

## **Item: 7.4**

**Monitoring and Audit Committee: 1 April 2021.**

**Internal Audit Report: Treasury Management.**

**Report by Chief Internal Auditor.**

### **1. Purpose of Report**

To present the internal audit report on procedures and controls relating to treasury management.

### **2. Recommendations**

The Committee is invited to note:

#### **2.1.**

That Internal Audit has undertaken an audit of the procedures and controls in place within the Council relating to the operational management of the treasury management function.

#### **2.2.**

The findings contained in the internal audit report, attached as Appendix 1 to this report, relating to the procedures and controls in place within the Council relating to the operational management of the treasury management function.

**It is recommended:**

#### **2.3.**

That the Committee review the audit findings to obtain assurance that action has been taken or agreed where necessary.

### **3. Background**

#### **3.1.**

The Local Government Investments (Scotland) Regulations 2010 set out the requirement for a local authority to obtain the consent of Scottish Ministers to make investments. The consent applies to a range of investments, which covers the investments of temporary surplus funds with banks and similar institutions, shareholdings in companies or joint ventures, loans to group undertakings and third parties and investment properties.

### **3.2.**

The objectives of this audit were to confirm that there are adequate processes and controls in place to ensure that the Council manages cash flows, its banking, money market and capital market transactions in accordance with statutory powers and approved policy and strategy.

## **4. Audit Findings**

### **4.1.**

The audit provides adequate assurance that the processes and procedures relating to the operational management of the treasury management function are well controlled and managed.

### **4.2.**

The internal audit report, attached as Appendix 1 to this report, includes three medium priority and five low priority recommendations within the action plan. There are no high level recommendations made as a result of this audit.

### **4.3.**

The Committee is invited to review the audit findings to obtain assurance that action has been taken or agreed where necessary.

## **5. Corporate Governance**

This report relates to the Council complying with governance and scrutiny and therefore does not directly support and contribute to improved outcomes for communities as outlined in the Council Plan and the Local Outcomes Improvement Plan.

## **6. Financial Implications**

There are no financial implications associated directly with the recommendations in this report.

## **7. Legal Aspects**

Complying with recommendations made by the internal auditors helps the Council meet its statutory obligations to secure best value.

## **8. Contact Officers**

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## **9. Appendix**

Appendix 1: Internal Audit Report: Treasury Management.



## Internal Audit

### Audit report

### Treasury Management

**Draft issue date:** 23 February 2021

**Final issue date:** 23 March 2021

<b>Distribution list:</b>	<b>Head of Finance</b> <b>Senior Manager (Corporate Finance)</b> <b>Accounting Manager (Corporate Finance)</b>
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## Audit Opinion

Based on our findings in this review we have given the following audit opinion.

### Adequate

Some improvements are required to enhance the effectiveness of the framework of governance, risk management and control.

A key to our audit opinions and level of recommendations is shown at the end of this report.

## Executive Summary

Our audit confirmed that the procedures in place for the operational management of the treasury management function were sound, and testing carried out found that controls are in place and working, with several areas of good practice evident. For example:-

- The Council is complying with the requirements of borrowing and treasury management rules within the CIPFA Code of Practice on Treasury Management in the Public Services (revised Dec 2017) which defines the policies and objectives for treasury management activities and the CIPFA Prudential Code for Capital Finance in Local Authorities (revised Dec 2017). The Council also complies with the requirements of legislation set out in the Local Government Investment (Scotland) Regulations 2010 and the Local Government in Scotland Act 2003.
- The risks associated with treasury management have been identified within the approved Treasury Management Practices. The document also details the controls which have been established to minimise the Council's exposure to these risks.
- In the Annual Investment Strategy 2020/21 the Council has defined its risk appetite as low in order to give priority to the security of its investments.
- Cash flow forecasting is carried out daily to ensure adequate funds are held in the bank account and surplus funds are invested.
- Loan transactions are authorised properly and carried out in accordance with policy. Working practices are well established and subject to supervisory checks.
- The report includes 8 recommendations which have arisen from the audit. The numbers of recommendations are set out in the table below under each of the priority headings. The priority headings assist management in assessing the significance of the issues raised.
- Responsible officers will be required to update progress on the agreed actions via Pentana Risk.

