**PART ONE** **Item 10**

**To: Joint Audit Committee**

**Date: 10th June 2013**

**By: Ian Perkin, Treasurer**

**Title: Treasury Management Governance Report 2012/13 and Icelandic Bank Update**

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**Purpose of Report/Issue:**

To report on activities and performance of the Police and Crime Commissioner's (PCC's) treasury management function. This report has been made annually to the Police Authority for a number of years under previous guidance.


**Summary:**
This report contains a summary of treasury management activities undertaken during 2012/13, primarily the investment of surplus cash in the last financial year, and shows the prudential indicators for the year.

This report also presents details of the responsibilities which are a requirement of the CIPFA Treasury Management Code of Practice (the Code of Practice) and provides an update on the recovery of funds deposited with the failed Icelandic Banks.


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**Recommendation(s) -**

The Joint Audit Committee is asked to note the contents of this report.

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## Introduction -

### 1 Treasury Management – Statutory Requirements

1.1 Compliance with the CIPFA Code of Practice is a requirement under The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003. The Code of Practice was updated following the collapse of the Icelandic Banks, and its key aim is to ensure that local authorities have in place comprehensive policies and practices for the effective management and control of their treasury management activities, including the effective management and control of risk.

*1.2* Treasury management is defined in the revised Code of Practice as "*the management of the organisation's 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.*

1.3 The table below lists the required treasury management reports and shows the Joint Audit Committee meeting to which they are presented each year:-

| **Treasury Management Governance Report** | **Reported to Joint Audit Comittee** |
|---|---|
| Annual Treasury Management Strategy | March |
| Annual Performance Report (Outturn) | June |
| Mid-year Performance Report | September |

The annual performance report for 2012/13 is set out in Section 2 of this report.

1.4 The revised Code of Practice emphasises that when assessing the performance of a treasury management provider, comparisons should only be made with other providers who have a similar risk appetite, and should always consider the security, liquidity and yield of funds invested. <u>Security and liquidity must always have priority over yield.</u>

## 2 Treasury Management Transactions 2012/13

The following treasury management transactions were undertaken in 2012/13:

2.1 Short Term Lending

In accordance with agreed policy, surplus cash was lent on a daily basis to Surrey County Council (SCC). The following loans were made during the year:

| | | |
|---|---|---|
| Number of Loans | | 251 |
| Total Interest Received | | £93k |
| Average Interest Earned | Q1 | 0.68% |
| | Q2 | 0.53% |
| | Q3 | 0.52% |
| | Q4 | 0.50% |

The average rate of return for the year was 0.56%, above the average London Inter-Bank BID rate (formerly Local Authority 7 day rate) for the same period of 0.39%.

2.2 Over the past year the PCC's treasury management provider, SCC, has continued to implement a risk averse approach to its management strategy. It did not breach any of the criteria in its approved investment strategy in respect of counterparty, sector or national limits, or the maximum term of a deposit for individual counterparties: criteria which are designed to protect the security and liquidity of funds.

2.3 Since the Icelandic experience, SCC have followed an extremely cautious approach, placing deposits only with UK banks and building societies. For these reasons, there continues to be a low level of risk associated with the PCC's existing treasury management arrangements.

2.4 The cost to the PCC for the services of Surrey County Council for 2012/13 was £16,694

2.5 Short Term Borrowing

All cash balances are lent overnight allowing us the flexibility to draw on our own resources. However, in June 2012, SCC provided a short term cash loan of £1.53m for a period of 1 day at a cost to the Force of £28.

2.6 Long Term Borrowing

No long term external borrowing was undertaken during the year, and no external long term debt was outstanding at the year end.

2.7 Future Borrowing Requirements

There is currently no requirement to borrow for the 2013/14 capital programme assuming sales of police stations/houses continue as planned. Sales in April 2013 alone has secured capital receipts in excess of £7.7m including the sale of Farnham Police Station (£4.5m), sale of Dorking Police Station (£1.5m) and sale of East Molesey Police Station (£0.6m) against a planned capital spend of £14.2m (see Appendix 3).

