

To: **Joint Audit Committee**

Date: **22nd June 2015**

By: **Ian Perkin, Treasurer**

Title: **Treasury Management Policy Statement and Strategy 2015 to 2018**

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

This report presents the updated Treasury Management Policy Statement and Strategy 2015 to 2018, to replace the previous strategy.

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### **2. Summary**

The Prudential Code requires the Police and Crime Commissioner (PCC) to approve a Treasury Management Strategy. In accordance with the CIPFA Code of Practice on Treasury Management, this strategy is based upon CIPFA's key recommendations, suggested policy statement and 12 treasury management practices.

The attached strategy has been updated to reflect working practices for the PCC and minor changes in legislation. There have been no significant changes since the previous strategy was approved.

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### **3. Recommendations**

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

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# Treasury Management Strategy

## 1. Introduction

- 1.1 This strategy document has been prepared with due regard to the Prudential Code, the CIPFA Code of Practice on Treasury Management and Cross-Sectoral Guidance Notes 2011 Edition and guidance issued by the Department for Communities and Local Government in relation to section 15(1)(a) of the Local Government Act 2003.
- 1.2 Its purpose is to set out a medium to long term strategy for investment of surplus funds and borrowing activities for the PCC. It identifies the risks and opportunities encompassed in those activities and, provides guidance for day to day decision making in these areas. In practice, these functions are carried out by SCC and therefore this document mirrors their strategy.
- 1.3 In accordance with *the CIPFA Code of Practice* on Treasury Management, this strategy is based upon CIPFAs key recommendations, suggested policy statement and 12 treasury management practices (TMPs), see Appendix A.

## **2 Reporting Requirements**

The PCC is required to review/approve, as a minimum, the following reports each year, which incorporate a variety of policies, estimates and actual outturn.

- PCC will approve an annual Treasury Management Policy Statement and Strategy
- PCC will approve borrowing limits and other prudential indicators
- PCC will review six monthly reports (annual and mid-year) on activities and performance of the Treasury Management function

## **3 Treasury Management Policy Statement**

The Office of the Police and Crime Commissioner defines its treasury management activities as:

- The management of cash flows, banking, money market and capital market transactions.
- The effective control of the risks associated with those activities.
- The pursuit of optimum performance consistent with those risks.

### **3.1 Risk appetite**

The appetite for risk is low. A premium is placed on the security of capital in terms of investment and on the maintenance of financial stability in terms of the costs of borrowing.

### **3.2 Risk management**

The monitoring and control of risk is considered to be the prime criteria by which the effectiveness of treasury management activities will be measured.

### **3.3 Value for money**

The Force is committed to the principle of achieving best value in treasury management. Although returns on investment remain low, this is offset by the competitive cost of the treasury management service provided by Surrey County Council (SCC).

### **3.4 Borrowing policy**

Currently, the PCC has no requirement to borrow and there is no requirement to borrow externally in the immediate future whilst there are sufficient cash balances available to utilise.

## **4 Current Arrangements**

- 4.1 SCC perform the treasury management function on behalf of the PCC therefore the treasury management strategy mirrors their strategy (see 5 below).
- 4.2 Cash balances are monitored on the PCC's behalf under a service level agreement with SCC. They aggregate any PCC surpluses with their own for investment in the money market and pay interest to the PCC based on their quarterly borrowing rate.
- 4.3 Since 2009/10, SCC has followed an extremely cautious approach as a direct result of their experience with Icelandic Banks. Moving into 2015/16, no significant changes are proposed to the treasury management strategy reflecting the current economic climate and risk appetite.
- 4.4 SCC use specific credit ratings to determine which institutions can be used for investments.
  - For specified investments, an institution will require the highest short-term credit rating from at least one of the three main credit rating agencies.
  - SCC does not expect to make non-specified investments.

## **5 Surrey County Council Investment Strategy 2015/16**

The relevant points from the SCC Strategy for the PCC are:

- 5.1 The primary consideration governing the Council's investment strategy is security first, liquidity second, and then return on investment as the third priority.
- 5.2 Since 2009/10 the Council have followed an extremely cautious approach as a direct result of their experience with Icelandic banks. Moving forward into 2015/16, no significant changes are proposed to the treasury management strategy reflecting the current economic climate and risk appetite. Only the use of approved counterparties from countries with a minimum sovereign credit rating of AAA from their three rating agencies. This restriction does not apply to the UK which has seen its AAA rating reduced.
- 5.3 All investments will be limited to 364 days maintaining the Council's desired level of prudent risk.
- 5.4 The bank rate is forecast by the Council's advisors to remain unchanged at 0.5% before starting to rise from quarter 4 of 2015.

