

**PART ONE**

**To: Joint Audit Committee**

**Date: 22<sup>nd</sup> June 2015**

**By: Ian Perkin Treasurer**

**Title: Surrey County Council Treasury Management Internal Audit Report 2014/15**

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**1). Introduction**

The Police & Crime Commissioners Treasury Management Function is carried out by Surrey County Council under the terms of a Service Level Agreement (SLA) which was renewed in April of this year.

**2). Treasury Management Internal Audit**

As part of the on- going monitoring of the operation of this agreement, twice-yearly management meetings will take place not later than the 31 March and 31 October each year and these meetings encompass not only contract performance in the preceding 6 month period and discussions about future treasury strategy, but will also cover the latest available Treasury Management Internal Audit Report.

For members information attached to this paper is the Surrey County Council (SCC) Treasury Management Internal Audit Report for 2014/15, together with the SCC Management Action Plan (MAP).

All of the recommendations made in the Internal Audit Report have been addressed and regarding the final MAP recommendation: any changes to money market fund repayment bank details requires two signatories, so the Pension Fund Strategic Manager would not on his own to have been able to arrange payments from the money market fund portal (Sun Guard) as indicated in the report.

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**Recommendation**

The Committee is asked to note the contents of the report and provide any appropriate advice and comment to the Police & Crime Commissioner on the Surrey County Council Internal Audit Report and Management Action Plan

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**Equality and Human Rights Implications:** None arising

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**Risk:** No specific risks arise from this report.

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<b>Contact details</b>	<b>Ian Perkin, Treasurer</b>
<b>Telephone number:</b>	01483 638724
<b>Email Address</b>	ianperkin@surrey.pnn.police.uk

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# **SURREY COUNTY COUNCIL AUDIT REPORT**

**Review of  
Treasury Management  
2014/15**

Prepared for: Sheila Little, Director of Finance  
Phil Triggs, Strategic Manager for Pension Fund and Treasury.

Prepared by: Luis Chowdhury, Auditor  
Gary Kandinsky, Lead Auditor

Sue Lewry-Jones  
Chief Internal Auditor  
Surrey County Council  
County Hall  
Kingston upon Thames  
Surrey  
KT1 2EA

**March 2015**

**Additional circulation list:**

External Audit	Grant Thornton UK LLP
Service Finance Manager	Susan Smyth
S151 Officer	Sheila Little
Strategic Director	Julie Fisher
Risk and Governance Manager	Cath Edwards
Audit and Governance Committee	All
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Chairman of Council Overview and Scrutiny Committee	Nick Skellett

**Glossary:**

The Prudential Code	A professional code of practice to support local authorities in taking capital investment decisions.
CIPFA	Chartered Institute of Public Finance and Accountancy
HSBCnet	HSBC online banking software
PWLB	Public Works Loan Board
SCC	Surrey County Council
TM	Treasury Management
SAP	SCC's Financial Ledger
SunGard	Software to manage deposits

**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) within Surrey County Council (SCC) is concerned with:
- cash flows, 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.
- 1.2 The Capital Finance and Accounting Regulations explicitly require English and Welsh authorities to have regard to the Treasury Management Code developed by the Chartered Institute of Public Finance. The code therefore strongly influences the best practice that SCC's Treasury Management function seeks to operate within.
- 1.3 A review of Treasury Management was included as part of the 2014/15 Annual Audit Plan and was undertaken following agreement of the Terms of Reference included at Annex A. This report sets out the findings and recommendations of the review. The completed Management Action Plan accompanies this report as Annex B.

**2. WORK UNDERTAKEN**

- 2.1 The Auditor undertook work to provide assurance that:
- Treasury Management policies, procedures and practices have been in place and whether they have been complied with;
  - the risks associated with Treasury Management function and the systems for monitoring and managing them operated effectively in period examined;
  - whether reasonably accurate cashflow statements were produced in a timely manner, reviewed and monitored in order to take appropriate actions as required;
  - if adequate segregation of duties existed for the various tasks undertaken as part of delivering the treasury management function and were sufficiently evidenced with management trails;
  - advice obtained from external Treasury Management Advisors was considered and applied appropriately;
  - treasury management records were accurately recording daily transactions; and
  - the information reported to the July and December 2014 Audit and Governance Committee was in accordance with the team's records.

