TONBRIDGE & MALLING BOROUGH COUNCIL

AUDIT COMMITTEE

01 October 2018

Report of the Director of Finance and Transformation

Part 1- Public

Matters for Recommendation to Cabinet

1 REVISED STATUTORY INVESTMENT GUIDANCE AND TREASURY MANAGEMENT AND PRUDENTIAL CODES OF PRACTICE

The revised Guidance and Codes impose additional requirements on local authorities aimed to address concerns arising from the commercialism agenda, in particular, the use of loans and the purchase of property to generate a profit.

1.1 Introduction

1.1.1 Under the Local Government Act 2003 the Council is required to comply with Statutory Guidance on Local Government Investments and through that guidance, have regard to the CIPFA Treasury Management Code of Practice and the CIPFA Prudential Code. Historically the scope of the statutory guidance and the codes was limited to the investment of an authority's cash surpluses and the management of borrowing undertaken to support its capital expenditure plans. Updated statutory guidance and codes have been issued that broaden that scope to include expenditure on loans and the acquisition of non-financial assets (property) intended to generate a profit.

1.1.2 The Statutory Guidance and Codes of Practice are lengthy documents and are not appended to this report. If a Member would wish to obtain copies please contact Michael Withey at michael.withey@tmbc.gov.uk

1.2 Statutory Guidance on Local Government Investments 2018 Edition

1.2.1 The Statutory Guidance on Local Government Investments requires authorities to prepare an annual investment strategy (the Strategy) to be approved by full Council prior to the start of each financial year. The disclosures required to be published and made publicly available in the Strategy may be included in a treasury management strategy, a capital strategy or any other publicly available document (e.g. budget presentation). The requirements and disclosures that arise in respect of loans and non-financial assets are summarised in [Annex1].

1.3 Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes 2017 Edition

Introduction

1.3.1 For the purposes of this Code CIPFA has adopted the following as its definition of treasury management activities:

- The management of the organisation's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and pursuit of optimum performance consistent with those risks.

1.3.2 Investments in the definition above covers all the financial assets of the organisation, as well as other non-financial assets which the organisation holds primarily for financial returns, such as *directly owned* investment property. This may therefore include investments which are not managed as part of normal treasury management or under treasury management delegations.

1.3.3 In the main, the changes made to the Code, address concerns arising from the 'commercialism agenda' to ensure the risks associated with investment in 'non-financial assets' which are held primarily for financial returns' are properly evaluated, reported, subject to scrutiny and managed over time.

1.3.4 The Code makes it clear that the control of risk and optimising returns consistent with the organisation's risk appetite should be applied across all investment activities, including more commercially based investments.

Key Principles

1.3.5 The Code identifies three key principles detailed below with a minor change made to Key Principle 2 highlighted in italics.

- Key Principle 1 – Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.

- Key Principle 2 – Their policies and practices should make clear that the effective management and control of risk are prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and *portfolio* liquidity when investing *treasury management* funds.

- Key Principle 3 – They should acknowledge that the pursuit of value for money in treasury management, and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management; their treasury management policies and practices should reflect this.

1.3.6 The Code further recommends the adoption of four key clauses and the preparation of a treasury management policy statement and treasury management practices in order to achieve the above.

Clauses to be Formally Adopted

1.3.7 It is recommended that the four clauses recommended to be formally adopted as set out in the Code and reproduced at **[Annex 2]** be adopted / readopted.

Treasury Management Policy Statement

1.3.8 It is recommended that the Treasury Management Policy Statement as set out in the Code and reproduced at **[Annex 3]** be adopted / readopted.

Treasury Management Practices

1.3.9 The TMPs (12) detail the processes and procedures to be followed in the operation and management of the treasury management function and run to many pages and as a result are not reproduced in full. Much of the changes detailed below focus on TMPs as they apply to non-treasury management investments.

- TMP1 *Risk management* amended to include within the General Statement that – “This organisation regards a key objective of its treasury management activities to be the security of the principal sums it invests. Accordingly, it will ensure that robust due diligence procedures cover all external investment.” This includes investment and risk management criteria for any material non-treasury investment portfolios.

- A new risk management consideration has been introduced under TMP1 covering inflation risk management – “The organisation will keep under review the sensitivity of its treasury assets and liabilities to inflation, and will seek to manage the risk accordingly in the context of the whole organisation’s inflation exposures.”

- TMP2 *Performance measurement* to include methodology and criteria for assessing the performance and success of non-treasury investments.

- TMP4 *Approved instruments, methods and techniques* includes a new paragraph regarding MIFID II – “This organisation has reviewed its classification with financial institutions under MIFID II and has set out in the schedule to this document those organisations with which it is registered as a professional client and those with which it has an application outstanding to register as a professional client.” Treasury Management Strategy

Statement will need to reflect in what circumstances an authority has opted up to professional status, and a schedule prepared of all counter parties where this applies, with a commitment that these arrangements will be regularly reviewed as appropriate.

- TMP5 *Decision making, governance and organisation* to include a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making.

- TMP6 *Reporting requirements and management information arrangements* to include where and how often monitoring reports are taken in relation to non-treasury investments.

- TMP8 *Cash and cash flow management* makes a correction to a previous error when referencing back to TMP1.

- TMP10 *Training and qualifications* to include how the relevant knowledge and skills in relation to non-treasury investments will be arranged.

Investments that are not part of Treasury Management Activity

1.3.10 A new section has been added covering investments that are not part of treasury management activity (commercialism agenda) and the primary reason for the changes made to the Code; requiring the inclusion of a new statement **[Annex 4]**.