Total	High	Medium	Low
8	0	3	5

The assistance provided by officers contacted during this audit is gratefully acknowledged.

## Introduction

The Council, through its Annual Treasury Management Strategy Statements, adopts CIPFA's definition of treasury management as "The Management of the Council's cash flows, its banking, money market and capital market transactions; the effective control of risks associated with those activities; and the pursuit of optimum performance consistent with those risks".

The Council's Annual Treasury Management Strategy Statement complies with the requirements of the Local Government in Scotland Act 2003, the CIPFA Prudential Code, the CIPFA Treasury Management Code and Scottish Government loans fund repayment regulations and investment regulations.

The Local Government Investments (Scotland) Regulations 2010 sets out the requirement for a local authority to obtain the consent of Scottish Ministers to make investments. The consent is provided by the Scottish Government Finance Circular 5/2010, the investment of money by Scottish Local Authorities is subject to the requirement to comply with the conditions of the Consent. The Consent applies to a range of investments, which covers the investment of temporary surplus funds with banks and similar institutions, shareholdings in companies or joint ventures and loans to group undertakings and third parties. It also covers investment properties.

The Consent requires local authorities to invest in a way that minimises the risk to the capital sum and optimises the return on investments consistent with those risks.

This review was conducted in conformance with the International Standards for the Professional Practice of Internal Auditing.

## Audit Scope

The objectives of the audit were to confirm that:

- Borrowing and lending transactions are in accordance with statutory powers and approved policy and strategy.
- Investment, annual borrowing requirements and daily balances are properly estimated.
- Borrowing, lending and investment transactions are properly controlled.
- Investment income, loan repayments and interest are received/paid on the due dates and in respect of valid treasury loans and investments.
- Deposits and interest are recalled/repaid on the due dates.
- Treasury management transactions are correctly recorded in bank accounts, the financial ledger, and other subsidiary records (e.g. registers).
- Council cash flows are effectively managed.
- Emerging risks due to procedural changes and remote working introduced during the Covid-19 are properly managed and mitigated.

# Audit Findings

## 1.0 Legislative and best practice compliance.

- 1.1 The Local Government Investments (Scotland) Regulations 2010 set out the requirement for a local authority to obtain the consent of Scottish Ministers to make investments. The Consent is provided by the Scottish Government Finance Circular 5/2010, 'The Investment of Money by Scottish Local Authorities' (the Consent) and sets out the requirements attached to the Consent when local authorities make investments. The Council is generally compliant to the requirements attached to the Consent.
- 1.2 The terms of the Consent require the Council to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals. These being; the prudential and treasury indicators and treasury strategy, a mid-year treasury management report and an annual treasury report.
- 1.3 At the time of our audit we were able to confirm that the prudential and treasury indicators and treasury strategy statement for the financial year 2020/21 and the annual treasury management annual report for 2019/21 report were presented to the Policy and Resources committee on the 18 February 2020 and 22 September 2020 respectfully. The mid-year update in respect of the Council's treasury management function for the period 1 April to 30 September 2020 was presented to the Policy and Resources Committee on 3 December 2020. All reports were presented within the required timeframes of the Consent, being before the commencement of the financial year and within six months of the end of the financial year respectfully despite the challenges of the COVID-19 pandemic working requirements.
- 1.4 A requirement of the Consent is that the Council's Annual Treasury Management Strategy Statement is made available to the public. Although the document could be found on the public record of the Policy and Resources Committee, some knowledge of committee practice was needed to access the document in this manner.
- 1.5 It is recommended that the Council's Annual Treasury Management Strategy Statement is subject to clearer referencing within the Council's website.

### Recommendation 1

- 1.6 Although risk appetite is defined in the Annual Treasury Management Strategy and treasury management practices are reviewed as part of the investment adviser's mid-year and full year reports, there is not a risk register specific to treasury management.
- 1.7 We recommend that a risk register, specific to treasury management is prepared and is reported periodically to the Investments Sub-committee of the Council for scrutiny.

