

Audit Scotland Report: Borrowing and Treasury Management in Councils

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1 Purpose

To provide Audit Committee with a summary of the Audit Scotland report: 'Borrowing and treasury management in Councils' and the Council's response in relation to the report's key messages.

2 Background

2.1 'Borrowing and treasury management in Councils' was published by the Accounts Commission in March 2015. The report can be obtained on Audit Scotland's Website

http://www.audit-scotland.gov.uk/docs/local/2015/nr_150319_borrowing_treasury_management.pdf

2.2 The objectives of the report were to answer:-

- What is borrowing and treasury management in councils?
- To what extent do councils' borrowing and treasury management strategies meet good practice and contribute to corporate plans and priorities?
- Can councils demonstrate the affordability and sustainability of borrowing decisions? For example can they show that borrowing will not adversely affect their financial position? Will that continue to be the case in the future?
- How effective are the governance arrangements for borrowing and treasury management? Governance covers areas such as responsibility and accountability for borrowing and treasury management decisions, arrangements for reporting decisions and for scrutinising them.

2.3 The Audit Scotland report is set out in three parts:

- Part 1: Setting the scene;
- Part 2: Demonstrating the affordability and sustainability of borrowing;
- Part 3: Effective management and scrutiny.

2.4 The key findings from the report are set out below:-

- Councils have total debt of £14.8 billion of which £12.1 billion, 82 percent, is from borrowing. Debt commits councils to charges over the long term. There are different types of debt with different features and varying degrees of risk.

- Borrowing is a key source of finance for councils to invest in vital public services. Overall borrowing has remained at around £12 billion for the last three years, with total assets of £39 billion. Councils have developed borrowing strategies to suit their own local priorities and needs, in response to the flexibility introduced by the Prudential Code in 2004. Seventeen councils have increased their borrowing levels, in real terms, over the last ten years.
- Councils are following the general principles of the relevant codes of practice in demonstrating short-term affordability, but they are not always highlighting the strategic importance of borrowing and treasury management or clearly analysing and reporting the long-term affordability and sustainability of their borrowing. Councils need to develop detailed analysis to support borrowing decisions and to demonstrate they represent best value for the council.
- Treasury management is a professionally run function in councils with appropriately qualified officers. Succession planning, ongoing training and the availability of appropriate professional qualifications are important. Councils have started to integrate their treasury management and capital investment functions which is a positive step.
- Councils need to improve scrutiny of borrowing and treasury management. This is a complex and technical subject and officers need to provide wider training and support to councillors, and also provide clearer, more accessible reports. The current governance structures in some councils could be improved to support more effective scrutiny.

Part 1 – Setting the Scene

- 2.5** This section of the Audit Scotland report sets out the current debt position for Local Authorities in Scotland. As at 31 March 2014, Councils' outstanding debt was £14.8 billion, with borrowing making up £12.1 billion, or 82 per cent, of this.
- 2.6** Councils use borrowing to pay for assets such as schools and roads to provide local services and meet local priorities. This has an impact on future revenue budgets, as the Council needs to pay interest on the borrowing. Total assets were £39 billion as at 31 March 2014.
- 2.7** The Prudential Code was introduced in 2004 to provide greater flexibility for Councils to manage and control their own capital investment activity, following a period of government regulation. Councils' borrowing strategies, levels of borrowing and debt profiles differ widely.

Part 2 – Demonstrating the affordability and sustainability of borrowing

- 2.8** The Audit Scotland report highlights that the six Councils sampled during the period of assessment were following the general principles and framework of the relevant codes of practice and regulations.

- 2.9 Whilst councils are using prudential indicators to demonstrate and monitor the short-term affordability of borrowing, the report states that Councils are not clearly analyzing and reporting their assessment of the longer-term affordability and sustainability of borrowing.
- 2.10 Officers present the repayment profile of borrowing to Councillors, but do not present this together with other information such as different budget scenarios, interest rate scenarios, or capital investment strategies. This is important to inform councillors of the future risks to the affordability and sustainability of current and new borrowing.
- 2.11 The report suggests that Councils could present information more clearly to Councillors. Some Councils are not presenting Councillors with all the relevant information at one time to support borrowing decisions; for example in the Treasury Management Strategy. This is important to ensure that decisions made are based on an assessment of all the relevant analysis and risk.

