STRATEGIC OVERVIEW AND SCRUTINY COMMITTEE

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Agenda Item 6

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SUBMISSION BY CLLR MJ WILCOX, THE LEADER OF THE COUNCIL & THE CABINET MEMBER FOR FINANCE, REVENUES & BENEFITS

Annual Report on Treasury Management Services and Actual Prudential Indicators 2009-10

1. Purpose of Report

Summary

1.1 The Annual Treasury Report is a requirement of the Council's reporting procedures. It covers the Treasury activity during 2009/10 and the actual Prudential Indicators for 2009/10.

1.2 It also provides an opportunity to review and update both the currently approved Treasury Management Strategy and the Medium Term Financial Forecast to take account of new and emerging issues.

1.3 The Report meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Council is required to comply with both Codes through Regulations issued under the Local Government Act 2003.

Revisions to the CIPFA Treasury Management and Prudential Codes, CLG Guidance on Investments

1.4 In November 2009 CIPFA released the revised Code of Practice for Treasury Management in the Public Services and accompanying Guidance Notes and the revised Prudential Code for Capital Finance in Local Authorities. The Communities and Local Government (CLG) also issued revised Guidance on Local Authority Investments for English authorities. The revised Codes/Guidance re-emphasise an appropriate approach to risk management, particularly in relation to the **security** and **liquidity** of invested funds.

1.5 This security of funds also applies to money we may borrow in advance to fund a capital project. During the capital project we would need to invest these funds until such time as they are spent. Any borrowing we undertake and its timing will be subject to value for money appraisals and will be reported to Full Council.

1.6 The Council has revised its treasury policy and practices documentation to take account of the requirements and changes in the revised Codes and Guidance.

1.7 The Treasury Management Code requires public sector authorities to determine an annual Treasury Management Strategy and formally report on their treasury activities and arrangements to full Council mid-year and after the year-end. These reports enable those tasked with implementing policies and undertaking transactions to demonstrate they have properly fulfilled their responsibilities, and enable those with ultimate responsibility/governance of the treasury management function to scrutinise and assess its effectiveness and compliance with policies and objectives.

1.8 The report is to full Council and is in addition also being submitted to Strategic (Overview and Scrutiny) Committee responsible for scrutiny of the Treasury Management function.

2. Background

2.1 The Economy and Events in 2009/10

- In order to stimulate growth, the Bank of England maintained the Bank Rate at 0.5% throughout the year. The Bank also took extreme measures on an extraordinary scale to revive the economy through its **Quantitative Easing** (QE) programme. Financed by the issuance of central bank reserves QE was initially announced at £75bn, and then extended in stages to £200bn.
- The Bank appears to have successfully staved off the very real risk of deflation. The increased supply of money in the system due to QE did not however translate into an increase in the movement of money in the system as banks are still unwilling to lend, and consumers are unwilling to borrow at pre-crisis levels.
- The November 2009 Budget was primarily about public debt. The Chancellor's forecast for net public sector borrowing in 2009/10 was £175bn or 12.4% of GDP. Gross gilt issuance was expected to hit a quite staggering £220bn in 2009/10. Standard & Poor's responded to the debt that the UK government was building up and a lack of a credible plan to reduce the debt burden by changing the UK's rating outlook from stable to negative.
- The outlook for 2010 was therefore for a period of slow and patchy growth in the economy accompanied by stubbornly high unemployment. The UK fiscal deficit remained acute. Cuts in public spending and tax increases were becoming inevitable and a credible plan to reduce the deficit was urgently required after the May General Election, the absence of which increased the potential of a sovereign downgrade. The likelihood of a hung parliament had grown and had the potential of being disruptive to financial markets.

2.2 Gilts and Money Market Rates

- LIBOR and LIBID rates (i.e. the rates at which a banks are willing to borrow from and lend to other banks) which had been stubbornly high in early 2009, slowly moved lower towards the Bank Rate of 0.5%.
- UK Government Gilts were the main beneficiary of the economic downturn (it is an asset class that responds positively to poor economic news); they also formed the significant bulk of the QE purchases and are thought to have pushed gilt yields, and consequently the cost of borrowing, lower by 0.5%.

2.3 Investment Strategies Approved Covering the 2009/10 Financial Year

- Council approved three Investment Strategies during 2009/10 and these are shown in **APPENDIX A**.
- The changes to the Investment Strategy demonstrate how we are monitoring and updating our strategies on an ongoing basis and seeking Full Council approval for significant changes.
- These Strategies also show how we have tightened our investment criteria to ensure the safe return of our investments.

2.4 Investments and Cash flow

- The investments that the Council had outstanding together with a summary of investment activity throughout the 2009/10 financial year is shown at **APPENDIX B**.
- The summary of investment activity information shows how restrictive our current list of eligible institutions remains in light of the “credit crunch” and problems in the banking sector.
- Our actual cash flow in 2009/10 closely followed the budgeted trend (**APPENDIX B)**.
- We received **£179,947** in net investment income in 2009/10 and this compares to a Revised Budget of **£180,060**.
- We undertook no new external borrowing in 2009/10 other than for finance leases.

2.5 The Performance of and Training within the Treasury Management Function

- The performance of the Treasury Management function should be measured against our investment objectives of Security (the safe return of our monies), Liquidity (making sure we have sufficient money to pay for our services) and Yield (the return on our investments) and these are shown in detail at **APPENDIX C**.
- Our aim for the risk status of our investments was **A+** and our investments at the 31st March 2010 had a more secure risk status of **AA-.**
- We temporarily borrowed on two occasions during 2009/10 due to cash flow requirements, however on both occasions our investments generated income yields higher than the costs of this borrowing.
- We achieved an average yield of **0.96%** and this compares to a 7 day London Interbank Bid rate (LIBID) of **0.39%.**
- During 2009/10 a total of **11 courses** were attended and every Member of the core Treasury Management Function attended at least one course (and in addition a key officer that provides absence cover together with a new Financial Services Manager within the wider Finance team also attended courses). These courses addressed skills ranging from the Introduction to Treasury Management to Strategic financial risks and treasury management, addressing the audit and governance issues.

