

ABERDEEN CITY COUNCIL

COMMITTEE	Audit, Risk and Scrutiny Committee
DATE	9 December 2020
EXEMPT	No
CONFIDENTIAL	No
REPORT TITLE	Internal Audit Report AC2103 – Treasury Management
REPORT NUMBER	IA/AC2103
DIRECTOR	N/A
REPORT AUTHOR	Colin Harvey
TERMS OF REFERENCE	2.2

1. PURPOSE OF REPORT

- 1.1 The purpose of this report is to present the planned Internal Audit report on Treasury Management.

2. RECOMMENDATION

- 2.1 It is recommended that the Committee review, discuss and comment on the issues raised within this report and the attached appendix.

3. BACKGROUND / MAIN ISSUES

- 3.1 Internal Audit has completed the attached report which relates to an audit of Treasury Management.

4. FINANCIAL IMPLICATIONS

- 4.1 There are no direct financial implications arising from the recommendations of this report.

5. LEGAL IMPLICATIONS

- 5.1 There are no direct legal implications arising from the recommendations of this report.

6. MANAGEMENT OF RISK

- 6.1 The Internal Audit process considers risks involved in the areas subject to review. Any risk implications identified through the Internal Audit process are as detailed in the attached appendix.

7. OUTCOMES

- 7.1 There are no direct impacts, as a result of this report, in relation to the Council Delivery Plan, or the Local Outcome Improvement Plan Themes of Prosperous Economy, People or Place.
- 7.2 However, Internal Audit plays a key role in providing assurance over, and helping to improve, the Council's framework of governance, risk management and control. These arrangements, put in place by the Council, help ensure that the Council achieves its strategic objectives in a well-managed and controlled environment.

8. IMPACT ASSESSMENTS

Assessment	Outcome
Impact Assessment	An assessment is not required because the reason for this report is for Committee to review, discuss and comment on the outcome of an internal audit. As a result, there will be no differential impact, as a result of the proposals in this report, on people with protected characteristics.
Privacy Impact Assessment	Not required

9. APPENDICES

- 9.1 Internal Audit report AC2103 – Treasury Management.

10. REPORT AUTHOR DETAILS

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Internal Audit Report

Finance

Treasury Management

Issued to:

Steven Whyte, Director of Resources
Jonathan Belford, Chief Officer – Finance
Fraser Bell, Chief Officer - Governance
Carol Smith, Accounting Manager
Lesley Fullerton, Finance Operations Manager
Neil Stewart, Accountant
Deirdre Nicolson, Solicitor
External Audit

EXECUTIVE SUMMARY

Treasury Management is defined as 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 the pursuit of optimum performance consistent with those risks. In practice, this means actively monitoring and managing banking transactions to ensure that cash is available to pay for debts as they fall due, while minimising borrowing costs as a result of debt and ensuring an acceptable balance is struck between security, liquidity and return, for any investments held. The Treasury Management function is maintained primarily by an Accountant who reports to the Finance Operations Manager. Decisions made by the team are informed by advice and information provided by the Council's Treasury Advisors.

In October 2016, the Council was assigned a credit rating, and subsequently completed a £370 million bond issue on the London Stock Exchange in November 2016; as a result of the bond issue, the Council is now required to comply with a number of regulations including the Market Abuse Regulation, the Disclosure and Transparency Rules, the Listing Rules and London Stock Exchange Admission and Disclosure Standards.

As at 30 June 2020, the Council's total external debt including overdraft was £1,109.5 million at an average interest rate of 2.15%, with temporary investments of £136.6 million at an average interest rate of 0.41%.

The objective of this audit was to provide assurance that the Council's Treasury Management procedures follow best practice and are being complied with. In general, this was found to be the case with: an approved Council Treasury Management Policy and Strategy in place; Committee reporting on performance as expected where possible; secure online banking arrangements; and evidence that in general the relevant treasury management Code of Practice is being complied with. Recommendations have been agreed with Finance to make some minor improvements to procedures and compliance, in relation to daily banking duties.

The Market Abuse Regulation (MAR) requires the Council to take all reasonable steps to ensure that any person on the Insider List with access to Inside Information acknowledges in writing the legal and regulatory duties entailed and is aware of the sanctions applicable to insider dealing and unlawful disclosure of Inside Information. A former member of staff was not previously included on the List when employed by the Council and one member of staff on the List had not been informed in writing of their duties / related sanctions as a result of being on the List. Governance has agreed to review the Insiders List and issue any required correspondence.

1. INTRODUCTION

- 1.1 Treasury management is described by the Chartered Institute of Public Finance and Accountancy (CIPFA) in its Introduction to the Treasury Management in the Public Services: Code of Practice as: “the management of an 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 the pursuit of optimum performance consistent with those risks” Money market transactions relate to short term investments in companies (e.g. commercial paper), banks (e.g. certificates of deposit) and governments (e.g. federal funds) , whilst capital market transactions relate to investments in stocks and bonds.
- 1.2 In practice, this means actively monitoring and managing banking transactions to ensure that cash is available to pay for debts as they fall due, while minimising borrowing costs as a result of debt and ensuring an acceptable balance is struck between security, liquidity and return, for any investments held.
- 1.3 The Aberdeen City Council Treasury Management team at the time of the audit consists of the Finance Operations Manager, an Accountant, and a Senior Finance Officer. Decisions made by the team are informed by advice and information provided by the Council’s Treasury Advisors.
- 1.4 As at 30 June 2020, the Council’s total external debt including overdraft was £1,109.5 million at an average interest rate of 2.15%, with temporary investments of £136.6 million at an average interest rate of 0.41%.
- 1.5 In October 2016, the Council was assigned a credit rating, and subsequently completed a £370 million bond issue on the London Stock Exchange in November 2016. This increased the level of debt and investments held by the Council.
- 1.6 The objective of this audit was to provide assurance that the Council’s Treasury Management procedures follow best practice and are being complied with.
- 1.7 The factual accuracy of this report and action to be taken with regard to recommendations made has been agreed with Jonathan Belford, Chief Officer – Finance, Carol Smith, Accounting Manager, Lesley Fullerton, Finance Operations Manager, Neil Stewart, Accountant, Fraser Bell, Chief Officer – Governance and Deirdre Nicolson, Solicitor.

