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Borrowing and treasury management in councils

Scrutiny guidance and questions for councillors

Accounts Commission

About the audit

1. Our audit 'Borrowing and treasury management in councils' assessed how councils show best value in borrowing and treasury management decisions. Its specific objectives 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 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.

Purpose of the scrutiny guidance and questions

2. We have developed this guidance to assist councillors in their borrowing and treasury management scrutiny role. Councillors have important responsibilities to ensure that the appropriate level of scrutiny is given to decisions made by council officers.

3. This guidance is intended to be used by councillors as an aide when scrutinising borrowing and treasury management reports and activity. It suggests potential questions that can be asked of council officers. It also outlines the reasons why these questions are important and what type of response should be expected. The suggested questions are for the following areas:

- treasury management strategies and related reports
- borrowing and other financial decisions
- affordability and sustainability
- performance and benchmarking.

4. This guidance is in three parts. Part 1 sets the scene and provides some background to borrowing and treasury management. Part 2 highlights the key responsibilities councillors have in relation to borrowing and treasury management. It also highlights the key scrutiny findings from our audit report. Part 3 contains some questions councillors can use when scrutinising borrowing and treasury management reports and activity.

Part 1

Setting the scene

Councils invest in services for communities

5. A council has a corporate plan setting out its priorities and objectives and how it plans to achieve them (Exhibit 1, page 4) This may, for example, include the priority to build a new school to deal with an expected increase in demand as a result of significant new housing. These plans are often over the medium term, typically three to five years, but may be over a longer term, ie up to 15 years. The council targets its resources, that is people, money and assets, at its priorities and objectives. The corporate plan should feed into the asset management plan to identify what assets are needed to achieve its objectives. For example, this could be building new housing. The council, through a capital investment plan, sets out how it will finance the spending on these assets. This may be by using cash resources, for example cash reserves built up over time or capital grants, or through external finance.

6. Methods of external finance include borrowing, Public Finance Initiative schemes and other mechanisms including Non Profit Distributing schemes, Tax Incremental Financing schemes, or the new Growth Accelerator Model. Entering into external financing arrangements will create debt for the council, and means that the council needs to pay financing charges each year over the life of the arrangement, which may be up to 50 years. It is important for a council to assess the affordability of decisions in the context of the financing charges of its total debt.