Part 3 – Effective Management and Scrutiny

- 2.12 The report outlines that Treasury Management is a professionally run function in Councils with appropriately qualified officers. Joint planning with other Councils, ongoing training and the availability of appropriate professional qualifications are important.
- 2.13 The report recommends that scrutiny of borrowing and treasury management decisions could be improved. This would involve officers providing clearer information to Councillors to help them in their scrutiny role. In most Councils, the content and clarity of reports could be improved, particularly performance information in year-end reports. All reports need to be easily accessible to Councillors and the public.
- 2.14 Councils need to provide a range of training and support to Councillors to help improve scrutiny of treasury management. The report states that there were no additional formal arrangements in place specifically aimed at helping Councillors in this complex area.
- 2.15 The study found some examples of where governance structures do not fully meet the Code's requirements and where there could be more consistency in reporting arrangements.

3 Midlothian Position

- 3.1 The following provides information on how Midlothian Council has or is addressing the key points and challenges raised in the Audit Scotland Report.

Part 1 – Setting the Scene

- 3.2 Midlothian Council's outstanding debt as at 31 March 2014 was £253.2 million, with borrowing making up £226.0 million, or 89% of this. Total assets were £654.7 million.

- 3.3** The Council's overall borrowing has increased over the last 10 years in real terms, reflecting the capital investment plans both for General Services and the Housing Revenue Account (HRA).
- 3.4** The Council has forward looking capital investment plans that outline proposed investment over the short and medium-longer terms. The Council's General Services Capital Plan, at the time of the Audit Scotland report, covered a 3 year forward looking cycle, and the HRA Capital Plan a 14 year forward looking period. The General Services Capital Plan 1516+ report to September Council expands the forward looking period of the plan to include the current year and the following 5 financial years.
- 3.5** The Council has utilised a number different methods of external financing including borrowing, PFI schemes and other mechanisms including the use of the new hubCo framework.
- 3.6** The Council also has a medium and longer term financial strategy, covering the period to 31 March 2021, as reported to Council in September.

Part 2 – Demonstrating the affordability and sustainability of borrowing

- 3.7** The Council complies with the Prudential Code for Capital Finance in Local Government and the Treasury Management Code of Practice, reporting on all of the required indicators both in the Strategy report at the outset of the financial year, and in the Outturn Report following the year end. As noted in the Audit Scotland report:-

“Clackmannanshire, East Lothian, Midlothian, Scottish Borders, Shetland Isles, West Dunbartonshire and West Lothian councils all provided comparative information in their annual reports on all indicators.

- 3.8** The report requests that Councils develop detailed analysis to support borrowing decisions and to demonstrate they represent best value to the Council. For long-term borrowing decisions, Midlothian Council officers, in conjunction with their treasury management advisers, run discounted cashflow models to assess the overall cost of the options available to the Council, in order to determine which option offers best value.
- 3.9** The Treasury Management reports provide assessments of responses to interest rate scenarios that the Council may potentially face throughout the course of the forthcoming financial year. In addition, the Capital Plan reports outline options for capital investment strategies. However, the Audit Scotland report suggests that further information should be included in the treasury management reports such as different budget scenarios and analysis of the longer-term affordability and sustainability of borrowing. The main treasury management reports will therefore be reviewed to ensure that where this information is available and provides a useful tool for members' analysis, this will be incorporated into the report.

