

**SURREY COUNTY COUNCIL**  
**INTERNAL AUDIT REPORT**

**Review of Treasury Management 2015/16**

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<b>Glossary:</b>	SCC - Surrey County Council
	TM - Treasury Management
	MMF - Money Market Funds
	PWLB – Public Works Loan Board

**Audit opinions:**

<b>Effective</b>	Controls evaluated are adequate, appropriate, and effective to provide reasonable assurance that risks are being managed and objectives should be met.
<b>Some Improvement Needed</b>	A few specific control weaknesses were noted; generally however, controls evaluated are adequate, appropriate, and effective to provide reasonable assurance that risks are being managed and objectives should be met.
<b>Significant Improvement Needed</b>	Numerous specific control weaknesses were noted. Controls evaluated are unlikely to provide reasonable assurance that risks are being managed and objectives should be met.
<b>Unsatisfactory</b>	Controls evaluated are not adequate, appropriate, or effective to provide reasonable assurance that risks are being managed and objectives should be met.

## 1. INTRODUCTION

- 1.1 Treasury Management (TM) is defined by CIPFA as “the management of the organisation’s investments and cash flows, its banking and money market capital transactions; the effective control of the risks associated with those activities: and the pursuit of optimum performance consistent with those risks”.
- 1.2 CIPFA’s TM code sets out various principles, indicators and practices to be applied by all public bodies. These include adoption of a framework, policy and strategy, use of prudential indicators, risk management, organisational control and cash flow management.
- 1.3 TM activity is carried out by the Pension Fund and Treasury team based in County Hall. As at 2 December 2015, there was £184.6m on short term deposit and there were long term loans totalling £397m.
- 1.4 A review of TM was included as part of the 2015/16 Annual Internal Audit Plan and was undertaken in line with the Terms of Reference included at Annex A. This report sets out the findings of the review. An agreed Management Action Plan accompanies this report at Annex B.

## 2. WORK UNDERTAKEN

- 2.1 Checks were carried out to ensure the following:
  - a) Suitable investment and borrowing strategies were in place, supported by policy and written procedures.
  - b) Risks were properly identified and recorded, with mitigation arrangements in place
  - c) Means of forecasting next day cash balances and requirements were methodical and logical, enabling suitable short-term investment decisions to be made.
  - d) Organisational control and staffing arrangements were satisfactory.
  - e) Investments were executed in line with strategy, properly controlled and justified.
  - f) Borrowing was properly justified, authorised, controlled and in line with prudential indicators and local strategy.
  - g) Payments, notably deposits with money market funds and other financial institutions, were suitably authorised, controlled and monitored.
  - h) External TM advisory service providers were appointed in line with financial regulations and that their performance was satisfactory.
  - i) Records of investment and borrowing were formally reconciled to the financial system (SAP) on a regular basis.
  - j) Interest receivable or payable was collected or paid on due dates and correctly recorded on SAP.
  - k) Suitable performance indicators were in place, and that performance was scrutinised by Finance management and the monitoring body.

## 3. OVERALL AUDIT OPINION AND RECOMMENDATIONS SUMMARY

- 3.1 The overall opinion following this audit is **Effective**.
- 3.2 Controls evaluated are adequate, appropriate, and effective to provide reasonable assurance that risks are being managed and objectives should be met.

3.3 **Recommendations analysis:** There are five low priority recommendations arising from this review, details are summarised in the table below:

Rating	Definition	No.	Para. ref.
<b>High</b>	Major control weakness requiring immediate implementation of recommendation	-	-
<b>Medium</b>	Existing procedures have a negative impact on internal control or the efficient use of resources.	-	
<b>Low</b>	Recommendation represents good practice but its implementation is not fundamental to internal control.	5	5.1.5, 5.4.5, 5.8.5, 5.10.4, 5.11.3
	<b>Total number of audit recommendations</b>	5	