**3. OVERALL AUDIT OPINION AND RECOMMENDATIONS SUMMARY**

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

Rating	Definition	No.	Para.Ref.
High	Major control weakness requiring immediate implementation of recommendation	0	N/a
Medium	Existing procedures have a negative impact on internal control or the efficient use of resources	1	Para 5:Sub 10.3
Low	Recommendation represents good practice but its implementation is not fundamental to internal control	4	Para 5:Sub: 3.6 /3.7./5.9/ / 10.2
<b>Total number of audit recommendations</b>		<b>5</b>	

**4. MANAGEMENT SUMMARY**

- 4.1 SCC complies with the CIPFA Code of Treasury Management in all material aspects. The Treasury Management risk register is reviewed by the Audit and Governance Committee at set intervals and between such meetings by officers, although the evidencing of such reviews could be improved. The Treasury Manager sees the benefit of a concise, higher focused, register. The Auditor was in broad agreement with the risk assessment scores used on the register and found the mitigations in place to be reasonable.
- 4.2 Treasury Management staff continue to operate an adequate system for estimating daily cleared balances to facilitate temporary investment. There were six occasions where the bank account inadvertently became overdrawn although the Authority had access to cash from alternative sources. The costs involved were minimal and Treasury Management staff do not think that additional controls to those already in place are required. The cashflow management approach used proves useful in building up and running down cash and available deposits to match the profile of payruns and large payments to suppliers, as well as planning for the receipt of large amounts of income. However, much of the liquidity is assured by adjusting money market deposits a day or so ahead of need.
- 4.3 The Treasury Management function operates within various targets and limits on the nature of borrowing and short-term investment, which provides a framework for managing the associated risks of cashflow management. Internal Audit conducted compliance testing on Treasury Management operation within these limits. This testing proved satisfactory and validated some of the key information reported to the December 2014 Audit and Governance Committee.
- 4.5 Based on the testing undertaken, the operation of controls over the use of the HSBCnet banking software for Treasury Management purposes are effective. The user account for one ex-employee in the banking team had not been removed promptly but has now been deleted. On one occasion, Treasury Management work has been undertaken away from County Hall, which provides some assurance over business continuity. Potential problems in accessing Watchword password devices should be given further consideration.
- 4.6 In view of the above findings, set out in more detail in section 5 of this report, the overall opinion is **Effective**.

**5. FINDINGS AND RECOMMENDATIONS****5.1 Compliance with CIPFA's Treasury Management Code****Finding**

- 5.1.1 The CIPFA's Treasury Management Code requires SCC to have the following in place:
- a clear Treasury Management policy statement with suitable Treasury Management practices;
  - suitable reporting arrangements for the discharge of Treasury Management duties;
  - adequate delegated responsibility for managing Treasury Management policies and decisions; and
  - a designated body to scrutinise Treasury Management strategy and policies.
- 5.1.2 A detailed review of SCC's compliance with the CIPFA's Treasury Management Code was conducted as part of the 2013/14 Internal Audit review of Treasury Management, which concluded that SCC's arrangements as documented are compliant with the code. As part

of this 2014/15, the Auditor considered whether there were any significant changes in the arrangements previous reviewed and noted:

- some minor changes in operational practice;
- a new trainee is working in the team as a Treasury Management officer and has been conducting the calculation of the daily cleared cash balances under supervision;
- a deposit sheet is completed for each deposit and investment; and these forms are now being reviewed by a second member of staff; and
- a daily list of short term deposits is produced, which is reviewed by a second officer to confirm that counter-party limits have been strictly adhered to.

5.1.3. The Internal Auditor confirmed liquidity is being assured through cash flow planning (see section 5.8) and that prudent limits to the boundaries of Treasury Management operations are set out in an annual report to Members of the Audit and Governance Committee (Section 5.7).

## 5.2 Implementation of Previously Made Recommendations

### Finding

5.2.1 The Auditor reviewed the progress made by the Treasury Management Team on agreed recommendations from the previous audit in 2013/14.

Recommendation from Treasury Management Audit (2014/15)	Progress Update
<p>To address the risk of fraud, corruption and significant error in the Treasury Management risk register, the Strategic Manager for Pension Funds and Treasury should more specifically analyse the key risks and controls in place, perhaps using a version of the Treasury Policy and Procedures as compliance checklists for monitoring purposes and reporting. <b>(Low Priority)</b></p>	<p>Adding more detail on this risk is not favoured by the TM team. The Risk Register is seen as most effective as a high level document, rather than one that focuses on the detail of risk mitigating controls. The TM function were able to elaborate verbally on what these controls are and some controls were evident on revised forms and systems now in use. <b>Auditor's assessment:</b> Not formally implemented as recommended but practice does not indicate significant control gaps.</p>
<p>The Strategic Manager for Pensions and Treasury should ensure that the Treasury Management risk register is reviewed quarterly and that such reviews are clearly evidenced. Where possible risks should include metrics, to help further highlight where actual performance is starting to become a concern. <b>(Medium Priority)</b></p>	<p>No formal record of the reviews which are carried out but the presentation of the Risk Register at Audit and Governance Committee every six-months evidences some of the discussions.</p> <p>Metrics not added to risk register, although the Risk Register is submitted and discussed alongside other reports which do contain metrics. <b>Auditor's assessment:</b> Not formally implemented as recommended but information is available and is used by Members and officers for this purpose.</p>