2. FINDINGS AND RECOMMENDATIONS

2.1 Treasury Management Policy and Strategy

- 2.1.1 The Scottish Government Finance Circular 5/2010 requires local authorities in Scotland to have regard to the Treasury Management in the Public Services Code of Practice (the TM Code). The CoP recommends that all public service organisations create and maintain, a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury activities. The Council has adopted the CoP as part of its Treasury Management Policy and Strategy, providing a basis to create clear treasury management objectives and to structure sound treasury management policies and practices. The CoP was last updated by CIPFA in 2017.
- 2.1.2 The Council's Treasury Management Policy and Strategy are reported annually to Full Council after having been reviewed by the Accountant and approved by the Chief Officer - Finance. The Policy and Strategy are reviewed at least three times a year (Annual Report, Year-End Summary and Mid-Year review). Additional reports may be produced outwith these, if necessary (e.g. removing a Counterparty, increasing Counterparty limits etc). The Policy and Strategy Report includes a number of key documents as required by the CoP. The Treasury Management Policy Statement defines the policies and objectives of the Council's treasury management activities, following the form of words recommended by CIPFA. The Borrowing Strategy sets out the prioritised borrowing methods the Council could use, as well as setting limits on certain types of borrowing and the debt maturity structure. The Investment Strategy notes the Council's investment priorities as the security of capital and liquidity of its investments, and sets a limit on longer-term, fixed rate investments. The Counterparty List details the approved banks and other financial institutions with which the Council can undertake short-term investments.
- 2.1.3 In addition, CIPFA has developed a Prudential Code to support local authorities when taking decisions on capital expenditure. This contains a number of prudential indicators. Prudential indicators should consider whether the Council has adopted the CoP; capital expenditure estimates over several financial years; estimates of financing costs to net revenue stream; debt versus the capital financing requirement over the current and next two financial years; various limits on borrowing; and authorised limits and operational boundaries for total external debt. Prudential Indicators chosen by the Treasury Management team for the forthcoming financial year are reported in the Annual Treasury Management Policy and Strategy Report presented in March for Full Council approval.
- 2.1.4 The CoP recommends that Full Council receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close. The reporting undertaken for 2019/20 and 2020/21 Treasury Management activities was reviewed.
- 2.1.5 The Council's Treasury Management Policy and Strategy was approved by Full Council on 4 March 2019 and 2 March 2020. The Year End Report made to Full Council on 24 June 2019 contained summarised information on Treasury Management activities and performance monitoring for the previous year and updates on the Counterparty List. The Mid-Year Review Reports, made to Full Council on 17 December 2018 and 9 December 2019, contained information on Treasury Management activities and performance monitoring during the year to date and predictions for the remainder of the financial year.
- 2.1.6 No Annual Report was presented to Committee in June 2020 as the meeting was cancelled due to the coronavirus lockdown. A report covering the 2019/20 Year End and 2020/21 Mid-Year Treasury Management performance is scheduled to be reported to full Council on 14 December 2020.

2.2 Written Procedures

- 2.2.1 Comprehensive written procedures which are easily accessible by all members of staff can reduce the risk of errors and inconsistency. They are beneficial for the training of current and new employees and provide management with assurance that correct and consistent instructions are available to staff, important in the event of an experienced employee being absent or leaving. They have increased importance where new systems or procedures are being introduced.
- 2.2.2 The Treasury Management (TM) team has developed a Treasury Management Manual which covers all regular activities as well as special events, TM staff duties and responsibilities, security measures and record retention. The Manual is maintained and distributed by the Accountant responsible for TM. The Manual contains extracts from the CIPFA Code of Practice and Prudential Code and lists the twelve Treasury Management Principles, which have been copied from CIPFA guidance without amendment for the Council's particular needs and circumstances. However, an appendix to the Manual (Appendix D) contains details of how the Principles are followed in practice. This Appendix is not listed in the Table of Contents.
- 2.2.3 The Service advised that the Manual is updated at least annually and the first page contains a dated list of revisions, with the most recent being an update to the Counterparty List on 2 March 2020. The Counterparty List and Settlement Instructions and Authorised Signatory List are up to date. The Authorised Signatory List refers to one employee by a former role and does not contain an entry for the employee currently filling that position. In addition, the Manual contains some out of date references in its description of procedures; for example, hand-drafted documents are required to be passed to "the typists" for completion, and the capital programme refers to the "new Aberdeen Exhibition and Conference Centre ... once it is fully operational". This has been known as TECA (The Event Complex Aberdeen) since July 2018 and was completed in August 2019. Additionally, the section on money laundering contains a web link which is no longer active (<http://www.hmrc.gov.uk/mlr/>). While the errors observed are minor, if the Manual is not thoroughly reviewed there is a risk that more significant errors will not be corrected.
- 2.2.4 Since the coronavirus lockdown began in March 2020 all members of the team have been working from home. As a result, all procedures which involved paper documents and manuscript signatures have been amended to use electronic formats. The TM Manual has not yet been updated to reflect this. Finance has advised that it had not been possible to amend the procedure recently due to the pressure of work and the pace of change. However, the team planned to revise procedures as necessary to ensure the new way of working is clear for all staff. A recommendation is included to track progress.

