ANNEX 2

CIPFA

TREASURY MANAGEMENT PANEL BULLETIN

TREASURY MANAGEMENT IN LOCAL AUTHORITIES – POST ICELANDIC BANKS COLLAPSE

March 2009

AT THE HEART OF PUBLIC SERVICES

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

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

Revised Treasury Management Code and Guidance

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

Treasury Management Objectives

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

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

Treasury Management Governance Arrangements

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

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

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

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

Monitoring

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

Gross and Net Borrowing

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

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

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

Skills and Training

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

CIPFA and the Association of Corporate Treasurers will be launching a joint treasury management qualification aimed at public sector organisations in June 2009.

CIPFA has also launched a risk management consultation paper and will look to develop practical guidance and toolkits for local authorities for management of treasury risk.

Counterparty Lists

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

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

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

Use of Treasury Management Advisers

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

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

Benchmarking

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