A separate risk should be added to the Treasury Management Risk Register on bank service outage. <b>(Low Priority)</b> .	Appropriate risk added to the risk register. <b>Auditor's assessment:</b> Implemented.
Business continuity arrangements for Treasury Management should be tested and the results evaluated. <b>(Low Priority)</b>	Use of HSBCnet and daily cash balances calculations recently undertaken from home successfully. A full test of all aspects of the BCP would need wider finance function planning and participation. <b>Auditor's assessment:</b> Substantially implemented, although a wider scenario response may be useful to practice at some point.
The Strategic Manager for Pension Funds and Treasury should review and reduce the number of Treasury Management staff who have access to the HSBC electronic banking system. <b>(Low Priority)</b>	A review was undertaken and as a result, three staff had their access privileges revoked. <b>Auditor's assessment:</b> Implemented. However, an account that related to a previous employee now needs to be addressed.

### 5.3 Risk Registers and Overall Risk Management Strategy

#### Finding

5.3.1 The December 2014 Treasury Management report to the Audit and Governance Committee confirms the three main TM risks are:

- security risks
- liquidity; and
- interest rates

5.3.2 The relatively priority given to managing the risks is such that 'security' is given the highest priority, then liquidity. The Auditor reviewed the current version of the Treasury Management Risk Register and confirmed that the residual risk scores for the individual risks show a number of security risks and also that interest rate risk on borrowing has the highest individual residual risk rating. The risk management action for this risk is the holding of fixed rate debt and the monitoring of the markets to identify any early pointers to rates change so that the authority would be able to extend borrowing before rates rose.

5.3.3 The Treasury Management function implemented a recommendation made at the previous audit regarding the production of a specific Treasury Management risk register. The register was last presented to the 1 December 2014 Audit and Governance Committee. The Auditor reviewed the register and the controls identified as being in place to mitigate the risks. The Auditor was able to confirm that the risk management strategies / controls to manage risk were generally satisfactory although noting that the risk on interest rates cannot be fully managed as this reflects circumstances that are beyond the control of the Authority.

5.3.4 The Auditor suggests that the risk register might still benefit from enhanced entries in the following areas:

- the potential need for unplanned capital resources at short notice for property investment; and

- risks related to inflation have not been recognised separately within the register. The Treasury Management function has taken the view that as the rate of inflation and interest rates are often linked there is no need to record inflation as a specific risk in addition to the interest rate risk. However there may be circumstances where the inflation and interest rates may move independently of each other as has happened in the past and this may impact on the timing of capital spends and related borrowings. Therefore it would be prudent to recognise inflation risks separately. Also deflationary pressures may have an impact on the timing of capital expenditure and thus new loans taken out. If inflation is to be recognised separately the mitigating actions should reflect strategies to apply if different inflation scenarios were to occur.

The Auditor also suggests that the evidencing of the review of risks in the register could be enhanced.

### **Risk**

- 5.3.5 The initial risk register may not be specifying all the potential risks and controls in sufficient detail and this may make it more difficult to monitor the management of these risks.

### **Recommendations**

- 5.3.6 The Strategic Manager, Pension Fund and Treasury should give further consideration to recommendations partially implemented from the previous audit by:
- more formally evidencing the periodic review of risks; and
  - further consideration to how treasury management performance metrics can be more explicitly linked to individual risk register items as part of outturn and half yearly reports taken to Audit and Governance. **(Low Priority)**
- 5.3.7 The Strategic Manager, Pensions and Treasury should consider adding additional risks to the risk register reflecting the potential need for additional capital cash resources for short notice investment opportunities and inflation / deflation. **(Low Priority)**

## **5.4 Security Risk**

### **Finding**

- 5.4.1 Security risks are managed using the Counterparty Limits set by the Council which control the nature and value of lending decisions to be made by SCC TM staff. It is acknowledged that the current Treasury Management Strategy is risk adverse in terms of the counterparties used and the various limits in place on counterparties. The Council has taken a cautious and risk adverse approach and continued to lend to UK banks with a rating of at least A- and Money Market Funds needing to demonstrate AAA ratings from all three rating agencies (S&P, Moody's, Fitch). The Auditor confirmed from Treasury Management records that these conditions were all observed in the periods examined. The Auditor also confirmed several of the ratings to documents issued by its advisors.
- 5.4.2 In 2015/16, the revised Treasury Management Strategy requires that Money Market funds need only be AAA rated by two of the three rating agencies and the maximum limit of investment in any one fund increased from £20m to £25m. These changes reflect the perception that the nature of these investments also remain relatively safe and the Auditor believes these assumptions to be reasonable.