2.8 General

Surrey County Council's treasury management officers monitor cash flow on behalf of Surrey Police and aggregate this with their own cash flow, before making appropriate investments on behalf of both organisations. Accordingly there was no requirement to deal with brokers or bankers during 2012/13.

## 3 Treasury Management Prudential Code indicators

3.1 Prudential Code indicators specific to treasury management are designed to ensure that treasury management is carried out in accordance with good professional practice.

3.2 The 2012/13 indicators for the year are set out at Appendix 1. Please note that these indicators have been prepared on the basis that the PCC's investment policy will remain unchanged.

## 4 Icelandic Banks Update

4.1 Surrey County Council placed £20m of deposits with two failed Icelandic Banks: Glitnir and Landsbanki. Of this £20m, the exposure for the PCC for Surrey was £1.5m. Surrey Police had previously made a provision of £0.4m in the event that a proportion of the deposits would not be recovered, this may be revised based upon the latest information and guidance from CIPFA.

4.2 On 28th October 2011, the Supreme Court of Iceland ruled that UK local authorities' claims qualified as priority claims. This means that the values of local authorities' claims in the Icelandic administrations, qualify for priority settlement. These decisions are now final and there is no further right of appeal.

4.3 The current position is that 50% of the Landsbanki deposit and approximately 84% of the Glitnir deposits have been repaid, with expected recovery rates now at 100% in respect of both banks (subject to exchange rate fluctuations). The balance owed on each deposit is shown in the following table.

Balances owed on Icelandic bank deposits - Joint SCC/Surrey Police

| Counterparty | Period (days) | Total Principa £000 | Rate % | Principal repaid £000 | Principal oustanding £000 |
|---|---|---|---|---|---|
| Glitnir | 364 | 5,000 | 6.25% | 4,192 | 808 |
| Glitnir | 366 | 5,000 | 6.20% | 4,193 | 807 |
| Landsbanki | 732 | 10,000 | 5.90% | 4,992 | 5,008 |
| | | 20,000 | | 13,377 | 6,623 |

Balances owed on Icelandic bank deposits - Surrey Police

| Counterparty | Period (days) | Principa l £000 | Rate % | Principal repaid £000 | Principal oustanding £000 |
|---|---|---|---|---|---|
| Glitnir | 364 | 375 | 6.25% | 314 | 61 |
| Glitnir | 366 | 375 | 6.20% | 314 | 61 |
| Landsbanki | 732 | 750 | 5.90% | 374 | 376 |
| | | 1,500 | | 1,002 | 498 |

## 5 Benchmarking of Treasury Management services from Surrey County Council

Following a recent benchmarking exercise it was found that Surrey County Council (SCC) continues to provide a Treasury Management (TM) service which is competitively priced. They also provide a competitive rate of return on our investments. Presently, we are getting a return of 0.6%, which is more favourable when compared to other Police Forces who outsource their TM (see Appendix 6).

The annual charge for TM services by SCC is £16,694 which is also very competitive when compared to charges incurred by others. For example, Kent Police are charged £13,000 for a 0.3% rate of return.

Boroughs managing TM in-house achieved a better rate of return but they invest over a longer period which yields higher interest. They also make riskier and varied investments (such as property markets and off shore investments), again this gives them higher yields.

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**Equalities Implications –** There are no equalities implications arising from this report.

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**Risk-** – The following risk arises from this report:

- If the PCC does not produce an annual performance review of treasury management activity in line with the CIPFA Treasury Management Code of Practice there is a risk of censure from the auditors and reputational damage as a consequence.

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**Human Rights –** There are no human rights implications arising from this report.