2.6 Balance Sheet

- The actual balance sheet and balance sheet summary compared to the projected balance sheet as at 31st March 2010 are shown at **APPENDIX D**.
- The reasons for the major variances between actual and projections are also shown at **APPENDIX D**.

2.7 Treasury Position

- Our Treasury Position as at 31st March 2010 is set out at **APPENDIX E**.
- Our investments continue to exceed our external debt. However, they have reduced from **£15.095m** on 31st March 2009 to **£9.545m** on 31st March 2010 and the reasons for this reduction are shown in the Balance Sheet commentary (**APPENDIX D**).

2.8 Prudential indicators 2009/10

- Our actual Prudential Indicators are shown in detail at **APPENDIX F** and are summarised in the financial implications section of this report.

2.9 Treasury Management Assurance

- One of the key questions for Members in relation to Treasury Management is:

“How can I be assured that agreed Treasury Management Strategies, Policies and Limits are being applied correctly within the Council ?”

- The answer to this question is provided by reviews that are undertaken by both independent internal and external bodies and these are shown in detail at **APPENDIX G**.
- Four reviews were recently undertaken in relation to Treasury Management:

1) The review of High Level Controls of the Treasury Management System – 2009/10 by Internal Audit.
2) A full review of the Treasury Management System – 2008/09 by Internal Audit.
3) A Review of Treasury Management – External Audit.
4) Treasury Management Strategy and Investment Process – Our Treasury Management Advisors.

- We have also requested a full review of the Treasury Management function by our Treasury Management Advisors, and the results of this review will be presented to Cabinet and the Strategic (Overview and Scrutiny) Committee in the half year Report.

2.10 The Staffordshire Hoard

- We are acting as the accountable body for the future fundraising activities linked to the Staffordshire Hoard Mercian Trail. The fundraising target for the entire project is £1.7m of which we could receive £0.5m. This money will need to be invested, until such time as the cash is required for the project, as determined by the Staffordshire Hoard Partnership. Our Treasury Management Strategy will be used as the framework within which we will invest these funds.
- This will mean that the level of our investments will increase until such time as the cash is spent by the Staffordshire Hoard Partnership.

3. Community Benefits

3.1 Management of the Council's resources is essential in order to ensure economical and efficient delivery of Council services.

4. Financial Implications

4.1 The Prudential Indicators are shown in detail at **APPENDIX F** and are summarised below:

PI	Capital expenditure	2009/10 Approved	2009/10 Revised	2009/10 Actual
1	Capital Expenditure (£m)	5.652	5.474	3.733
2	Ratio of Financing Costs to Net Revenue Stream (%)	-5	-1	-1
3	Capital Financing Requirement (£m)	0.112	0.839	0.847
3	Net external borrowing does not exceed the Capital Financing Requirement in the current year and the next two years.	True	True	True
4	Actual External Debt (£m)	Not Applicable		0.277
5	Incremental impact of capital investment decisions on Band D Council Tax (£)	0	6.60	0.51
6	Authorised limit (£m) (Maximum)	7.710	8.707	0.877
7	Operational boundary (£m) (Maximum)	0.100	1.365	0.877
8	Adoption of CIPFA Code of Practice in Treasury Management	Yes	Yes	Yes
	Interest Rate Exposures (%)			
9	Upper Limit for Investments Fixed Interest Rate Exposure	-100	-100	-99
9	Upper Limit for Investments Variable Interest Rate Exposure	-50	-50	-39
10	Upper Limit for Borrowings Fixed Interest Rate Exposure	0	100	100
10	Upper Limit for Borrowings Variable Interest Rate Exposure	0	30	0

	Maturity Structure of Fixed Rate Borrowing (Upper Limit) (%)			
11	Under 12 months	0	20	14
11	12 months and within 24 months	0	20	27
11	24 months and within 5 years	0	30	59
11	5 years and within 10 years	0	40	0
11	10 years and within 20 years	0	60	0
11	20 years and within 30 years	0	40	0
11	30 years and within 40 years	0	40	0
11	40 years and within 50 years	0	40	0
11	50 years and above	0	20	0
12	Principal sums invested > 364 days (£m)	3.900	2.500	0

9.	Risk Management Issues

	Risk Description	Likelihood / Impact	Status	Countermeasure
A	Counterparty default	Medium / High	Financial	Investments are restricted to those organisations with the lowest credit risk: a) The Debt Management Agency Deposit Facility. b) Money Market Funds with an AAA rating. c) Deposits with other Local Authorities. d) Business Reserve and Term Deposits with a long term credit rating of A+. As conditions in the Financial Sector improve, we may diversify the counterparty list based on our advisor's recommendations.
B	Adverse Interest Rate fluctuations	Low / Low	Financial	The budget for investment income will be monitored as part of the Council's budget monitoring procedures.
C	Actual cash flows are different to those that are planned	Low / High	Financial	The Council maintains a comprehensive cash flow model that is updated on a daily basis to reflect both actual and planned cash flows. An element of the Council's investment portfolio will be invested in call accounts.
D	Planned capital receipts are not received	Medium / High	Financial	The budget for capital receipts will be monitored as part of the Council's budget monitoring procedures.

Background Documents:

CIPFA Code of Practice for Treasury Management in the Public Services Treasury Management Strategy Report 2010/11 to 2014/14 – Cabinet 9th February 2010.
The Prudential Code for Capital Finance in Local Authorities

APPENDIX A

Investment Strategies Approved Covering the 2009/10 Financial Year.

