

Treasury Management Panel Bulletin

Treasury Management – Update

December 2009

Introduction

Following the collapse of the Icelandic Banks, treasury management in public sector organisations continues under the spotlight. Two national reports were published, the Audit Commission's "Risk and Return" on local authority treasury management and the Communities and Local Government Select Committee's Review of local authority investments.

This Treasury Management Bulletin provides an update on CIPFA's work to date and planned workload on treasury management.

It should be noted that this bulletin constitutes advice only. It does not have the status of formal guidance under legislation.

This Bulletin covers the following:

- Revised Treasury Management Code and Guidance
- Revised Prudential Code
- Consultation
- Response to the Select Committee Report
- Assessing the credit worthiness of counterparties
- Joint Qualification with the Association of Corporate Treasurers
- Member Training
- Treasury Management Key Skills
- Future Work for the TM Panel

Revised Treasury Management Code and Guidance

The reports from the Communities and Local Government Select Committee and the Audit Commission and the feedback received in the consultation process helped to inform the revised code and guidance, which are now available from the CIPFA shop.

<http://www.cipfa.org.uk/codes/>

The revised Treasury Management Code has been strengthened after the Select Committee Report endorsed the overarching framework of the original code: "The principles enshrined in the Government guidance and the CIPFA Codes are clearly correct".

The areas strengthened are as follows:

Minimum reporting requirements – The original Code required two reports each year, one prior to the start of the financial year which set the strategy and one after the close of the financial year reporting operational activity compared to the strategy. The revised Code requires that in addition to these two reports, as a minimum, a mid year report is also presented to the body responsible for approving the budget. The aim of this report is to give those with overall responsibility for treasury management an opportunity to consider treasury management at a time when they are not approving the budget.

Whilst the Code specifies the minimum reporting requirements to full Council, organisations should ensure that their reporting is appropriate and relevant and keeps those responsible for treasury management fully informed.

Scrutiny – An organisation's strategy should identify the body responsible for the scrutiny of treasury management. This is to ensure that treasury management receives the appropriate focus. It is best practice for the strategy to be scrutinised prior to its approval, with scrutiny during the year being an ongoing process.

Training for those charged with governance – The responsible finance officer must ensure that appropriate training is available in order for those responsible for treasury management can effectively discharge their duties. This includes those charged with governance and officers. The Code also stresses that those charged with governance recognise their individual responsibilities to ensure that they have the necessary skills to complete their role effectively.

Approval – the consultation process sought comment on the practicalities of a body other than that which approves the budget (for example executive or cabinet) to approve the treasury management strategy. Whilst there were some positive comments about this leading to more effective scrutiny the overarching concern was about the disadvantages of divorcing the budget approval, MRP policy, Annual investment strategy and prudential indicators from the treasury management strategy. Hence the approval of the strategy remains as the body which approves the budget.

This means that the strategy and amendments to it should be approved by full council, whereas a relevant committee may approve changes to operational process, such as Treasury Management Practices or policy statements. Where policy statements are part of the strategy these should be approved by full council.

Revised Prudential Code

The Prudential Code has been revised and has taken into account feedback following the consultation process and has also considered the implications of the implementation of International Financial Reporting Standards (IFRS).

The key changes are an increased emphasis on capital planning and asset management and a number of changed definitions to take into account IFRS.

In addition three of the treasury management indicators have been moved to the treasury management code where they are more appropriate. All prudential and treasury management indicators should continue to be approved together by the body who approves the budget.

The two Codes are effective for the financial year commencing 1 April 2010. This means that organisation's treasury management strategies for 2010/11 will need to reflect the new requirements and Prudential Indicators should be set on the revised definitions. That said, whilst the revised Prudential Code is effective from 1 April 2010, until balance sheets are restated for IFRS the definitions in the original Code definitions may still need to be used. Similarly, once the 2009/10 balance sheet has been restated for IFRS the 2009/10 Prudential Indicators will need to be calculated using the definitions in the revised Code.

Organisations are reminded that where they have PFI or leases which are coming onto the balance sheet for the first time, that they should review the impact on their prudential indicators, especially the authorised limit and operational boundary.

Consultation

Attention is drawn to two separate consultations, one from the Department of Communities and Local Government (CLG) and the other from the Public Works Loans Board (PWLB).

The CLG consultation is asking for comments on proposed changes to the Capital Finance Regulations, Investment Guidance and Minimum Revenue Provision Guidance, with a deadline of **4 January 2010**.

