

INTERNAL AUDIT REPORT

FROM: Audit and Risk Manager **SUBJECT:** Treasury Management
TO: Head of Finance **DATE:** 9 November 2016
C.C. Chief Executive
Deputy Chief Executive (AJ)
Strategic Finance Manager
Principal Accountant (Capital
& Treasury Management)

1 Introduction

- 1.1 In accordance with the Audit Plan for 2016/17 an examination of the above subject area has been completed. This report presents the findings and conclusions drawn from the audit for information and action where appropriate. This topic was last audited in December 2014.
- 1.2 Wherever possible, findings have been discussed with the staff involved in the procedures examined and their views are incorporated, where appropriate, into the report. My thanks are extended to all concerned for the help and co-operation received during the audit.

2 Background

- 2.1 The purpose of a treasury management function is to plan, organise and control cash and borrowings so as to optimise interest and cash flows and to minimise the cost of funds. Unsurprisingly, this function resides within the Finance department at the council.
- 2.2 At the date of audit there was £80.8m invested in a range of investments. There were long term capital borrowings of £136.2m.

3 Scope and Objectives of the Audit

- 3.1 An extensive examination has been undertaken using the CIPFA systems-based control evaluation models. This entailed completion of Internal Control Questionnaires (ICQs) and testing of controls in accordance with evaluation programmes. Detailed testing was performed to confirm that controls identified have operated as expected with documentary evidence being obtained where possible, although some reliance has had to be placed on verbal discussions with relevant staff.
- 3.2 The objectives that have been considered as part of this audit include:
- To ensure that the council's cash flow, debt management and investment activities are appropriately managed.

- Treasury management activities are achieving a favourable rate of return on investment, which enables the council to operate within a balanced budget for 2016/17, and cash flow is effectively optimised.
- To ascertain whether the council has appropriate controls in place to address the key risks in carrying out treasury management activities.

3.3 The expected controls covered by the CIPFA control matrices for treasury management are categorised into the following main headings:

- (1) Policies and procedures
- (2) Staffing
- (3) Risk management
- (4) Cash flow
- (5) Lending
- (6) Borrowing
- (7) Capital investment
- (8) Payments
- (9) External service providers
- (10) Fraud prevention
- (11) Records and reconciliations
- (12) Monitoring and reporting
- (13) Security of data

3.4 The 2014/15 audit report was followed up with the objective of confirming that the three recommendations have been implemented.

4 Findings

4.1 Recommendations from Previous Report

4.1.1 The current position in respect of the recommendations from the audit reported in December 2014 is as follows:

| Recommendation | Management Response | Current Status |
|---|---|---|
| 1 The daily procedure notes should be updated to reflect current practices, with the manual being updated to include current documentation. | The daily procedure notes will be updated as soon as possible. | Upon review, it was confirmed that continual reviews have taken place to ensure that the procedure notes remain up-to-date. |
| 2 A quarterly detailed reconciliation between Treasury Management investment spreadsheet records per counterparty / money market fund should be prepared and signed off as correct. | Quarterly detailed reconciliations will be performed and signed off at the end of each quarter beginning December 2014. | Inspection of the reconciliation process for Q1 confirmed that the recommendation has been implemented. |

| Recommendation | Management Response | Current Status |
|--|--|--|
| 3 The above reconciliation should detail any incorrect transaction values requiring journal adjustment between principal and interest received, with the objective of ensuring that the financial reporting to Executive is facilitated. | Any adjustments revealed during the quarterly reconciliations will be journalled on completion of the reconciliation in order to ensure that TOTAL is kept up to date. | Inspection of the reconciliation for Q1 confirmed that no journal adjustments had been required for incorrect postings to TOTAL. |

4.2 **Policies & Procedures**

4.2.1 The annual Treasury Management Strategy Plan, as approved by the Executive and Council in February 2016, is well supported by the set of twelve updated Treasury Management Practices (TMPs) procedures.

4.3 **Staffing**

4.3.1 The staffing arrangements for treasury management was considered and deemed to be suitable.

4.3.2 Evidence provided demonstrated that, in 2016, staff attended seminars run by sector specialist Capita (Sector) and CIPFA to enhance their professional development.

4.4 **Risk Management**

4.4.1 The TMPs and the 2016/17 Treasury Management Strategy Plan were evaluated to ascertain whether all of the risks identified in the CIPFA control matrices for risk management had been appropriately considered. The testing confirmed that all the relevant risks had been assessed.