#### 4. MANAGEMENT SUMMARY

- 4.1 The TM function complies with all the CIPFA code requirements and performs effectively although there is some scope for marginal improvement in terms of:
- producing a comprehensive office manual complete with written procedures, and
  - holding paper-based records more securely.
- 4.2 A detailed strategy statement for 2015/16 was produced and presented to the Audit & Governance Committee in July 2015. A policy statement has been created and is maintained.
- 4.3 A risk register is maintained and all respective risks and mitigating factors appear to have been identified.
- 4.4 Tests confirmed that routine tasks, such as preparation of cash flow calculations and determination and arrangement of short term and medium term investments were managed effectively. Although the TM team consists of only three staff, there is a sufficient number of reserve staff who are able to perform routine daily tasks if necessary.
- 4.5 Finance management acknowledge that the current investment strategy is risk-averse and possibly over-cautious, mainly in light of the collapse of the Icelandic banks in 2008. Investment strategy is continuously reviewed, but in line with CIPFA guidance, current investment policy is such that it protects capital and availability of funds ahead of return, summarised as “security, liquidity and yield only once the former two are satisfied”.
- 4.6 In terms of long-term borrowing, SCC remains well within the prudential measures. Borrowing amounts to £397m, 97% of which are low interest fixed rate loans from the Public Works Loan Board (PWLB). Borrowing strategy is regularly reviewed with reference to potential future changes to interest rates.
- 4.7 In view of the findings of the Internal Audit review, which are set out in more detail in section 5 below the audit opinion is: **Effective**.

#### 5. FINDINGS AND RECOMMENDATIONS

##### 5.1 Policies and Procedures

###### Findings

- 5.1.1 There is a clear strategy statement for 2015/16, which includes reference to prudential indicators, and an up to date policy document. The policy document covers risk appetite, risk management, value for money, and borrowing and investment policy.
- 5.1.2 Financial Regulations dated October 2014 make reference to Treasury Management at paragraphs 7.5 to 7.9 and this sets out the high level roles and responsibilities, In

particular, the Director of Finance will ensure that treasury management activities administered within the parameters defined and agreed by Council and those defined by statutory requirements and professional best practice.

- 5.1.3 CIPFA guidelines recommend the existence of a formal “office manual” which should include details of policy, strategy, and procedures to be followed for administering the system. Although the TM team work within a clear framework and use established routines for ensuring activities are administered correctly, there are no comprehensive written procedures and there is no “office manual”. Some process notes are in existence but these have not yet been incorporated into a comprehensive office manual.

#### Risk

- 5.1.4 Guidance and reference documentation available to TM staff may be insufficient to enable them to discharge their responsibilities in line with set procedures and standards.

#### Recommendation

- 5.1.5 In line with CIPFA guidance, an office manual, incorporating the existing treasury management practices, should be produced containing comprehensive background information (i.e. policy, strategy) and formal desk instructions to be followed when carrying out routine responsibilities.

### **5.2 Risk Register**

- 5.2.1 A risk register is in place, with twelve risks identified. The assessment documentation covers the expected risks associated with TM. The two main risks identified are the risk of interest rate fluctuations when borrowing and an over-prudent investment strategy. Both of these risks are closely scrutinised on a continuous basis by the TM team with regular consultation with the Audit & Governance Committee.

### **5.3 Staffing**

#### Findings

- 5.3.1 The TM team consists of 3 members (the Strategic Manager, the Senior Accountant and the Senior Finance officer). All staff are sufficiently qualified, trained and experienced to carry out their roles. The Strategic Manager manages the planning of longer term borrowing and lending but is not involved in daily administrative tasks. Most of the administrative tasks, which include collecting data affecting next day cash flow, estimating next day cash flow requirements and proposing short term lending agreements, are performed by the Senior Finance Officer. The Senior Accountant routinely carries out supervisory checks and approves short term lending arrangements. Current staffing arrangements are considered satisfactory, providing sufficient management check and separation of duties.
- 5.3.2 Where TM staff are absent from duty, there are satisfactory arrangements in place to provide cover. Several Finance staff who have previously worked in the TM team can be relied upon to deputise when necessary.

### **5.4 Cash Flow Management**

#### Findings

- 5.4.1 There is a set daily routine whereby details of cash holdings and expected income and expenditure are recorded on the daily balances sheet in order to forecast next day opening bank balances. The TM team aim for next day opening balance forecasts to be as accurate as possible. Evidence on daily balance sheets (and the cash flow listings which summarise movements over a historical period) suggests forecasting is generally effective.