### Recommendation 2

## 2.0 Contract Management

- 2.1 The Council's contract with Royal Bank of Scotland for the provision of banking services allowed for a maximum extension until 30 April 2021. When deciding whether to engage the permitted two-year extension in 2019, under the terms of the contract, a consultant was engaged to benchmark and confirm that charges under this contract were in line with market rates. At the time of our report, we were advised that discussions were under way with the

Procurement Manager regarding the options available to the Council in forming a new contract.

- 2.2 The Services referred to at 2.1, should now either be tendered for, or a Non-Competitive Action (NCA) assessment carried out, in accordance with the Council's Contract Standing Orders.

### **Recommendation 3**

- 2.3 Following an action plan developed by the Head of Finance, in consultation with the Council's investment advisors, Hymans Robertson, various fund managers were appointed to four new mandates.
- 2.4 A selection of potential fund managers to these short-term investments were provided to the Council by its investment advisors.
- 2.5 The process at 2.3, under the requirements of the Council's Contract Standing Orders should have included a formal NCA process.

### **Recommendation 4**

- 2.6 In practice the four mandates referred to at 2.3 are subject to ongoing review and we are advised could be terminated at short notice should they not perform in line with expectation. However, the maximum investment value, and associated management fee should be taken into account when assessing whether contracts are published on the Council's contract register.
- 2.7 Mandates where fees could exceed £50,000 must be published on the Council's contracts register.

### **Recommendation 5**

- 2.8 Investment analysis services are provided to the Council by the Link Group who acquired Capita Asset services in 2017. The Council's original contract with Capita Asset Services for the provision of professional treasury management consultancy services expired on 26 September 2016. Since then we are advised that the services of the Link Group are renewed annually.
- 2.9 In taking into account the re-occurring nature of the investment analysis services it should be considered whether these services should be subject to a tendering exercise or NCA process.

### **Recommendation 6**

## **3.0 Training**

- 3.1 The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. Training has not been provided during the COVID-19 pandemic throughout the current financial year so far, however a good level of training had been provided in previous years. During the 2019/20 financial year training was facilitated to Members in respect of developing a long-term capital investment strategy, ethical investments, investment strategy and treasury management.

#### **4.0 Council to Council short term lending.**

- 4.1** All short-term lending during the 2020/21 financial year has been carried out in compliance with the annually approved treasury management strategy and temporary loan reports are presented to the Investments Sub-committee on a regular basis.
- 4.2** All local authorities continue to maintain strong credit ratings from credit rating bodies and, under legislation, lending is secured on the future income of the borrowing council.
- 4.3** Short term borrowing and lending between local authorities in the UK has risen rapidly in recent years as rates have become more favourable compared to those available from the Public Works Loan Board (PWLB), from £3.188 billion at 31 March 2014 to £11.678 billion at 31 March 2020, an increase of 266%. Press and research indicates that some local authorities are borrowing for commercial purposes that seem to be outwith CIPFA's Prudential Code. We have summarised some of this research, relating to local authorities the Council has made short term loans to, in Annex A.
- 4.4** We recommend that the Council obtains advice from its investment advisors whether lending criteria could, and if so, should be further differentiated amongst borrowers within the same category, including council to council lending.

#### **Recommendation 7**

- 4.5** The Council utilises the services of a Broker when carrying out Council to Council Lending.
- 4.6** The Council should maintain a list of Brokers it engages with in carrying out Council to Council lending.