4.4.2 The updated corporate risk register includes the 'Risk of insufficient financial resources to enable the council to meet its objectives'. To mitigate against this, evidence provided confirmed that the long term credit rating criteria for lenders has been revised for 2016/17 with the objective of increasing the rate of return on investment.

4.4.3 A well embedded process is in place whereby the Treasury Management team receive daily and weekly updates of counter party credit ratings from Capita (the council's treasury advisers). As a result of changes in credit ratings the lending list is updated.

4.4.4 It was noted that counterparty maximum investment limits, both in terms of financial value and period, are in place. These are underpinned by the current short term and long term credit ratings per counterparty category so that the risk to the investment portfolio is diversified. The lending procedures are judged to be appropriate to mitigate against investment risks.

- 4.4.5 Following the United Kingdom's decision to leave the European Union, Capita provided evidence of changes in counter party credit ratings. Upon receipt of this information nine overseas counterparties have been added to the lending list who all met the minimum short term and long term credit rating criteria.
- 4.4.6 Arrangements are in place to report the updated lending list to the Finance and Audit Scrutiny Committee, along with the half year performance results, at the committee meeting on 29 November 2016.

4.5 **Cash Flow**

- 4.5.1 TMP 8 provides guiding principles to ensure that the council has sufficient cash liquidity to pay current liabilities and identify any surplus cash available for investment. This principle was reviewed and compared with the daily treasury management procedure notes. The procedure note review confirms that they are up-to-date and adequately document the full process and controls to manage working day cash flow, and make relevant treasury management decisions such as placing surplus cash to earn the best rate of interest available in the money market.
- 4.5.2 A walkthrough test was undertaken on the cash flow forecasting and monitoring system to ensure that the controls were operating as documented in the procedure notes. Upon review of relevant supporting documentation it was confirmed that the surplus money had been invested with the counterparties offering the most effective return.
- 4.5.3 Sample testing was also undertaken to ensure that daily cash flow management is consistently being completed during the year. It was confirmed that the relevant cash flow documentation had been completed and, for the two days tested, no surplus monies were available for investment decisions to be made, demonstrating that working day cash flow controls are in place.

4.6 **Lending**

- 4.6.1 The approved lending list clearly documents those counterparties that meet the required minimum credit ratings as set out in section two generic requirements of TMP 1 (Risk Management – Credit and Counterparty Risk) and TMP 4 (Approved Instruments, Methods and Techniques) (i.e. short term F1 and long term A).
- 4.6.2 Testing was undertaken on a sample of investments to confirm that the counterparty credit ratings were compliant with the lending criteria on the day of initiating the investments. In each case it was confirmed that the investment had been made with a counterparty that held an appropriate credit rating.
- 4.6.3 A test to check that up-to-date information is held with regards to the currently available investment interest rates was completed. Appropriate documentation, provided by Capita, was found to be in place which provides a daily benchmark of investment rates of return for investment periods to facilitate lending decisions.

- 4.6.4 Testing was also completed on another sample of investments to ascertain whether the counterparties were covered by the approved lending list investment types, as defined in the Treasury Management Strategy, and to ensure that the associated lending limits were being adhered to. In addition, segregation of duties controls were tested. In all cases the investments were compliant with the defined controls and segregation of staff duties was demonstrated.
- 4.6.5 A test checking the four Principal Accountants' access to the treasury management records in the shared folders was completed. It was highlighted that the newest staff member had not been granted access to the shared folders.

Risk

Staff who are responsible for authorising lending do not have full access to the treasury management folders which contain documents that may facilitate investment decision making.

Recommendation

Authorise the IT Help Desk to give Principal Accountant (Housing) access to the treasury management folders.

- 4.6.6 Further testing was performed to ensure that investment money was being returned at the end of the maturity period. A walkthrough of one investment was tested. Testing confirmed that the principal and interest receivable, as per the treasury management records and the cash flow diary, had been received, with the amount being checked by treasury management staff on the bank statement, and the matured investment had been posted to the General Ledger.

4.7 Borrowing

- 4.7.1 The 2016/17 annual Treasury Management Strategy outlined the authorisation limit of £207.1m and operational boundary limit of £163.1m. At the date of audit, the Public Works Loan Board (PWLB) capital borrowings of £136.2m was clearly within these limits.

- 4.7.2 Upon review, it was confirmed that the procedure and authorisation controls for payment of the £2.4m PWLB interest payable, as at 28 September 2016, had been complied with.