Recommendation

Finance should revise the Treasury Management Manual so that information is up to date.

Service Response / Action

Agreed. The procedures have already been updated in line with remote working. These need to be reflected in the manual.

Implementation Date

December 2020

Responsible Officer

Accountant

Grading

Important within audited area

2.3 Treasury Management Data

- 2.3.1 Confidential financial data is held in the Treasury Management team shared drive, to which access is restricted. The restriction is primarily to ensure that only relevant staff are able to access and amend the monitoring spreadsheets, in order to prevent accidental modification or deletion; the Service does not believe there would be a risk of data breach or inappropriate action if a staff member left the team but kept their access to the drive.
- 2.3.2 Details of transactions are held in a database designed to record loans and investments, which is provided and maintained by the supplier. The system administrator is the Accountant responsible for TM, who creates and revokes access to users as required; in general access is restricted to view-only. A list of users was provided and all access was appropriate.
- 2.3.3 Banking data is held in the online business banking portal provided by the Council's banking services provider. This allows transaction data to be downloaded, transfers to be made between the General and Instant Access accounts, and CHAPS payments to be created. Dual factor authentication is in place with each officer provided with their own individual log-in and authentication device. The log in requires a non-descriptive username; password; memorable information; and confirmation token. Each member of staff is given their own authentication device (confirmation token) and guidance on secure storage of these is given verbally when the device is issued. Shared access is not permitted.
- 2.3.4 Access to view the online portal is administered by the Accountant responsible for TM and is provided on request by the employee or by their line manager. The request process is informal and not recorded. Access is provided to specified accounts and may be set to read-only or transactional as appropriate. A list of staff with access to the system was provided; all access was appropriate.
- 2.3.5 As all Treasury Management data is held electronically in the Council network it is backed up on a daily basis in the usual way, which has been reviewed in previous audit reports such as AC1912 Data Security in a Cloud Based Environment and AC1810 Major IT Business Services, and found to be satisfactory. The transaction database and online banking portal systems are hosted by the system providers, who are responsible for securing the system data. In addition, printouts of bank statements and copies of deal tickets are taken on a daily basis as part of TM activities, providing further backups of data.

2.4 Prudential Code

- 2.4.1 Scottish local authorities are required to have regard to CIPFA's Prudential Code under Part 7 of the Local Government in Scotland Act 2003. The objective of the CIPFA Prudential Code is: to provide a framework for Local Authority capital finance that will ensure that capital expenditure and investment plans are affordable; that all external borrowing and other long-term liabilities are prudent and sustainable; that treasury management and other investment decisions are taken in accordance with good professional practice; and that the organisation is accountable for treasury management decisions made. The Prudential Code does not suggest indicative limits or ratios, which are the responsibility of the organisation, subject to any legislative controls.
- 2.4.2 Scottish Ministers have statutory powers (section 36 of the 2003 Act) to impose capital expenditure limits either at the 'all Scotland' level or for a particular local authority, including for different types of capital expenditure. As at July 2020, Ministers have not used this power.

- 2.4.3 Local authorities are required to set prudential indicators, having regard to:
- service objectives, e.g. strategic planning for the authority;
 - stewardship of assets, e.g. asset management planning;
 - value for money, e.g. option appraisal;
 - prudence and sustainability, e.g. implications of external debt and whole life costing;
 - affordability, e.g. implications for council tax; and
 - practicality, e.g. achievability of the forward plan.
- 2.4.4 The Prudential Code states that the prudential indicators for the forthcoming and following years must be set before the beginning of the forthcoming year. In response to recommendations made by Audit Scotland in their *“Borrowing and Treasury Management in Councils”* report, the Council now includes its prudential indicators in the annual Treasury Management Policy and Strategy report, as well as in the budget setting report that is presented to Full Council. Prudential Indicators are reported showing the prior year actual results, as well as estimated figures for the next five years. This supports the longer-term view that the Council is required to take.
- 2.4.5 The Council has set indicators indicating: the affordability of the authority’s capital plans; showing external debt is kept within sustainable prudent limits; as well as indicators detailing planned capital expenditure, and limits for external debt. Within the Council’s daily treasury management sheets, each of the prudential indicators are calculated to ensure the limits are not breached throughout the year. This is recognised as good practice.
- 2.4.6 The Prudential Code states that, in order to ensure that over the medium term net debt will only be for a capital purpose, the authority should ensure that net debt does not, except in the short term, exceed the total capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. A statement from the Chief Officer - Finance was included with the report on Prudential Indicators presented to Full Council in March 2020 to confirm this was the case.