The key changes to the investment guidance are as follows:

- the guidance makes even clearer that the investment priorities should be **security and liquidity**, rather than yield
- investment strategies should still go to the full council at the start of each year, but authorities are encouraged to consider submitting **revised strategies** at other times
- strategies should be **published**
- authorities should not rely just on **credit ratings** but consider also other information on credit risk
- strategies should comment on the use of **treasury management consultants**
- strategies should comment on the investment of **money borrowed in advance of spending needs**

- strategies should report on the procedures for ensuring that the authority's treasury management staff have the right kind of training in investment management.

The PWLB consultation is seeking comment on proposed changes to PWLB interest rate setting in order to reduce the differential loan rates and prepayment debt and has a deadline of **8 January 2010**.

Links to both are below:

<http://www.communities.gov.uk/publications/localgovernment/changefinanceconsultation>

<http://www.dmo.gov.uk/documentview.aspx?docname=PWLB/condoc20090928.pdf&page=>

Response to the Select Committee report

CIPFA was grateful for the opportunity to input to the Select Committee's inquiry and welcomed the Select Committee's report and in particular its support for the measures proposed in the recent Treasury Management Bulletin produced by the Treasury Management Panel. Robust scrutiny of treasury management within local authorities is vital in making sure that taxpayer's money is managed effectively and safely.

To download the full response see link below:

http://www.cipfa.org.uk/panels/treasury_management/download/response_to_communities_and_loc_gov_select_committee_sep09.pdf

Assessing the Credit Worthiness of Investment Counterparties

The Select Committee expressed concern that there was an over reliance by local authorities on credit ratings alone when assessing the credit worthiness of counterparties. They recommended that local authorities should be made aware of wider financial information. Whilst the revised code and guidance notes warns authorities not to place sole reliance on credit ratings it was not felt appropriate to detail other potential sources of information in the Code or guidance notes as they would quickly become out of date. The Code does stress the importance of considering country, sector and group limits when considering counterparties.

In addition the following identifies some of the possible sources of additional information in order to assess the credit worthiness of investment counterparties:

- **Quality financial press** – watch for any market rumours
- **Credit default swaps** - CDS are a financial instrument for swapping the risk of debt default. The buyer of a credit default swap pays a premium for effectively insuring against a debt default. He receives a lump sum payment if the debt instrument is defaulted. The seller of a credit default swap receives monthly payments from the buyer. If the debt instrument defaults they have to pay the agreed amount to the buyer of the credit default swap. Absolute prices can be unreliable, however trends in CDS spreads do give an indicator of relative confidence about credit risk.

- **Share price**– changes in share prices are an indicator of market confidence
- **Annual reports**
- **Statements to the market**
- **Information on government support for banks**– if a government is likely to step in to support a bank then this reduces the risk of default
- **Credit ratings of that government support**– how much weight should you place on potential support from a government that does not itself have a high credit rating?
- **The rates being paid** - If they're out of line with the market, there's a reason and could indicate that the investment is likely to carry a high risk
- **What other banks are saying** - Rumours spread quickly in markets
- **Information provided by management advisors**– this is may include some of information detailed above.
- **Market price (and movement in the market price) of existing debt securities issued by counterparties** – if other lenders are getting worried about a particular counterparty they will be selling the counterparty's debt securities and, by doing so, pushing down the price of those securities in the market.

Joint Qualification with the Association of Corporate Treasurers

Students have now started the on the first course and enrolments are now being taken for the second sitting. This starts on 12 April 2010 with the exam scheduled for 7 October 2010. The enrolment deadline is 31 March 2010.

The course is designed to give students a fundamental understanding of the core aspects of treasury management. Whilst the course does have a public sector focus, it also covers many aspects of treasury management which are currently relevant to corporates rather than public bodies. The reason for this is as follows:

- Firstly, knowledge of these areas helps put the public finance aspects of the course into context, showing the contrast between the two sectors and enhancing understanding of treasury in the public finance world.
- Secondly, it ensures that students are aware of areas of treasury management which may at some point in the future have relevance in public bodies.
- Thirdly it is to ensure that students have a well grounded qualification that enables them to transfer skills to other sectors.

The course has optional 5 days tuition and 2 revision days. It is web based and aimed to take between 150 to 200 hours of study. For more information see the link below:

<http://www.treasurers.org/qualifications/certitmpf>

Member Training

The revised Treasury Management Code enhances the role of members, especially in relation to scrutiny of treasury management strategy, policy and processes. In order to perform their duties it is essential that those charged with governance receive appropriate training, which is also strengthened in the Code. CIPFA can assist you to assess your requirements and provide individual training which has been developed from existing scrutiny training. Join with neighbouring authorities to gain even better value for money. **To find out more contact ann.mcfadyen@cipfa.org.uk.**

Treasury Management Key Skills

In order to assist public sector organisations to ensure that those responsible for treasury management have the necessary skills, the CIPFA Panel have developed a key skills table as detailed below.