- 5.4.2 Each daily balances sheet is supported by the HSBC bank statements, which also show the next day's expected payments and listings of holdings in every other account (such as the Police Fund and every individual school balance). Details of other known anticipated movements in and out of the bank (such as payroll, loan repayments, rates payable etc) are attached to the daily balances sheet for retention in a local file. All such evidence in the two month test period (October and November 2015) was found to be available for audit inspection.
- 5.4.3 Any abnormal variances between estimated and actual opening balances are investigated and accounted for by the TM Team. Brief details of reasons for significant variances are annotated on the daily balances spreadsheet. For example, an opening balance deficit of £10.3m on 23 November 2015 was annotated as "police precept and failed transfer".
- 5.4.4 Details of what constitutes an abnormal variance are not formally specified but are understood to be in the region of £200k for under-estimates and £30k for over-estimates. Variances in this range were recorded on nine occasions out of 43 working days in October and November 2015. However the auditor was of the opinion that forecasting was reasonable and there were no systemic reasons for any failure to provide reasonable estimates of cash holdings.

#### Risk

- 5.4.4 Criteria for investigating reasons for inaccurate cash flow forecasting may not be sufficiently formal and recorded reasons may not be sufficiently clear.

#### Recommendation

- 5.4.5 A formal procedure for investigating reasons for cash flow forecasting variances should be prepared and incorporated into the office manual. Acceptable tolerances should be stated. Reasons for individual variances should be recorded in more detail than at present so that any systemic issues can be more easily identified.

### **5.5 Lending (Cash Deposits)**

#### Findings

- 5.5.1 In the current economic climate, and in the light of problems experienced after the failure of the Icelandic banks in 2008, the recent strategy for lending has been to place money with money market funds (MMFs) and banks with high credit ratings. Placing money with local authorities via a broker is also permitted to achieve better interest rates and diversification. This conservative low-risk approach meets CIPFA's criteria of "security, liquidity then yield".
- 5.5.2 Under the terms of the agreed policy (which was ratified by the Audit & Governance Committee) up to £25m can be placed in each MMF (e.g. Goldman Sachs, JP Morgan and Morgan Stanley). Funds of up to £25m can also be deposited in banks with suitable credit ratings (currently minimum A+ rated by at least two credit agencies). Up to £60m can also be deposited with UK banks that have nationalised status. Deposits of up to £20m can also be placed with other local authorities. TM staff, Finance Management, and the Audit & Governance Committee acknowledge that the strategy may be over-cautious but strategy is under continuous review and a revised strategy is to be presented in February 2016.
- 5.5.3 In the course of the current financial year up to the end of November 2015, the maximum sums deposited into any account were as scheduled on the table overleaf:

Name	Type	Max sum deposited
Morgan Stanley	Money Market Fund	£25m
Goldman Sachs	Money Market Fund	£25m
JP Morgan	Money Market Fund	£25m
Insight	Money Market Fund	£25m
Aberdeen	Money Market Fund	£25m
Santander	Credit rated bank	£20m
Goldman Sachs Intl.	Credit rated bank	£20m
Lloyds	UK bank (nationalised status)	£60m
NatWest	UK bank (nationalised status)	£60m
Nationwide BS	Credit rated Building Society	£20m
Cornwall CC	Local Authority	£20m
Eastleigh	Local Authority	£20m
Fife	Local Authority	£20m
North Lanarkshire	Local Authority	£20m
Salford	Local Authority	£20m
Woking	Local Authority	£20m
West Dumbartonshire	Local Authority	£20m

5.5.4 It was therefore confirmed that all cash deposits made in the period examined were fully compliant with SCC's strategy and policy.

5.5.5 Deposit sheets are raised for each investment made and these are independently checked and authorised. The auditor questioned the basis of making specific deposits with local authorities and accepted that each investment decision was made to achieve the best possible return on investment within the approved investment strategy.

## 5.6 Payment Controls (On Line Banking)

### Findings

5.6.1 Payments of funds deposited into the various financial institutions are made on-line using the HSBC online account payments system. This is a two stage payment process ensuring separation of the proposal and authorisation duties. Each staff member uses a PIN token to access the HSBC online account. PIN tokens are accounted for satisfactorily and 22 tokens are in circulation, having been issued to relevant staff.

5.6.2 Access to Sungard, the system which enables staff to view MMF activity is restricted to six staff all of whom have a genuine operational access requirement.