The full SCC Treasury management Strategy Statement and Prudential indicators 2015/20 can be viewed at:

<http://mycouncil.surreycc.gov.uk/mgConvert2PDF.aspx?ID=19449&ISATT=1#search=%22treasury%20management%20policy%22>

**Background papers:**

CIPFA: The Prudential Code

CIPFA: The Prudential Code, Guidance Notes

Local Government Act, 2003

Surrey County Council: Treasury Management Strategy

CIPFA Treasury Management in Public Services – 2011 Edition

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**Police and Crime Commissioner for Surrey**

Treasury Management Practices (TMP)

2015 to 2018

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## Introduction

The objectives set out in the policy statement can be achieved through the adoption of CIPFA's 12 treasury management practices (TMPs), which deal in some detail with the following issues:

- TMP1 Risk management
- TMP2 Best value and performance management
- TMP3 Decision-making and analysis
- TMP4 Approved instruments, methods and techniques
- TMP5 Organisation, clarity and segregation of responsibilities, and dealing arrangements
- TMP6 Reporting requirements and management information arrangements
- TMP7 Budgeting, accounting and audit arrangements
- TMP8 Cash and cash flow management
- TMP9 Money laundering
- TMP10 Staff training and qualification
- TMP11 Use of external service providers
- TMP12 Corporate governance

### 1.1 Risk Management (TMP1)

#### 1.1.1 Liquidity

Purpose: To avoid the risk that cash will not be available when it is needed, that ineffective management of liquidity creates additional unbudgeted costs, and that the PCC's police and crime plan will be compromised.

#### Current arrangements

Approved minimum cash balances	£0
Approved minimum short-term investments	£0

#### Bank overdraft arrangements:

Net overdraft, in case of need	£20,000
Government Procurement Cards, issue of cards	£1,000,000
BACS (payment of salaries)	£10,000,000

Currently, day-to-day cash balances are monitored on our behalf under a service level agreement with Surrey County Council. They aggregate any PCC surpluses with their own for investment in the money market and to pay interest to the PCC based on their quarterly internal borrowing rate.



### 1.1.2 Interest rate

Purpose: To avoid the risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the PCC's finances, against which it has failed to protect itself adequately.

Current arrangements: Currently, the PCC has no requirement to borrow. The Prudential Code requires the authority to fix each year the proportions of interest on borrowing and investment which may be subject to either fixed or variable rates. Since our investment activity is undertaken by Surrey County Council, it is important to ensure that any limits set by the PCC do not conflict with the County Council's prevailing limits. In order to achieve this both fixed and variable rate exposure the upper and lower limits for the PCC have been set at 0% and 100% respectively.

Surrey County Council employs a treasury consultant to advise on treasury strategy, provide economic data and interest rate forecasts. Their advice has been that the bank rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 4 on 2015.

The investment returns expectations by Surrey County Council's treasury consultant is shown in the table below.

<b>Period</b>	<b>Base Rate</b>
2015/16	0.50%
2016/17	0.75%
2017/18	1.25%

### 1.1.3 Exchange rate

Purpose: To avoid the risk that fluctuations in foreign exchange rates create an unexpected or unbudgeted burden on the PCC's finances, against which it has failed to protect itself adequately.

Current arrangements: The PCC's investments with Surrey County Council are not at any exchange rate risk as monies are not invested in foreign currencies.

### 1.1.4 Inflation

Purpose: To avoid the risk that prevailing levels of inflation cause an unexpected or unbudgeted burden on the PCC's finances, against which it has failed to protect itself adequately.

Current arrangements: Inflation has been included in the 2015/16 budget at the following rates:

	Employees	Utilities	Fuel	Rent & Rates
2015/16	1%	2%	2%	2%

### 1.1.5 Credit and counterparty

Purpose: To avoid the risk of failure by a third party to meet its contractual obligations under an investment, borrowing, capital, project or partnership financing arrangement, particularly as a result of the third party's diminished creditworthiness, and the resulting detrimental effect on the PCC's capital or revenue resources.