Full Council approved three Investment Strategies during 2009/10 and these are shown in the table below:

Specified Investments[1]

<table>
<tr><th rowspan="2">Financial Asset Category</th><th colspan="2">Strategy Approved 23rd February 2010</th><th colspan="2">Strategy Approved 14th July 2009</th><th colspan="2">Strategy Approved 24rd February 2009</th></tr>
<tr><th>Minimum Criteria</th><th>Limits</th><th>Minimum Criteria</th><th>Limits</th><th>Minimum Criteria</th><th>Limits</th></tr>
<tr><td>UK Banks and Building Societies – upper category</td><td rowspan="3"><u>Minimum Short Term Rating</u>

Fitch = F1
Moody's = P-1
Standard and Poors = A-1

<u>Minimum Long Term Rating</u>

Fitch = A+
Moody's = A1
Standard and Poors = A+</td><td rowspan="3">£3 million / less than 1 year and subject to Arlingclose advice</td><td rowspan="3"><u>Minimum Short Term Rating</u>

Fitch = F1+

<u>Minimum Long Term Rating</u>

Fitch = AA-</td><td rowspan="3">£5 million / 3 years or Period of the Guarantee</td><td>Short Term: F1+
Long Term: AA-
Financial Strength: C
Support: 3</td><td>£3 million / 3 years</td></tr>
<tr><td>UK Banks and Building Societies – middle category</td><td>Short Term: F1
Long Term: A-
Financial Strength: C
Support: 3</td><td>£2 million / 364 days</td></tr>
<tr><td>UK Banks and Building Societies</td><td>The organisation is an eligible institution.</td><td>£3 million / Period of the guarantee</td></tr>
<tr><td>Non UK Banks and Building Societies (Covered by a Government Guarantee)</td><td colspan="2">Investment category now removed</td><td colspan="2">Investment category now removed</td><td>Wholesale deposits in the bank are covered by Government guarantee
The Government providing the guarantee is AAA rated by all three ratings agencies.
The Council's investments are limited to the amounts and maturities being within the terms of the stipulated guarantee.</td><td>£1 million / period of the guarantee</td></tr>
<tr><td>Non UK Banks and Building Societies</td><td colspan="2">Investment category now removed</td><td colspan="2">Investment category now removed</td><td>Short Term: F1+
Long Term: AA-
Financial Strength: C
Support: 3</td><td>£1 million / 3 months</td></tr>
<tr><td>Building Societies not meeting minimum credit ratings</td><td colspan="2">Investment category now removed</td><td colspan="2">Investment category now removed</td><td>Not applicable</td><td>£3 million</td></tr>
<tr><td>Deposits with Money Market Funds</td><td>Fitch = AAAmmf

Moodys = Aaa/MR1+

Standard and Poors = AAAm</td><td>£1.5 million</td><td>AAA</td><td>£3 million</td><td>AAA</td><td>£3 million</td></tr>
<tr><td>UK Government</td><td>Not applicable</td><td>No limit</td><td>Not applicable</td><td>No limit</td><td>Not applicable</td><td>£3 million</td></tr>
<tr><td>Local Authorities, Parish Councils etc</td><td>Not applicable</td><td>No limit</td><td>Not applicable</td><td>£3 million</td><td>Not applicable</td><td>£3 million</td></tr>
</table>

Group Limit	£4 million	£5 million	£3 million
Money Market Funds Limit	£6 million	New criteria	New criteria
Sovereign Limit	100% UK	New criteria	New criteria

[1] Specified Investments are the lowest risk investments being in high security and high liquidity investments made in Sterling, Short term investments made with UK Government and other Local Authorities and short term money market transactions with a "high credit quality".

Non Specified Investments

Financial Asset Category	Strategy Approved 23rd February 2010		Strategy Approved 14th July 2009		Strategy Approved 24rd February 2009	
	Minimum Criteria	**Limits**	**Minimum Criteria**	**Limits**	**Minimum Criteria**	**Limits**
The Council's own bank (where credit ratings are not sufficient)	Not applicable	£100,000	Not applicable	£100,000	Not applicable	2 days
Deposits with a maturity of greater than one year	Minimum Short Term Rating Fitch = F1+ Moody's = P-1 Standard and Poors = A-1+ Minimum Long Term Rating Fitch = AA- Moody's = Aa3 Standard and Poors = AA-	£2.5 million	Minimum long term rating of AA-	£3.9 million	Minimum long term rating of AA-	£3.9 million
Group Limit	£4 million		£5 million		£3 million	
Sovereign Limit	100% UK		New criteria		New criteria	

These tables show that we are:

- Monitoring and updating our strategies on an ongoing basis and seek Full Council approval for significant changes.
- Tightening our investment criteria to ensure the safe return of our investments.

Investments and Cash flow in 2009/10

Investments at 31st March 2010

The table below shows a breakdown of our investments at the end of the financial year:

Counterparty	Principal	Matures	Days to Maturity	Rate	Credit Rating[2] 31/03/10	Foreign Parent
Barclays Bank	£2,000,000	20-Apr-10	20	0.50%	AA-	No
Nationwide	£2,000,000	20-Apr-10	20	0.59%	A+	No
Lloyds TSB	£2,000,000	21-Jul-10	112	1.35%	A+	No
Nationwide	£1,000,000	21-Apr-10	21	0.53%	A+	No
Barclays Bank	£1,000,000	21-Jul-10	112	0.70%	AA-	No
Bank of Scotland	£1,000,000	10-Jun-10	71	1.12%	A+	No
Royal Bank of Scotland	£545,000	01-Apr-10	Call	0.80%	A+	No
Total	**£9,545,000**					

However, the previous table only shows the investment position on one particular day of the financial year, the table below shows a summary for the whole of the financial year:

Counterparty	Number of Deals	Total Principal Invested	Is the Counterparty on our current list of eligible institutions?
Clydesdale Bank (Including Yorkshire Bank)	90	£39,023,000	Yes
Abbey National (Santander)	16	£18,852,165	Yes
Royal Bank of Scotland	16	£15,850,000	Yes
Barclays Bank	7	£12,000,000	Yes
Nationwide Building Society	7	£10,000,000	Yes
Lloyds TSB Bank	4	£8,006,199	Yes
Bank of Scotland	14	£6,330,000	Yes
Debt Management Office	4	£5,200,000	Yes
Standard Life	1	£2,000,000	Yes
Leeds Building Society	1	£1,500,000	No
Newcastle Building Society	1	£1,500,000	No
Yorkshire Building Society	1	£1,000,000	No
Invesco Aim	2	£880,000	Yes
Chelsea Building Society	1	£750,000	No
Hammerwich Parish Council	1	£200,000	Yes
Alliance and Leicester Building Society	1	£110,000	No
Total	**167**	**£123,201,364**	

The table shows how restrictive our current list of eligible institutions remains in light of the "credit crunch" and problems in the banking sector. Additionally, when we changed Treasury Management Advisors in June 2009, we were advised to stop investing with Building Societies other than the Nationwide due to their perceived greater counterparty credit risk and this means they are not classed as eligible institutions on our current list.

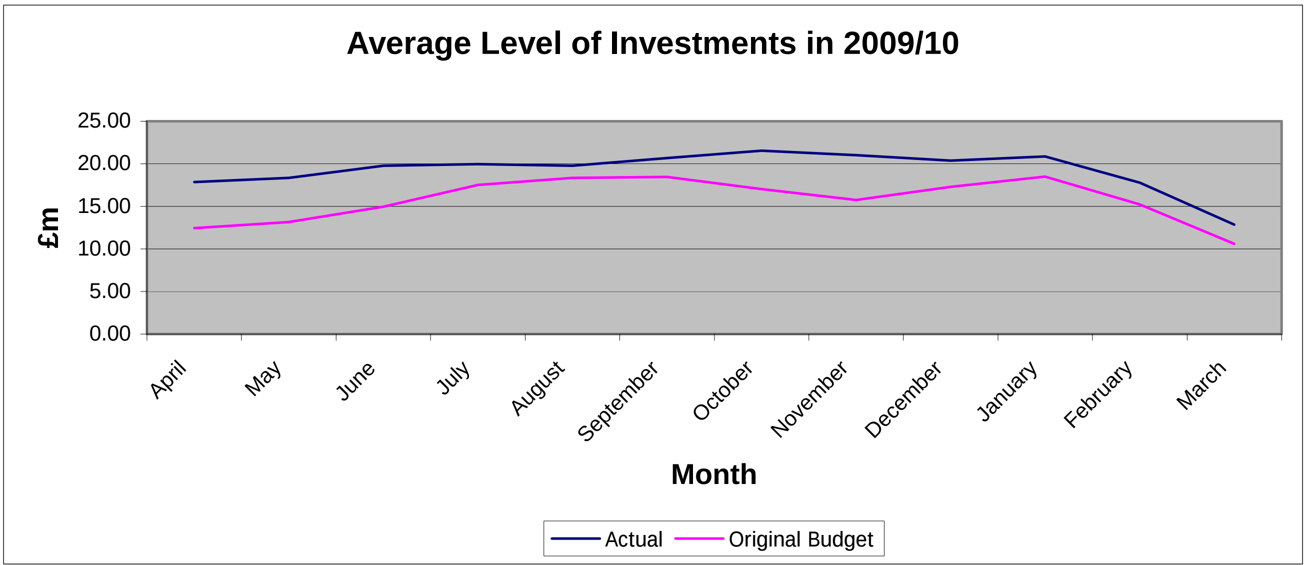
This list is reviewed on an ongoing basis and takes account of the following sources of information:

- Advice from our Treasury Management advisors.
- Credit Ratings.
- Credit Default Swaps prices.
- Share Prices.
- Information in the general and financial media.

[2] This is the lowest rating provided by the three credit rating agencies - Moodys, Fitch and Standard and Poors.

Cash flow for 2009/10

The graph below compares the budget for average investment levels in 2009/10 with the actual levels.



The graph shows that the actual trend of investments followed the budgeted trend very closely. The higher than budgeted average level of investments was due mainly to the higher level of investments at the 31st March 2009[3].

Investment Income and Borrowing Cost Budgets for 2009/10

Net Investment Income

In terms of interest receipts, there are two key risks / sensitivities:

a) The interest rate receivable.
b) The amount of money we have available to invest.

The interest rates, amounts of money we had available to invest, interest receipts, interest paid and net investment income are shown in the table below:

Details	**2009/10 Approved**	**2009/10 Revised**	**2009/10 Actual**
Average Amount we had available to Invest (£m)	17.56	19.51	19.24
Average Interest Rate (%)	1.80	0.97	0.96
Interest Receipts (£)	315,640	194,640	184,302
Interest Paid (£)	-31,640	-14,580	-4,355
Net Investment Income (£)	**284,000**	**180,060**	**179,947**

New External Borrowing Costs

No new borrowing was undertaken and no additional borrowing costs were incurred in 2009/10.

[3] The reasons for the higher than expected level of investments at 31st March 2009 were reported to Cabinet on 29th June 2009.

Performance of the Treasury Management Function

The performance of the Treasury Management function should be measured against the investment objectives of Security (the safe return of our monies), Liquidity (making sure we have sufficient money to pay for our services) and Yield (the return on our investments).

Security

Our aim for the risk status of our portfolio was **AA-** using the Fitch long-term credit rating. However, in line with best practice we now utilise the lowest rating from the three credit rating agencies as the basis for assessing the risk status and this has revised the risk status to **A+.**

The investments outstanding at the 31st March 2010 had a risk status of **AA-** and this is compliant with our aim and the recommendations from our Treasury Management advisors.