#### **Recommendation 8**



## Action Plan

Recommendation	Priority	Management Comments	Responsible Officer	Agreed Completion Date
1. Referencing to the Treasury Management Strategy Statement on the Council's website should be more prominent.	Low	We are happy to add the Treasury Management Strategy Statement in a more prominent location on the Council's website.	Head of Finance	End of September 2021
2. There should be a Treasury Management risk register. This risk register should be reported to the Investments Sub-committee periodically.	Low	Consideration of the development of a Treasury Management Risk Register will be discussed with the Council's Treasury Advisers, Link Asset Services. If it is determined to proceed with a risk register this will be reported to the Investments Sub-committee.	Head of Finance	End of September 2021
3 A contract for banking services should now either be subject to tendering or an NCA process completed.	Medium	The banking services contract has been under discussion with the Procurement Service for some months but hasn't been progressed due to pressures on the Procurement Team. The intent is to complete an NCA for an extension on the grounds that the Pandemic has seriously interrupted the normal business of the Council.	Head of Finance	End of March 2021
4 Controls should be put in place so that mandates to Investment Managers are subject to NCA' where required under the	Medium	The Investments Sub-committee was consulted on the procurement routes being followed. Consultants Hymans Robertson were appointed to assist with	Corporate Finance Senior Manager	There are no immediate plans to revise the investment strategies or change fund managers.

Council's Contract Standing Orders.		<p>the reviews of the Strategic Reserve Fund and the Pension Fund and to advise on a compliant process for the transition to revised investment strategies. Appendix 2 to the "Orkney Islands Council - Strategic Reserve Fund Investment Strategy Review - Follow Up" that was presented to the Investments Sub-committee on 28 February 2019 considered compliant options for selection and appointment of Fund Managers</p> <p>A national framework agreement was used to select the short leet of Fund Managers for the Passive Bonds Mandate. Under the Council's Contract Standing Orders this action should have been preceded with an NCA. A direct investment in an asset class through a pooled fund is a direct investment decision and therefore an OJEU procurement process is not required</p> <p><b>Internal Audit Comment</b></p> <p>We are satisfied with the current mandates; the recommendation was made with regard to any future mandates.</p>		
5 Controls should be put in place so that mandates to Investment Managers are recorded on the Council's contract	Medium	<p>This will be discussed with the Procurement Manager.</p> <p>Contracts with Fund Managers are open ended agreements rather</p>	Corporate Finance Senior Manager	End of June 2021

register when applicable under its Contract Standing Orders.		than contracts for specific time periods and may be terminated at short notice		
6 Consideration should be given to whether the Council's investment performance services should be subject to a tendering exercise or NCA process.	Low	<p>It is the view of Management that this service, which was deminimis when first entered into, represents good value in that the incumbent Treasury Adviser's have built up a good knowledge of the Council finances.</p> <p>The Council makes use of the Treasury Advisers proprietary software for treasury management activity so that a change of advisers would represent a major upheaval with a training requirement for a change of software.</p> <p>An NCA will be discussed with the Procurement Manager for the extension of this contract.</p>	Corporate Finance Senior Manager	End of September 2021
7 The Council should obtain advice from its investment advisors whether lending criteria could, and if so, should be further differentiated amongst borrowers within the same category, including council to council lending.	Low	<p>Agreed.</p> <p>The Council's Treasury Advisers will be asked to consider whether there should or could be further differentiation among borrowers within the same category, including council to council lending with a view to inclusion in the next annual revision of the Treasury Management Strategy Statement.</p>	Head of Finance	February 2022

<p>8 The Council should maintain a list of brokers used in carrying out Council to Council lending.</p>	<p>Low</p>	<p>Agreed. The Council currently uses a single broker. Management is happy for the broker's name to be included in the Treasury Management Strategy Statement when it is next updated.</p>	<p>Corporate Finance Senior Manager</p>	<p>February 2022</p>
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## Key to Opinion and Priorities

### Audit Opinion

Opinion	Definition
<b>Substantial</b>	The framework of governance, risk management and control were found to be comprehensive and effective.
<b>Adequate</b>	Some improvements are required to enhance the effectiveness of the framework of governance, risk management and control.
<b>Limited</b>	There are significant weaknesses in the framework of governance, risk management and control such that it could be or become inadequate and ineffective.
<b>Unsatisfactory</b>	There are fundamental weaknesses in the framework of governance, risk management and control such that it is inadequate and ineffective or is likely to fail.