Current arrangements: The PCC's only direct counterparty in relation to treasury management is Surrey County Council. All investments made by Surrey County Council are made in accordance with that Council's investment policies and prevailing legislation and regulations.

### 1.1.6 Legal and regulatory

Purpose: To avoid the risk that the PCC, or a third party, fails to act in accordance with its legal powers or regulatory requirements, and to ensure that the Force suffers no losses accordingly.

Current arrangements: It is a requirement of the service level agreement with Surrey County Council that they obtain satisfactory documented evidence that any counterparties are acting within their powers and that they have met the requirements of the Data Protection Act, the Money Laundering Regulations, 2003 and any other relevant legislation.

### 1.1.7 Fraud, error and corruption, and contingency management

Purpose: To minimise the risk that the PCC fails to identify the circumstances in which the Force might be exposed to losses through fraud, corruption and other eventualities in its treasury management dealings, and fails to employ suitable systems and procedures and maintain effective contingency management arrangements to these ends. This includes the area of risk commonly referred to as operational risk.

Current arrangements: Surrey County Council has adopted the CIPFA treasury management practices and will accordingly look to minimise risk in this area. Whilst much reliance is placed upon Surrey County Council, the OPCC monitors the cash balances and interest payments on a regular basis as part of the budget monitoring function, this in turn minimises risk in this area.

### 1.1.8 Market value of investments

Purpose: To avoid the risk that, through adverse market fluctuations in the value of principal sums that the PCC invests, its stated treasury management policies and objectives are compromised, against which effects it has failed to protect itself adequately.

Current arrangements: Interest on our investment with Surrey County Council is based on the average interest on investments by the County. The County Council has embraced the spirit of the Prudential Code and has stated that it will take a cautious approach to its treasury strategy but that borrowing and investment will "take the most appropriate form depending on the prevailing

interest rates at the time". The County Council currently uses only those instruments for investment that have no impact on the market value of principal sums. The County's treasury strategy would also permit the use of:

- Negotiable bonds
- Bills
- Stock issues
- Sterling Commercial Paper, and
- Sterling Medium Term Notes

Their proposed use would be subject to prior approval by the County's Audit & Governance Committee.

## **1.2 Best value and performance measurement (TMP2)**

1.2.1 The following methods, policies and benchmarks will be applied for evaluating the impact of treasury management decisions:

- Value for money  
The Force is committed to the principle of achieving best value in treasury management. Although returns on investment are low, this is offset by the competitive cost of the treasury management service provided by Surrey County Council (SCC). SCC continue to provide value for money.
- Banking Services  
The PCC currently uses the services of the HSBC.

## **1.3 Decision-making and analysis (TMP3)**

1.3.1 Day-to-day investment decisions are taken on behalf of the PCC by Surrey County Council.

1.3.2 A quarterly record is provided by Surrey County showing the daily balances that have been invested and the average internal rate of return applied.

## **1.4 Approved instruments, methods and techniques (TMP4)**

The PCC has adopted the approved instruments, methods and techniques recommended by Surrey County Council, as follows:

### **1.4.1. Investment**

The following instruments are available to use for investment:

- Gilts
- Treasury Bills
- Deposits with banks, building societies and local organisations (and certain other bodies)
- Certificates of Deposits with banks or building societies
- Sterling Money Market Funds

- Government Debt Management Agency Deposit Facility

Surrey County Council will lend to the following organisations on a short-term basis; no lending is done to any organisation on a long-term basis:

- Banks and Building societies meeting the leading criteria
- Local Authorities as set out in the Local Government Act 2003
- Enhanced Cash/Corporate Bonds pooled funds

#### 1.4.2 Approved Methods of Raising Finance

The following list specifies the borrowing instruments, on and off balance sheet, which may be utilised in seeking to achieve the Treasury Management objectives. All these instruments are permitted for use:

Short-term: All instruments repayable within one year.

Long-term: Loans from Public Works Loan Board (PWLB), Bonds and Mortgages.

Overdraft: The PCC may borrow by overdraft, i.e. short-term, from authorised banks or the Bank of England.

Leasing: Operating leases fall outside of the capital controls, therefore this form of finance will be used where legally possible for the purchase of equipment and vehicles (the PCC's current policy is to purchase vehicles outright under the Joint Transport Service led by Sussex Police).

### **1.5 Organisation, clarity and segregation of responsibilities, and dealing arrangements (TMP5)**

1.5.1 The overall responsibility for treasury management lies with the PCC, who has plenary powers in relation to all borrowing and investment matters.