In addition, we are currently keeping the length of our investments relatively short term to ensure that we can react to changes in counterparty credit risk very easily. Our Treasury Management advisors have recommended investments are for no longer than **1 year** in duration to manage counterparty credit risk.

The average length of investments we made in 2009/10 was **84 days**.

Liquidity

Measuring the performance in relation to liquidity is a much more difficult task and the easiest way to assess performance is to see how frequently we needed to borrow on a temporary basis during the financial year. In 2009/10 we temporarily borrowed on two occasions - **£500k on 3rd June 2009 for 5 days at 0.35%** (we earnt **1.06%** on our investments for the same period) and **£600k on 3rd August 2009 for 7 days at 0.30%** (we earnt **0.91%** on our investments for the same period).

Yield

In 2009/10 we achieved an average interest rate of **0.96%** and this compares to our performance indicator of the average 7-day London Inter-bank Bid (LIBID) rate, which was **0.39%.**

Training within the Treasury Management Function

Our Treasury Management Practices (TMP 10) states "This organisation recognises the importance of ensuring that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them. It will therefore seek to appoint individuals who are both capable and experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills. The Director of Finance, Revenues and Benefits will recommend and implement the necessary arrangements."

We have two points of access for training:

- Our Treasury Management Advisors run regular courses and we are entitled to two free places on each course.
- We are members of the CIPFA Treasury Management Forum and this entitles us to four places on various courses as part of our membership subscription.

During 2009/10 a total of **11** courses were attended and every Member of the core Treasury Management Function attended at least one course (and in addition a key officer that provides absence cover together with a new Financial Services Manager within the wider Finance team also attended courses). These courses addressed skills ranging from the Introduction to Treasury Management to Strategic financial risks and treasury management, addressing the audit and governance issues together.

Balance Sheet

Balance	31 Mar 2009 Actual £m	31 Mar 2010 Actual £m	31 Mar 2010 Estimate £m	Variance To Estimate £m
1. Fixed Assets	44.237	43.111	46.547	-3.436
3. Long Term Debtors	0.079	0.065	0.077	-0.012
3. Current Assets (including accrued interest)	3.705[4]	8.225	5.081	3.144
3. Bank	0.060	0	0	0
2. Investments (excluding accrued interest)	15.095	9.545	10.884	-1.339
3. Current Liabilities	-4.165[4]	-4.950	-5.484	0.534
2. Long Term Creditors – Finance Leases	-0.183	-0.232	-0.144	-0.088
3. Long Term Creditors – Section 106	-1.201	-1.537	-0.727	-0.810
2. Long Term Creditors – Borrowing	0	-0.039	-0.721	0.682
3. Provisions	-0.077	-0.079	-0.077	-0.002
3. Trusts / Bequests	-0.018	0	-0.018	0.018
3. Unapplied Grants, Contributions & Section 106	-3.165	-2.618	-1.792	-0.826
1. Deferred Capital Grants & Contributions	-6.722	-7.162	-8.090	0.928
3. Pension Scheme	-17.120	-36.373	-17.120	-19.253
Total Assets less Liabilities	**30.525**	**7.956**	**28.416**	**-20.460**

1. Revaluation Reserve	2.128	1.900	2.128	-0.228
1. Capital Adjustment Account	35.236	33.202	35.490	-2.288
3. Deferred Credits	0.013	0.012	0.011	0.001
3. Pension Scheme	-17.120	-36.373	-17.120	-19.253
4. Usable Capital Receipts	2.360	2.446	2.033	0.413
4. Burntwood Leisure Centre Sinking Fund	1.185	0.739	0.712	0.027
4. Burntwood Synthetic Pitch Sinking Fund	0.029	0.029	0.029	0
4. City Centre Redevelopment Sinking Fund	0.086	0.024	0.025	-0.001
4. King Edwards Leisure Centre Sinking Fund	0.031	0.031	0.031	0
4. Lombard Street Car Park Sinking Fund	0.017	0.017	0.017	0
4. Elections	0.078	0.078	0.078	0
4. Public Open Spaces	0.013	0.013	0.013	0
4. Three Spires Multi Storey Reserve	1.380	1.383	1.536	-0.153
4. Earmarked Reserves	1.083	1.099	0.835	0.264
4. Grant Aid	0.038	0.040	0.038	0.002
4. Depot Relocation	0.050	0.050	0.050	0
4. Collection fund	-0.062	-0.056	0	-0.056
4. General Fund Balance	3.980	3.322	2.510	0.812
Total Equity	**30.525**	**7.956**	**28.416**	**-20.460**

Balance Sheet Summary

1. Capital Financing Requirement	0.151	0.847	0.839	0.008
2. Net Investments Position	14.912	9.274	10.019	-0.745
3. Net Creditors	-4.795	-0.906	-2.951	2.045
4. Balances and Reserves	-10.268	-9.215	-7.907	-1.308

[4] Restated Balances.

APPENDIX D

Balance Sheet Commentary

Capital Programme

Our capital programme outturn of **£3.733m** represented an under spending of **£1.701m** compared to our final budget of **£5.434m.**

During 2009/10 the Council undertook a major review of its Capital Programme and during the review project managers were encouraged to delay spend where possible. This proactive action has contributed to the level of under spend in this financial year and has provided additional flexibility in enabling the Council to redirect unspent resources to other more pressing capital investment needs.

This under spending has meant that we also used fewer usable capital receipts, grants and contributions and Section 106 to fund our spend and therefore these balances are higher than forecast.

In addition, because we had sufficient levels of investments we were able in 2009/10 to delay undertaking significant levels of external borrowing.

Revenue Budget

Our revenue budget under spent by **£0.812m**.

In addition, a further **£0.379m** was appropriated to earmarked reserves.