## Internal Audit

### Treasury Management - 2014/15

5.4.3 During the year no Counterparty was removed from the list. The Treasury Management Team also undertakes an analysis of the investment portfolio at year-end against historic default rates to estimate the potential maximum exposure to default.

5.4.4 The Internal Auditor examined the daily lending (investment) on a sample of ten days during 2014/15 and confirmed that:

- no local authority had been lent more than £20m; and
- lending to banks, building societies and other financial institutions has been within the specific counterparty limit set out in reports to the Audit and Governance Committee, as informed by the credit ratings in place on those specific days. No lending practice warranted further comment by the Internal Auditor.

## 5.5 Liquidity

5.5.1 The liquidity risk is managed by restricting term deposits to less than one year and ensuring that daily cash balances remain above £15m. Internal Audit testing of Treasury Management records of deposits and other records confirmed that the length of deposit condition was observed. Although the total cash deposit balance remained above £15m throughout the year, the SCC bank account went overdrawn by accident six times during the year. Immediately available cash balances include the:

- Bank Account balance
- Money Market funds; and
- Call Account.

5.5.2 The instances of the bank account going over-drawn are shown below:

Date	Bank A/c Balance	Explanation
1/4/14	£797k OD	Reason not recorded. The actual reason related to an urgent transfer re: the Surrey Police. On occasions staff do record comments providing more detailed explanation but this is not standard practice.
24/4/14	£17.470m OD	A withdrawal from one of the Money Market Fund managers had not been processed successfully due to a technical issue with their systems. Some additional interest (approx. £1400) would have been incurred on the overdraft above interest earned from the fund.
23/9/14	£0.509m OD	A withdrawal from the Call Account had not been processed by staff at the bank.
19/11/14	£1.919m OD	A local authority had failed to repay their loan on time. It was received the following day.
28/1/15	£0.519m OD	Treasury Management input error on a low risk transfer from Surrey Police general a/c in reverse. The Authoriser did not identify the error.
1/12/14	£3.019m OD	Two local authorities had failed to repay loans £3.3m on time. These were received two days later.

5.5.3 The maturity profile on the PWLB loans remains such that 88% of debt does not mature for ten years or more. SCC's policy is that no more than 50% of the debt portfolio should

be due to be refinanced in specific periods over the next five years, and therefore there is no risk to this limit being breached based on the current profile.

5.5.4 The Auditor reviewed three money market fund transactions. It was confirmed that:

- monies were placed with money market funds from the approved counter party;
- a deposit sheet had been completed and subjected to supervisory checking; and
- the transaction had been confirmed to a SunGard report.

5.5.5 A further two call account transactions were examined and the Auditor was able to confirm that the transactions were with NatWest with whom a Call Account has been authorised. Deposit sheets had been completed and checked.

5.5.6 Funds are held in both the call account and the individual Money Market Funds throughout the year. The Auditor was able to confirm that balances always remained within agreed financial limits and that the credit ratings for each of the counterparties met the requirements of the Treasury Management Strategy.

5.5.7 The Auditor selected a sample of 10 short term deposits that had been placed with Barclays, the Debt Management Office (DMO) and a selection of local authorities. Testing established that all investments had been made within agreed counter-party limits and that the duration of all loans was for less than 365 days. A deposit sheet had been completed in each case and had been subject to supervisory checking. The loans had been repaid by each counter-party on time including the agreed amount of interest.

#### **Risk**

5.5.8 Where the bank is overdrawn on an unplanned basis, interest is charged at 4% on the overdraft. The Auditor accepts the interest involved is relatively small and in the majority of the cases this is the result of action by other bodies.

#### **Recommendation**

5.5.9 The Strategic Manager, Pension Fund and Treasury should seek to minimise instances of bank accounts becoming overdrawn. Where issues occur, a clear account of the reason for the instance should be recorded on the cash flow spreadsheet. **(Low Priority)**

### **5.6 Use of Expert Advice**

#### **Finding**

5.6.1 The TM Team continues to use Capita Asset Services, an agency which provides advisory and consultancy services on treasury management which regularly provides:

- weekly debt monitoring reports (covering changes in PWLB rates and other matters)
- a daily executive summary of market news, economic data and forecasts, money market rates, gilt yields, and interest rate predictions;
- a weekly newsletter, including an economic commentary and a diary of expected announcements and statistics relating to interest, inflation and exchanged rate; and
- a credit weekly list, which updates the authority on credit rating scores.

