

PERFORMANCE AND AUDIT SCRUTINY COMMITTEE

20 January 2009

Report of the Director of Governance & Procurement

ITEM 12 TREASURY MANAGEMENT: INVESTMENT WITH HERITABLE BANK

Purpose of the Report

To provide the Committee with information on the investigation into the investment made with Heritable Bank plc, one of the Icelandic banks who have gone into administration.

Background

The Council made an investment of £1 million with Heritable Bank in January 2008, for a period of 364 days (ie. the investment principal and interest earned was to be repaid to the Council in January 2009).

In October 2008 Heritable Bank went into administration, along with several other Icelandic banks. Consequently, together with many other local authorities who had investments with these Icelandic banks, the recoverability of the Council's investment with Heritable was called into doubt.

As a result of this the Head of Financial Services reviewed the circumstances surrounding the investment, and raised a concern that the period of the investment appeared to have exceeded the time limit for the bank in force when the investment was arranged. Internal Audit were requested to investigate.

A full copy of the Internal Audit report on the findings of the investigation is attached at Appendix I.

The investigation confirmed that the £1M investment with Heritable Bank for a period of 364 days did exceed the maximum specified investment limit for that bank as per the Council's approved counterparty list in force at the time (which specified a maximum investment period of 3 months for Heritable). The investment therefore represented a non adherence to the Council's Treasury Management policy.

The other main concerns arising from the investigation are summarised below:

- The Council's Treasury Management Practices were approved in February 2004, and have not been updated since that time. They have become out of date in some areas, particularly in relation to the job titles of the key officers involved in Treasury Management activities,
- The daily counterparty spreadsheet used to monitor compliance with investment limits is not printed off and retained, and is over-written on an ongoing basis,

- Officers arranging loans are relatively junior and can commit the Council to a deal worth several million pounds with no involvement of any more senior officer in investment decisions,
- Concerns were noted over the adequacy and completeness of training provided to some officers who had been responsible for arranging investments. For example, it did not appear that they had been made aware of the Treasury Management Practices document in all cases,
- A further more recent incident was identified where the maximum investment value for a bank as specified on the approved investment counterparty list was exceeded, although on this occasion all monies were re-paid to the Council in full and on-time.

A number of recommendations to improve procedures and controls were made by Internal Audit, and implementation of these has been agreed with managers as set out in the Action Plan within the attached report.

These recommendations will be followed-up by Internal Audit in due course, and it is proposed that an update will be provided to the Audit Committee once this follow-up review has been completed.

The situation regarding the recoverability of the investment is still to be confirmed, and may take some months to clarify with any certainty. However, the investment does only represent a small proportion of the Council's total investment portfolio, and it remains unlikely that services will be significantly adversely affected even if the full amount were to not be re-paid.

CIPFA have recently issued guidance on the accounting treatment for impaired investments following on from the Icelandic banks situation, which the Council will apply when producing its financial statements for 2008/09.

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Charnwood

Leading in Leicestershire

Internal Audit Services

Treasury Management Investigation 2008

Internal Audit Report

LIMITED ASSURANCE

December 2008

Contents:

1. Introduction	Page No
Background	3
2. Executive Summary	
Overall Assessment	4
3. Action Plan	5-8
4. Detailed Findings	9-10

Circulation:

Officer	Draft Report	Final Report
Geoff Parker (Deputy Chief Executive)	Y	Y
Ian Geary (Head of Financial Services)	Y	Y
Simon Jackson (Chief Financial Officer)	Y	Y
Brian Hayes (Chief Executive)		Y
Keith Ireland (Director of Governance & Procurement)		Y

I. Introduction

I.1 Background

This report sets out the findings of an investigation into the circumstances surrounding the investment of £1M with Heritable Bank on 30 January 2008.

Following notification that Heritable had gone into administration, it became apparent that the maximum investment period specified for the bank on the Council's approved investment counterparty list at the time the investment was made had been exceeded.

The purpose of the investigation has been to determine the circumstances surrounding the arrangement of the investment, how the apparent non adherence to the Council's Treasury Management processes had occurred, and whether any improvements were required to prevent any similar situations arising in the future.