Asset Impairments

Our Valuer undertook an impairment review on the value of our assets at the Balance Sheet date. The valuer identified that our office and commercial property needed to be impaired by a further **£2.124m**.

Pensions

Our FRS 17 balance sheet this year has deteriorated from last year and FRS 17 deficits are bigger in monetary terms this year and have increased by **£19.253m**. This is because of the impact of unfavourable investment returns, which has only been offset to some extent by more favourable financial assumptions.

Debtors

Our debtor's balances increased by **£3.144m** and this was principally in relation to the following:

Business Rates **£2.643m** – this is due to the revaluation of industrial units for example in Fradley Park.

Housing Benefits **£1.727m** – this is due to increases in Council Tax and Housing Benefit claimants.

Claims for these sums have been submitted to the relevant Government Departments and both of these debts will be paid in this financial year.

Treasury Portfolio

The current portfolio position is set out below. Market conditions, interest rate expectations and credit risk considerations will influence the Council's strategy in determining the borrowing and investment activity against the underlying Balance Sheet position.

Average Rate %	31 March 2009 £m	%	Existing Portfolio	31 Mar 2010 Approved £m	31 Mar 2010 Revised £m	31 Mar 2010 Actual £m	%	Average Rate %
			External Borrowing:					
			Fixed Rate – PWLB		-0.721			
			Fixed Rate – Brewery Loan[5]			-0.045	16	
	-0.183	100	Existing long-term liabilities		-0.144	-0.232	84	
	-0.183	**100**	**Total External Debt**		**-0.865**	**-0.277**	**100**	
			Investments:					
			Managed in-house					
2.12	14.200	100	Fixed Interest Investments	7.825	10.875	9.000	94	0.80
0.88	0.895		Variable Interest Investments			0.545	6	0.80
			Money Market Funds					
	15.095	**100**	**Total Investments**	**7.825**	**10.875**	**9.545**	**100**	
	14.912		**(Net Borrowing Position) / Net Investment position**	**7.825**	**10.010**	**9.268**		

In conjunction with advice from our treasury advisor, the Council will keep under review the options it has in borrowing from the PWLB, the market and other sources identified in the Treasury Management Practices Schedules up to the available capacity within its CFR and Affordable Borrowing Limit (defined by CIPFA as the Authorised Limit).

Long-term Borrowing/Other Long-term Liabilities: Strategy and Outturn

The Council's borrowing requirement for 2009/10 and that of two succeeding financial years was estimated at **£5.654m** of which Unsupported Borrowing amounted to **£5.654m**.

The Council's strategy was to fund **£5.654m**, i.e. 100% of its borrowing requirement over the next three years at optimum rates with a spread of maturities.

However, because we had sufficient levels of investments we were able in 2009/10 to delay undertaking significant levels of external borrowing. This had the following advantages:

- It meant we did not need to find counterparties to invest our funds with and;
- We minimised the costs to the Council because we would have paid circa 4% for long term loans however we were only receiving circa 1% on our investments.

Our current Balance Sheet projections indicate we could continue to follow this strategy until 2011/12. However, we will need to constantly review these projections in line with changes to our budgets. In addition, we will need to take account of changes in the wider economy specifically in relation to interest rates.

In 2009/10 our borrowing requirement was projected to be **£0.839m** and the actual borrowing requirement was **£0.847m**.

[5] Long Term is £39k and Short Term is £6k.

COMPLIANCE WITH PRUDENTIAL INDICATORS 2009/10

1 Background:

There is a requirement under the Local Government Act 2003 for Local Authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators. It should be noted that CIPFA undertook a review of the Code in early 2008 and issued revised Code in November 2009.

The Council implemented its strategy within the limits and parameters set in its treasury policy, strategy statement and Prudential Indicators against the prevailing market conditions and opportunities as follows:

(a) Financing its capital spending from government grants / usable capital resources / revenue contributions, etc. rather than from external borrowing.

(b) Adhering to the paramount requirement of safeguarding the council's invested balances during a period of unprecedented money market dislocation; maintaining adequate diversification between institutions; optimising investment returns subject to the overriding requirement of security and liquidity.

(d) Forecasting and managing cash flow and undertaking short-term borrowing and lending to preserve the necessary degree of liquidity.

2. Net Borrowing and the Capital Financing Requirement:

This is a key indicator of prudence. In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Local Authority should ensure that the net external borrowing does not, except in the short term, exceed the total of Capital Financing Requirement in the preceding year plus the estimates of any additional Capital Financing Requirement for the current and next two financial years.

The Director of Finance, Revenues and Benefits reports that the Authority had no difficulty meeting this requirement in 2009/10, nor are there any difficulties envisaged for future years.

3. Estimates of Capital Expenditure (Prudential Indicator 1):

3.1 This indicator is set to ensure that the level of proposed Capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax.

Capital Financing	2009/10 Approved £m	2009/10 Revised £m	2009/10 Final £m	2009/10 Actual £m
Fixed Assets	5.652	3.222	3.184	2.477
Capital Expenditure Funded from Revenue under Statute		2.252	2.250	1.256
Total	**5.652**	**5.474**	**5.434**	**3.733**

3.2 This capital expenditure has been financed as follows:

Capital Financing	2009/10 Approved £m	2009/10 Revised £m	2009/10 Final £m	2009/10 Actual £m
Capital receipts	2.671	1.029	1.051	0.746
Burntwood Sinking Fund	0.050	0.131	0.131	0.104
Capital Grants and Contributions	2.931	3.428	3.334	1.942
Revenue contributions	0	0.157	0.189	0.237
Unsupported borrowing	0	0.729	0.729	0.704
Total	**5.652**	**5.474**	**5.434**	**3.733**

4. Ratio of Financing Costs to Net Revenue Stream (Prudential Indicator 2):

4.1 This is an indicator of affordability and demonstrates the revenue implications of capital investment decisions by highlighting the proportion of the revenue budget required to meet the borrowing costs associated with capital spending. The financing costs include existing and proposed capital commitments.