## 5.7 Long Term Borrowing

### Findings

5.7.1 Long term borrowing as at December 2015 totalled £397m. All borrowing is from the Public Works Loan Board (PWLB) with the exception of one loan of £10m that was taken out with Barclays in 2003.

5.7.2 The extent of long term borrowing is well within the Prudential Indicator limits. The authorised limit is £668m and the operational boundary limit is £599m. These figures, which have been corroborated by the auditor against records held by Finance, were reported in the half-year report presented to the Audit & Governance Committee on 7 December 2015.

5.7.3 Also as stated in the half year report, borrowing in 2014/15 totalled £160m, all from the PWLB. The three most recent loans are detailed overleaf:

PWLB Loan No.	Date of Loan	Sum Borrowed	Interest rate	Term
503741	16/02/2015	£30m	3.27%	50 years
503779	28/02/2015	£30m	3.29%	50 years
503824	19/03/2015	£30m	3.19%	46 years

5.7.4 These long-term loans above were arranged to fund the balance of the external borrowing requirement for 2015/16 which was forecast as £90m and to take advantage of the low fixed term interest rates that were offered by the PWLB. The available audit trails (such as e-mails and meeting notes) made it clear that the loans had been properly discussed with both the Deputy Chief Finance Officer and the Director of Finance, and then formally approved by the Director of Finance.

## 5.8 Reconciliation of Records to Financial Ledgers (SAP)

### Findings

5.8.1 Details of lending and borrowing are recorded on SAP. TM staff reconcile SAP details to supporting office records on a regular basis.

5.8.2 Details of interest payable and received are also recorded on SAP. Cross checks carried out by the auditor between SAP and local records and bank statements gave assurance that records were up to date and accurate.

5.8.3 As at 2 December 2015, details of long term borrowing recorded on SAP account 8660 matched office records. The overall total of short term investment loans recorded on SAP account 8374 (£184.6m) also matched office records, but SAP narrative details of investments with individual organisations did not match, as shown below.

SAP (£m)	Investment / Fund	TM records (£m)
1.8	Morgan Stanley MMF	25.0
0.0	Goldman Sachs MMF	1.8
20.0	JP Morgan MMF	25.0
17.8	Insight MMF	17.8
25.0	Aberdeen MMF	25.0
31.4	Santander	20.0
20.0	GS International	20.0
45.0	Lloyds 32 day	20.0
10.0	Lloyds fixed	10.0
20.0	Nationwide	20.0
5.0	Natwest	0.0
-6.4	Lloyds 1 day	0.0
-5.0	Warrington BC	0.0
<b>184.6</b>	<b>TOTAL</b>	<b>184.6</b>

### Risk

5.8.4 Details of investments with individual institutions may not be recorded accurately on SAP.

### Recommendation

5.8.5 TM staff should continue to periodically review details of deposits recorded on SAP and if necessary request that appropriate action is taken to ensure that details of individual deposits are correct.

## 5.9 Monitoring and Reporting

### Findings

- 5.9.1 In line with CIPFA expectations, TM provide detailed half-yearly and annual updates to the Audit & Governance Committee. The most recent report issued was the half-year report produced on 7 December 2015. This report covered the investment and borrowing position, prudential indicators, debt maturity profile, return on investments, member and officer training, external advisors, counterparty limits and risk.
- 5.9.2 In terms of organisational control, the auditor was satisfied that routine TM performance and key issues and decision making was being monitored by the Strategic Manager, and that regular verbal updates were being provided to the Deputy Chief Finance Officer or the Director of Finance.
- 5.9.3 Key issues and relevant decisions are suitably outlined in strategy documents and updates prepared by the Treasury Strategic Manager.

## 5.10 Use of External Service Providers

### Findings

- 5.10.1 In line with CIPFA guidance, external advisors have been appointed to provide regular information designed to assist TM decision making.
- 5.10.2 Up until recently, the external advisors were Capita Asset Management. The contract for services has recently been re-tendered and Arlingclose Limited was selected in January 2016. However a formal contract has not yet been signed.

### Risk

- 5.10.3 It is possible that services could be provided before a contract is in place.

### Recommendation

- 5.10.4 The contract for the provision of external advisory services should be signed as soon as possible.