The Authority also receives advice from its frequent contact with its Brokers. At weekly meetings of the Treasury Manager, the Chief Finance Officer and her Deputy, these reports are used to help inform the conversation on the borrowing position. The Auditor confirmed that these meetings had been taking place regularly during the year.

5.6.2 Demonstrating the usefulness of this advice is somewhat difficult given the generic nature of the advice provided. However, the Auditor reviewed one example of where the authority sought expert advice prior to borrowing on that particular day.

## 5.7 Borrowing

- 5.7.1 All of SCC's current long-term borrowing has been taken from the Public Works Loan Board (PWLB), whose purpose is to provide loans to local authorities in order to finance capital spend, apart from a £10m market loan taken from Barclays.
- 5.7.2 SCC uses the weighted average interest rate for its PWLB long term loans to benchmark its borrowing performance and takes account of the low rates of interest available on its own internally invested cash balances. The average PWLB rate in 2014/15 to September 14 was 4.6%. During 2014/15 SCC had borrowed later and less and at a lower rate than had been anticipated as interest rates had remained low with no very immediate prospect of them rising. During 2014/15 three new PWLB loans totalling £70m were taken, which were used to finance 2014/15 capital programme requirements. A further £30m PWLB loan was taken out in February 2015 as a first part of a planned borrowing tranche to finance the 2015/16 Capital Programme.
- 5.7.3 From 1 November 2012, HM Government reduced by 20 basis points (0.2%) the interest rates on loans to local authorities who provided certain information on their plans for long-term borrowing and associated capital spending. This new rate is called the certainty rate. SCC provides this information to the PWLB on an annual basis. The Auditor reviewed this information which is in a very summary predefined format and noted that the amount SCC notified the PWLB as needing was £57m. However, actual borrowing exceeded that amount by £13m.
- 5.7.4 Although individual PWLB requests will involve the authority indicating the period in months before the loan will be applied to finance capital expenditure this does not appear to be an onerous control monitored in any way by the PWLB. Neither is there specific monitoring by the authority that this timeframe has been met. Taking PWLB loans ahead of a pressing need provides SCC with flexibility and access to a low rate when expectations are that rates could rise in the future.
- 5.7.5 Interest on PWLB loans is paid by direct debit. Interest is paid twice a year. The Auditor examined the interest payment made in September 2014 and was able to confirm the amount paid to Treasury Management loans records. Interest is also paid every six months on the Barclays LOBO (Lenders Option, Borrowers Option) loan. It was noted from testing that an interest payment of £249k was due on 24th December 2014. However it had been overlooked and was not paid until 26 January 2015, although no surcharge was incurred. There may be scope for setting up a direct debit to ensure timely payment. The interest paid was confirmed back to Treasury Management loans records.

## 5.8 Reporting Governance

### Finding

- 5.8.1 The Treasury Team have submitted two reports to Audit and Governance Committee so far during 2014/15, which meets the agreed reporting requirements. In 31 July 2014, a Treasury Management Outturn report 2013/14 was submitted, which also included:
- the revised Treasury Management Risk Register;
  - a schedule of all of the council's mandatory Prudential Indicators relating to treasury management as required by the CIPFA's Prudential Code, as agreed at the budget meeting of 12 February 2013;
  - a summary of how SCC maintained its borrowing within its authorised limit and its 'operational boundary' of borrowing;
  - an informative summary of investment and borrowing;
  - an outline of how the authority manages the funds of schools and the Surrey Police Authority;

- an update on the situation regarding the recovery of losses from the Icelandic banks; and
- Members officer training and access to professional advice.

5.8.2 In December 2014, the Treasury Management Team submitted its half-yearly report to the Audit and Governance Committee, which amongst other things included updated schedules and narrative on the mid-year position on the Prudential Indicators; the borrowing limits and analysis of Treasury Management performance in the period. Audit testing confirmed key elements of the detail reported. The Auditor noted that there remains substantial headroom for the Authority to borrow further, should it so wish and that its loan repayment profile will not force it back to the market for difficult to meet refinancing in the short term.

5.8.3 SCC's Treasury Management Practices includes a specific mention on anti-money laundering controls (TMP 9), which states that:

"Procedures will be enforced for verifying and recording the identity of counterparties and reporting suspicions and will ensure that staff involved in this area are properly trained. The present arrangements, including the name of the officer to whom reports should be made, will be detailed in the treasury management procedure manual....."

5.8.4 The Auditor noted that the Treasury Management Procedure manual has not yet been updated for changes in job titles. There is one new Treasury Management Team member and an apprentice. They have both received induction training but it unclear how this covered anti-money laundering measures. However, the SCC Anti-money laundering policy is available to all staff via the SNET and the Auditor provided these new staff with a copy.