4.2 The ratio is based on costs net of investment income.

No. 2	Ratio of Financing Costs to Net Revenue Stream	2009/10 Approved %	2009/10 Revised %	2009/10 Actual %
	Non-HRA	-5	-1	-1
	Total	**-5**	**-1**	**-1**

5. Capital Financing Requirement (Prudential Indicator 3):

5.1 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. In order to ensure that over the medium term net borrowing will only be for a capital purpose, the Council ensures that net external borrowing does not, except in the short term, exceed the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years.

No. 3	Capital Financing Requirement	2009/10 Approved £m	2009/10 Revised £m	2009/10 Actual £m	2010/11 Approved £m	2010/11 Approved £m
	Non-HRA	0.112	0.839	0.847	3.537	5.466
	Total CFR	**0.112**	**0.839**	**0.847**	**3.537**	**5.466**

6. Actual External Debt (Prudential Indicator 4):

6.1 This indicator is obtained directly from the Council's Balance Sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

No. 4	Actual External Debt as at 31/03/2010	£m
	Borrowing	0.045
	Other Long-term Liabilities (Finance Leases)	0.232
	Total	**0.277**

7. Incremental Impact of Capital Investment Decisions (Prudential Indicator 5):

7.1 This is an indicator of affordability that shows the impact of Capital investment decisions on Council Tax levels when the budget for the year was set.

No. 5	Incremental Impact of Capital Investment Decisions	2009/10 Approved £	2009/10 Estimate £	2009/10 Actual £
	Increase in Band D Council Tax	0	6.60	0.51

8. Affordable Borrowing Limit, Authorised Limit and Operational Boundary for External Debt:

8.1 The Council has an integrated treasury management strategy and manages its treasury position in accordance with its approved strategy and practice. Overall borrowing will therefore arise as a consequence of all the financial transactions of the Council and not just those arising from capital spending reflected in the CFR.

8.2 The **Authorised Limit (Prudential Indicator 6):** This is the maximum amount of external debt that can be outstanding at one time during the financial year. The limit, which is expressed gross of investments, is consistent with the Council's existing commitments, proposals for capital expenditure and financing and with its approved treasury policy and strategy and also provides headroom over and above for unusual cash movements. This limit was set at **£8.707m** for 2009/10.

8.3 **Operational Boundary (Prudential Indicator 7)**: This is limit is set to reflect the Council's best view of the most likely prudent (i.e. not worst case) levels of borrowing activity and was set at **£1.365m** for the financial year.

8.4 Levels of debt are measured on an ongoing basis during the year for compliance with the Authorised Limit and the Operational Boundary. The Council maintained its total external borrowing and other long-term liabilities within both limits; at its peak this figure was **£0.877m**.

9. Adoption of the CIPFA Treasury Management Code (Prudential Indicator 8):

9.1 This indicator demonstrates that the Council has adopted the principles of best practice.

No. 8	**Adoption of the CIPFA Code of Practice in Treasury Management**
	The Council approved the adoption of the CIPFA Treasury Management Code at its Full Council meeting on 25th February 2003. The Council has incorporated any changes resulting from the CIPFA Treasury Management Code within its treasury policies, practices and procedures. At its meeting on 24th February 2009 the Council originally approved its Prudential Indicators for 2009/10. The Prudential Indicators for the Capital Financing Requirement and the Authorised Limit were amended by Council on 14th July 2009 to provide extra flexibility in relation to Finance Leases. The Prudential Indicators were fully revised and approved by Council on 23rd February 2010 to reflect the results of the Capital Programme review.

10. Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure (Prudential Indicators 9 and 10):

10.1 These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. The exposures are calculated on a gross basis. The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

No.	Interest Rate Exposures	2009/10 Approved %	2009/10 Revised %	2009/10 Actual (during the financial year) %		
				Highest	Lowest	Average
	Investments					
9	Upper Limit for Fixed Interest Rate Exposure	-100	-100	-99	-61	-84
	Upper Limit for Variable Rate Exposure	-50	-50	-39	-1	-16
	Borrowings					
10	Upper Limit for Fixed Interest Rate Exposure	0	100	100	100	100
	Upper Limit for Variable Interest Rate Exposure	0	30	0	0	0

11. Maturity Structure of Fixed Rate borrowing (Prudential indicator 11):

11.1 This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

11.2 It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

No. 11	Maturity structure of fixed rate borrowing	Lower Limit %	Upper Limit %	Actual Borrowing as at 31/3/2010 £	Percentage of total as at 31/3/2010 £
	Under 12 months	0	20	6,000	14
	12 months and within 24 months	0	20	12,000	27
	24 months and within 5 years	0	30	27,000	59
	5 years and within 10 years	0	40	0	0
	10 years and within 20 years	0	60	0	0
	20 years and within 30 years	0	40	0	0
	30 years and within 40 years	0	40	0	0
	40 years and within 50 years	0	40	0	0
	50 years and above	0	20	0	0

11.3 The only long-term fixed rate borrowing the Council currently has is in relation to a brewery loan of **£0.045m** and whilst the upper limit has been exceeded, the size of this loan and its maturity profile will not cause any financial issues for the Council.

12. Upper Limit for total principal sums invested over 364 days (Prudential Indicator 12):

12.1 This indicator is set in order to allow the Council to manage the risk inherent in investments longer than 364 days. For 2009-10 this limit was set at **£2.50m**. At their peak, these investments totalled **£0m**.

13. Balanced Budget

13.1 The Council complied with the Balanced Budget requirement.

14. External Service Providers

14.1 Arlingclose is appointed as the Council's treasury management advisor. The Council is clear as to the services it expects and is provided under the contract. The service provision is comprehensively documented.

