Borrowing and treasury management in councils

ACCOUNTS COMMISSION

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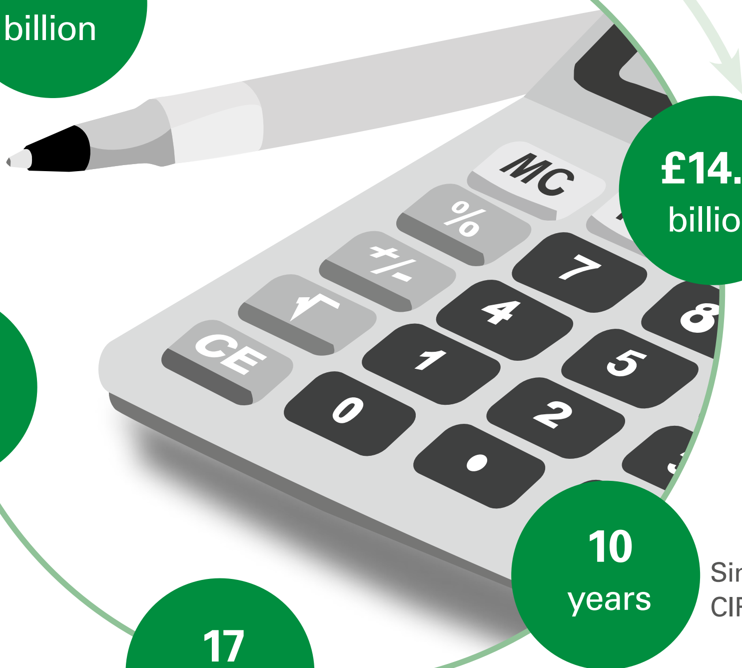
Exhibit data

When viewing this report online, you can access background data by clicking on the graph icon. The data file will open in a new window.

Key facts



£12.1 billion
Borrowing by Scottish councils

+

£2.7 billion
Other debt of Scottish councils, mainly Public Private Partnerships

=

£14.8 billion
Total debt of Scottish councils

£39 billion
Value of council assets

10 years
Since the introduction of CIPFA's Prudential Code

17 from 32
Councils have increased borrowing levels in the last ten years

Summary

Key messages

1 Councils have total debt of £14.8 billion of which £12.1 billion, 82 per cent, is from borrowing. Debt commits councils to charges over the long term. There are different types of debt with different features and varying degrees of risk.

2 Borrowing is a key source of finance for councils to invest in vital public services. Overall borrowing has remained at around £12 billion for the last three years, with total assets of £39 billion. Councils have developed borrowing strategies to suit their own local priorities and needs, in response to the flexibility introduced by the Prudential Code in 2004. Seventeen councils have increased their borrowing levels, in real terms, over the last ten years.

3 Councils are following the general principles of the relevant codes of practice in demonstrating short-term affordability, but they are not always highlighting the strategic importance of borrowing and treasury management or clearly analysing and reporting the long-term affordability and sustainability of their borrowing. Councils need to develop detailed analysis to support borrowing decisions and to demonstrate they represent best value for the council.

4 Treasury management is a professionally run function in councils with appropriately qualified officers. Succession planning, ongoing training and the availability of appropriate professional qualifications are important. Councils have started to integrate their treasury management and capital investment functions which is a positive step.

5 Councils need to improve scrutiny of borrowing and treasury management. This is a complex and technical subject and officers need to provide wider training and support to councillors, and also provide clearer, more accessible reports. The current governance structures in some councils could be improved to support more effective scrutiny.

Recommendations

These recommendations focus on the evidence gathered and our findings on borrowing within councils. We suggest councils consider the wider relevance of these to total debt.

Council officers should:

- use the treasury management strategy to present a wider strategic view of borrowing and treasury management. It should use clear and accessible language and be prepared for councillors as the key audience. It should include how the borrowing strategy is informed by corporate priorities and capital investment needs. The strategy should include:
  - links to capital investment plans and corporate objectives
  - all borrowing and other debt
  - prudential indicators as a core part of the strategy
  - a clear assessment of the affordability and the impact on revenue budgets both in the short and long term
- create more detailed and longer-term borrowing and treasury management analysis as informed by the council's financial strategy. It should include:
  - scenario planning to show the potential impact of different budget scenarios, income generation plans, and changes in external factors such as interest rates
  - analysis of capital financing options to compare affordability and sustainability between different debt and borrowing options
  - the use of indicators over a longer period than the minimum three years set by the Prudential Code
- share strategies with other councils to help inform good practice, and exchange of ideas
- carry out joint planning with other councils to identify future qualification and training needs and enhance their capacity, in order to negotiate with training providers
- review the content of year-end reports to ensure they provide an assessment of the effectiveness of the year's borrowing and treasury management activities and the performance of the treasury management function. This should include appropriate indicators, comparative figures, and appropriate explanations.

