its Bank Rate by 0.25% to 5%.

2.3 However, inflation was rising sharply, as a result of the strength of global commodity and food prices and the very steep rise in oil prices. The CPI inflation measure breached the 3% upper limit of the Governments' target range in April. The Bank of England was concerned that these external cost pressures could eventually transform into a domestic wage/price spiral and kick start a bout of damaging inflation.

2.4 Rates were left on hold through the summer months and there seemed to be some signs of a gradual return to slightly more normal conditions in the money markets. But this was not to last. Mid-September saw a "sea change" in financial markets and economic policies. The collapse of US investment bank, Lehman Brothers, dealt a devastating blow to the markets. Liquidity dried up almost completely making it extremely difficult for banks to function normally. These developments culminated in the failure of the entire Icelandic banking system in early October.

2.5 The failure of the Icelandic banking system had a major impact on local authority investments. A number of local authorities had deposits with Icelandic institutions and these investments are still at risk. It is important to stress, however, that Copeland Borough Council was not involved in the Icelandic failure. At this point in time recovery rates have not been fully disclosed by the respective institutions, although early indicators suggest a good, albeit not 100% recovery.

2.6 The crisis in the financial markets deepened and threatened a complete 'melt-down' of the world financial system. This, together with evidence that economies had entered recession prompted a number of significant policy changes. In the UK these featured the following:

2.6.1 a major rescue package totalling as much as £400bn to recapitalise the banking system
2.6.2 a series of interest rate cuts down to 2% in early December
2.6.3 a fiscal expansion package, including a 2.5% cut in VAT.

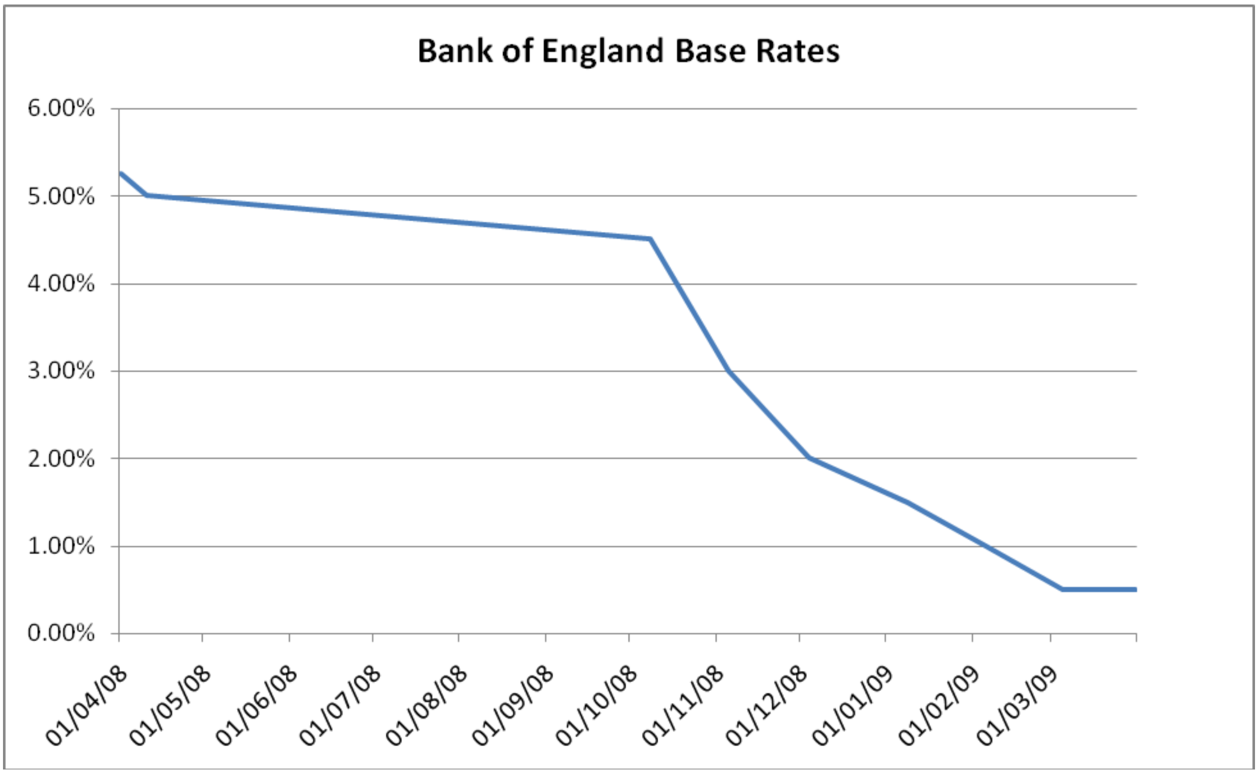
2.7 The New Year failed to herald a change in the fortunes of the banking sector. Central banks continued to ease monetary policies in an attempt to reduce borrowing rates and hence alleviate some of the cost pressures being experienced by financial institutions and, more to the point, the corporate and household sectors.

