

Internal Audit Report
Treasury Management
Issued: 30 May 2018

Level of Assurance	The overall control framework is of a good standard with only minor elements of risk identified which are either accepted or being dealt with by management.
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Executive Summary

1.0 Introduction

CIPFA defines Treasury Management (TM) as: the management of the local authority'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. The Local Government in Scotland Act 2003 requires the Council to set out its treasury strategy for borrowing and investment and also Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

The CIPFA Treasury Management in the Public Services Code of Practice (the Code) stipulates that the Council should receive an annual report on the strategy and plan to be pursued in the coming year; a mid-year review; and an annual report on the performance of the treasury management function, on the effects of the decisions taken and the transactions executed in the past years, and on any circumstances of non-compliance with the organisation's treasury management policy statement and treasury management policies (TMPs). The Code also states that the body responsible for scrutiny, such as an audit committee, will have responsibility for the scrutiny of treasury management policies and practices.

Treasury activity is recorded on the Logotech Treasury Management system which is administered by Financial Services.

As at 26 January 2018, the Council's borrowing in respect of its asset base was £246M and the authorised limit for borrowing, which reflects approved General Services and HRA Capital Plans, was £482M. Investments (including cash / bank balances) were £74M and a budgeted investment return of 0.72% on investments placed during the financial year is expected. Investment counterparties and vehicles are detailed in the Treasury Management and Investment Strategy and in placing investments the risk criteria used, in order of importance, is security, liquidity and yield. In February 2016, the Council committed to draw down two £10M forward dealt loans at fixed interest rates to hedge against future borrowing rate movements. The first was drawn in June 2017 and the second will be drawn in November 2018 (to match two £10M loans maturing on same dates).

A review of the Loans Fund accounting arrangements is currently being undertaken which includes an assessment of the period over which Loans Fund advances are projected to be repaid. A savings target of £0.5M has been attached to the review and reflected in the 2018/19 budget.

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2.0 Audit Objective

The objective of the audit was to test controls over policies and practices, strategies and reporting and compliance with the Treasury Management Code of Practice. A copy of the terms of reference for the review is attached at Appendix 2.

3.0 Conclusion

Following our audit field work and discussions with Management, we have seen that the Treasury Management function has comprehensive policies and procedures in place. The investment and borrowing strategies and prudential indicators are reported regularly to Council before, during and at the end of each financial year. There is authorisation at every stage of the treasury process with adequate segregation of duties. The Treasury Management team meet regularly with Financial Services Management and external Consultants to ensure compliance with the Council's strategy and that risks are adequately identified and managed.

We noted that the three main treasury management reports are being presented to the Audit Committee after they have been approved by Council meaning that there is no scrutiny in advance of approval. In addition, whilst the Treasury Management team have comprehensive arrangements in place to assess and manage risk they do not make use of the Council's risk management system, Pentana Performance, which would also allow reporting of the risks as part of the Council's overall risk management reporting to Management, Council and the Audit Committee. The Council uses external treasury management advisers and it was noted that following the expiry of the contract in 2015, the service was not competitively tendered but was further extended and that a 'Non-Competitive Action form' was not completed to support this decision.

We have therefore on this occasion rated this audit as **Good** in accordance with the Definitions of Ratings included on page 7. We have raised 3 Medium rated recommendations (detailed in Section 5) to reduce risk further and these recommendations have been agreed by Management.

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Control Objective	Findings	Result	Recommendation Reference
and control of risk are prime objectives for treasury management activities, the Council's risk appetite forms part of the annual strategy and priority is given to security and liquidity when investing funds.	<p>of their work. Reports to Council discuss the risks and the methods of mitigating those risks. When placing investments, the risk criteria used by the Treasury Management team and the Financial Services Management team, in order of importance, has been and continues to be security, liquidity then yield. The Treasury Management Practices outline in detail the roles and responsibilities of the Treasury Management team and the Financial Services Management team, and detail extensively the policies and procedures for controlling interest rate risk, credit and counterparty risk, liquidity risk, exchange rate risk, refinancing risk, legal and regulatory risk, fidelity insurance arrangements and market risk.</p> <p>The Treasury Management team do not make use of the Council's risk management system, Pentana Performance (formerly Covalent), which would allow reporting of the risks as part of the Council's overall risk management reporting to Management, Council and the Audit Committee.</p>	Average	2
4.3 The pursuit of value for money and the use of suitable performance measures are reflected in treasury management policies and practices	<p>The treasury management borrowing and investment strategies are to borrow to fund the capital plans of the Council in a cost effective way and to invest with creditworthy counterparties in order to achieve best value for the Council. In June 2017 the annual treasury management report reported that Midlothian Council had the lowest Loans Fund Rate for 2015/16 of all Mainland Authorities; this has been maintained for 2016/17 and will be reported in June 2018. In addition, performance indicators comparing return on investments show that, in comparison with its peer benchmarking group, Scotland and UK local authorities, that the Council has a higher performance than expected and this is covered in Treasury Management Outturn reports to Council in 2015/16 and 2016/17.</p> <p>The Code states that services (such as the use of external advisers and consultants) should be subject to regular competition which would usually be via a competitive tendering process. The Council uses Link Asset Services as</p>	Excellent	N/A
		Average	3