1.5.2 The Treasurer takes overall responsibility for implementing the treasury management policy.

1.5.3 The Treasurer is responsible, under Section 151 of the Local Government Act 1972, for ensuring that the treasury management operation complies with the needs of the PCC and that its financial affairs are properly administered.

1.5.4 Day to day responsibility for treasury management rests with the Treasurer.

1.5.5 The day-to-day administration of treasury management is carried out by staff of Surrey County Council under the terms of a service level agreement. The approved activities of the Treasury Management Providers are as follows:

- Cash flow management (daily balances and longer term forecasting)
- Investing surplus funds in approved investments
- Interest rate exposure management
- Dealing with brokers and other external finance specialists

Four London Brokers, as shown below, are authorised to deal for Surrey County Council:

- Sterling International Brokers
- Tullet Prebon
- RP Martins
- Tradition

## **1.6 Reporting requirements and management information arrangements (TMP6)**

1.6.1 The Treasurer will:

- prepare an annual Treasury Management Policy Statement and Strategy for the PCC to approve.
- recommend borrowing limits and other Prudential Indicators to be considered by the PCC as part of the budget setting process.
- report every six months (at the end of year and mid-year) to the PCC on the activities and performance of the Treasury Management function.

## **1.7 Budgeting, accounting and audit arrangements (TMP7)**

1.7.1 Annual revenue budgets will include estimates of expected earnings on investment based on cash flow predictions for the forthcoming year and an examination of economic conditions and forecasts considered jointly with the PCC's treasury management provider at an annual review meeting that will take place in December each year.

1.7.2 Annual revenue budgets will also include the expected cost of the provision of treasury management services and any direct overheads. Currently, this estimate is for an annual fee for the work carried out by Surrey County Council for which Surrey County Council is required, under the terms of a service level agreement, to provide an estimate prior to the start of each financial year. The payment to Surrey County Council is based on 17% of the gross salary costs of their appointed senior finance officer for treasury, 8.5% of a pension fund and treasury manager plus 20% to cover the cost of administrative overheads.

## **1.8 Cash and cash flow management (TMP8)**

1.8.1 Under the terms of the current arrangement with Surrey County Council, daily cash flow monitoring is carried out by the treasury management provider supported by information supplied by the Officer of the Police and Crime Commissioner relating to:

- Precept and grant income flows
- Cheque and BACS payment runs
- Payroll payment runs
- Other known receipts and payments in excess of £100,000 per transaction

1.8.2 In reviewing the effectiveness of treasury management services, the Office of the Police and Crime Commissioner maintains a historic record of actual cash flow, daily balances, returns on investment from Surrey County Council and a variety of benchmark interest rates including:

- LIBID 7 day rates
- SCC average rate of return

## **1.9 Money laundering (TMP9)**

1.9.1 Surrey County Council is required to comply with the Money Laundering Regulations as are all UK professionals when they engage in financial and investment activities.

## **1.10 Staff training and qualifications (TMP10)**

1.10.1 The PCC is aware of the growing complexity of treasury management in general, and its application to the public sector in particular. Modern treasury management demands appropriate skills, including:

- A knowledge of money and capital market operations
- An awareness of available sources of funds and investment opportunities
- An ability to assess and control risk, and
- An appreciation of the implications of legal and regulatory requirements

1.10.2 The PCC has a personal development system that should identify staff requiring training and support in treasury management functions. This is balanced with the service provided by SCC.

## **1.11 Use of external service providers (TMP11)**

1.11.1 Treasury management functions are provided by Surrey County Council under a service level agreement.

## **1.12 Corporate governance (TMP12)**

- 1.12.1 This document should be read in conjunction with the scheme of Governance documents which includes financial regulations and a scheme of delegation.
- 1.12.2 It is considered that this document taken as a whole with the service level agreement with Surrey County Council for the provision of treasury management activities, demonstrates a robust, rigorous and disciplined set of processes that are designed to balance prudence and sound risk management with the pursuit of the optimum return on investment.
- 1.12.3 Reporting arrangements have been designed to demonstrate openness and clarity whilst maintaining an appropriate split of duties and responsibilities.
- 1.12.4 In respect of the organisation's dealings with counterparties, external service providers and other interested parties, clear procedures have been developed to enable the PCC, as far as is practicable, to monitor their adherence to the legal or regulatory regimes under which they operate.