2.8 With official interest rates in the US already at close to zero at end-2008, the Bank of England was at the forefront of policy easing. The Bank Rate was cut in successive monthly moves from 2% at the outset of the year to the historically low level of 0.5% in March. Thereafter, the Bank resorted to the quantitative easing of monetary policy via a mechanism of buying securities from investment institutions in exchange for cash. This commenced in early March and is expected, ultimately, to amount to £150bn.

2.9 Central Government also launched the second phase of its support operations for the banking industry during the second half of January. During the course of the quarter, two major banks, RBS and Lloyds Group, needed substantial cash injections; action that led the public sector to assume near-full ownership. In addition to this, the Dunfermline Building Society was rescued from bankruptcy.

2.10 The problems of the financial markets since late 2007 spread to other parts of the economy. Economic data confirmed that the UK was in recession and the latest Bank of England Inflation Report (published in mid-February) registered a marked change in official forecasts for 2009 and 2010. Economic activity was

2.11 The generally uncertain backdrop to the UK and the financial markets prevented a marked easing in overall money market liquidity. While the situation did show some signs of improving as the financial year drew to a close, the margin between official interest rates and those quoted in the inter-bank market for periods longer that 1-month remained very wide.



3. TREASURY MANAGEMENT IN 2008-09

3.1 The Council still has the one remaining Market Loan in its debt portfolio, of £5 million. We continually assess the position of this loan with our Treasury Consultants, Butlers, to see whether we are securing the best terms for the Council. At the current time, the advice is to leave this loan in its present form.

3.2 During the year interest of £1,462,862 was received. This was in excess of our budget estimates by £143,173. This equates to an average rate of return on investments of 5.67% compared to average base rate of 3.62%.

3.3 The average rate of return on investments held by external fund managers in the year was 6.48%. The volatility of the market conditions produced a very wide range of results from a high of 7.16% to a low of 4.7%.

3.4 A list of investments held at 31st March 2009 is attached at Appendix B.

3.5 A number of factors allowed the Council to exceed the budgeted interest, in spite of the dramatic reductions in interest rates and uncertainty in the financial markets from November 2008, these included the interest rates from April to October being higher than estimated, slippage in the Capital Programme (i.e. less draw down of reserves than expected), and a balance of £5.8 Million (National Non Domestic Rate) owed to the Government for 2007/08 being held for longer than anticipated.

3.6 Due to the uncertainty in the financial markets from November, acting within the Treasury Management Strategy, the pool of available counter-parties (i.e. those financial institution/organisations that we can place money with), within the approved criteria, was restricted to safer instruments and institutions. Currently this involves the use of AAA rated Money Market Funds and institutions with higher credit ratings than those outlined in the investment strategy or which are provided support from the Government.

3.7 In December 2008 and January 2009 £9Million of the Councils core balances were invested for a period of 364 days at an average interest rate of 3.17%. This was designed to lock in the best interest rates available at that time for as much of the 2009/10 year as was prudent. Pressures on the budget for next year and beyond, now mean that we must strive to maximize the level of interest that we can earn but the security of the Council's investments must remain the primary consideration and therefore we will continue to work closely with Butlers to ensure that our counter-party list is secure and enables us to secure the best return for the Council.