- 3.10** The Audit Scotland report states that both the layout and the content of treasury management reports could be improved, with additional information on links to the capital investment plan and corporate objectives included in the Treasury Strategy report.
- 3.11** The Treasury Management strategy document is already a substantial document, which contains clear links to the capital investment plans for both General Services and HRA, links to the Council's overall borrowing and debt and an assessment of the prudential indicators. Nonetheless, and in line with paragraph 3.8 above, a further review of all three of the main treasury management reports will be undertaken to ensure their consistency with the recommendations of the Audit Scotland report.
- 3.12** The Council have integrated their treasury management and capital investment functions, which as the report notes in a positive step.

Part 3 – Effective Management and Scrutiny

- 3.13** The Council's Treasury Management function contains professionally qualified officers. Regular training through both the Scottish Treasury Management Forum, and the Council's Treasury Management advisers, Capita, is undertaken by such officers, to ensure continued professional development and a broad understanding of the current market and the position of other Local Authority peers in the market.
- 3.14** The Council participates in the wider Capita Asset Services Investment Benchmarking Groups and the Scottish Treasury Management Forum Benchmarking Group. Information on performance against peers from these groups are regularly reported to Council in the various Treasury reports. More generally in relation to scrutiny of financial plans, the Council already has in place governance structures which considers financial plans and in year progress against the approved budgets. The information provided to support this process is continually reviewed and updated to ensure that appropriate scrutiny can be undertaken
- 3.15** The Audit Scotland report recommends that Councils need to provide a range of training and support to Councillors to help improve the scrutiny of Treasury Management. A training session held by Capita, with Elected Members, was undertaken on Tuesday 14 June 2011. A further training session, again to be held by Capita, shall be arranged in due course. In addition, a training session involving other senior officers both in Finance and across services shall be arranged to further widen the knowledge of the impact of both treasury management decisions on the Council's revenue budget, and the impact of service investment decisions on the Council's capital investment plans and revenue budget.
- 3.16** Members of the Audit Committee are invited to reflect on the contents of both this report and the Audit Scotland report and consider how the scrutiny of the Treasury Management function could be improved as well as what additional support they believe would assist in undertaking their role.

4 Report Implications

4.1 Resource

There are no direct resource implications as a result of this report.

4.2 Risks

The Council currently complies with all the relevant Treasury Management and Prudential Codes of Practice and regulations. However, Treasury Management decisions involve a significant level of financial risk and the proposals in this report are designed to strengthen the scrutiny and governance of the Treasury Management function within the Council

4.3 Single Midlothian Plan and Business Transformation

Themes addressed in this report:

- Community safety
- Adult health, care and housing
- Getting it right for every Midlothian child
- Improving opportunities in Midlothian Sustainable growth
- Business transformation and Best Value
- None of the above

4.4 Key Priorities within the Single Midlothian Plan

This report does not directly impact Midlothian Council's key priorities.

4.5 Impact on Performance and Outcomes

Whilst not directly impacting Midlothian Council's and wider partners performance and outcomes the report does ensure consideration is given to the wider strategic planning and objectives as part of Midlothian Council's response to Audit Scotland's findings for the areas noted in the report.

4.6 Adopting a Preventative Approach

This report does not directly impact actions and plans in place to adopt a preventative approach.

4.7 Involving Communities and Other Stakeholders

This report does not directly relate to involving communities and stakeholders.

4.8 Ensuring Equalities

This report does not recommend any change to policy or practice and therefore does not require an Equalities Impact Assessment.

4.9 Supporting Sustainable Development

The challenges highlighted in the Audit Scotland report have informed Midlothian Council's position in relation to treasury management and the subsequent budgeting and longer term planning and therefore supports ongoing sustainable development.

4.10 Digital Services Issues

There are no direct Digital Services implications arising from this report.

5 Recommendations

The Committee is asked to:

- a) Note the Audit Scotland report and its recommendations;
- b) Note that the reporting of Treasury Management activities will be reviewed;
- c) Consider how scrutiny of Treasury Management could be improved within the Council and what further support would assist in delivering that scrutiny.

Date: 08 September 2015

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Background Papers:

Audit Scotland Report: Borrowing and Treasury Management in Council

http://www.audit-scotland.gov.uk/docs/local/2015/nr_150319_borrowing_treasury_management.pdf