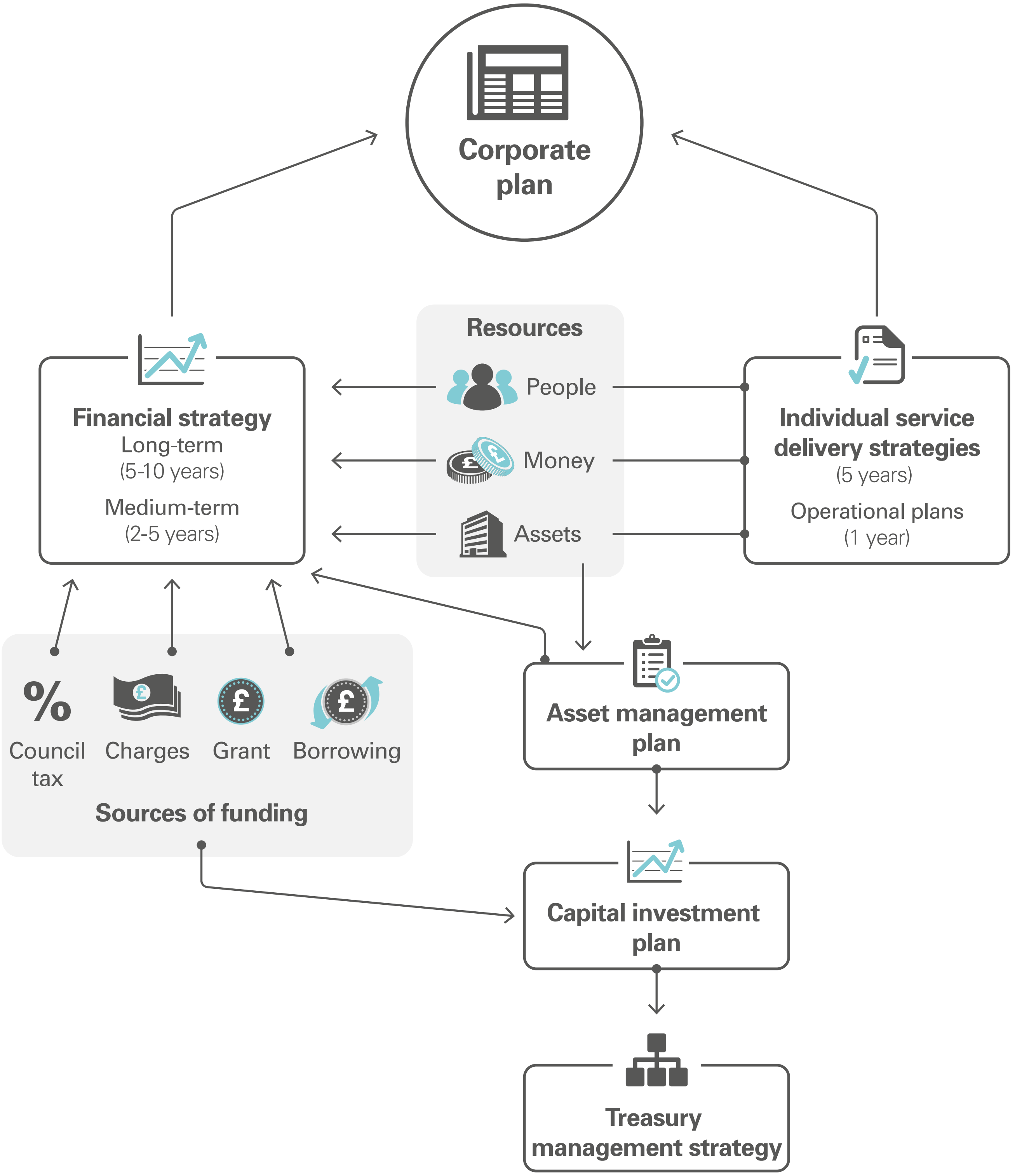
7. Councils should also have medium (two to five year) and long-term (five to ten year) financial strategies. The council will estimate future funding and income, costs and demand for services, and how much it will need to spend to achieve its future objectives. The strategy should identify how the council will make up any shortfall between estimated funding and projected costs and demand. The financial strategy should include the financing cost of borrowing and other debt. This is the annual repayment of interest charged on borrowing or other external financing and any other associated costs. Councils make this repayment out of future budgets, so it decreases the level of available budget remaining and reduces flexibility in future budget decisions.

8. Borrowing involves accessing finance and then repaying it over a longer period of time. These periods can be for up to 50 years, so today's decisions can have a sustained impact on future generations. Borrowing decisions involve a careful balancing act between prioritising investment, and making sure the council can:

- manage the consequences of its decisions over the whole life of the borrowing
- provide evidence showing how it will manage these long-term consequences.

9. Borrowing therefore is set firmly within the framework of wider council activity and should be driven by the corporate plan, capital investment plan and medium and long-term financial strategies (Exhibit 1, page 4).