14.2 The Council is also clear that overall responsibility for treasury management remains with the Council.

15. Minimum Revenue Provision

15.1 The Council's MRP policy for 2009/10 was approved by Council on 24th February 2009. It was determined that the Asset Life Option would be adopted for Unsupported Borrowing (i.e. Borrowing incurred without support from the Government through the Revenue Support Grant system).

Treasury Management Assurance

One of the key questions for Members in relation to Treasury Management is:

How can I be assured that agreed Treasury Management Strategies, Policies and Limits are being applied correctly within the Council ?

The answer to this question is provided by reviews that are undertaken by both independent internal and external bodies. The various bodies and the type of review they undertake are shown below.

The Internal Audit Function

Internal Audit annually reviews the Treasury Management function due to the high level of risk attached to the activity. These reviews are either:

- A review of the high level controls of the Treasury Management System required by our External Auditors or;
- A full review of the Treasury Management System.

The Review of High Level Controls of the Treasury Management System – 2009/10

The review was undertaken of the High Level Controls of the Treasury Management system, including the summary of anticipated controls assurance, as required by External Audit and included in the audit plan for 2009/10.

The Financial Services Team and the Treasury Management system is well established and based on the high level control work undertaken; the controls are operating effectively in an Adequately Controlled Environment.

However, one area of improvement was identified through testing:
The following reconciliations are not being completed promptly –

- Monthly Bank Reconciliations of general and payments accounts to the general ledger. The last reconciliation completed was for November 2009.
- Treasury Management records to general ledger. To date only the reconciliation for April 2009 has been completed.
- Interest payments to the general ledger. To date only the reconciliation for April 2009 has been completed.

A full review of the Treasury Management System – 2008/09

Overall Audit Opinion – Well Controlled.

We are pleased to note that there are a number of good controls in operation:

- ✓ The procedures for the use of brokers are clearly, comprehensively detailed and flow-charted within the Treasury Management Manual produced by the Senior Financial Services Manager in January 2007.
- ✓ The Treasury Management statement is approved each year by the Executive Committee and performance updates are provided quarterly.
- ✓ There are clear policies and procedures for the investment of Council's funds.
- ✓ Investments can be traced to all sources and there is adequate documentation to support the transaction being made.
- ✓ Redemptions can be traced to all sources and there is adequate documentation to support the transaction being made.
- ✓ All investments are made in accordance with Council policy and statutory requirements.
- ✓ The Council has adequate insurance in place for the Treasury Management function.

Areas for improvement include:

1. Treasury Management reconciliation's are not always undertaken timely. For instance July was completed in September and August/September/October were completed in December 2008. **(Recommendation1).**
2. The CHAPS/BACS and TM authorisations for the Financial Services Manager have not been removed. **(Recommendation 2).**

All recommendations are followed up after 6 months and then a final follow up is undertaken after a further 3 months.

The results of the implementation of recommendations are reported as a Performance Indicator to Audit Committee (including a list of follow ups by system and this includes recommendations that have been implemented and those that have not been implemented) and a copy of reports go to the Chair and Vice Chair of Audit Committee together with relevant Portfolio Holders.

External Audit

External Audit review Treasury Management as part of their Audit of the Council's Financial Statements.

The Annual Audit Letter for 2008/09 included the results of an audit on the Treasury Management Function following the Icelandic banking crisis and the results are detailed below:

"In October 2008, a number of Icelandic Banks went into administration and a large number of Councils and public institutions were directly affected by this collapse. Lichfield District Council had no investments in Icelandic Banks in October 2008 but you have not been complacent in responding to this banking crisis.

You have reviewed your treasury management framework in June 2009, and agreed changes to your limits and counterparties for investments. You have also strengthened your low risk investments policy by increasing the limits with the eight government backed institutions and with the government debt agency. The Council has also changed its treasury management advisors and the new advisors are to carry out a review of the of the Council's treasury management function. Treasury management activities are reported to Cabinet quarterly as part of the overall finance report, but I note there is currently no formal reporting to your Audit Committee."

Our External Treasury Management Advisors

As part of our contract with Arlingclose Ltd, we require them to undertake a review of our Treasury Management Practices, processes and systems to ensure they are "fit for purpose" and comply with Legal and Regulatory requirements and Best Practice. This review was originally planned to take place during 2009/10 however it was delayed pending the publication of revised guidance from CIPFA in relation to the Treasury Management Code. This guidance was published in November 2009 and we have therefore arranged for this review to take place in **July 2010**. The results of this review will be presented in the half yearly Treasury Management Report to both Cabinet and Strategic (Overview and Scrutiny) Committee.

In addition, we seek feedback from Arlingclose Ltd when we review our Strategies, Practices, Processes or systems to ensure what we are proposing complies with Legal and Regulatory requirements and Best Practice.

We have sought feedback on two separate occasions this year in relation to the Treasury Management Strategy Report and the design of our new investments process.

APPENDIX G

The Treasury Management Strategy Report

"With reference to your email, our feedback to Lichfield DC on the preparation of its treasury strategy for 2010/11:

Arlingclose is impressed with the level of detail within the background working papers which has formed the basis of the Report, in particular the cashflow forecast and the capital programme. The strategy is aligned to the forward projections within these working documents for the capital programme, its potential funding and the use of the Council's surplus funds. We are also pleased to note that the strategy reflects the framework within which ***Lichfield*** will be working rather than being a generic outline councils may in general work within.

The spreadsheets you provided alongside the draft treasury strategy statement have given us a really good insight into the capital and revenue projections the Council is making, which then drive the intended strategy – they are very informative, and we thank for doing so. (We don't often get to see this depth of detail)."

Our new Investments Process

"We are encouraged to see you're taking additional measures and initiative in terms of assessing creditworthiness, in addition to the information we provide."