2. Executive Summary

LIMITED ASSURANCE

- 2.1 Internal Audit can only give limited assurance to those charged with governance. There are significant weaknesses in the internal control environment within the areas reviewed, and further action is required to manage risks to an acceptable level.

The main concerns arising from the investigation can be summarised as follow:

- The Council's Treasury Management Practices were approved in February 2004, and have not been updated since that time. They have become out of date in some areas, particularly in relation to the job titles of the key officers involved in Treasury Management activities,
- The daily counterparty spreadsheet used to monitor compliance with investment limits is not printed off and retained, and is over-written on an ongoing basis,
- Currently, the officers arranging loans are relatively junior and can commit the Council to a deal worth several million pounds with no involvement of any more senior officer,
- Concerns have been noted over the adequacy and completeness of training provided to some officers who have been responsible for arranging investments. For example, it does not appear that they have been made aware of the Treasury Management Practices document in all cases,
- A further more recent incident has been identified where the maximum investment value for a bank as specified on the approved investment counterparty list was exceeded, although on this occasion all monies were re-paid to the Council in full and on-time.

This report highlights two instances of non adherence to the Council's Treasury Management policy. The first is in relation to the £1M investment with Heritable Bank, where the maximum investment period for that institution was exceeded, and the second is in relation to three consecutive investments with Dexia Bank, which in total caused the maximum investment value for that institution to be exceeded.

The Treasury Management Practices require that any instances of non adherence should be brought to the attention of elected members as soon as possible.

3. Action Plan

Observation	Risk	Recommendation	Priority	Response/Agreed Action	Officer Responsible	Action Date
<p>I. The Treasury Management Practices, as approved in February 2004 have become out of date and need to be reviewed.</p>	<p>Non adherence to or breach of the specified practices due to changes in circumstances</p>	<p>I. The Treasury Management Practices should be reviewed and brought up to date, and any amendments approved by Members as appropriate</p>	<p>High</p>	<p>Reports will be brought before Cabinet that will set out:</p> <ul style="list-style-type: none"> • Updated Treasury Management practices reflecting forthcoming CIPFA guidance • Updated Treasury Strategy for 2008/09 and Treasury Strategy for 2009/10 <p>Treasury Management practices and Strategy will be introduced in line with these reports as agreed by Cabinet.</p>	<p>Deputy Chief Executive</p>	<p>31 March 2009</p>

Observation	Risk	Recommendation	Priority	Response/Agreed Action	Officer Responsible	Action Date
2. The daily counterparty spreadsheet used to monitor compliance with investment limits is not printed off, and is over-written on an ongoing basis	Lack of an adequate audit trail to confirm compliance with investment limits	2. The daily counterparty spreadsheet should be printed off each time an investment is arranged, and attached to the other documents relating to the investment	High	The counterparty list will be printed off daily and attached to the documents in respect of each investment arranged.	Head of Financial Services	Action from 1 December 2008
3. Currently the officers arranging loans are relatively junior and can commit the Council to a deal worth several millions of pounds with no involvement of any more senior officer	Lack of segregation of duties and significant responsibility resting with junior officers could lead to inappropriate investment decisions	3. Review the allocation of responsibilities for arranging and authorising investments	High	A. Allocation of responsibilities will be reviewed for arranging and authorising investments. B. These will be reflected in updated Treasury Management practices reflecting forthcoming CIPFA guidance.	Deputy Chief Executive	A. By 31 December 2008 B. By 31 March 2009
4. Concerns have been noted over the adequacy and completeness of training provided to some officers who have been	Inadequate training could lead to non-compliance with Treasury Management procedures,	4. Review the training provided to all officers undertaking any activities related to Treasury Management to ensure it is adequate and sufficient and that they are fully aware of	High	Training will be given to all officers required to undertake Treasury Management activities. This will reflect the new Treasury Management	Head of Financial Services	Interim records confirming an understanding of existing Treasury Management

Observation	Risk	Recommendation	Priority	Response/Agreed Action	Officer Responsible	Action Date
responsible for arranging investments. For example, it does not appear that they have been made aware of the Treasury Management Practices document in all cases	and inappropriate investment decisions.	the required controls and processes, and their responsibilities		practices. Officers will evidence that they have received training by signing a Treasury Management training record that will be maintained in the finance department.		procedures to be created and maintained from 1 December 2008 covering current Treasury Management staff. A revised record will be maintained from 1 April 2009 reflecting the amended Treasury Management practices.
5. There are two instances of non adherence to the Treasury	Failure to notify elected members of non	5. The two instances of non adherence to the Council's Treasury Management policy noted in this report	High	This should be incorporated into the revised report introducing the revised	Deputy Chief Executive	31 March 2009