2.5 Treasury Management Practices

- 2.5.1 The CoP is recognised as best practice for Local Authority Treasury Management activities. It follows that compliance with the Treasury Management Practices (TMP’s) it contains demonstrates that the organisation is acting appropriately to ensure that Council assets are protected and best value maintained.
- 2.5.2 The TM practices described in the CoP are:
1. Risk Management
 2. Best Value and Performance Measurement
 3. Decision-Making and Analysis
 4. Approved Instruments, Methods and Techniques
 5. Organisation, Clarity and Segregation of Responsibilities, and Dealing Arrangements
 6. Reporting Requirements and Management Information Arrangements
 7. Budgeting, Accounting and Audit Arrangements
 8. Cash and Cash Flow Management
 9. Money Laundering
 10. Staff Training and Qualifications
 11. Use of External Service Provider
 12. Corporate Governance

2.5.3 Risk Management

2.5.3.1 The CoP TMP 1 states that “the common and overriding aim of such organisations should be the effective identification, monitoring and control of risk”, and lists nine specific risks that public sector organisations should seek to mitigate. The TM Policy Statement included in the TM Manual and reported to Committee includes the wording recommended by CIPFA identifying risk management as key. Risk management is described in detail in the Annual TM Policy & Strategy Report made to Full Council each year and the Council's risk appetite is described therein as "low", with the Investment Strategy formulated accordingly.

2.5.3.2 Risk management is described in detail in the TMP 1 section of the Council's TM Manual. The section includes risks associated with credit and counterparties, liquidity, interest rates, inflation risks and refinancing, and those arising from legal and regulatory issues, fraud, error, corruption and contingency measures, and fluctuations in market prices.

2.5.4 Best Value and Performance Measurement

2.5.4.1 TMP 2 recommends that organisations carry out ongoing analysis of value added by the TM function and performance monitoring in order to ensure best value. In the section on TMP 2 Performance Measurement in the Council's TM Manual Appendix D, Finance states that "the treasury management function will be the subject of ongoing analysis of the value it adds in support of the organisation's stated business or service objectives. It will be the subject of regular examination of alternative methods of service delivery and of the scope for other potential improvements. The performance of the treasury management function will be measured using the criteria set out by the Chief Officer - Finance."

2.5.4.2 Finance advised that debt management benchmarks are calculated periodically by the team and are reported as part of the triannual TM reports to Council and in the Annual Accounts; the report on TM performance includes the average rate of external debt, the proportion of short-term and variable debt, the proportion of debt maturing within next two years, and the performance of investment earnings. The reports also measure compliance with Borrowing and Investment Strategies, the TMS and Prudential Indicators. Copies of the Treasury Management Policy & Strategy reports, and the Mid-Year Reviews, submitted over the last financial year were obtained and seen to show satisfactory levels of performance.

2.5.4.3 The “Daily Treasury Sheet” spreadsheets used by Finance enable investment and borrowing decisions to be made based on the forecast daily cash position (opening bank balance plus known receipts less known payments), records of existing investments and borrowing and prudential code limits. These spreadsheets provided adequate assurance that best value was being sought by Finance when undertaking daily treasury management duties.

2.5.4.4 Through the Council's Treasury Management Consultants the TM team participate in an Investment Benchmarking Group, which measures security, liquidity and yield against a small group of authorities in Scotland plus additional portfolios from a broader local authority base on a national basis. The consultants also provide regular reports on capital financing and borrowing.

2.5.4.5 Performance measures are also included in an annual return to the CIPFA Scottish Branch Treasury Management Forum who collate all 32 Scottish Local Authorities, to allow benchmarking on local and national levels. The Accountant responsible for TM submits

the borrowing and the pool rate year-end figures to the Forum and on a monthly basis also submits the investment balances.

2.5.5 Decision Making and Analysis

2.5.5.1 The CoP advises that “the treasury management strategy should be supplemented by the provision of monitoring information ... records should be kept of the processes and the rationale behind those decisions.” All transactions are recorded in the TM transaction management and recording system, from which monitoring reports can be produced. Further detailed records are maintained by the Accountant responsible for TM through the Daily Treasury Sheet spreadsheets used to monitor cash flow and prudential indicators, as well as daily “Treasury E-returns” journal spreadsheets for recording transactions in the ledger, which should be completed by the Finance Development Officer and approved by an Accountant before being submitted to the Bank Reconciliation team for processing. The Daily Treasury Sheets record details of borrowing and investment decisions.

~~2.5.5.2~~ Monitoring spreadsheets, Daily Sheets and E-returns for June 2020 were reviewed and seen to show complete records of transactions. However, while the sheets contain a field to be completed by a manager confirming approval of the decision-making, this has not been completed since the sheets began to be completed electronically in March 2020 due to the coronavirus lockdown. This is considered further in 2.5.20.

2.5.6 Approved Instruments, Methods and Techniques

2.5.6.1 Per TMP 4, organisations should employ only approved instruments, methods and techniques, and use them within the limits and parameters defined in TMP1, Risk Management. “Methods and techniques” refers to approved TM activities such as borrowing; lending; debt repayment and rescheduling; and financial risk management.

2.5.6.2 Investment instruments approved under The Local Authority (Capital Finance) (Approved Investments) Regulations 1990 and subsequent amendments, include: deposits with banks and building Societies or local authorities up to 365 days; Pooled Investment Funds such as pension funds; and deposits with Government (including HM Treasury and Local Authorities).