Exhibit 1
Corporate and strategic influences on treasury management strategy



Source: Audit Scotland

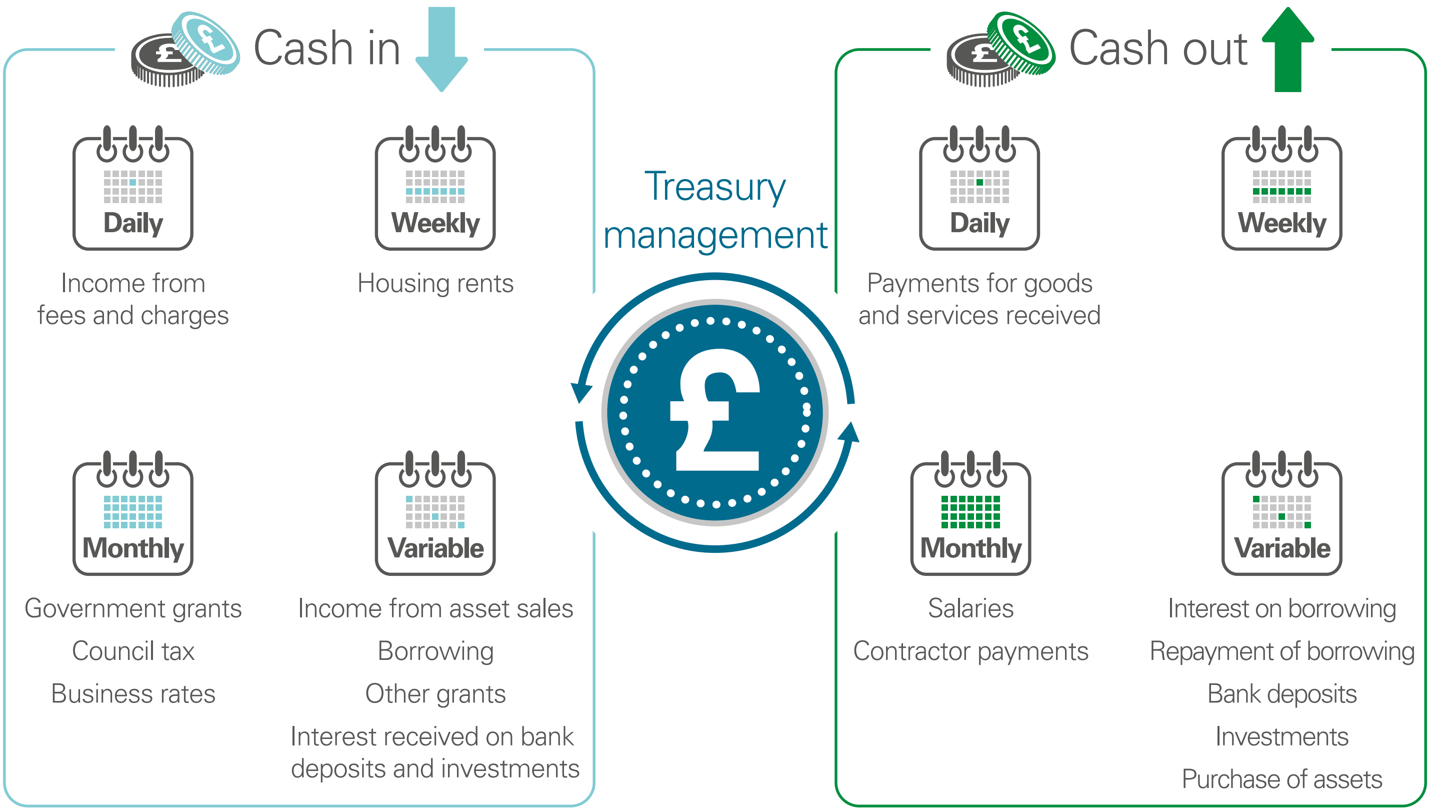
Borrowing is a key part of treasury management

10. Treasury management is the process that councils use to ensure cash is available when needed. This includes day-to-day expenses like paying salaries or electricity bills, and building new assets, such as a new school, or improving existing ones, such as roads. It also involves ensuring that any temporary surplus cash is safely invested. Borrowing is one of the larger cash flows that a council needs to manage, so borrowing is a central part of treasury management. Exhibit 2 shows examples of the typical cash flows in a council together with their timing.

Exhibit 2

Treasury management activities

An example of a council's cash flows with their timing to demonstrate their variability and predictability.



Source: Audit Scotland

11. Councils have two types of budgets to finance and to balance: revenue and capital. Revenue expenditure pays for daily activities like salaries or electricity bills. Capital expenditure is what councils spend on premises, equipment and vehicles; on improvements like roads repairs; and on providing new assets like schools or council houses. Councils can borrow to finance capital expenditure but not revenue expenditure, unless approved by Scottish Ministers. Borrowing charges are revenue expenditure. Councils that own council houses must keep a separate budget and account for revenue and capital expenditure on the housing stock. Borrowing to invest in housing must be repaid from the future housing budget, and therefore funded from future housing rental income.

Councils must comply with borrowing and treasury management rules and regulations

12. In recognition of the importance of capital investment in assets and treasury management to council activities, CIPFA and the Scottish Government set codes of practice and regulations for councils to follow. These ensure that councils have effective processes and practice in place to control, manage and govern capital investment decisions, that include borrowing, and treasury management practices (Exhibit 3).

13. The Prudential Code was introduced in 2004 as a framework to support councils and help them show effective control over levels of, and decisions relating to, capital investment activity, including borrowing. Before this, capital investment levels in councils were government-regulated.

14. This self-regulating approach has enabled councils to adopt borrowing and treasury management strategies that fit with their corporate plans and objectives. The framework allows for councils themselves to judge what is affordable and sustainable and will differ depending on local circumstances. The Prudential Code sits alongside CIPFA's treasury management code, which sets out the requirements for professional treasury management practice.

