CIPFA BULLETIN 02

Treasury and Capital Management Update

October 2018

The Treasury and Capital Management Panel oversees the production of CIPFA Bulletins to assist practitioners with the application of the requirements of the Prudential Code and the Treasury Management Code, and to provide advice on emerging or urgent accounting issues. Bulletins provide influential guidance that is intended to be best practice, but are not prescriptive and do not have the formal status of Prudential Code or the Treasury Management Code.

Please address any queries to CIPFA Technical Enquiry Service for CIPFA members and students
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INTRODUCTION

1. The Treasury and Capital Management Panel has responsibility for the Prudential Code and the Treasury Management Code. The Panel's aims are:

   - Enhancing the skills and expertise of treasury management staff and those charged with governance.
   - Supporting and promoting best practice, along with the Treasury Management Network, in the effective understanding and management of treasury risks.
   - Promotion of effective strategic capital planning.
   - Continued development of effective asset management planning to ensure the most effective utilisation of assets.
   - Developing the scope of the panel to ensure that cross-sectoral and devolved government agendas are addressed

2. Practitioners will be aware that following a substantial review process last year both the *Prudential Code for Capital Finance in Local Authorities* (Prudential Code) and *the Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes* (Treasury Management Code) were updated and were issued by CIPFA in December 2017.

3. This CIPFA Bulletin covers a number of issues that CIPFA considers that it would be useful to highlight for practitioners. However, CIPFA would comment that this should not replace direct reference to the Prudential and Treasury Management Codes, the *Code of Practice on Local Authority Accounting in the United Kingdom* and the relevant statutory provisions for the Prudential Framework across the United Kingdom.

STATEMENT ON BORROWING IN ADVANCE OF NEED AND INVESTMENTS IN COMMERCIAL PROPERTIES

4. A statement on borrowing in advance of need and investments in commercial properties has been issued by Rob Whiteman the CIPFA Chief Executive and Richard Paver the Chair of the Treasury and Capital Management Panel. It may be accessed on the Panel website. As is set out in the statement CIPFA shares the concerns raised in relation to the recent continuation and (in a small number of cases) acceleration of the practice of borrowing to invest in commercial property. CIPFA will therefore issue more guidance and will make it clear that these investment approaches are not consistent with the requirements of fiscal sustainability, prudence and affordability.

THE PRUDENTIAL CODE AND THE CAPITAL STRATEGY

5. The update to the Prudential Code introduced the requirement for local authorities to produce a capital strategy to demonstrate that the authority takes capital expenditure and investment decisions in line with service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability. CIPFA's guidance on the production of the capital strategy is included in its Prudential Code Guidance Notes. This Bulletin provides some additional high level pointers to assist local authorities in their production.

6. The capital strategy is an important document which would need to reflect the individual authority's circumstances. The Treasury and Capital Management Panel is

clear therefore that local authorities should consider their own approaches to the production of the strategy and should not rely on a template methodology to its production.

7. The purpose of the capital strategy is to tell a story that gives a clear and concise view of how a local authority determines it's priorities for capital investment, decides how much it can afford to borrow and sets its risk appetite. It need not duplicate other documents but should include cross references where relevant. It should provide enough detail to ensure that all members understand how the authority is delivering stewardship of the authority's resources, prudence and sustainability and meeting the authority's reporting requirements.

8. Although the production of a capital strategy is a new reporting requirement it should form a part of the authority's integrated revenue, capital and balance sheet planning and should reflect information already used in this process.

9. An important consideration for the capital strategy is that it should set out the long term context in which capital expenditure and investment decisions are made.

10. The capital strategy should focus on any commercial activities an authority is delivering, for example, through its group structures. This should include processes for ensuring effective due diligence and defining the authority's risk appetite. Importantly it should also consider proportionality in respect of overall resources (see also the CIPFA statement referred to in paragraph 4 above).

11. The Chief Finance Officer (CFO) amongst his/her other fiduciary duties should report explicitly on the affordability and risk associated with the capital strategy and where appropriate have access to specialised advice to enable them to reach their conclusions.