4. TREASURY MANAGEMENT AND INVESTMENT STRATEGIES 2009/10

4.1 Although it is still early in the financial year current indications are that the Council is on track to achieve the budgeted investment interest in 2009/10. This is however, supported by £81,500 of earmarked reserves as the Council wishes to ensure a managed reduction in income support from Treasury Management to the general budget. This projection assumes that interest rates do not fall any further and start to recover in October in line with the forecasts of our Treasury Management advisers (Butlers). It should be noted, however, that the investment balances used in the current estimates are based on the cashflow of known major items. The timing of Capital Programme spend has a major impact on the estimated balances. An acceleration of spend against the Capital Programme would cause the balances to fall more quickly than anticipated and the interest forecast will need to be reduced.

4.2 The economic outlook remains uncertain. The 2009/10 Treasury Management Strategy, approved by Council on 24th February 2009, set out wide criteria for available counter-parties which could be used under normal market conditions.

4.3 In response to the exceptional market conditions, the Strategy also set out temporary restrictions on further investment activity, restricting activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval and limiting the time period for investments. Currently this involves the use of AAA rated Money Market Funds, UK Building Societies with credit ratings (and this does not include local Building Societies; Cumberland and Furness), UK banks with higher credit ratings than those outlined in the investment strategy or which are provided support from the Government.

4.4 It is proving increasingly difficult to achieve competitive interest rates in the restricted market. Currently the rated Building Societies are giving better returns than the available Banks but there are only three of these Building Societies, active in the market, with whom we do not already have the maximum investment and only one of these with whom we have less than £2.5Million.

4.5 The highly rated and supported Banks are offering relatively low interest rates because they know that lenders are being ultra cautious in their choice of counter-parties and they are confident of obtaining their required level of borrowing.

4.6 Executive is asked to consider recommending to Council increasing the lending maximum to £5 Million for those currently approved institutions (para 4.3) and this to be used at the discretion of the Head of Finance and reported to the next Executive meeting. This would provide more flexibility to place deposits, yet limit the exposure to risk which you would increase if you lent to lower or non-rated institutions. This request reflects our experience so far – for a short period of time during the first quarter of 2009/10 the maximum investment limit of £3Million was breached. This contravention of the criteria was a direct result of the difficulties of identifying institutions of sufficiently high credit quality, with whom the Council had investments of less than £3Million and who were willing to take investments at the level offered by the Council.

4.7 The situation regarding borrowing remains unchanged from that reported to the February Council and the Council will continue to take a cautious approach. In the event that borrowing is necessary, the Head of Finance and MIS, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time and taking into account contemporaneous forecasts. Executive agreement would be sought.

5. IMPACT ON CORPORATE PLAN

5.1 By ensuring that the Council utilises its resources effectively, Treasury Management supports delivery of the Corporate Plan.

List of Appendices

Appendix A: Prudential Indicators 2008/09

Appendix B: Investments as at 31st March 2009

Appendix C: Regulatory Framework

Appendix D: RISK AND RETURN: English Local Authorities and the Icelandic Banks – a summary of the March 2009 Audit Commission report

List of Background Documents: Treasury Management Strategy Statement, Investment Strategy and Minimum revenue Provision Strategy Report 2009/10 to Full Council 24th February 2009

List of Consultees: Corporate Team, Head of Finance

<u>CHECKLIST FOR DEALING WITH KEY ISSUES</u>

Please confirm against the issue if the key issues below have been addressed. This can be by either a short narrative or quoting the paragraph number in the report in which it has been covered.

Impact on Crime and Disorder	None
Impact on Sustainability	None
Impact on Rural Proofing	None
Health and Safety Implications	None
Impact on Equality and Diversity Issues	None
Children and Young Persons Implications	None
Human Rights Act Implications	None
Section 151 Officer Comments	No further comments to add. Treasury Management budget is actively monitored and reported through quarterly budget monitoring processes.
Monitoring Officer Comments	No comments

Please say if this report will require the making of a Key Decision YES/~~NO~~

THE PRUDENTIAL CODE AND PRUDENTIAL BORROWING

1. Introduction

1.1 The Local Government Act 2003 introduced a new borrowing system for local authorities known as the Prudential Code (the Code). This gives to Councils much greater freedom and flexibility to borrow without government consent so long as they can afford to repay the amount borrowed.

1.2 The aim of the Code is to support local authorities when making capital investment decisions. These decisions should also be in line with the objectives and priorities as set out in the Council's Corporate Plan.