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**Attachments:**

Appendix 1 **–** 5 - 2012/13 Prudential Indicators

Appendix 6 – Benchmarking of Treasury Management

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**Background papers –**

This document has been prepared with due regard to:-

Surrey Police Prudential Indicators 2012/13,

CIPFA The Prudential Code for Capital Finance in Local Authorities – 2011 edition

CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes – 2011 edition

CIPFA Treasury Management in the Public Services: Guidance Notes for Local Authorities including Police Authorities and Fire Authorities – 2011

CIPFA LAAP bulletin 82 – Update No. 7 – May 2013

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**Contact details -**


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|---|---|
| **Name:** | Sue Eaton |
| **Job Title:** | Financial Accountant |
| **Telephone number:** | 01483 630696 |
| **Email address:** | eaton10499@surrey.pnn.police.uk |

**Prudential Indicators For Affordability**

| No. | Indicator | Definition | Last Year's Actual | This Year's Actual | Future Year Targets | | | Comments |
|---|---|---|---|---|---|---|---|---|
| | | | 2011/12 | 2012/13 | 2013/14 | 2014/15 | 2015/16 | |
| 1 | **Ratio of financing costs to net revenue stream** | Financing costs / net revenue stream * 100% | 0.10% | 0.29% | 0.29% | 0.29% | 0.28% | The figures are positive when the PCC is a net borrower. The numbers are very small because interest payable on borrowing represents a very small proportion of our net revenue stream. |
| 2 | **Estimate of the incremental impact of capital investment decisions on the council tax precept** | (i) Forecast total budgetary requirements for the authority based on no change to the existing capital programme *less* (ii) Forecast total budgetary requirement for the authority with the changes to the capital programme included in the calculation.<br>(iii) Take the difference between (i) and (ii) and calculate the addition or reduction to Council Tax that would result | n/a | n/a | £0.00 | -£0.03 | -£0.03 | The figures are decreasing as the revenue costs associated with the planned borrowing for the capital programme increase (MRP and interest payable). They will reduce as the principal is repaid. |

**Prudential Code** **Appendix 2**

**Prudential Indicators For Prudence**

| No. | Indicator | Definition | | Last Year's Actual 2011/12 £'000 | This Year's Actual 2012/13 £'000 | Future Year Targets 2013/14 £'000 | Future Year Targets 2014/15 £'000 | Future Year Targets 2015/16 £'000 | Comments |
|---|---|---|---|---|---|---|---|---|---|
| 1 | **Borrowing and the capital financing requirement** | An authority must ensure that external borrowing does not, except in the short term, exceed the capital financing requirement in the preceding year plus the estimates of any capital financing requirement for the current and next 2 financial years. | | ✓ | ✓ | ✓ | ✓ | ✓ | It will not be necessary to finance the 2013/14 capital programme from borrowing. As a result of the continued OPR programme of selling Police Stations and Police Houses, there are available resources to fully finance the capital programme. |

| | 2011/12 | 2012/13 | 2013/14 | 2014/15 | 2015/16 |
|---|---|---|---|---|---|
| Investments | -9,532 | -8,537 | -12,558 | -14,503 | -11,821 |
| External borrowing | 0 | 0 | 0 | 0 | 0 |
| **Capital Financing Requirement to be monitored against existing borrowing** | **14,388** | **13,676** | **12,970** | **12,277** | **11,597** |
| **Is net external borrowing > total capital financing requirement?** | NO | NO | NO | NO | NO |
| **Management action required** | None | None | None | None | None |

**Prudential Code** **Appendix 3**

**Prudential Indicators For Capital Expenditure**

| No. | Indicator | Definition | Last Year's Actual | This Year's Actual | Estimated Future Year Targets | | | Comments |
|---|---|---|---|---|---|---|---|---|
| | | | 2011/12 £'000 | 2012/13 £'000 | 2013/14 £'000 | 2014/15 £'000 | 2015/16 £'000 | |
| 1 | **Total Capital Expenditure** | Total capital expenditure incurred | 10,234 | 8,249 | 14,167 | 6,150 | 5,350 | As per the Capital Programme. |
| 2 | **Capital Financing Requirement** | Fixed assets, deferred charges, revaluation reserve, capital adjustment account plus government grants deferred (plus, for future years, future capital expenditure less usable capital receipts, grants, contributions etc.) | 14,388 | 13,676 | 12,970 | 12,277 | 11,597 | The figures increase as the amount of the capital programme funded by borrowing increases; and it will reduce in the future as the principal is repaid. |