12. The Prudential Code Guidance Notes includes more detailed and practical guidance in this area, including indicative checklists (though it should be noted that these checklists are not a blueprint particularly as an authority's capital strategy has to reflect the individual authority's circumstances).

THE PRUDENTIAL CODE INDICATORS

13. Practitioners will also be aware that on the revision of the Prudential Code there were a number of revisions to the prudential indicators ie:

- The **removal of the impact on council tax indicator** – this is to allow focus on a longer term and a more informed view of affordability.

- **Restructuring of the Code's guidance on indicators** – this is to remove duplication and to improve readability. In addition terminology has been improved, for example, the reference to 'ratio' was moved from the indicators for financing costs to net revenue stream.

- **New guidance on local indicators** – this was needed to reflect local circumstances, including local indicators showing the impact of residual liabilities arising from group structures.

TREASURY MANAGEMENT IN THE PUBLIC SERVICES: CODE OF PRACTICE AND CROSS-SECTORAL GUIDANCE NOTES

14. The Treasury Management Code was also updated in 2017 following the review process outlined above and as a result of the changes to the public sector landscape of service delivery. Specifically it has clarified that investments include both financial

instruments but also other types of investments. It has also been updated to reflect the changes in the Prudential Code and has a new section on non-treasury management investments.

STATUTORY GUIDANCE ON LOCAL GOVERNMENT INVESTMENTS

Introduction

15. The Ministry of Housing, Communities and Local Government (MHCLG) issued its Statutory Guidance on Local Government Investments (3rd Edition) (Statutory Investment Guidance) in February 2018. The Statutory Investment Guidance was amended in response to changing practices for local authority investments (for example, for investment in economic regeneration and authorities investing in non-financial assets) and following the recent changes in the Prudential Code.

16. Local authorities in England are required to 'have regard' to the Statutory Investment Guidance as the Guidance was issued by the Secretary of State under Section 15 (1) of the Local Government Act 2003.

17. More commentary on the Statutory Investment Guidance is included in both the Treasury Management and the Prudential Code Guidance Notes.

STATUTORY GUIDANCE ON THE MINIMUM REVENUE PROVISION (ENGLAND)

18. The MHCLG also issued Statutory Guidance on Minimum Revenue Provision (Statutory Guidance on the MRP) in February 2018. Local authorities are again required to 'have regard' to this guidance.

19. This includes a number of clarifications on determining a prudent level of minimum revenue provision in respect of capital expenditure financed by borrowing or credit arrangements and is applicable from 1 April 2019 although early adoption is encouraged. This is with the exception of those changes relating to the section "Changing Methods for Calculating MRP", which apply from accounting periods starting on or after 1 April 2018. The updated guidance also includes the clarification that the MRP cannot be negative. CIPFA's detailed guidance on the Statutory Guidance on the MRP will be available in the update to *Practitioners Guide to Capital Finance in Local Government* which is currently being drafted.

STATUTORY GUIDANCE ON THE MINIMUM REVENUE PROVISION (WALES)

20. The Welsh Ministers issued a consultation on the Statutory Guidance on the Minimum Revenue Provision which closed in August 2018. This guidance includes many of the changes introduced by the English Guidance discussed above. However, at the time of drafting this Bulletin this has not yet been issued.

ACCOUNTING FOR CONTRACTS WITH LENDER OPTION BORROWER OPTION CLAUSES

21. The CIPFA/LASAAC Local Authority Accounting Code Board issued its clarification statement on contracts with LOBO clauses in May 2018.