5.8.5 Treasury Management staff were asked how they meet the client identification requirements of the SCC anti-money laundering policy. Staff indicated that they will be informed of key contacts by the counter-party on official stationery and will only deal with these staff. The policy requires evidence of checks to be kept and retained for 5 years. Although the checking being undertaken may not rigidly conform to the Money Laundering Policy, the Auditor was content that working through notified key contacts and retaining all correspondence broadly accorded with the spirit of the policy.

5.8.6 Matters relating to SCC's deposits with two Icelandic banks (Landsbanki and Glitnir) were recently finally settled. The settlement was against a background of the security of future repayments looking less attractive due to possible currency depreciation and other capital controls, including exit penalties. The Central Bank of Iceland conducted a recent auction (in respect of the final Glitnir balance) at an exchange rate final bid of ISK200/EUR. Offers submitted at or above ISK201/EUR were accepted in full and offer prices set below ISK200/EUR were not sold. SCC bid was successful at ISK210/EUR, generating a speedy receipt although this entailed a financial loss. At the exchange rate of EUR 1.35 to GBP 1, this resulted in a receipt of £1,614,148. Around £25,000 of this receipt will go to the Surrey Historic Buildings Trust. This transaction will also involve a total write off of £631,852. There is already a provision within SCC's accounts for £564,000 of this loss.

## 5.9 Cashflow Management

### Finding

5.9.1 The SCC Treasury Management Team conduct a daily exercise to calculate the estimated cleared bank account balance. This facilitates the short-term investment of surplus cash to ensure it generates interest. The Internal Auditor confirmed that the subsequent actual cleared balances were generally fairly close to the daily estimates, which provides some assurance over the methodology used to calculate the cleared balance and the Team's ability to maximise interest from temporary investment. Treasury Management staff use a spreadsheet cashflow forecasting system that covers the remainder of the financial year and separate worksheets for both 2014/15 and 2015/16.

5.9.2 The Internal Auditor considered the level of detail behind the forecasting tool and found that it considered the main income and expenditure headings and includes reasonable estimates of forthcoming receipts and payments. The Internal Auditor compared the available cash resources on a daily basis for several months and confirmed that:

- in a typical month, cash balances increase in the early part of the month following receipt of regular precept and business rate income (£53 m and £7m respectively) and fall at the end of the month once large payments such as the payroll, pensions and HMRC (£33m, £6m, £10m respectively) have been made; and
- in the six month period to September 2014 the total cash balance including short term deposits increased from the start of the year (balance £126m) to a high of £279m, before reducing down to £54m at the end of December 2014. In January and February 2015, two new PWLB loans of £40m helped increase cash available. These loans are then taken out to finance capital expenditure which the Council had previously opted to finance out of its own cash reserves.

## 5.10 Key Transactional Controls

### Finding

5.10.1 In previous audits, the Internal Auditor considered the overall segregation of duties between the S151 Officer and the Treasury Management staff, including the scheme of delegation as per SCC's Constitution, and the detailed stipulations of the Treasury Management Practices documentation maintained within the Treasury Management Team. The TM Team indicated that no major changes have occurred since the last audit.

### HSBCnet

5.10.2 The Auditor considered controls over access to HSBCnet (online electronic banking system). There are two levels of access to the HSBCnet online banking system; systems administrators and standard users. Systems administrators have additional access rights to standard users. They are able to initiate or authorise payments within specified limits and also carry out administrative roles such as adding and removing users. The system imposes a separation of duties as it requires two system administrators to complete any administrative action.

5.10.3 A review of a recent user list confirmed that there are six system administrators, all of whom currently work for Surrey County Council. They occupy busy senior roles and so this number of administrators is needed. All systems administrators were found to have accessed the system in the previous three months. Access had been withdrawn for one user who had not accessed the system in a number of years. The system requires any

two from the list of standard users and system administrators to be involved in all payments; one to initiate and another to authorise. Standard users are allocated access to either initiate or approve payments within a specified limit.

5.10.4 The Auditor reviewed a copy of the systems user list and noted that:

- 17 standard users currently have access to the system. Six of these users work for the banking team and were given access to enable them to carry out banking downloads into SAP;
- users either work for the Treasury Management Team or have previously worked for the team and access has remained so that they can act as contingency cover during staff absence;
- three users are senior finance staff who may be called upon to initiate or authorise payments; and
- several users have been deleted from the system as access was no longer deemed necessary.

5.10.5 The Auditor identified one former banking team member who still had a HSBCnet user account and this has now been deleted. The report demonstrates that the user had not accessed the system since they had left, though their access and authentication ('Watchword') devices were still 'live' at the time of the audit. Once identified by the Auditor, this was immediately addressed. The Auditor noted that two users are currently on maternity leave but that their access remains active. This is considered to be low risk due to the system requirement for two users to be able to complete any action.