1.3 The key objectives of the Code are to ensure, within a clear framework, that the capital investment plans of the Council are affordable, prudent and sustainable, or if appropriate to demonstrate that they may not be. A further key objective is to ensure that treasury management decisions are taken in accordance with good professional practice and in a manner that supports prudence, affordability and sustainability. These objectives are consistent with and support local strategic planning, local asset management planning and proper option appraisal. They also encourage sound treasury management decisions.

2. Prudential Indicators

2.1 To demonstrate that the Council has fulfilled these objectives, the Code sets out indicators that must be used. It is for the Council itself to set any indicative limits or ratios. It is also important to note that these indicators are not designed to be comparative performance figures indicators but to support and record the Council's decision making process.

2.2 The final performance indicators for 2008/09, as compared to the budget set out in the Treasury Management Strategy Report and approved by Full Council on 26th February 2008, are set out below. The compilation and monitoring of these indicators is central to the operation of the Code.

3 CAPITAL EXPENDITURE AND FINANCING OF THE EXPENDITURE

3.1 The table below shows the Prudential Indicator (PI) which highlights the actual 2008/09 capital expenditure position compared with the original position. The financing of the capital programme is also shown.

	2008-09 Budget £000	2008-09 Actual £000
Capital Expenditure		
Total Expenditure	5,646	4,643
Financed By:		
Capital Receipts	2,052	1,454
Capital Grants	3,575	3,170
Capital Reserves	19	19
Revenue		
Net Capital Requirement	**0**	**0**

4. THE COUNCIL'S BORROWING NEED (THE CAPITAL FINANCING REQUIREMENT)

4.1 The table below shows the Council's Capital Financing Requirement, which is the Council's underlying external indebtedness for a capital purpose. It flows directly from the capital expenditure plans above, and will also be adjusted for annual revenue charge for debt repayment (the Minimum Revenue Provision). The Council currently and for the foreseeable future has no Minimum Revenue Provision requirement, and therefore no contribution is required from the revenue budget to cover these costs.

	2008-09 Budget £'000	2008-09 Actual £000
Capital Financing Requirement – CFR		
Total CFR	0	0
Net Movement in CFR	0	0
PI – External Debt		
Borrowing	5,000	5,000
Other long term liabilities	0	0
Total Debt 31 March	5,000	5,000

5. LIMITS TO BORROWING ACTIVITY

5.1 The first key control over the Council's activity is a Prudential Indicator to ensure that over the medium term, net borrowing will only be for a capital purpose. Net external borrowing should not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for 2009/10 and the following two financial years. This allows some flexibility for limited early borrowing for future years.

	2008-09 Budget £'000	2008-09 Actual £000	2009-10 Estimated £'000	2010-11 Estimated £'000	2011-12 Estimated £'000
Gross Borrowing	5,000	5,000	5,100	5,100	5,100
Investments	-24,564	-20,205	-21,357	-19,022	-18,832
Net Borrowing	-19,564	-15,205	-16,257	-19,022	-18,832
CFR	0	0	0	0	0

5.2 The Head of Finance and MIS reports that the Council complied with this prudential indicator in 2008-09, and no difficulties are envisaged for the current or future years. This view takes into account current commitments, existing plans, and the proposals in the Budget Report.

5.3 A further two prudential indicators control or anticipate the overall level of borrowing. These are:

5.4 **The authorised limit –** This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

5.5 **The operational boundary –** This indicator is based on the probable external debt during the course of the year; it is not a limit and actual borrowing could vary around this boundary for short times during the year. CIPFA anticipate that this should act as an indicator to ensure the authorised limit is not breached.

Authorised limit for external debt	2008-09 Budget £'000	2008-09 Actual £000
Borrowing	5,000	5,000
Temp Rev and Capital estimate	4,000	0
TOTAL	**9,000**	**5,000**

Operational boundary for external debt	2008-09 Estimated £'000	2008-09 Actual £000
Borrowing	5,100	5,000
TOTAL	**5,100**	**5,000**

6. AFFORDABILITY PRUDENTIAL INDICATORS

6.1 The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans on the overall Council's finances.

6.2 **Actual and estimate of the ratio of financing costs to net revenue stream –** This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

Ratio of Financing Costs to Net Revenue Stream	2008-09 Budget £'000	2008-09 Actual £000
General Fund	-8%	-6%

6.3 **Estimates of the incremental impact of capital investment decisions on the Council Tax –** This indicator identifies the trend in the cost of proposed changes in the three year capital programme recommended in the budget report compared to the Council's existing approved commitments and current plans. They are required to be approved annually and will be reported to Full Council at the same time as the next Budget and Council Tax Setting Report.

