INTERNAL AUDIT REPORT

FROM:	Audit and Risk Manager	**SUBJECT:**	Treasury Management
TO:	Head of Finance	**DATE:**	20 January 2023
C.C.	Chief Executive Strategic Finance Manager Principal Accountant (RW) Portfolio Holder (Cllr Hales)		

---

1 Introduction

1.1 In accordance with the Audit Plan for 2022/23, an examination of the above subject area has recently been completed by Ian Davy, Principal Internal Auditor, and this report presents the findings and conclusions for information and, where appropriate, action.

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 cooperation received during the audit.

2 Background

2.1 In its Treasury Management Code of Practice, CIPFA defines treasury management as:

"The management of the organisation's borrowing, investments and cash flows, including 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."

2.2 The Council maintains an investment portfolio, with investments ranging from longer-term corporate equity funds to liquid money market funds, and a long-term borrowing portfolio with the loans relating to Public Works Loans Board (PWLB), with the most recent of these loans being for 'forward lending' to Vistry.

3 Objectives of the Audit and Coverage of Risks

3.1 The management and financial controls in place have been assessed to provide assurance that the risks are being managed effectively. The findings detailed in the following sections confirm whether the risks are being appropriately controlled or whether there have been issues identified that need to be addressed.

3.2 In terms of scope, the audit covered the following risks:

1. Monies are not invested with appropriate funds leading to loss of capital / lack of return on investment.
2. Payments are not received in respect of monies lent / invested.

3. Payment of excessive interest rates on monies borrowed.
4. Inappropriate management of cash flow (liquid funds not available when needed, excessive funds not generating income, etc.).
5. Non-compliance with Codes and regulations lead to professional or organisational sanction.
6. Qualification of value for money conclusion by external auditors.
7. The Council invests in, or fails to divest from, funds which do not meet the Council's 'net zero' agenda.
8. Loss through error, misappropriation, unauthorised dealing, inappropriate transacting, etc.
9. The strategic direction is weak, vague, or inconsistent with organisational objectives.
10. Inappropriate advice is received on management of funds.

3.3 These were identified during discussion between the Principal Internal Auditor, the Principal Accountant (PA) and the Assistant Accountant (AA). The 'financial risks' identified during this discussion (risks 1 to 4 above) were also reflected in the Finance Risk Register (Poor day to day treasury management of bank balances; borrowing; cash flow; investments and interest rate volatility).

3.4 Risk 7 was a new risk identified. In hindsight, the risk could also have covered other 'Environmental, Social & Governance' risks, such as the human rights records of the countries whose banks are being invested in.

3.5 The work in this area impacts specific strands of the Council's Business Strategy, specifically the internal Money strand (financial footing over the longer term) with regards to the better return / use of the Council's assets.

4 Findings

4.1 Recommendations from Previous Reports

4.1.1 The current position in respect of the recommendations from the audit reported in March 2019 is as follows:

Recommendation	Management Response	Current Status
The Treasury Management Practice statements should be revised to reflect the proper status of Internal Audit in the control environment and risk-based determination of audit frequencies.	The Treasury Management Practices will be reviewed for the 2020/21 Treasury Management Strategy.	Whilst there are other issues within the Treasury Management Practices that need to be addressed (see 4.3.1 below), the latest version available (March 2022) adequately covers the role of internal audit and the risk-based frequency if the audits to be performed.

4.2 **Financial Risks**

4.2.1 **Risk: Monies are not invested with appropriate funds leading to loss of capital / lack of return on investment.**

The Council's counterparty limits and credit rating requirements are formally agreed as part of the Treasury Management Strategy that is reported to and agreed by Council, via Cabinet, on an annual basis. These are also stated in the relevant Treasury Management Practice (TMP) document (TMP1 – Risk Management).

The credit ratings are reviewed, with the latest Treasury Management Activity Report to Overview & Scrutiny Committee (28 September 2022) containing specific reference to the fact that the credit ratings had been retained through the relevant period for Money Market Funds and Call Accounts.

Investments are detailed on spreadsheets maintained by the Assistant Accountant (AA) and testing was undertaken to ensure that the investments were all in line with the agreed limits and ratings.

No issues were noted with the actual investments, but an issue was noted that one of the sampled funds had been incorrectly classified on the counterparty spreadsheet, and the investment limit did not tie in with the figures on the strategy in another case.