#### Authentication Devices

5.10.6 Authentication devices are used to access HSBCnet. Users input a PIN number into the device and the device generates a code which the user is required to enter into HSBCnet. After staff enter their user name and password and then the authentication code, if HSBCnet successfully authenticates the code, the user is then able to gain access.

5.10.7 Two staff with administrative access to HSBCnet are required to request and register a device if additional devices are needed. HSBC issue PIN numbers directly to device holders. The last three devices were issued to the two newest members of the Treasury Management Team and the Senior Specialist Pensions Advisor who was issued a device so that he can authorise payments if other staff are absent. There have been no losses of authentication devices or PIN numbers recorded in the last 12 months. Should a device be lost, two staff with administrative access to HSBCnet are needed to cancel the device and request a replacement. Although there has been no loss of PIN numbers known to the Treasury Management Team, staff are aware that there is a process for resetting the related device which should ensure that any lost PIN numbers cannot be used successfully.

#### Controls over access to SunGard (online money market fund portal)

5.10.8 SunGard is a portal used to deposit monies with individual money market funds from SCC's counter parties list. All members of the Treasury Management Team and a number of others in a contingency capacity have been given access to SunGard. The Strategic Manager (Pensions and Treasury) and Senior Treasury Officer are authorised to request for new users to be granted access. An email is sent to SunGard detailing user details and the level of access needed. SunGard then issue the user with a user name and password. SunGard forces a password change every six months.

5.10.9 Deposits and withdrawals in SunGard can be transacted by users without further formal authorisation by a second user. The Treasury management team opted to dispense with a formal separation of duties due to concerns that transactions may not take place as the tight timescales which need to be followed may not permit a second authorisation check to be completed in time. Withdrawals automatically transfer monies to a nominated bank account. To change the nominated bank account an instruction is required to be sent to the relevant Money Market Fund and would need to be signed by a signatory which would be one from four of the Finance Leadership Team, one of which is the Strategic Manager for Pension Funds and Treasury, who also has access to SunGard.

### **Risk**

5.10.10 In the event of disaster scenario which results in physical access to the Council's offices being denied, it is unclear how staff would be able to initiate/authorise transactions if they do not have access to an authentication device.

5.10.11 Monies could potentially be diverted using Sungard to a non-counterparties bank account.

### **Recommendation**

5.10.12 Treasury Management should consider the arrangements for holding two devices off-site to ensure that business continuity can be enabled if required. **(Low Priority)**

5.10.13 The Strategic Manager for Pension Funds and Treasury should not be able to use SunGard to affect the transfer of deposits. **(Medium Priority)**

## **5.11 Record Keeping**

5.11.1 There are several key spreadsheets used by Treasury Management staff which are used to:

- determine and record the daily treasury management actions;
- record loans and other investments;
- maintain cash flow forecasts; and
- calculate and record interest payments.

5.11.2 These files are held on the SCC network and are protected by regular back up routines and so if they are lost or become corrupted they can be restored to the previous day's version. To avoid data being corrupted some cells within the cash flow spreadsheet containing key formula have been password protected. In addition, staff saves an additional copy of two key spreadsheets each month in a separate network folder. Copies had been saved in October 2014 and in January 2015. The Auditor has advised the Treasury Management Team that a more exact match of who can access the treasury management files could be achieved by moving the position of the Treasury Management folder on the network drive and asking IMT to adjust the list of those with access rights. Management do not assess there to be a significant risk to the current arrangements but would consider using additional password controls on files.

5.11.3 Key Treasury Management electronic files are held on the section's folder which resides on the network within the H: drive. Access to the folder is available to a wider range of finance staff as some of these staff provide cover for Treasury management staff or may need to view some of the information. To prevent records from being accidentally amended / corrupted, it may be worth considering password protecting key files but the risk is

acknowledged as being very low. There is a SAP Treasury Product on the market and other alternatives but the cost of these solutions would not justify the investment or be able to deliver substantial savings through improved cashflow management or reduced staff costs. If in the future, the Authority moves towards the use of SharePoint or other document management software, this might also improve the audit trail over who had last edited documents

5.11.4 Paper files are also maintained which hold copies of daily deposit and investment sheets and relevant confirmation slips as a well as PWLB letters which confirm details of each new loan. Paper based records are subsequently archived periodically and stored securely.

## **6. ACKNOWLEDGEMENT**

6.1 The assistance and co-operation of all the staff involved was greatly appreciated.

## TREASURY MANAGEMENT 2014/15

### TERMS OF REFERENCE

#### BACKGROUND

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

- cash flows, 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.