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Control Objective	Findings	Result	Recommendation Reference
	<p>its external treasury management advisers. It was noted that following the expiry of the contract in 2015, the service was not competitively tendered but was further extended and a 'Non-Competitive Action form' was not completed to support this decision. Management have advised that at the expiry of the contract in 2015, the Financial Services Team assessed options and determined the continuation of the contract represented best value. There are only two Treasury Management Advisers within the market, the annual fee (under £25,000) remained at the same level and the value of the contract was minimal in the context of the annual loans fund budget so it was felt there was no value in engaging in a full tender (the tender undertaken in 2009 resulted in only 1 tender being submitted).</p> <p>Although a Letter of Engagement, agreeing the term of appointment and fees is in place, it was noted that it is in the name of another local authority and not Midlothian Council.</p>		
4.4 Treasury payments and receipts are adequately controlled and accounted for on the treasury management system and financial ledger	<p>There is a satisfactory level of control over treasury payments and receipts. These are embedded in the creditor payments system and transactions have a satisfactory level of separation of function and control. Transactions are recorded on the ledger accurately and in a systematic manner.</p>	Excellent	N/A

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5.0 Recommendations

No	Recommendation	Priority	Manager	Target Date
1	<p>The three main Treasury Management reports should be submitted to the Audit Committee to enable them to be adequately scrutinised prior to being recommended to Council.</p> <p>Management comment</p> <p>The timing of committees has precluded this in the past but the timing of future committees will be reviewed to facilitate this requirement.</p>	Medium	Senior Accountant Projects and Treasury	31//03/19
2	<p>The risks associated with Treasury Management should be recorded on the Council's Risk Management system (Pentana Performance) to allow reporting of the risks as part of the Council's overall risk management reporting to Management, Council and the Audit Committee.</p>	Medium	Senior Accountant Projects and Treasury	30/09/18
3	<p>A 'Non-Competitive Action form' should be completed to support the decision taken over the Council's use of Treasury Management Advisers.</p>	Medium	Senior Accountant Projects and Treasury	Complete

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APPENDIX 1

Definitions of Ratings

Audit Opinion

Level of Control	Reason for the level of Assurance given
Excellent	The control framework is of a high standard with no unacceptable risks identified.
Good	The control framework is of a good standard with only minor elements of risk identified which are either accepted or being dealt with by management.
Average	The overall control framework is of an average standard. Some weaknesses have been identified in the controls and improvements are possible.
Weak	The control framework is weak and requires improvement as significant issues exist with the adequacy and effectiveness of the Internal Control arrangements. These control deficiencies could result in delivery of poor service or disruption to service to the residents of Midlothian, financial loss or reputational damage to the Council.
Poor	The control framework is inadequate or ineffective and the issues identified require immediate attention to prevent the delivery of poor service or disruption to service to the residents of Midlothian, financial loss or reputational damage to the Council.

Recommendation Rating

Priority	Risk Definition
High	Legal / regulatory issues would normally be regarded as high risks. Strategic risks would normally be regarded as high risks. Financial impact - £50K plus and / or national press interest
Medium	£5K - £49K and / or local press interest
Low	Under £5K and / or no press interest.

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Distribution

- Members of the Audit Committee
- Kenneth Lawrie, Chief Executive
- John Blair, Director Resources
- Gary Fairley, Head of Finance and Integrated Service Support
- David Gladwin, Financial Services Manager
- Gary Thomson, Senior Accountant Treasury and Projects

Audit Team

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Reviewer:	Elaine Greaves	Principal Auditor	0131 271 3285

TERMS OF REFERENCE Treasury Management

Audit Objective and Scope

Audit Objective

The objective of the audit is to test controls over policies and practices, strategies and reporting and compliance with the Treasury Management Code of Practice.

Scope of Audit

The audit will focus on the key controls to ensure that:

1. Policies and practices, strategies and reporting arrangements for the effective management and control of treasury management activities are in place and comply with the CIPFA Treasury Management Code of Practice 2011;
2. Effective management and control of risk are prime objectives for treasury management activities, the Council's risk appetite forms part of the annual strategy and priority is given to security and liquidity when investing funds;
3. The pursuit of value for money and the use of suitable performance measures are reflected in treasury management policies and practices; and
4. Treasury payments and receipts are adequately controlled and accounted for on the treasury management system and financial ledger.

Potential Risks

The CIPFA code identifies eight main treasury management risks as follows:

- Credit and counterparty risk;
- Liquidity risk;
- Interest rate risk;

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- Exchange rate risk;
- Refinancing risk;
- Legal and regulatory risk;
- Fraud, error and corruption, and contingency management;
- Market risk.

Audit Approach

The audit approach consists of:

- fact finding interviews with key employees;
- review of appropriate documentation which includes any risk or best value reviews that have been conducted and risk registers that are in place;
- interrogation of any relevant systems and sample testing as required;
- closure meeting with local management to discuss the findings and any recommendations from the review;
- draft and final reporting.

Timescales & Reporting

The audit will commence in November 2017 and fieldwork is expected to be completed by the end of December 2017. The audit will be reported to the first available Audit Committee following completion of the Report.

Information Requirements

Access to all relevant systems, documentation and employees.

Audit Resource

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