In both cases, the limits stated were below the agreed limits, so the investments had not breached the set limits. However, it does mean that there is more room in some funds that could have led to better rates being received.

Recommendation

It should be ensured that the Counterparty Limits spreadsheet accurately reflects the agreed limits and the 'classification' of the funds invested in.

Upon review, it was also noted that several tabs on the spreadsheet were redundant and some columns on the tabs being maintained were also outdated.

Advisory

Consideration should be given to undertaking housekeeping on the investment spreadsheets to ensure that any redundant data is removed.

The Principal Accountant (PA) advised that judgement calls are made on the funds to be invested in, based on emails received from the Council's treasury advisers (Link). He highlighted that, generally, the Council will aim for the best rate in line with the SLY principles (Security / Liquidity / Yield).

However, other considerations may also be taken into account such as, whether the relevant investment limits have been reached and whether the funds are in line with the Council's objectives etc.

The AA prepares cash flow projections on a periodic basis that identify the need for liquid funds, and these will also be referred to when investment decisions are being taken.

4.2.2 **Risk: Payments are not received in respect of monies lent / invested.**

The Grant & Loans Manager (GLM) will advise the AA of any new loans that are being provided. A 'Loans' folder is included on the Treasury Management section of the Finance I: drive that includes details on the loans in place.

A 'position spreadsheet' showing the loans that were in place as at the end of the 2021/22 financial year summarised the interest receivable each year with details of the individual payment schedules being incorporated into the relevant loan spreadsheets, with some detailing the specific payments due and others setting out the total for the year and the monthly amounts due.

Testing was undertaken to ensure that repayments due during the current financial year had been received as required and had been credited against the relevant debtor. No issues were identified.

4.2.3 **Risk: Payment of excessive interest rates on monies borrowed.**

The only (recent) external borrowing has been the £60m loans from the PWLB (Public Works Loan Board) towards the joint venture with Vistry. Six separate loans with differing maturity dates have been taken out and then lent to Vistry in order to facilitate house building within the district.

The Treasury Management Strategy Report 2021/22 highlighted that PWLB rates were very low at the time of the borrowing and would, therefore, have been justifiable and reports to Executive / Council relating to the financing of the joint venture highlighted the need for the funds and the specific advice that had been received.

The borrowing strategy included within the 2021/22 Treasury Management Strategy highlights that:

"… the upside risk of PWLB and other borrowing rates as a result of economic factors make it prudent to consider 'externalising' more of the internal borrowing by taking out PWLB loans during 2021/22".

The Treasury Management Strategy also sets out the approved sources of borrowing with the PWLB at the top of the list and, whilst the 'merits' of using PWLB had lessened since the previous year (with the strategy highlighting other sources of funding that could be considered), it is considered that the PWLB loans were the most appropriate source of funding at the time that the borrowing was required.

4.2.4 **Risk: Inappropriate management of cash flow (liquid funds not available when needed, excessive funds not generating income etc.).**

The PA advised that 'money market funds' are used for short-term investments as the money invested is instantly accessible should liquid funds be required. He also highlighted that a core ‘minimum investment amount’ had been set (currently £30m, although discussions are underway to potentially reduce this to £20m). If the capital programme required funds that would move investments below this position, borrowing would be undertaken accordingly (through the PWLB).

Nothing is set out in terms of a maximum cash position although the PA highlighted that we would not want to leave too much in the bank at the end of each day, with best overnight rates being reviewed.

The Counterparty Investment spreadsheet shows that the Council had over £65m invested at the time of audit testing with core funds accounting for approximately £37.5m of this total which appropriately exceeds the minimum agreed level.

The PA advised that Link have highlighted the need to ladder the investments so that maturities are spread out over relevant periods and do not all require re-investment at the same time, helping to ensure that the best interest rates can be achieved during the current financial climate. Daily and weekly updates / forecasts are provided by Link and the account manager from Link will also provide updates should interest rates be expected to change.

Upon review of the investments made in the current financial year, the maturity date of the investments was found to cover various dates across the remainder of the financial year as appropriate.

4.3 **Legal and Regulatory Risks**

4.3.1 **Risk: Non-compliance with Codes and regulations lead to professional or organisational sanction.**

The PA advised that all relevant staff have access to copies of the relevant codes (the latest, 2021, editions), with copies being saved within the Finance Common folders on the shared network drive.