2.5.6.3 In the TMP4 section of Appendix D in the TM Manual there are no details of approved instruments, methods or techniques. Instead reference is made to details in the Policy Statement, Borrowing Strategy and Investment Strategy, and the limits and parameters defined in the TMP1 Risk Management section. TMP1 refers back to TMP4 and also “the schedule to this document”, wording copied from the CIPFA CoP; there is no schedule. The Service advised that this was an oversight and would be corrected during the next revision. There are no specific tools or instruments mentioned in the rest of the section; per the CoP it is desirable to include details and individual limits of approved instruments, methods, techniques and investments in the TMP document. However, details of approved instruments, methods and techniques for both borrowing and investments are laid out comprehensively in the reports on TM Policy & Strategy which are annually approved by Full Council.

2.5.6.4 The Council’s Loans Fund may borrow from any other UK local authority or government guaranteed institution which includes the PWLB or successors. In addition, the Council may borrow from any bank, financial institution, insurance company or utility company which is governed by MiFID, the EU Markets in Financial Instruments Directive (2004/39/EC). The majority of borrowing is from the Public Works Loan Board, which exists to lend money from the National Loans Fund to local authorities and can provide finance with varying terms and interest payable to cover shortfalls. In addition to

the PWLB, the Service is permitted to borrow from the open market with rates payable depending on current market conditions.

- 2.5.6.5 Under the CIPFA Prudential Code, the Council sets its own borrowing limits but must demonstrate, via the Prudential Indicators, that any borrowing is affordable, prudent and sustainable. The portfolio of loans held should be regularly reviewed to ensure that these are being managed as effectively as possible. Long-term borrowing requirements relates to borrowing that is required to fund the capital programme of the Council. The objective is to arrange borrowing activities in order to minimise the average rate of interest payable on the Council's loan debt, while spreading the maturities of the debt over different timeframes to minimise exposure to interest rate movements. Long term borrowing as at 31 March 2020 was £942.5m of which £485.4m was from the PWLB and the balance from market instruments such as bonds and mortgages.
- 2.5.6.6 The Council's recent Bond issue of £370 million is another form of long-term borrowing, to be repaid over 35 years. The Bond is discussed in more detail in the final section of this report.
- 2.5.6.7 Local authorities are also able to take out temporary loans from other UK authorities for periods of less than a year. Brokers contact the Council each morning to ascertain its short-term borrowing needs and to quote the rates they are able to offer. The Treasury Officer prepares a deal ticket detailing the counterparty, principal borrowed, interest rate and duration. This is then approved by an authorised signatory.
- 2.5.6.8 Local authorities are required by law to maintain a Loans Fund, from which advances are paid to Services to fund capital expenditure. Under the Local Government (Scotland) Act 1975 all external borrowing was required to be held in the Fund. The Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016 amended this, simplifying the statutory purpose of the Fund and giving Councils flexibility. Councils now also have the power to determine the period and annual repayments for Fund advances due to capital expenditure incurred by borrowing, provided the method is prudent; this is in contrast to the prescriptive methodology under the 1975 Act, which specified that advances had to be repaid either by equal instalments or by the annuity method.
- 2.5.6.9 The Loans Fund activity is reconciled to the Ledger on a monthly basis. Details of loans and investments are taken from the Daily Sheets and input to a Monthly Reconciliations spreadsheet to be matched to General Ledger balances. This is done by the Accountant on a preceding month basis and authorised by the Finance Operations Manager.
- 2.5.6.10 Loans monitoring spreadsheets and reports were reviewed. All transactions had been fully and appropriately recorded in the transaction management and recording system, and in the Ledger. Spreadsheets in the Daily Treasury Sheet are used by the Accountant to record details of borrowing and investments, and calculate limits and exposure; testing was satisfactory. Only the Chief Officer - Finance or the Finance Operations Manager may authorise long term borrowing. No unauthorised borrowing was observed.
- 2.5.6.11 The Prudential Indicators of authorised / operational limits for external debt for 2019/20, as discussed in 2.1.3 above, were £1,698m / £1,544m (2020/21 £1,815 / £1,650). Temporary borrowing as at 31 March 2020 per the Daily Sheet was £1.317m, well within limits. As at 30 June 2020 the Council had no exposure to long-term variable rate loans.
- 2.5.6.12 The fixed rate debt maturity profile is monitored using the Daily Treasury Sheet by the Accountant which links to a separate spreadsheet detailing the dates the Council's

external loans mature. The Council's agreed prudential limits for the maturity of fixed rate debt are as follows:

- Under 12 months – 20%
- 12 months and within 24 months – 20%
- 24 months and within 5 years – 50%
- 5 years and within 10 years – 75%
- 10 years and above – 90%.

2.5.6.13 The Daily Interest Rates and Bank Balances (Daily Treasury) spreadsheet and debt maturity spreadsheet as at 30 June 2020 were reviewed to ensure the above prudential limits were being respected; this was the case.

2.5.6.14 The Council's current average duration until maturity of Public Works Loan Board (PWLB) and Lender Option Borrowing Option (LOBO) loans (a form of borrowing from banks which public bodies have been permitted to undertake as an alternative to the PWLB) is approximately 35 years.

2.5.6.15 The Prudential Indicator for exposure to variable rate debts is a maximum of 30%. As at 30 June 2020 this was at 12.04%.