### Recommendations

Priority	Definition	Action Required
<b>High</b>	Significant weakness in governance, risk management and control that if unresolved exposes the organisation to an unacceptable level of residual risk.	Remedial action must be taken urgently and within an agreed timescale.
<b>Medium</b>	Weakness in governance, risk management and control that if unresolved exposes the organisation to a high level of residual risk.	Remedial action should be taken at the earliest opportunity and within an agreed timescale.
<b>Low</b>	Scope for improvement in governance, risk management and control.	Remedial action should be prioritised and undertaken within an agreed timescale.

## Annex A

### Analysis of short term inter council borrowing and lending

Short term borrowing and lending between local authorities in the UK has risen rapidly in recent years, from £3.188 billion at 31 March 2014 to £11.678 billion at 31 March 2020, an increase of 266%. Short term inter-council lending rates are becoming more favourable than those to loans available from the Public Works Loan Board (PWLB).

From CIPFA's Prudential Code, dated 2017 it is clear that a local authority must not borrow more than, or in advance of, need purely to profit from the investments of the extra sums.

Orkney Islands Council's own Treasury Management Strategy allows some flexibility in the short term but over the medium term, borrowing will only be for a capital purpose.

The Council has recently made loans to Thurrock Council and West Dunbartonshire.

A table showing the growth borrowings by both Councils is shown below in figure 1.

	<u>13/14</u>	<u>14/15</u>	<u>15/16</u>	<u>16/17</u>	<u>17/18</u>	<u>18/19</u>	<u>19/20</u>
	<u>£'000</u>	<u>£'000</u>	<u>£'000</u>	<u>£'000</u>	<u>£'000</u>	<u>£'000</u>	<u>£'000</u>
Thurrock	94,000	119,750	163,850	204,750	553,000	920,100	1,061,200
West Dunbartonshire	39,000	55,000	74,500	124,500	152,500	200,500	219,000

*Figure 1*

Thurrock Council's short term borrowing of over £1 billion, which is repayable within 12 months, accounts for nearly 10% of all short-term inter-local authority borrowing in the UK and more than double its annual total comprehensive income of approximately £470 million.

West Dunbartonshire Council's short-term borrowings are the highest of any Scottish local authority according to data published by the Ministry of Housing, Communities and Local Government.

Thurrock Council's borrowing has received recent publicity both nationally and locally.

On 22 May 2020 the Bureau of Investigative Journalism reports, inter alia,

"Under the direction of a senior council officer Thurrock borrowed from about 150 local authorities across the UK with little public scrutiny. These loans were not for direct funding of council services or investing in infrastructure – instead they financed solar farms more than a hundred miles away.

Sean Clark, Thurrock's director of finance, oversaw the investment of £604m in the solar industry, investments he says were prompted entirely by intermediaries approaching him with money-making opportunities".

“At last count Thurrock owed other councils an unprecedented £1bn.”

“An investigation by The Bureau has discovered the council has poured at least £74m, and possibly hundreds of millions more, into a single company, Rockfire Capital, whose financial model raises serious questions over how likely it is that the public money would be recovered in full if the business failed.

“John Kent, the former Labour leader of Thurrock council, claimed that the council had declined to give elected members or the public adequate details of precisely how it invested the money.”

“It was signed off by officers with no reference to members whatsoever,” said Labour’s John Kent, who was the leader of the council at the time. “I knew absolutely nothing about it.” The council blamed a “period of commercial sensitivity” for the secrecy”.

“Rockfire’s founder and chief executive, has received from the business while his company pulled in hundreds of millions of pounds of public money – £7.7m in dividends since 2015.”

On 17 October 2020, the Bureau of Investigative Journalism, under the heading “Fraud allegations call £400m council investments into question”, reported that Thurrock Council were approached by Rockfire Capital to invest £145 million in bonds linked to 19 Solar farms across the country. During the case the owner of Rockfire confirmed that he had received an arrangement fee of around £5 million, which it was claimed was not disclosed to Thurrock Council.

On the same day, The Times reported that a solar industry expert described the fee as “excessive” and “out of the market”. The owner of Rockfire capital disputes both the solar industry expert’s claim and of any wrongdoing.