The codes are appropriately referred to in the strategy reports to Members and in the TMPs in place.

The Council does not have a specific Treasury Management Policy Statement in place. However, the report presented to Cabinet, which sets out the Treasury Management Strategy, effectively covers the requirements of the code with regards to this statement.

Whilst the recommended form of words set out in the code have not been specifically adopted, the report sets out a definition of Treasury Management, the assessment and management of risk, and how the activity will support the achievement of the Council’s objectives.

Advisory

Consideration should be given to including the recommended form of words within future Treasury Management Strategy reports or within the strategy itself.

As suggested above, the Council has a formal suite of TMP documents. These cover the twelve headings as required by the code.

A few issues were noted, including:

- There was still reference to the Finance & Audit Scrutiny Committee. This needs to be amended to the Audit & Standards Committee.
- Some sections in the document were highlighted. The AA advised that, at the time the latest version was prepared, it was not clear which version of 'SONIA' (Sterling Overnight Index Average) would be relevant.
- Parts of TMP5 were missing (i.e. no details of relevant officers, no choice where options were specified, etc.) The AA suggested that these parts were from a previous version and could be removed.

Recommendation

The Treasury Management Practice documents should be reviewed to ensure that they are complete and up to date.

As highlighted above, the strategy is reported to Cabinet each year before being presented to Council for approval. An annual report and half-yearly performance reports are also reported for scrutiny.

These performance reports had previously been reported to the Finance and Audit Scrutiny Committee but, with the change of committee structure, the latest set of reports was presented to the Overview and Scrutiny Committee with future reports to be presented to Audit and Standards Committee.

Section F(13)(ii) of the Scheme of Delegation states that:

"(The Head of Finance shall have authority to) manage the Council's cash flow (including the collection fund), placing short terms investments and arranging loans in accordance with the approved Treasury Management Strategy'.

TMP5 then sets out the further delegation to staff and sets out the responsibilities of various members of staff throughout the Council.

4.4 Reputational Risks

4.4.1 Risk: Qualification of value for money conclusion by external auditors.

Details of deposits made were extracted from the Ci Anywhere system, based on the relevant nominal codes. Testing was then performed to check that the details were appropriately recorded on the investment records with appropriate evidence being retained to support the investment and that the transaction had been appropriately authorised.

The transactions were all found to be appropriately recorded on the investment spreadsheets and the transactions had been authorised as appropriate. However, the AA advised that the 'evidence' to highlight why the decision had been taken to make the specific investments was not (generally) retained although was able to provide an example relating to a recent investment.

Advisory

Consideration should be given to retaining correspondence relating to the investment decisions in the folders with the (HSBCnet) authorisation emails.

Details of the recent PWLB loans were provided, with confirmation documents from the UK Debt Management Office being held which show terms to maturity and the interest rate along with details of the payments due for both the interest and the repayment of the principal sums. Notification is also received when payments are due.

All transactions were found on the ledger (with one initially being found to be incorrectly coded, but this was amended once flagged at the time of the audit) and were confirmed to have been paid on the bank statements.

The PA advised that market testing had been undertaken for the 'advice' contract although there is a fairly limited market. This led to Link Asset Services being awarded the contract through a direct award process from an ESPO framework with the justification being that there is only one other provider and they had previously declined to tender.

The use of brokers tends to be based on their access to funds that the Council wishes to invest in with their commission fees being wrapped up in the rates offered.

4.4.2 **Risk: The Council invests in, or fails to divest from, funds which do not meet the Council's 'net zero' agenda.**

The PA confirmed that there is no direct investment in funds that invest in fossil fuels and the money market funds and banks that the Council uses do not directly invest in fossil fuels either although it is not always clear what the investments fund further down the supply chain.

There had previously been £6m in two equity funds where the breakdown provided by fund managers showed that there was investment in fossil fuel companies.

The initial decision to divest from these funds was agreed by Council in May 2020, with an update on the 'successful' divestment being confirmed in the 2021/22 Annual Treasury Management Report.

The PA highlighted that the Council has access to, and has invested in, a number of specific 'ESG funds' (Environmental, Social & Governance) although there is nothing to date in the CIPFA code regarding the use of these funds and how to balance their use against the SLY principles.