Exhibit 3
Codes of Practice and Regulations

The Prudential Code for Capital Finance in Local Authorities-CIPFA	A professional code of practice to help councils with capital investment decisions by providing a framework. The Prudential Code sets out indicators that councils must use to help demonstrate public accountability. It also recommends that councils have an integrated treasury management strategy within which its borrowing and investments are managed.
Treasury management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes-CIPFA ('the CIPFA treasury management code')	Adopting this code is a requirement of the Prudential Code. This makes recommendations to provide a basis for councils to create clear treasury management objectives and to structure and maintain sound treasury management policies and practices. A key recommendation is for a treasury management strategy before the start of the year, a mid-year report and an end-year review report.
Finance Circular 5/2010-The investment of money by Scottish local authorities	Provides Scottish ministers' consent for councils investing money and sets out the recommendations and requirements they must meet when making investments. It requires local authorities to 'have regard' to the Prudential Code and the Treasury Management Code and recommends that the strategy form part of a wider single annual strategy covering capital investment, treasury management and prudential information.
Local Government (Scotland) Act 1975	Sets out the statutory basis on which councils can borrow and lend.

Source: Audit Scotland

15. A key requirement of the codes is for councils to produce an annual treasury management strategy before the start of each financial year. CIPFA and the Scottish Government recommend that this is a single integrated strategy that combines plans for capital investment, including borrowing, treasury management, and investment. It also recommends that the strategy includes prudential indicators that are set out within the Prudential Code. These form a set of a 12 limits and ratios that all councils must calculate and use to show to councillors and the public that capital investment plans are affordable and sustainable.

16. Our audit report focused on borrowing, to finance capital investment, and treasury management. Most of the indicators are not specific to borrowing but relate to total capital investment and are calculated using figures for total finance costs, total capital expenditure or total debt. This allows councils to assess the affordability of borrowing in the context of the total debt position of the council. The indicators relating specifically to borrowing are the estimated and actual capital financing requirement. This calculates the amount of capital investment that needs to be met from borrowing or other method of external finance.

17. The prudential indicators are designed to help councils make and record local decisions. They are not designed to be comparative performance indicators across councils as they are set according to the individual needs of each council. In particular, councils had widely different debt positions when the Prudential Code was introduced. These differences are likely to increase over time as councils' choices reflect local priorities. The system is designed specifically to help councils take local decisions in ways that are publicly accountable.

Part 2

Scrutiny responsibilities and report findings

Councillor scrutiny responsibilities

18. Councillors have a key role in holding officers to account. Borrowing and treasury management decisions are complex and involve a significant level of financial risk. It is essential that any decisions are effectively scrutinised to demonstrate sound financial management and help councils achieve their local outcomes and priorities.

19. The main ways in which councillors do this is by scrutinising and approving borrowing and treasury management strategies and reports. Council officers are required to produce an annual treasury management strategy prior to the start of each financial year, which needs to be approved by full council. Councillors should also be presented with a mid-term and year-end report which monitors the progress made against the annual strategy.

20. Prior to approval by full council, these reports should be scrutinised by an appropriate scrutiny committee. Councils' scrutiny committees are a vital part of a council's governance arrangements and it is important that these committees are effective. Councillors on committees need to have a combination of technical knowledge and scrutiny skills for the committee to be most effective.

21. The codes of practice and regulations place certain requirements on a council's governance structure. CIPFA suggest the below allocation of duties and responsibilities for those involved in approving and scrutinising borrowing and treasury management activities (Exhibit 4).

Exhibit 4
Allocation of responsibilities for scrutinising borrowing and treasury management activities

Full council	• Receives and reviews reports on treasury management policies, practices and activities • Approves annual strategy
Committee or panel with responsibility for scrutiny	• Approves or amends the organisation's treasury management policy statement and treasury management practices • Considers and approves budget • Approves the division of responsibilities • Receives and reviews regular monitoring reports and acts on recommendations • Approves the selection of external service providers and agrees terms of appointment • Reviews the treasury management policy and procedures and makes recommendations to the responsible body
The responsible officer	• Monitors the council's compliance with policy and practices • Submits regular treasury management policy reports • Submits budgets and budget variations • Recommends the appointment of external service providers

Source: Audit Scotland

22. There is a responsibility placed on council officers to ensure that councillors are enabled to provide effective scrutiny. This includes ensuring that information provided to councillors is clear and understandable. Officers should also ensure that councillors are aware of the wider impact that borrowing and treasury management decisions can have.

23. Councillors charged with governance have a personal responsibility to ensure that they have the appropriate skills and training for their role. Council officers are responsible for ensuring that councillors have the required level of technical knowledge and scrutiny skills. This is done through providing training to councillors as and when required, which is often part of the induction process at the start of a political term.