	Key Skills #
Those responsible for approval	<p>Knowledge of:</p> <ul style="list-style-type: none"> the regulatory framework governing borrowing and investments <p>Overview of the organisation's:</p> <ul style="list-style-type: none"> approach to management of its treasury risks powers to invest and borrow
Those charged with governance	<p>Clear understanding of the organisation's:</p> <ul style="list-style-type: none"> powers to invest and borrow <p>Understanding of:</p> <ul style="list-style-type: none"> the regulatory framework governing borrowing and investments the different types of treasury risk the different types of instruments available for use <p>Knowledge of:</p> <ul style="list-style-type: none"> The organisation's portfolio and the instruments it is using the organisation's treasury management practices key risk and performance management techniques the key driver's in the organisation's cash flow the liquidity needs of the organisation
Responsible finance director	<p>Extensive knowledge of:</p> <ul style="list-style-type: none"> the regulatory framework governing borrowing and investments <p>Detailed understanding of:</p> <ul style="list-style-type: none"> the different types of treasury risk the approach to management of its treasury risks the sources of treasury advice and their status <p>Detailed knowledge of:</p> <ul style="list-style-type: none"> the techniques being used to manage risk and performance the organisation's delegations and treasury management practices <p>Understanding of:</p> <ul style="list-style-type: none"> personal responsibilities, especially if a CIPFA member the different types of instruments available for use and their key risks the key driver's in the organisation's cash flows the organisation's liquidity position and potential calls against cash reserves the organisation's debt and investment profiles and their impact on liquidity <p>Knowledge of:</p> <ul style="list-style-type: none"> the relevance of the Financial Services and Markets Act 2000 and market regulation <p>Overview of:</p> <ul style="list-style-type: none"> general market conditions

Treasury Manager	<p>Extensive knowledge of:</p> <ul style="list-style-type: none"> the regulatory framework governing borrowing and investments <p>Detailed understanding of:</p> <ul style="list-style-type: none"> the different types of treasury risk the approach to management of its treasury risks the techniques being used to manage risk and performance the organisation's portfolio and the instruments it is using the organisation's liquidity position and potential calls against cash reserves <p>Understanding of:</p> <ul style="list-style-type: none"> how the treasury risks can be mitigated and the instruments available for this the sources of treasury advice and their status <p>Detailed knowledge of:</p> <ul style="list-style-type: none"> the contractual arrangements with brokers and advisors the organisation's delegations and treasury management practices the organisation's debt and investment profiles and their impact on liquidity market procedures and their applicability to the organisation's activities and compliance by their own organisation <p>Knowledge of:</p> <ul style="list-style-type: none"> the relevance of the Financial Services and Markets Act 2000 and market regulation general market conditions <p>Ability to:</p> <ul style="list-style-type: none"> produce and interpret the organisation's cash flow forecast and model the impact of key variables
Treasury Officer	<p>Detailed knowledge of:</p> <ul style="list-style-type: none"> the organisation's delegations and treasury management practices the organisation's portfolio and the instruments it is using market procedures and their applicability to the organisation's activities and compliance by their own organisation <p>Understanding of:</p> <ul style="list-style-type: none"> the regulatory framework governing borrowing and investments the relevance of the Financial Services Act and Markets Act 2000 and market regulation approach to management of its treasury risks the different types of instruments available for use and their key risks the need to forecast cash flow and liquidity cash flow forecasts the key liquidity needs of the organisation <p>Knowledge of:</p> <ul style="list-style-type: none"> general market conditions

In addition to the above, all CIPFA members who are responsible for treasury management must adhere to the CIPFA Standards of Professional Practice on Treasury Management which can be found at <http://cipfa.org.uk/conduct/standards.cfm>

Future Work programme for the TM Panel

The next Panel Bulletin will cover the services provided by and regulation of Treasury Management Advisors. Both the advisors and the Financial Services Authority will be involved in its production.

The Panel will continue its work promoting excellent treasury management practice across the public services. This will include work on risk management in 2010, which follows on from the discussion paper produced in October 2008, which can be found at the link below:

http://www.cipfa.org.uk/panels/treasury_management/download/risk_management_discussion_paper_oct2008.pdf

FEEDBACK/COMMENTS

If you have any feedback/comments on any item in this bulletin or any questions on the work of the panel, please email mandy.bretherton@cipfa.org.uk