2.5.6.16 The Local Government Investments (Scotland) Regulations 2010 permits local authorities to make investments subject to them gaining the consent of Scottish Ministers. Consent has been issued through Finance Circular 5/2010 subject to compliance with the terms of the consent. The Council's Annual Investment Strategy is included in the Treasury Management Strategy report. It states that only temporary, short term investments which are made with reference to cash flow requirements should be undertaken; this is in order to ensure liquidity and avoid exposure to fluctuating or higher interest rates. The Strategy lists approved counterparties and maximum permitted duration of lending, financial limits and acceptable risks.

2.5.6.17 Investments are made based on daily cash flow requirements showing surplus funds available. These are evidenced via the Daily Treasury Sheets. The Scottish Government (Finance Circular 5/2010), with reference to the Prudential Code for Capital Finance in Local Authorities, requires that Councils set out their approach to "borrowing in advance" within their treasury management strategy where new borrowing would result in total external debt exceeding the Capital Financing Requirement (CFR) for the following 12 months. The Service states in its strategy that it will not "borrow to on-lend", i.e. borrowing at a low rate and lending at a higher rate, as this is "unlawful and this Council will not engage in such activity"

2.5.6.18 The investment portfolio is reviewed on a daily basis by the Accountant responsible for TM, who is also responsible for selecting approved counterparties and for monitoring changes in credit ratings and adding or removing parties from the list as appropriate, subject to Committee approval. Changes in ratings are notified by the Treasury Advisors in their regular bulletins, although the Accountant also monitors financial markets news on a daily basis.

2.5.6.19 There are currently around 30 counterparties listed, with varying rates payable. These include EU banks, other local government authorities, building societies, and Money Market Funds. In addition, the Council also has an Instant Access account with the banking services provider which can be paid into and withdrawn from instantly with

interest paid at the Bank of England base rate (currently 0.1%). At the end of the day surplus funds can be invested in the Instant Access account or with listed counterparties in order to reduce the General Account balance while earning interest.

2.5.6.20 Investment monitoring spreadsheets and reports were reviewed. All investments were with approved counterparties with credit ratings within the agreed credit rating thresholds and for appropriate amounts; they were fully recorded on the Daily Sheets and timeously recorded in the Ledger.

2.5.7 Organisation, Clarity and Segregation of Responsibilities, and Dealing Arrangements

2.5.7.1 The CoP TMP 5 requires a clear written description of staff roles and responsibilities, and segregation of duties between the main aspects of the TM function. These are clearly defined in the TM Manual, with details on authorisation limits and statements on duties of each post. TM policies and procedures are approved by the Chief Officer - Finance, while daily transactions and monitoring are carried out by the Accountant responsible for Treasury Management under the supervision of the Finance Operations Manager. Recording activities and other administrative duties are carried out by the Finance Development Officer.

2.5.8 Reporting Requirements and Management Information Arrangements

2.5.8.1 As reported in section 2.1.5 above, regular reports have been made to Committee as required by the CoP. The reports contained detailed information on the TM function's performance and decision-making.

2.5.9 Budgeting, Accounting and Audit Arrangements

2.5.9.1 Per TMP7 the Chief Officer - Finance should prepare an annual budget for TM to be approved by Committee, bringing together all the costs involved in the running the TM function together with associated income. The net capital financing budget for 2020/21 was reported to Council on 3 March 2020.

2.5.9.2 The Council's Loans Fund is its central financing accounting arrangement. Effectively the Council's services borrow from the Loans Fund to finance their capital expenditure and the Loans Fund in turn borrows from third parties such as the Public Works Loan Board and the London Money Market. Each year the services' accounts repay a proportion of the sums previously borrowed, based on the life of the related asset financed by the Loans Fund, along with a share of the interest paid on loans and expenses of managing the Loans Fund. All interest and management expenses are initially paid by the Loans Fund and then recharged to service accounts at an average rate which is sufficient to recover each year's expenditure in full. The 2019/20 Loans Fund revenue account and balance sheet was included in the audited annual accounts as required.

2.5.9.3 The Treasury Management function is regularly reviewed by both Internal and External Audit.

2.5.10 Cash and Cash Flow Management

2.5.10.1 TMP 8 defines measures required to ensure that at no point are there less than adequate cash reserves or borrowing, overdraft or standby arrangements, to mitigate the risk that the Council may not have sufficient liquidity to meet short-term financial obligations. The Annual Investment Strategy identifies the liquidity risk, limits and maximum periods of

each investment category to ensure that the Council's policy on minimising risk and maintaining the security of funds and liquidity is followed.