7. TREASURY MANAGEMENT PRUDENTIAL INDICATORS

7.1 The first treasury indicator requires the adoption of the CIPFA Code of Practice on Treasury Management. This Council adopted that Code on 14th March 2002.

7.2 The Upper Limits on Variable Rate Exposure indicator is the maximum limit for variable interest rates based upon the debt position net of investments.

7.3 The Upper Limits on Fixed Rate Exposure is similar to the indicator above, but covers maximum limit on fixed interest rates.

	2008-09 Budget £'000	2008-09 Actual £000
Prudential indicator limits based on debt only		
Limits on fixed interest rates	£5,000	-£13,600
Limits on variable rates	£0	-£1,605

8. MATURITY STRUCTURES OF BORROWING

8.1 These gross limits are set to reduce the Council's expose to large fixed rate loans (those instruments which carry a fixed interest rate for the duration of the instrument) falling due for refinancing.

Maturity Structure of Fixed Borrowing	**2008/09 Revised Lower Limits**	**2008/09 Revised Upper Limits**
Under 12 Months	0%	50%
12 Months to 2 years	0%	0%
2 years to 5 years	0%	0%
5 years to 10 years	0%	0%
10 years and above	0%	100%

INVESTMENTS AS AT 31ST MARCH 2009

As at 31st March 2009 the Council held investments totaling £20,205,291, ranging from call accounts to loans with maturity dates up to 26th January 2010, with the following institutions:

Bank of Scotland
Britannia Building Society
Chelsea Building Society
Natwest
Newcastle Building Society
Norwich and Peterborough Building Society
RBS MMF
Skipton Building Society
Stroud and Swindon Building Society
West Bromwich Building Society
Yorkshire Building Society

Regulatory Framework, Risk and Performance

1.1. The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2007/08);
- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the ODPM (now DCLG) has issued Investment Guidance to structure and regulate the Council's investment activities.
- Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8th November 2007.

1.2. The Council has complied with all of the above relevant statutory and regulatory requirements which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

RISK AND RETURN: English Local Authorities and the Icelandic Banks

The following is a summary of the above report, published by the Audit Commission in March 2009. The summary extracts the key messages, lessons learned and recommendations for improving treasury management processes.

1.0 INTRODUCTION

1.1 The collapse of the Icelandic banks, and their UK subsidiaries, in October 2008, resulted in £954 million of public money being put at risk (3.1% of the value of their total investments). This report has reviewed treasury management arrangements, with the benefit of hindsight, to identify what went wrong, the lessons learned and to make recommendations to improve the management of taxpayers' money.

1.2 Treasury Managers are charged with maintaining the security and liquidity of an organisation's cash assets, while generating a yield or return on that money. Local Authorities draw a valuable income from interest earned on surplus cash, by placing it on deposit in bank or building society accounts or in money market investments. The focus of this report is on Local Authorities' arrangements for placing and managing cash on deposit or in investments. It does not cover treasury management arrangements for borrowing or managing debt. Nor does it consider the performance of external treasury advisers, brokers or credit rating agencies.

2.0 KEY MESSAGES

- **The national treasury management framework is broadly right.** The investment framework requires that Local Authorities should invest prudently and should primarily seek to safeguard public funds rather than to maximise returns. However, the framework has weaknesses, which have contributed to poor practice:

    - Statutory guidance gives weight to credit ratings but not to other relevant information (and no advice on other potentially useful sources of information is provided).

    - The Chartered Institute of Public Finance and Accountancy (CIPFA) guidance gives insufficient attention to risks which may be inter-related, for example banks in the same group or country.

    - More guidance is needed about how to manage the full range of risks .