**Prudential Indicators For External Debt**

| No. | Indicator | Definition | Last Year's Actual | This Year's Actual | Future Year Targets | | | Comments |
|---|---|---|---|---|---|---|---|---|
| | | | 2011/12 £'000 | 2012/13 £'000 | 2013/14 £'000 | 2014/15 £'000 | 2015/16 £'000 | |
| 1 | **Authorised Limit** | Authorised limit for external debt = authorised limit for borrowing + authorised limit for other long term liabilities | | | 18,673 | 17,835 | 17,012 | Equals the operational boundary for external borrowing plus a provision of 10% to meet any potential cash flow fluctuations. |
| 2 | **Operational Boundary** | Operational boundary for external debt = operational boundary for borrowing + operational boundary for other long term liabilities | | | 17,146 | 16,384 | 15,636 | The operational boundary provides sufficient latitude to borrow externally to fund the entire capital programme in the event that none of the anticipated capital grants or capital receipts are received. |
| 3 | **Actual External Debt** | Actual external debt = actual borrowing + actual other long term liabilities as at 31st March each year. | 1,879 | 1,879 | | | | These figures represent the long term liability outstanding for one property lease. |

**Prudential Code**

**Prudential Indicators For Treasury Management** **Appendix 5A**

| No. | Indicator | Definition | Last Year's Actual | This Year's Actual | Future Years Targets | | | Comments |
|---|---|---|---|---|---|---|---|---|
| | | | 2011/12 | 2012/13 | 2013/14 | 2014/15 | 2015/16 | |
| 1 | **Treasury Management** | The PCC must adopt the CIPFA Code of Practice For Treasury Management in the Public Services | YES | YES | YES | YES | YES | |

**Treasury Management Indicators**

| No. | Indicator | Definition | Last Year's Actual | This Year's Actual | Future Years Targets | | | Comments |
|---|---|---|---|---|---|---|---|---|
| | | | 2011/12 | 2012/13 | 2013/14 | 2014/15 | 2015/16 | |
| 2a | **Upper Limit On Variable Interest Rate Exposure** | Variable interest rate exposure = interest payable on variable rate borrowing less interest receivable on variable rate investments | 0% - 100% | 0% - 100% | 0% - 100% | 0% - 100% | 0% - 100% | The use of variable or fixed rate loans will be decided in consultation with the PCC's Treasury Management provider (SCC) as the need arises. |
| 2b | **Upper Limit On Fixed Interest Rate Exposure** | Fixed interest rate exposure = interest payable on fixed rate borrowing less interest receivable on fixed rate investments | 0% - 100% | 0% - 100% | 0% - 100% | 0% - 100% | 0% - 100% | |
| | Projected interest payable on borrowing (£000s) | | £0 | £0 | £0 | £0 | £0 | The assumption is that all borrowing will be external. |
| | Projected interest receivable on investments (£000s) | | -£164 | -£95 | -£100 | -£101 | -£102 | |