- 2.5.10.2 The transaction management and recording system used to record Council loans and investments captures the expected interest payments and investment income as well as expected loan principal repayments and investment repayments for forecasting cash requirements. In addition, known and estimated payments and receipts are recorded in the system for cash forecasting purposes.
- 2.5.10.3 The officer responsible for cash and cash flow management is the Chief Officer - Finance. The Finance Operations Manager is responsible for preparing adequate cash flow projections. The officer who carries out day-to-day cash flow management activities is the Accountant responsible for TM. Each morning, the Accountant takes a screenshot of the Council's bank account balances online and ensures there are no material differences to that in the transaction management system, then enters the day's values into a new Daily Treasury Sheet spreadsheet. The screenshot of bank balances is saved to a spreadsheet in the same dated folder as the Daily Treasury sheet as evidence. Known receipts and payments are added to and deducted from the group cleared balance in order to determine the daily borrowing requirement. Short-term temporary loans will be sought or surplus funds invested in order to leave the General Bank account balance as close to zero as possible. The guidance states that surplus funds should generally be used to repay short-term borrowing, but if this is not possible the funds may be lent on a cash deposit basis to the Council's Bankers in an interest-bearing Instant Access account.
- 2.5.10.4 The Council has a liquidity policy stating that 50% of all temporary deposits should be held as liquid deposits, that is, instantly accessible. This is referenced in the TM Manual and must be taken into account when considering the deposit of surplus funds.
- 2.5.10.5 There are no specific guidelines regarding acceptable upper and lower limits for the closing bank balance each day, however credit balances expose the Council to the opportunity cost of having funds in a bank account which attracts no interest, and overdrawn balances expose the Council to unnecessary overdraft interest. The Treasury Management Manual states that a debit balance of between £150,000 and £250,000 is the target to leave on the bank overdraft to cover cash bankings being made that day which have not yet been notified to the Treasury Section.
- 2.5.10.6 The Daily Treasury Sheet spreadsheet is used for recording bank account balances (forecast and cleared) and calculating the daily borrowing requirement for each day, on the Daily Interest Rates and Bank Balances worksheet. The Daily Sheet also contains worksheets recording details of external temporary loans and investments, and analyses of debts and loans to confirm that prudential code limits have not been breached, as discussed in section 2.5.6 above. A screenshot from the TM transaction management and recording system is also included to evidence the day's transactions. A new spreadsheet based on a master template is prepared for each working day and saved in a dated folder in the TM shared drive.
- 2.5.10.7 Internal Audit reviewed Daily Sheets for thirty days between June and July 2020, checking the anticipated cleared balance to the actual cleared bank balances. The Daily Sheets were complete and accurate and had been checked for all days reviewed. No long-term borrowing or loans were present, all temporary loans and investments were with approved counterparties and were for appropriate amounts. On one day (02/06/2020) the closing balance of -£1,186,611.64 exceeded the target debit amount of between £150,000 and £250,000. It was noted on the Sheet that this was because a scheduled income payment was not received until the next day. The sum was within the agreed overdraft limit and so attracted an interest charge of £36. On one day (25/06/2020) the closing balance could not be confirmed by Internal Audit during testing as the bank balance spreadsheet had

not been retained in the folder for that day. The figure (-£33,431) was later provided by the Bank Reconciliations team and was acceptable, being below the target debit amount of £150,000.

- 2.5.10.8 Prior to the coronavirus lockdown, the Daily Sheets were printed out and completed in manuscript before being signed by the officers responsible and then reviewed and dated by the Finance Operations Manager. All the sheets reviewed identified the two officers who had completed and checked them, but without evidencing this through signatures, and the sheets showed no sign of having been reviewed by the Finance Operations Manager.
- 2.5.10.9 If sheets are not reviewed and authorised there is a risk of cash forecasting errors and poor treasury management decisions. If the Sheets are to be completed electronically from now on the Service should consider how assurance may be obtained that the Sheets have been checked and reviewed by the appropriate officers.

<u>Recommendation</u>		
The Service should introduce a method of electronic authorisation for Daily Treasury Sheets.		
<u>Service Response / Action</u>		
Agreed. A system has subsequently been created with line management checking of sheets completed to date.		
<u>Implementation Date</u>	<u>Responsible Officer</u>	<u>Grading</u>
Implemented	Accountant	Significant within audited area

2.5.11 Anti Money Laundering

- 2.5.11.1 TMP 9 recommends that procedures are maintained for verifying and recording the identity of counterparties, and reporting suspicions of fraud or money laundering. The Council's Anti Money Laundering policy was approved by Audit, Risk and Scrutiny Committee on 26 June 2019 covering these areas; the Council's Treasury Management manual covers the Treasury section's money laundering procedures.

2.5.12 Staff Training and Qualifications

- 2.5.12.1 TMP 10 advises that both staff involved in the treasury management functions and those with a policy, management or supervisory role should be professionally competent and have access to the skills and knowledge required to carry out the role effectively.
- 2.5.12.2 The TM Manual's section on TMP 10 recognises the importance of staff and Elected Members being properly equipped to fulfil their roles and responsibilities. The Finance Operations Manager is responsible for ensuring that staff acquire and maintain appropriate levels of skills, training and expertise. The Chief Officer - Finance is responsible for providing Councillors with adequate training and guidance; this is generally provided through the Treasury Advisers and arranged by the Finance Operations Manager.
- 2.5.12.3 The Service maintains a record of staff training showing external and internal training with dates and details of subjects covered. The record was reviewed and is up to date, includes all staff involved in treasury management, and shows regular and appropriate training being undertaken.

2.5.13 Use of External Service Provider

2.5.13.1 Per TMP 11 any appointed external advisor should be subject to a full evaluation of cost and benefit, with adequate documentation and regular review. The Council's Treasury Advisors provide daily and weekly updates on rate movements as well as market forecasting, and quarterly training sessions. For some larger deals they will also provide independent commentary to support decision-making. The contract is re-tendered every three years. Although the same provider has been used for some years, since the tendering process is regular and competitive the Service are confident that best value is being obtained.

2.5.13.2 All contracts should be recorded in BOrganised, the hosted contracts register. Tender documents from 2019 are recorded, with the contract with the Council's Treasury Advisors from 1 April 2019 to 31 March 2022. The contract is valued at £51,000 and was procured and approved appropriately. The contract documents show the provider offering a comprehensive range of advice and analysis tools and Finance advised the reports were received regularly and they were happy with the provider's performance. However, bulletins and reports were not usually retained after they had been reviewed by Finance.