1.3.11 These investments should be proportional to the level of resources available to the organisation and the organisation should ensure that the same robust procedures for consideration of risk and return are applied to these decisions.

1.3.12 Due diligence procedures should ensure effective scrutiny of proposed investments, identification of risk to both capital and returns, any external underwriting of those risks, and the potential impact on the financial sustainability of the organisation if those risks come to pass. Where necessary independent and expert advice should be sought to ensure due diligence is suitably robust.

1.3.13 A published schedule should be agreed by Council that set outs the organisation's investment management practices for non-treasury investments. Where a Capital Strategy is produced by a local authority including the authority's approach to commercial activities, the detail may be published separately. The authority should ensure effective arrangements are in place for the effective scrutiny of strategy and policies.

1.3.14 A register of investments and financial guarantees should be maintained and regularly reviewed as part of performance reporting arrangements, including periodic reassessment of the probability of financial guarantees being called upon.

1.3.15 For ease of reference the additional text to be added to the TMPs as a result can be found at **[Annex 5]**.

1.4 Prudential Code for Capital Finance in Local Authorities 2017 Edition

1.4.1 The objectives of the Prudential Code are to ensure, within a clear framework, that the capital expenditure plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice and in full understanding of the risks involved and how these risks will be managed to levels that are acceptable to the organisation.

1.4.2 The Prudential Code requires authorities to look at capital expenditure and investment plans in the light of overall organisational strategy and resources and ensure that decisions are being made with sufficient regard to the long run financing implications and potential risks to the authority. Effective financial planning, option appraisal, risk management and governance processes are essential in achieving a prudential approach to capital expenditure, investment and debt.

1.4.3 To demonstrate that local authorities have fulfilled these objectives, the Prudential Code sets out the indicators that must be used, and the factors that must be taken into account. The Prudential Code sets out a clear governance procedure for the setting and revising of a Capital Strategy and prudential indicators. This will be done by the same body that takes the decisions for the local authority's budget.

1.4.4 The Capital Strategy is intended to give a high level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services along with an overview of how associated risk is managed and the implications for future financial sustainability.

1.4.5 The Capital Strategy to include the authority's approach to commercial activities including processes ensuring effective due diligence and defining the authority's risk appetite including proportionality in respect of overall resources; and requirements for independent and expert advice and scrutiny arrangements. An overview of the governance process for approval and monitoring and ongoing risk management of any other financial guarantees and other long-term liabilities; and a summary of the knowledge and skills available to the authority and confirmation that these are commensurate with the authority's risk appetite.

1.4.6 The additional paragraphs to be added to the Council's Capital Strategy as a result can be found at **[Annex 6]** and the prudential indicators required to be published under the 2017 Code can be found at **[Annex 7]**.

1.5 Legal Implications

1.5.1 The Local Authorities (Capital Finance and Accounting (England) Regulations 2003 require local authorities to have regard to both documents.

1.5.2 Under Section 151 of the Local Government Act 1972, the Section 151 Officer has statutory duties in relation to financial administration and stewardship including securing effective arrangements for treasury management.

1.5.3 In addition, Link Asset Services are employed to provide independent advice on legislative and professional changes that impact on the treasury management function.

1.6 Financial and Value for Money Considerations

1.6.1 A purpose of the Code is to encourage the pursuit of value for money in treasury management, and to promote the reasoned use, development and appreciation of appropriate and practical measures of performance.

1.6.2 Performance is monitored against a benchmark return and against other local authorities in Kent and the broader local authority pool via Link's benchmarking service.

1.7 Risk Assessment

1.7.1 Link Asset Services are employed to provide advice on the content of the Treasury Management and Annual Investment Strategy and this, coupled with a regular audit of treasury activities ensures that the requirements of the Strategy and the Treasury Policy Statement adopted by this Council are complied with.

1.7.2 Credit ratings remain a key tool in assessing risk. It is recognised that their use should be supplemented with sovereign ratings and market intelligence. Appropriate sovereign, group and counterparty limits are established to ensure an appropriate level of diversification.

1.7.3 In the light of these safeguards and stringent Treasury Management Procedures it is considered that any risks to the authority implicit in the Treasury Management function have been minimised.

1.8 Equality Impact Assessment

1.8.1 The decisions recommended through this paper have a remote or low relevance to the substance of the Equality Act. There is no perceived impact on end users.

1.9 Recommendations

1.9.1 Members are asked to **recommend** to Cabinet and subsequently full Council:

1) To note the new requirements and disclosures contained in the Statutory Guidance on Local Government Investments 2018 Edition set out at **[Annex 1]**.

2) The four clauses to be formally adopted as set out in the Code and reproduced at **[Annex 2]** be readopted.

3) The Treasury Management Policy Statement as set out in the Code and reproduced at **[Annex 3]** be readopted.

4) To note the new statement pertaining to investments that are not part of treasury management activity reproduced at **[Annex 4]**.

5) To note the additional paragraphs to be added to the Council's TMPs as set out at **[Annex 5]**.

6) To note the additional paragraphs to be added to the Council's Capital Strategy as set out at **[Annex 6]**.

7) To note the prudential indicators as set out at **[Annex 7]**.

Background papers: contact: Michael Withey
Neil Lawley

Statutory Guidance on Local Government Investments (3rd Edition) 2018
Treasury Management Code of Practice and Cross-Sectoral Guidance Notes 2017 Edition
Prudential Code 2017 Edition

Sharon Shelton
Director of Finance and Transformation