Audit findings

24. Our audit report found that councils need to improve scrutiny of borrowing and treasury management. As this is a complex and technical subject, officers need to provide councillors with access to the skills and knowledge they need to carry our their role effectively. The audit report found that current governance structures in some councils could be improved to support more effective scrutiny.

25. We found that some councils use additional scrutiny arrangements in this area. This included using non-executive appointments to provide financial expertise and nominating a lead member on the scrutiny committee for finance. Councillors asked a range of scrutiny questions, from issues of detail to questions of clarification, and all councillors we spoke to would welcome additional support.

26. The layout and content of reports could be improved. In year-end reports, performance monitoring is not reported fully and consistently across councils. Some councils do not provide any comparative data, which makes it difficult to reach an objective opinion on performance. Officers must use accessible language in reports. Many of the strategies and reports we reviewed contained technical language, which does not enable effective scrutiny.

27. Councils do provide both scrutiny training and treasury management training to councillors. Attendance at training sessions is generally poor, but councillors who did attend had positive views. However, some councillors told us that they are not always confident in challenging the strategy or reports. Training and support should equip all councillors with a minimum level of knowledge and understanding. Councillors noted it was often difficult to attend training owing to other commitments.

Audit recommendations for improved scrutiny

Council officers should:

- use the treasury management strategy to present a wider strategic view of borrowing and treasury management. It should use clear and accessible language and be prepared for councillors as the key audience. It should include how the borrowing strategy is informed by corporate priorities and capital investment needs. The strategy should include:
  - links to capital investment plans and corporate objectives
  - all borrowing and other debt
  - prudential indicators as a core part of the strategy
  - a clear assessment of the affordability and the impact on revenue budgets both in the short and long term
- review the content of year-end reports to ensure they provide an assessment of the effectiveness of the year's borrowing and treasury management activities and the performance of the treasury management function. This should include appropriate indicators, comparative figures, and appropriate explanations.

Council officers and councillors involved in treasury management should:

- review governance arrangements, and update as necessary, to ensure they provide:
  - the treasury management strategy, mid-year and year-end reports to the same council committee, and that the full council has access to them
  - councillors with mid-year reports by the end of December each year
  - councillors with the wider picture, that is, make the links to capital investment decisions and revenue budgets
  - councillors with access to all reports relating to borrowing and treasury management activity including risk registers
- ensure scrutiny arrangements are robust by:
  - considering widening the range of training options to councillors on borrowing and treasury management activities and whether this training should be mandatory
  - considering whether training for councillrs provides a balance of scrutiny skills and knowledge of treasury management.

Part 3

Scrutiny checklist for councillors

Questions for councillors on borrowing and treasury management

Question	Why should I ask this?	What do I expect to see/hear in the response from officers?
Treasury management strategy and related reports		
Do the contents of the treasury management strategy and related reports include all recommendations in the CIPFA codes?	The CIPFA codes are best practice guidance and councils should be meeting the guidance. Only in exceptional circumstances should councils not be following the guidance.	Officers should provide assurance that reports meet all recommendations but will highlight any departures from the code with an explanation why.
Do the contents of the treasury management strategy reflect the wider picture of how we plan to meet our capital commitments?	CIPFA's Prudential Code helps councils demonstrate good capital investment decisions. The treasury management strategy reflects how these decisions impact on treasury management activity. Our expectation is that the strategy is self-explanatory.	Minimal additional explanation should be required from officers to explain the wider context.
Borrowing and other financing decisions		
Is the proposed borrowing option the best option for the council?	Other viable financing options may be available. Officers should be considering all options and appraising these.	Officers can explain the other options that they have considered. Officers should be able to demonstrate that they have considered different scenarios. The treasury management strategy should reflect on the options that have been considered and include links to further information.

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Question	Why should I ask this?	What do I expect to see/hear in the response from officers?
What would affect the decision and how will I be informed if the situation changes?	Economic circumstances, such as interest rates, may change throughout the year that will affect decisions. As a councillor you should expect officers to keep you updated on significant changes in circumstances that will affect treasury management decisions.	Officers may be able to offer briefings or updates in these circumstances.
What are the risks?	Treasury management risks should be identified within the appropriate council risk register. In making or approving decisions you need to be aware of the potential risks and how likely they are to emerge. New financing options may have additional or different risks to traditional borrowing.	Officers should: • outline how they identify, monitor and act on treasury management risks • identify and discuss the risks and the likelihood of them occurring • refer to other treasury management risk registers and reports.
Have we received any external advice?	It may be helpful to seek external advice, particularly on new financing options.	Officers should explain the nature of any advice they received and whether or not they took it.
What are other councils doing?	Councils have policies in place, have different circumstances and have to do what is right for them but knowing what other councils are doing can provide assurance on your own decisions.	Officers should: • know whether there are any councils with similar circumstances and draw comparisons • be aware of other councils' borrowing patterns and where they are borrowing from • be aware of new financing options and whether other councils are using them, and their experience of using them.