2.5.14 Corporate Governance

2.5.14.1 The final practice in the TM Code, TMP 12, recommends that organisations state their commitment to embracing the principles of corporate governance in their treasury management activities, notably openness and transparency. The Council's TM documents including the TM Policy and Strategy, the annual accounts, and the HRA and Non-HRA Capital Plans are all made available to the public online through the Council's website.

2.6 **Credit Rating and Bond Issue**

2.6.1 In 2016 the Council had a requirement to raise finance to support its Capital Programmes, including the construction of a new exhibition and conference centre. An index-linked bond was identified as a suitable option. Bonds are a type of debt security that can be traded in the capital markets. The issuer (in this case, the Council) borrows money by selling bonds to bondholders; the issuer receives the money and the bondholder receives a promise from the issuer to repay the debt at a later date, usually with interest.

2.6.2 In October 2016, the Council were assigned a credit rating when Moody's Investors Service confirmed an Aa2 rating, just one level below that of the UK's sovereign rating. On 1 November 2016, the Council's bond issue was launched on the London Stock Exchange, and £370m of index-linked bonds were issued to investors.

2.6.3 As a result of the bond issue, the Council is now required to comply with a number of regulations which were reported to Full Council in December 2016. This report included an appendix provided by the Council's legal advisors, Brodies LLP, who had been involved throughout the process, which detailed the Council's continuing obligations following the bond issue. These include compliance with the Market Abuse Regulation, the Disclosure and Transparency Rules, the Listing Rules and London Stock Exchange Admission and Disclosure Standards.

2.6.4 Responsibilities for compliance with Bond requirements are primarily with the Governance function; however, the TM team are responsible for debt repayments, interest payments, and contributing to the annual credit rating presentation. The Bond-related activities involving the TM function are detailed in the TM Manual, including a list of milestone events by day, week, month and year; the guidance in the Manual is clear and comprehensive. The Service confirmed that these activities had been completed as required; that the

proceeds of the Bond had been used as proposed, for the completion of the new exhibition and conference centre (TECA); and that current agreements were in place with the Principal Paying Agent and Calculation Agent (BNY Mellon). This has previously been tested in detail in Internal Audit report AC1921 Bond Trust Deed.

- 2.6.5 The report to Council in August 2016 prior to the issue of the Bond highlighted the importance of maintaining a suitable credit rating and the need for the appointed credit rating agency to conduct reviews at least once every twelve months to revise the credit rating. The latest review by the credit rating agency (Moody's) resulted in a confirmation in November 2019 of Aa3 with the rating reduced from stable to negative, in line with the recent change to the UK's rating; this was reported in the Council's Annual Accounts for 2019/20.
- 2.6.6 Article 18 of MAR requires the Council to take all reasonable steps to ensure that any person on the Insider List acknowledges in writing the legal and regulatory duties entailed and is aware of the sanctions applicable to insider dealing and unlawful disclosure of Inside Information. The Protocol states that the Head of Legal and Democratic Services is responsible for issuing letters detailing these duties and sanctions to all persons on the Insider Lists. The recipients of the letter are required to return an acknowledgement slip to the Chief Officer - Governance, confirming they have read the letter
- 2.6.7 A sample of eight individuals expected to be included on the permanent Insider List, and a further two who should have been added then removed, based on the requirements of the Protocol, was selected. Governance was requested to confirm the List status of the individuals concerned and that they had received and acknowledged the Letter.
- 2.6.8 Eight of the individuals were still active as Councillors or employees and were on the List. One individual had been removed on leaving the Council. One individual, who had left the Council recently, had never been added to the list although their role was included in the Protocol (Communications). Of the nine who were or had been on the list, eight had been sent copies of the Letter, and seven had returned acknowledgement slips which had been scanned and recorded by the Solicitor.
- 2.6.9 The Service advised that the missing acknowledgement slip had been received but had not been scanned before the advent of lockdown; it would be searched for and added to the file as soon as possible. The individual who had not been sent the Letter would be contacted immediately; this was an oversight by the Cluster.
- 2.6.10 If Letters are not sent to and acknowledged by individuals on the Insiders List there is no assurance that they have understood their responsibilities and the potential sanctions.

Recommendation

Governance should review the Insiders List to ensure that all appropriate individuals are listed as required.

Governance should ensure that all Letters are sent and acknowledgements are recorded promptly.

Service Response / Action

Agreed.

Implementation Date

Implemented

Responsible Officer

Solicitor

Grading

Significant within audited area

AUDITORS: C Harvey; A Johnston; L Jarvis

Appendix 1 – Grading of Recommendations

GRADE	DEFINITION
Major at a Corporate Level	The absence of, or failure to comply with, an appropriate internal control which could result in, for example, a material financial loss, or loss of reputation, to the Council.
Major at a Service Level	<p>The absence of, or failure to comply with, an appropriate internal control which could result in, for example, a material financial loss to the Service/area audited.</p> <p>Financial Regulations have been consistently breached.</p>
Significant within audited area	<p>Addressing this issue will enhance internal controls.</p> <p>An element of control is missing or only partial in nature.</p> <p>The existence of the weakness identified has an impact on a system's adequacy and effectiveness.</p> <p>Financial Regulations have been breached.</p>
Important within audited area	Although the element of internal control is satisfactory, a control weakness was identified, the existence of the weakness, taken independently or with other findings does not impair the overall system of internal control.