4.8 Capital Investment

- 4.8.1 Testing against the CIPFA control matrices for Prudential Indicators has not identified any control weaknesses. The 2016/17 operational boundaries for debt (Housing Revenue Account £150m and General Fund £13m) are in place, and enquiries confirmed that no external borrowing has been required in the year to date.

4.9 Payments

- 4.9.1 The Principal Accountant (Capital & Treasury Management) advised that all staff that are able to use the HSBCnet system for making on-line payments

have a HSBC pin card, with each user having their own user IDs and passwords.

- 4.9.2 Enquiries confirmed that HSBC allocate unique pin numbers daily to the designated finance team who can authorise investments using HSBCnet. This payment control limits any risk of financial loss.

4.10 **External Service Providers**

- 4.10.1 A procurement process for banking services for the period 1 March 2015 to 29 February 2020 was completed in quarter four of the 2014 calendar year. Upon review of the documentation held it was confirmed that HSBC were awarded the banking contract in compliance with the Code of Procurement Practice.

- 4.10.2 As previously highlighted, Capita are the council's treasury advisers. Upon review of an agenda and presentation papers from a meeting held in August 2016, it was confirmed that they are providing up-to-date treasury management advice.

- 4.10.3 A walk through test to benchmark the use of money market brokers to facilitate the provision of interest rate yields in excess of the London interbank (LIBID) rate was completed. The broker investment documentation confirmed that the actual investment will better the LIBID rate.

4.11 **Fraud Prevention**

- 4.11.1 The annual renewal of the fidelity guarantee insurance policy was reviewed to establish the level of cover to mitigate against the risk of fraud. Inspection of the insurance policy for all employees confirms that a £5m insured loss is in place and enquiries with the Insurance and Risk Officer confirms this is considered adequate.

4.12 **Records & Reconciliations**

- 4.12.1 Money market counterparties credit the interest receivable to the council at varying points during the financial year. Sample testing was undertaken to ensure that the monies due had been received as appropriate. The evidence reviewed from the control reconciliations demonstrated that all three counterparties had credited the correct amount of interest and the interest values had been subsequently posted to the General Ledger.

4.13 **Monitoring & Reporting**

- 4.13.1 TMP 6 requires reporting of treasury performance to the Finance and Audit Scrutiny Committee on at least a biannual basis. Upon review it was confirmed that a treasury management report for 2015/16 was reported to the committee on 28 June 2016. Evidence seen confirms that the draft report for the 1st half year performance will be reported as documented in paragraph 4.4.6 above.

4.14 **Security of Data**

4.14.1 Upon review, it was confirmed that the treasury management records are held on the shared IT finance folders which can only be accessed by authorised finance staff and, therefore, data is securely managed.

5 **Conclusions**

5.1 Following our review we are able to give a SUBSTANTIAL degree of assurance that the systems and controls in place for treasury management are appropriate and are working effectively.

5.2 The assurance bands are shown below:

| Level of Assurance | Definition |
|---------------------------|---|
| Substantial Assurance | There is a sound system of control in place and compliance with the key controls. |
| Moderate Assurance | Whilst the system of control is broadly satisfactory, some controls are weak or non-existent and there is non-compliance with several controls. |
| Limited Assurance | The system of control is generally weak and there is non-compliance with controls that do exist. |

5.3 A minor issue was identified, however, relating to the lack of access to the treasury management records for one of the Principal Accountants.

6 **Management Action**

6.1 The recommendation arising above is reproduced in the attached Action Plan (Appendix A) for management attention.

Richard Barr
Audit and Risk Manager

Action Plan

Internal Audit of Treasury Management – November 2016

| Report Ref. | Recommendation | Risk | Risk Rating* | Responsible Officer(s) | Management Response | Target Date |
|-------------|--|--|--------------|--|--|-------------|
| 4.6.5 | Authorise the IT Help Desk to give Principal Accountant (Housing) access to the treasury management folders. | Staff who are responsible for authorising lending do not have full access to the treasury management folders which contain documents that may facilitate investment decision making. | Low | Principal Accountant (Capital & Treasury Management) | E mail request sent to ICT Helpdesk 16 October and access enabled. | Completed. |

* Risk Ratings are defined as follows:

High Risk: Issue of significant importance requiring urgent attention.

Medium Risk: Issue of moderate importance requiring prompt attention.

Low Risk: Issue of minor importance requiring attention.