Cont.

Question	Why should I ask this?	What do I expect to see/hear in the response from officers?
Affordability and sustainability		
Is the borrowing and finance affordable?	Decisions will impact on current and future budgets when finances are already tight.	Officers should: • detail the costs of different options and scenarios • detail the impact of the preferred option on the revenue budget.
What is our current maturity profile for our borrowing?	Borrowing decisions made today have a long-term impact on revenue budgets. The maturity profile shows the future impact of past and current borrowing decisions. It will highlight future periods of demand on the revenue budget. Councils should be trying to 'smooth' their maturity profile, that is, try to ensure as even a spread of debt and demand on the revenue budget as possible.	A chart of maturity dates is usually easier to interpret. Officers will be able to identify future periods of potential financial pressure from the charts. Officers can explain what steps are being taken now to ensure the financial resources are in place in future. Officers can also explain how decisions to borrow will affect the future profile.
How does our profile compare to other councils?	This can highlight whether the council will face similar pressures to others. It is useful for drawing on the experience of other councils.	A chart comparing the council's profiles with others will highlight similarities and differences. Officers can explain similarities with other councils and may be able to explain how other councils plan to deal with similar financial pressures.
What other debt do we have? (Examples include: PPP/PFI, NPD and TIFs)	Commitments to borrow shouldn't be taken in isolation. Other debt has a long-term financial impact.	The treasury management strategy should set out all of the council's existing liabilities. The strategy should indicate the financial commitments and include a link to the detail.
Are we liable for the debt of ALEOs or other external bodies?	Effective risk management includes identifying and monitoring potential financial commitments.	The treasury management strategy should include the nature of debt with ALEOs or other external bodies. Officers should be able to identify debts, what the relationships are, what the nature of the potential debt is and the likelihood of it occurring. Officers should be able to refer to a risk assessment.

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Question	Why should I ask this?	What do I expect to see/hear in the response from officers?
Performance and benchmarking		
What do the prudential indicators tell me?	The indicators use technical terms and are based on figures from the financial statements. They can indicate an increasing proportion of spend on debt repayments and when things are becoming less affordable. It is useful to compare trends year-on-year. There is the potential for comparing trends and patterns with other councils although the indicators are meant to be used by councils individually.	The treasury management strategy should explain, in layman's terms, what the indicators mean. Officers should provide further explanation or clarification. Although indicators are for the use of individual councils, officers may be able to draw trend comparisons with other councils. Officers should explain any action they have taken or plan to take in relation to the indicators.
Is 'under-borrowing' a good thing? What does this mean in practice?	'Under-borrowing' means the council did not need to borrow up to the level of the estimated capital financing requirement. 'Under borrowing' is usually seen as positive but can be a sign of other issues, such as, not accurately identifying the borrowing requirement or slippage in the capital programme.	Officers should explain why this happened, for example, additional money from capital receipts meant the reduced need to borrow less.
Do we have other performance measures?	The Prudential Code sets out the minimum requirements for performance reporting. Councils can introduce other performance measures.	Officers should be able to explain the purpose, details and any necessary remedial action in relation the performance measure.
What do our advisors cost and what do we get for this?	There are very few advisors in the market. The council needs to: • ensure that a thorough and impartial appointment process is in place • have assurance that advice is tailored to the individual authority • ensure that officers ultimately take the decisions.	Officers should provide details of: • the tendering process for appointing the advisors • the cost and terms of the contract, including what services the advisors will provide • examples of advice not taken and why.

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Question	Why should I ask this?	What do I expect to see/hear in the response from officers?
Do we have the treasury management skills that we need?	This is a very technical area that requires suitably skilled and trained staff. CIPFA treasury management qualification is no longer available. It is important to have succession planning: that is, what arrangements are in place if treasury management staff leave.	Officers should be able to: • detail the cost, number of staff and skills/qualifications of those involved in treasury management • justify current staffing requirements • detail future staff needs or training requirements and how they will be met.