He advised that the use of ESG funds will be reflected in the 2023/24 treasury management strategy and suggested that these funds will be used when the rates are comparable with other investments options.

4.5 Fraud Risks

4.5.1 Risk: Loss through error, misappropriation, unauthorised dealing, inappropriate transacting, etc.

The PA advised that the AA and the Accountancy Assistant undertake the day-to-day functions and would raise the individual transactions. They are not involved in authorising the transactions which is undertaken by any two from the 'list' (generally the PAs but also the Strategic Finance Manager, Exchequer Manager and the Benefits and Customer Services Manager).

The AA retains evidence of the emails sent by the authorising officers which show the trails from her initial emails asking for authorisation and the subsequent responses from the two authorising officers. The only transactions that do not require two authorising officers are the transfers of funds between two of the Council's accounts.

Testing was undertaken on a sample of investments to ensure that the two-stage authorisation process had operated with records being retained accordingly. No issues were identified.

The AA advised that there are ad-hoc reviews to ensure that funds had been received as expected (i.e. the return of principal sums at maturity along with interest due), with the main checks being performed when the 'longer term' investments have reached maturity.

Testing was undertaken on a sample of matured investments and withdrawals from Money Market funds to ensure that the funds received were in line with the amounts calculated. The testing proved satisfactory.

The spreadsheets used to track the investments use formulas to calculate the expected returns, with the 'money market' spreadsheet being updated daily with the interest rate available.

Due to the number of different formula-driven calculations on the spreadsheets it was only possible to undertake a cursory review of the formulae. No issues were identified and the interest received in relation to matured funds was found to agree to the figures calculated (as per the testing set out above).

4.6 Other Risks

4.6.1 Risk: The strategic direction is weak, vague, or inconsistent with organisational objectives.

The Treasury Management Strategy itself does not make specific reference to the Council's objectives. However, when reported to Executive / Cabinet and then Council, the covering report refers to how the strategy, the Treasury

Management Practices and the Treasury Management 'service' help the Council achieve its objectives.

4.6.2 **Risk: Inappropriate advice is received on management of funds.**

As highlighted above, the Council uses Link Treasury Service Limited for its (external) treasury management advice as well as the provision of training.

Link is a well-established company that have been used by the Council for several years and are regulated by the Financial Conduct Authority.

They were appointed via a framework and the framework provider (ESPO) are expected to ensure that the company is appropriate to qualify for their place on the framework.

5 Summary and Conclusions

5.1 Section 3.2 sets out the risks that are under review as part of this audit. The review highlighted weaknesses against the following risks:

- Risk 1 – Monies are not invested with appropriate funds leading to loss of capital / lack of return on investment.
- Risk 5 – Non-compliance with Codes and regulations lead to professional or organisational sanction.

5.2 Further 'issues' were also identified where advisory notes have been reported. In these instances, no formal recommendations are thought to be warranted, as there is no risk if the actions are not taken.

5.3 In overall terms, however, we are able to give a SUBSTANTIAL degree of assurance that the systems and controls in place in respect of Treasury Management are appropriate and are working effectively to help mitigate and control the identified risks.

5.4 The assurance bands are shown below:

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

6 Management Action

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

Richard Barr
Audit and Risk Manager

Appendix A

Action Plan

Internal Audit of Treasury Management – December 2022

Report Ref.	Risk Area	Recommendation	Rating*	Responsible Officer(s)	Management Response	Target Date
4.2.1	Financial Risks - Monies are not invested with appropriate funds leading to loss of capital / lack of return on investment.	It should be ensured that the Counterparty Limits spreadsheet accurately reflects the agreed limits and the 'classification' of the funds invested in.	Low	Principal Accountant	The Counterparty Limits spreadsheet will be updated for inclusion in the Treasury Management Strategy Statement report for 2023/24 currently being drafted.	27/01/23
4.3.1	Legal and Regulatory Risks - Non-compliance with Codes and regulations lead to professional or organisational sanction.	The Treasury Management Practice documents should be reviewed to ensure that they are complete and up to date.	Low	Principal Accountant	The TMPs will be reviewed as soon as time permits.	31/03/23

* The ratings refer to how the recommendation affects the overall risk and are defined as follows:

High: Issue of significant importance requiring urgent attention.
Medium: Issue of moderate importance requiring prompt attention.
Low: Issue of minor importance requiring attention.