CIPFA

REPORT

Committee	PRUDENTIAL CODE STEERING GROUP
Venue	Thistle Hotel, Charing Cross Date 11 July 2002
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Subject	Issues paper – detailed format of the draft treasury management prudential indicators

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PURPOSE

To consider an issues paper on draft prudential indicators for treasury management, for consideration for revisions to the draft Prudential Code.

REPORT

1 The issues

The draft Prudential Code suggests, as the first treasury management prudential indicator, adoption by a local authority of CIPFA's Code of Practice for Treasury Management in the Public Services. Next, it proposes that authorities set limits for their:-

– variable rate interest exposures
– fixed rate interest exposures
– maturity of borrowings, and
– investment of principal sums

Matters arising:

(a) Adoption of the Treasury Management Code as the first prudential indicator has not been an issue.

(b) Very broad support has been given for placing limits on interest rate exposures (both variable and fixed), and on the maturity of borrowings, as an extension of current legal requirements and accepted best practice.

(c) Rather less support has been expressed for placing limits on the investment of principal sums, even though this is common practice where external fund managers are employed.

(d) Substantial adverse comment has been made about the large numbers of proposed indicators, and the practical inflexibilities this may bring.

(e) Road testing is likely to highlight more clearly any practical problems and drawbacks, particularly with regard to the setting of both upper and lower limits for interest rate exposures and the maturity of borrowings.

(f) There has been some debate about whether interest rate limits and limits on the maturity of borrowings should be expressed in absolute terms or, as the draft suggests, as % of totals.

2 **Ideas for consideration**

(a) On 31 October last, the Steering Group considered the limits to be set in respect of interest rate exposures. Whilst the Group decided on 4, the original proposal to the Group had been for just 2 categories, viz:

(1) all variable rate plus short-term fixed rate, and
(2) all longer-term fixed rate.

The Group also considered having 3 categories, splitting variable rate from short-term fixed rate. The Group may wish to reconsider this issue in the light of comments received.

(b) In respect of the maturity of borrowings, the limit periods in the exposure draft are annual up to 10 years, then a single limit in excess of 10 years. This is more than current practice, and is also more than FRS 13 requires for companies, viz:

– under 12 months
– 12 and under 24 months
– 24 months and under 5 years, and
– 5 years +

The Group may wish to consider whether there are too many periods as presently drafted, and whether, say, the limits might rather be annual up to 5 years, then in 5 year steps.

(c) On the issue of whether limits should be expressed as % of totals or as absolute amounts, the Group may wish to consider requesting road-testing authorities to produce exemplifications on both bases, so that conclusions may be drawn on which is the more meaningful. It may be the case that authorities would find it helpful if the Code gave them flexibility to set local limits on either basis, depending on their circumstances.

(d) On the issue of whether, and if so in what form, limits are appropriate to the longer-term investment of principal sums, the Group may consider that an authority managing its own cash internally should in principle subject itself to similarly rigorous limits as are applied to external managers. There are growing numbers of authorities having sufficient levels of cash balances to warrant consideration of longer-term investment strategies. Longer-term investment to secure higher returns can bring risks not solely associated with changes in interest rate levels. The Group may wish to wait for the results of road-testing before reviewing again the appropriateness of the draft Code limits.

RECOMMENDATION

The PCSG is asked to consider this issues paper on draft prudential indicators for treasury management, for consideration for revisions to the draft Prudential Code.