| No. | Indicator | Definition | 2011/12 Lower | 2011/12 Upper | 2012/13 Lower | 2012/13 Upper | 2013/14 Lower | 2013/14 Upper | 2014/15 Lower | 2014/15 Upper | 2015/16 Lower | 2015/16 Upper | Comments |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 3 | **Maturity Structure of Borrowing** | Amount of projected fixed rate borrowing that is maturing in each period/Total projected fixed rate borrowing at the start of the period * 100% | | | | | | | | | | | |
| | | | Lower | Upper | Lower | Upper | Lower | Upper | Lower | Upper | Lower | Upper | |
| | | Under 12 months | 0% | 100% | 0% | 100% | 0% | 100% | 0% | 100% | 0% | 100% | |
| | | 12 months and within 24 months | 0% | 100% | 0% | 100% | 0% | 100% | 0% | 100% | 0% | 100% | |
| | | 24 months and within 5 years | 0% | 100% | 0% | 100% | 0% | 100% | 0% | 100% | 0% | 100% | |
| | | 5 years and within 10 years | 0% | 100% | 0% | 100% | 0% | 100% | 0% | 100% | 0% | 100% | |
| | | 10 years and above | 0% | 100% | 0% | 100% | 0% | 100% | 0% | 100% | 0% | 100% | |

| No. | Indicator | Definition | 2011/12 | 2012/13 | 2013/14 | 2014/15 | 2015/16 | Comments |
|---|---|---|---|---|---|---|---|---|
| 4 | **Principal Sums Invested For Periods Longer Than 364 days (£000's)** | Total principal sums invested to final maturities beyond the period end | £0 | £0 | £0 | £0 | £0 | The SCC Treasury Management strategy allows for longer term investment, however at this time all investments are limited to a maximum period of 364 days. |

## Benchmarking of Treasury Management services from Surrey County Council

**Appendix 6**

| Name of Organisation | Managed in house or outsourced | Average Interest | Charges incurred | Name of advisors | Types of investments | If in house, how many FTE involved? |
|---|---|---|---|---|---|---|
| Elmbridge Borough Council | in house | 2.22% | £8,000 | £8K is the charge for Advisory services from Sector | Fixed term cash deposits up to 1 year | 1 |
| Guildford Borough Council | in house | 1.06% | £14,000 | £14,000 for advisory services to Arlingclose | Money Market Funds and Banks | |
| Hampshire Police | Hampshire CC | 0.93% | £13,700 | | longer period investments e.g. 2 years | |
| Kent Police | Kent CC | 0.33% | £13,000 | | | |
| Mole Valley District Council | in house | 1.39% | £7,275 | £7.3K is the charge for Advisory services from Sector | Mainly short-term investments, call accounts and a couple of loans that are for greater than 364 days | 1 |
| Reigate & Banstead Borough Council | in house | 1.84% | £8,500 | £8,500 is the charge for advisory services from Sector | Fixed rate deposits or LIBOR tracking investments with cap and collar | 0.5 |
| Spelthorne Borough Council | in house | 1.59% | £14,000 | £14,000 for advisory services to Arlingclose | Cash deposits, CD's, Treasury Bills, EIB bonds and pooled equity & property funds | 0.5 |
| Surrey Heath Borough Council | in house | 0.85% | £6,000 | £6,000 for advisory services to Sterling International Brokers Ltd | Investments made in accordance with the CLG guidance on Local Authority Investments, on the basis of Fitch, Moody's and Standard & Poors credit ratings | 0.5 |
| Sussex Police | W Sussex CC | 0.70% | £14,500 | | | |
| Tandridge District Council | in house | 1.65% | £11,700 | Sterling Cash Management Services £4,200 pa . Arlingclose Advisory Services £7,500 pa | Reserve Accounts, Money Market Funds and Short Term loans | 2 + cover |
| Thames Valley Police | in house | 1.58% | £14,500 | £14.5K is the charge for Advisory services from Sector | Fixed term investments and use of MMF and call accounts | 2 + manager |
| Waverley Borough Council | in house | 1.20% | £9,000 | £9K is the charge for Advisory services from Sector | | |
| Woking Borough Council | in house | 0.40% | £8,200 | £8,200 is the charge for advisory services from Sector | Were just using Money Market Funds, but currently not using anything. | 0.5 |
| | | | | | | |
| Surrey Police | Surrey CC | 0.56% | £16,694 | | | |