- **The best organisations balance risk and reward and arrangements include:**
    - regular review and scrutiny of policy and procedures;
    - appropriately trained staff and engaged elected Members; and
    - the use of a wide range of information including, but not limited to, credit ratings.
- **Poorer performing organisations:**
    - have weak governance;
    - depend exclusively on credit ratings; and
    - have staff who are inadequately trained.

3.0 PRUDENT TREASURY MANAGEMENT BEHAVIOURS

The following characteristics were identified:

Characteristic	Prudent Behaviour
Attitude to risk	Cautious. Recognise the need to own all risk-reward decisions and the need to maintain a questioning, challenging mindset.
Approach to risk management	Manage risk proactively: • invest funds with riskier counterparties only for short periods of time; • consider the possibility of breaking a deposit before maturity; • manage the counterparty list without waiting for a rating downgrade; and • consider country limits for counterparties.
Use of credit ratings	Recognise that credit ratings and comments from advisers are merely one source of information that can be used to build an understanding of risks in the markets and with counterparties.

Characteristic	Prudent Behaviour
Governance and scrutiny	Elected Member oversees finance function, takes an interest in the treasury policy and challenges assumptions built into the limits and minimum credit criteria. Finance staff proactively approach elected Members and provide briefings on key issues relevant to the treasury policy, including risk limits. Elected Members are able to provide robust challenge to the key policy parameters.
Use of information	Extensive. Includes actively researching counterparties and the markets.
Relationship with counterparties	Know the bankers that they are investing with.
Reliance on yield	Prioritise security and liquidity above yield. Maintain a balance between security, liquidity and yield by investing short-term where risk dictates. For some, it is rare to invest for longer than three months.
Achievement of security and liquidity	Carry out scenario testing to ensure that the sensitivity of the portfolio to the market is understood. Normal expectation is for specified investments of six months or less.
Resource management, staff development and expertise	Allocate the equivalent of at least one full-time member of staff to the role of investing funds and performing research into counterparties and investment instruments. Actively encourage networking and training.

Characteristic	Prudent Behaviour
Resource management, staff development and expertise (Cont'd)	Staff gather information about the markets and counterparties that includes: • reviewing information and credit measures available from all rating agencies; • actively seeking out information available from newspapers and the internet; and • looking into other measures of risk.

4.0 RECOMMENDATIONS

4.1 **Central Government should:**

- Review and revise the weaker aspects of the national framework highlighted above, especially the weight given to credit rating;

- Enable and require the Debt Management Office to provide deposit accounts to public bodies, if those bodies cannot achieve the security they require in the market; and

- Review the cost of early repayment of debt to the Public Works Loans Board, to ensure that it is not acting against the wider public interest by encouraging authorities to hold unnecessarily large cash deposits.

4.2 **CIPFA should:**

- Revise and tighten its Code of Practice for Treasury Management to take account of the findings in this report;

- 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;

- 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

- Co-ordinate 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.

4.3 **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;

- 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;

- Ensure elected Members receive regular updates on the full range of risks being run;

- 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;

- 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;

- Ensure that the full range of options for managing funds is considered (for example, it is sometimes possible to request the return of a deposit before the maturity date – although there may be payment of a penalty) and note that early repayment of loans, or not borrowing money ahead of need, may reduce risks;

- Use the fullest range of information before deciding where to deposit funds;

- Be clear about the role of external advisers and recognise that Local Authorities remain accountable for decisions made; and

- Look for economies of scale by sharing resources between Authorities or with pension funds, while maintaining separation of those funds.

4.4 **The Audit Commission will:**

- Ask their auditors to follow up this report, as part of their Use of Resources work;

- Work with CIPFA to ensure that the lessons learned are included in the revised treasury management guidance; and

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

5.0 CONCLUSIONS

5.1 The Audit Commission concluded that many Authorities have acted prudently and balanced their risks. Others have been less cautious, by following ratings exclusively and perhaps striving to achieve a high yield (because of performance and budget pressures), without due regard to the risks involved. A small group of Authorities has been negligent in their stewardship of public funds.

5.2 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.

5.3 If Authorities are going to deposit cash in the commercial sector, to benefit from the higher rates of interest available, then they must ensure that their treasury management is properly resourced, managed and scrutinised. The full range of risks need to be recognised and managed.

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