The legal status of the Treasury Management Code issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) derives in England and Wales from the regulations issued under the Local Government Act 2003. The Capital Finance and Accounting Regulations explicitly require English and Welsh authorities to have regard to the Treasury Management Code. The CIPFA's Treasury Management Code 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.

However, 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 Auditor has discussed the key risks associated with treasury management with the Strategic Manager, Pension Funds and Treasury. This discussion identified several risks from the Treasury Management risk register where it would be particularly useful to assess the effectiveness of controls over the management of the following risks:

- 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;
- the 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 2014/15. The audit will aim to provide assurance that adequate internal controls are in place and operating satisfactorily.

## **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;
- the risks associated with Treasury Management function are the systems for monitoring and managing them effectively;
- whether accurate cashflow statements are produced in a timely manner, reviewed and monitored in order to take appropriate actions as required;
- if adequate segregation of duties exists for the various tasks undertaken as part of delivering the treasury management function and sufficiently evidenced with management trails;
- the use of external Treasury Management Advisors and the application of the advice they provide;
- the accuracy of treasury management records with regard to their day-to-day use in treasury management operations; and
- the reasonableness of information reported to the December 2014 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
- Business continuity
- Value for Money

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 take place in December 2014. It is anticipated that the findings and recommendations arising from this review will be reported to Audit and Governance Committee in 16 February 2015. To achieve this, the report will need to be finalised by 31 January 2015.

## **REPORTING ARRANGEMENTS**

Auditor: Gary Kandinsky, Lead Auditor  
Supervisor: Simon White, Audit Performance Manager  
Reporting to: Sheila Little, Chief Finance Officer and  
Deputy Director for Business Services  
Philip Triggs, Strategic Manager, Pension Funds and Treasury  
Audit Ref: KF2 / 2014/15

<b>MANAGEMENT ACTION PLAN</b>
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<b>Directorate:</b>	Business Services
<b>Audit report:</b>	KF2/2014/15 - Treasury Management
<b>Dated:</b>	20 March 2015

**PRIORITY RATINGS**

**Priority High (H)** - major control weakness requiring immediate implementation of recommendation

**Priority Medium (M)** - existing procedures have a negative impact on internal control or the efficient use of resources

**Priority Low (L)** - recommendation represents good practice but its implementation is not fundamental to internal control

I agree to the actions below and accept overall accountability for their timely completion. I will inform Internal Audit if timescales are likely to be missed.

The auditor agrees that the actions set out below are satisfactory.

Lead Responsible Officer (HOS) Sheila Little, Director of Finance

Auditor Gary Kandinsky, Lead Auditor

Date 31 March 2015

Date 31 March 2015

Para Ref	Recommendation	Priority Rating	Management Action Proposed	Timescale for Action	Officer Responsible	Audit Agree?
5.3.6	<p>The Strategic Manager, Pension Fund and Treasury should give further consideration to recommendations partially implemented from the previous audit by:</p> <ul style="list-style-type: none"> <li>more formally evidencing the periodic review of risks; and</li> <li>further consideration to how treasury management performance metrics can be more explicitly linked to individual risk register items as part of outturn and half yearly reports taken to Audit and Governance.</li> </ul>	Low Priority	<p>Reviews and revisions of the risk register registers are evidenced and submitted to A&amp;G Committee at budget, outturn and monitoring meetings.</p> <p>Further consideration before next six-monthly report to A&amp;G Committee will involve formal discussion with Internal Audit.</p>	27 July 2015	Phil Triggs	Yes

<b>MANAGEMENT ACTION PLAN</b>
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Para Ref	Recommendation	Priority Rating	Management Action Proposed	Timescale for Action	Officer Responsible	Audit Agree?
			Action points from discussions at A&G are formally minuted and included within the A&G committee action tracker.			
5.3.7	The Strategic Manager, Pension Fund and Treasury should consider adding additional risks to the risk register reflecting the potential need for additional capital cash resources for short notice investment opportunities and also on risks re inflation and deflation.	Low Priority	Agreed.	1 April 2015	Phil Triggs	Yes
5.5.9	The Strategic Manager, Pension Fund and Treasury should seek to minimise instances of bank accounts becoming overdrawn. Where issues occur, a clear account of the reason for the instance should be recorded on the cash flow spreadsheet.	Low Priority	Agreed.	1 April 2015	Phil Triggs	Yes
5.10.2	Treasury Management should consider the arrangements for holding two devices offsite to ensure that business continuity can be enabled if required.	Low Priority	Staff carrying the devices with them on key fobs is a favoured alternative control.	1 April 2015	Phil Triggs	Yes
5.10.3	The Strategic Manager for Pension Fund and Treasury should not be able to use SunGard to affect the transfer of deposits.	Medium Priority	Agreed.	1 April 2015	Phil Triggs	Yes