Observation	Risk	Recommendation	Priority	Response/Agreed Action	Officer Responsible	Action Date
Management Practices highlighted in this report, and the Practices specify that if the stated policy is not adhered to that this must be brought to the attention of elected members	adherences to the policy would constitute a further non adherence	should be brought to the attention of elected Members promptly and in a suitable manner		Treasury Strategy.		

Detailed Findings

4.1 Investment with Heritable Bank

- 4.1.1 At the time that the £1M was invested with Heritable Bank for 364 days in January 2008, the bank was included on the Council's approved counterparty list with a maximum investment value of £3M, and a maximum investment period of 3 months. The maximum investment period for this institution was therefore exceeded. Had the 3 month maximum period been complied with, the Council would have recovered its £1M principal and interest before Heritable went into administration.
- 4.1.2 The investigation into the circumstances surrounding how the approved investment limit came to be exceeded has resulted in disciplinary action being taken against a member of staff.
- 4.1.3 It has become apparent during the investigation that in-house investments made by the Financial Services team, and which typically range between £1M and £2M, are arranged by relatively junior officers. Whilst there are clear parameters and limits specified within which investment decisions are made, there is no routine involvement or check by more senior officers that these parameters and limits have been complied with before investment commitments are made.
- 4.1.4 Concerns have also been noted relating to the training provided to officers involved in Treasury Management activities. For example, some of those officers have not been made aware of the Council's 'Treasury Management Practices' document, which was approved by Members in 2004, and which is the key document setting out the processes and responsibilities for Treasury Management activities.
- 4.1.5 The Treasury Management Practices document has also not been updated since its approval in 2004, and has become out of date in some aspects, particularly in relation to job titles of those officers involved in Treasury Management.
- 4.1.6 It has also been noted that the approved counterparty spreadsheet, which is used to monitor compliance with investment limits, is not printed off to support investment transactions, and is over-written on an ongoing basis as new investments are made and existing investments are re-paid to the Council.

4.2 Review of Other Recent Investments

- 4.2.1 A review of all other recent in-house investments was undertaken during the investigation to confirm that the correct processes and procedures had been followed.

- 4.2.2 This review revealed one other instance where the approved investment limits had been breached when arranging an investment, this time in respect of the maximum investment value for the bank concerned.
- 4.2.3 Between 25 July 2008 and 6 August 2008, a total of £4.5M was invested with Dexia Bank, in the form of 3 separate investments (investment nos. 579, 580 and 581). The maximum total investment specified for this bank on the Council's approved counterparty list at this time was £4M.
- 4.2.4 The investment principal sums and interest for all of these investments were paid to the Council on time and in full. However, it is a matter of concern that this represents a further non adherence to the Council's approved investment limits.
- 4.2.5 It has been ascertained that at the time these investments were made, an officer was being trained re the processes for arranging investments, and therefore due to two officers being involved, there may have been an oversight which resulted in one of the investments not being recorded on the counterparty spreadsheets. If this was the case, when a subsequent investment was made, it would not have been apparent that the maximum investment value limit for the bank was being exceeded. However, as noted previously in this report, the counterparty spreadsheet is not printed off, and is regularly over-written, and so there is no audit trail to confirm exactly what happened in this case.

4.3 Previous Internal Audit Findings

- 4.3.1 The most recent Internal Audit report in respect of Treasury Management, issued in January 2008, noted an instance where the maximum investment period for a particular bank had been exceeded when arranging an investment. However, on this occasion the Head of Financial Services had been aware of the limit being exceeded, and had made a decision to vary the limit to take advantage of a beneficial interest rate deal which was on offer. The Internal Audit report recommended that where such decisions were taken, that they should be documented.
- 4.3.2 The two instances noted above where investment limits were exceeded either in terms of the period of the investment, or the total value of investments made with a particular bank, arose due to breakdowns in controls and procedures, and the Head of Financial Services was not aware that the limits had been exceeded.