22. The Treasury and Capital Management Panel issued a Bulletin in 2015 which covered contracts with LOBO clauses.

TREASURY MANAGEMENT IN THE PUBLIC SERVICES: GUIDANCE NOTES FOR LOCAL AUTHORITIES INCLUDING POLICE FORCES AND FIRE AND RESCUE AUTHORITIES 2018 EDITION

23. CIPFA published the abovementioned publication in August 2018. These sector-specific guidance notes draw attention to the requirements of statutes and regulations, and to common practices and current issues specific to local authority treasury management. This publication has been updated for the changes to both the Treasury Management and Prudential Code and changes to legislation and statutory guidance:

24. The key changes are:

- the provision of guidance on the setting of local indicators, where relevant.
- the guidance includes reference to the Statutory Investment Guidance and reflects the ability to merge the investment strategy into a wider capital strategy.
- a new section on non-treasury management investments has been included to provide further guidance on what is required in this area.
- in addition the opportunity has been taken to streamline the indicators following the 2017 consultations ie:
  - the principal invested for longer than 364 days indicator has been changed to principal invested over a year in line with financial reporting definitions
  - the interest rate exposure indicator has been removed and replaced with a requirement for the Treasury Management Strategy to state how interest rate exposure is managed and monitored, and
  - the maturity structure of borrowing indicator has been extended to cover variable as well as fixed rate debt.

THE PRUDENTIAL CODE FOR CAPITAL FINANCE IN LOCAL AUTHORITIES \ GUIDANCE NOTES FOR PRACTITIONERS 2018 EDITION

25. CIPFA published the abovementioned publication in September 2018. This guidance concentrates on providing practitioners with a practical interpretation of the Prudential Code to enable them to meet its key principles of ensuring that capital programmes are affordable, prudent and sustainable and to explain this effectively to those charged with governance.

26. The publication provides detailed guidance on how to produce the capital strategy introduced as a new requirement to the Prudential Code in 2017. It also reflects the changes to the prudential indicators and new guidance on the other changes to the Prudential Code in 2017. The publication also reflects the latest in the changes to the statutory provisions in the Prudential Framework.

MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE (MIFID II)

27. Practitioners are reminded that the process for electing to opt up to professional status with financial institutions is a continuous process and is not a one-off transaction.

28. Whilst financial institutions will make decisions on clients electing to opt up, local authorities are responsible for the information they have provided including updating that information when there are significant changes. These changes could include staffing changes within the treasury management team or a change to the CFO, plus any major changes to the elected members with decision-making responsibilities or local authority appointed advisors. It is expected the financial intuitions will look to refresh the data annually but local authorities should not wait to rely on this process.

THE IMPACT OF BREXIT ON TREASURY MANAGEMENT ACTIVITIES

29. Practitioners will be aware that a key part of treasury management is the management of risk and the protection of the principal sums invested. Local authorities will therefore want to consider the impact of Brexit on the approach to their treasury management activities including the risk of Brexit to the UK financial systems.

APPLICATION OF THE UK MONEY MARKETS CODE AND THE STATEMENT OF COMMITMENT

30. CIPFA has been approached by the Bank of England on the issue of the production of the Statement of Commitment to the Money Markets Code for more information on the Statement see here.

31. The UK Money Markets Code was published in April 2017. The Code sets out the standards and best practice expected from participants in the deposit, repo and securities lending markets in the UK. The Money Markets Committee agreed to the development of a public register of Statements of Commitment to the Code.

32. CIPFA would welcome any commentary from practitioners on how local authorities might be able to provide a Statement of Commitment and therefore would be grateful if local authorities could provide their views to the Secretary of the Treasury and Capital Management Panel by 5 November 2018.

CIPFA FINANCIAL SERVICES E-LEARNING TRAINING

33. In partnership with Intuition Know-How, CIPFA are now offering online learning materials and activities to help you develop your knowledge and skills at your own location and pace as well as supporting the requirements of Markets in Financial Instruments Directive (MiFID II).

34. The training platform has over 500 tutorials.

35. Find out more at: http://www.cipfa.org/training/e-learning-materials/financial-services-e-learning.

36. In addition, CIPFA has developed a recommended learning path which will provide direction for those that require it and will result in the award of a CIPFA certificate for successful completion which can be used for CPD purposes.

37. The coverage extends to all areas of financial services such as:

- corporate and commercial banking
- investment banking and capital markets
- financial analysis and valuation
- credit and risk management

- regulation and compliance
- asset management.

38. For more information and to register please contact: E: vlesupport@cipfa.org.