## 5.11 Security of Data

### Findings

- 5.11.1 Data security was found to be satisfactory although it was noted that routine paperwork such as daily balances sheets and deposit sheets were not locked away overnight or when not in use.

### Risk

- 5.11.2 TM records may not be held sufficiently securely.

### Recommendation

- 5.11.3 To protect against loss of TM records, notably daily balances sheets, supporting records and deposit sheets, routine paperwork should be held more securely and locked away overnight in the existing lockable cupboard which is located in the TM office.

## 6. ACKNOWLEDGEMENT

- 6.1 The assistance and cooperation of all the officers involved in the completion of this audit is greatly appreciated.

## **TERMS OF REFERENCE**

### **Treasury Management 2015/16**

#### **BACKGROUND**

Treasury Management is the management of Surrey County Council's (SCC):

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

The Treasury Management code issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) identifies the following three principles whilst acknowledging the difficulties between striving for effective risk management and control and pursuing value for money:

- ensuring that public bodies put in place the necessary framework to ensure the effective management and control of treasury management activities;
- that the framework clearly states that responsibility for treasury management lies clearly within the organisation and the strategy clearly states their appetite for risk; and
- that value for money and suitable performance measures should be reflected in the framework.

The code clearly states that the aim of the investment policy of the organisation should be to protect capital and availability of funds before the returns from them. It further states that although local authorities may use the facilities provided by external Treasury Management Advisors, the responsibility for treasury management must always remain with the authority and cannot be passed to an external party.

#### **PURPOSE OF THE AUDIT**

The audit will seek to gain assurance that controls over the associated risks are satisfactory. The main risks have previously been identified as follows:

- Failure to adequately protect the Council against the risk of fluctuations in interest rates creates an unexpected or unbudgeted burden on the Council's finances;
- Collapse of the council's main bankers, leading to a total shutdown of banking services and an inability to pay invoices or bank income, and a possible loss of balances held;
- Failure to adequately protect the Council against the risk of loss through fraud, error, corruption and to maintain effective contingency management arrangements;
- Counterparty risk within the SCC treasury management operation;
- Failure to adequately protect the Council against unauthorised access to offices or computer systems, leading to theft of private data, causing reputational and financial damage;
- Concentration of knowledge in small number of officers and risk of departure of key staff; and
- Inaccurate cash flow forecasts for Treasury Management leads to shortfalls on cash levels & redemptions necessary to ensure that funds available.

In view of the size and nature of transactions within SCC's treasury management activities and the requirement for SCC to comply with CIPFA's Treasury Management Code, the review of this function is included as part of the key financial program for 2015/16.

## WORK TO BE UNDERTAKEN

The audit will review the following areas:

- Treasury Management policies, procedures and practices in place and whether they are complied with;
- Production of cash flow statements and whether they are accurate, produced in a timely manner, reviewed and monitored in order to take appropriate actions as required;
- Segregation of duties and whether they are in place for the various tasks undertaken as part of delivering the treasury management function and sufficiently evidenced with management trails;
- Use of external Treasury Management Advisors and the application of the advice they provide;
- Accuracy of treasury management records with regard to their day-to-day use in treasury management operations; and
- Reasonableness of information reported to the June 2015 Audit and Governance Committee.

## OUTCOMES

The findings of this review will form a report to Surrey County Council management, with an overall audit opinion on the effectiveness of systems in place and recommendations for improvement if required. Subject to the availability of resources, and the agreement of the auditee, the audit will also seek to obtain an overview of arrangements in place for:

- Data quality and security;
- Equality and diversity;
- Value for Money; and
- Business continuity.

The outcome of any work undertaken will be used to inform our future audit planning processes and also contribute to an overall opinion on the adequacy of arrangements across the Council in these areas.

## TIMESCALES

Audit fieldwork will commence on 30 November 2015 and it is anticipated that the findings and recommendations arising from this review will be reported to Audit and Governance Committee on 22 February 2016. To achieve this, the report will need to be finalised by 21 January 2016.

## REPORTING ARRANGEMENTS

Auditor:	John Edwards, Lead Auditor
Supervisor:	Simon White, Audit Performance Manager
Reporting to:	Sheila Little, Director of Finance Phil Triggs, Strategic Manager, Pensions and Treasury