Council officers and councillors involved in treasury management should:

- review governance arrangements, and update as necessary, to ensure they provide:
  - the treasury management strategy, mid-year and year-end reports to the same council committee, and that the full council has access to them
  - councillors with mid-year reports by the end of December each year
  - councillors with the wider picture, that is, make the links to capital investment decisions and revenue budgets
  - councillors with access to all reports relating to borrowing and treasury management activity including risk registers
- ensure scrutiny arrangements are robust by:
  - considering widening the range of training options to councillors on borrowing and treasury management activities and whether this training should be mandatory
  - considering whether training for councillors provides a balance of scrutiny skills and knowledge of treasury management.

About the audit

1. This audit assesses how councils show best value in borrowing and treasury management decisions. Its specific objectives are to answer:

- What is borrowing and treasury management in councils?
- To what extent do councils' borrowing and treasury management strategies meet good practice and contribute to corporate plans and priorities?
- Can councils demonstrate the affordability and sustainability of borrowing decisions? For example, can they show that borrowing will not adversely affect their financial position? Will that continue to be the case in future?
- How effective are the governance arrangements for borrowing and treasury management? Governance covers areas such as responsibility and accountability for borrowing and treasury management decisions, arrangements for reporting decisions and for scrutinising them.

2. Councils have total debt of £14.8 billion, of which 82 per cent (£12.1 billion) is as a result of borrowing (Exhibit 1, page 9). Total debt includes Private Finance Initiative/Non Profit Distributing (PFI/NPD) contracts, Tax Incremental Financing (TIF), the City Deal agreement, the Growth Accelerator Model (GAM) and borrowing. Each type of debt has unique features, is at different stages of development and implementation and has varying degrees of risk. This is the first report that we have produced on council debt with the focus specifically on borrowing. This allows us to focus on the arrangements that councils have in place to assess the affordability of borrowing. We may propose further work on other elements of council debt in due course.

3. This report focuses on whether councils openly and clearly demonstrate the affordability and sustainability of borrowing decisions over the short term, ie the next couple of years, and long term, that is ten years onwards to cover the term of the borrowing. It also looks at whether councils' approach to borrowing, as outlined in their treasury management strategy, reflects their corporate priorities and aims. Councillors have a key role in holding officers to account and this report evaluates the councillor's role in considering borrowing and treasury management reports, including the strategy. We use the term borrowing to mean borrowing from a source outwith the council.

4. Our focus is on borrowing to fund capital expenditure, such as building schools or improving roads. We did not evaluate day-to-day cash, investment and borrowing transactions. We have not explored in detail other forms of debt. This includes the new capital financing options available to councils including TIF, or City Deal that may have an element of borrowing to them (Exhibit 1, page 9). These new options are just being introduced and are not yet fully operational. Although the messages in our report are based on current borrowing, they will apply equally to other forms of debt including these new financing options.

5. We gathered audit evidence from:

- published and unpublished data on borrowing and treasury management activity including audited accounts, Chartered Institute of Public Finance and Accountancy (CIPFA) statistics and Scottish Government data
- our review of the treasury management strategies of 12 councils
- fieldwork at six councils involving interviews with officers and councillors
- interviews with representatives from organisations including the Scottish Government, CIPFA, CIPFA Treasury managers' forum and the Society of Local Authority Chief Executives (SOLACE).

6. Appendix 1 provides further details of our audit approach.

7. This report has three parts:

- Part 1: setting the scene
- Part 2: demonstrating the affordability and sustainability of borrowing
- Part 3: effective management and scrutiny.

8. Our website contains a *Supplement: Scrutiny guidance and questions for councillors* [PDF] to help them implement the recommendation we make in this report.

Exhibit 1
Borrowing is 82% of total debt

Total debt £14.8bn

Borrowing £12.1bn

From Public Works Loan Board (public sector source of lending for public bodies)

From banks

Borrowing charges paid from revenue budget over life of loan.

Public Private Partnership £2.7bn

Private Finance Initiative

Partnership where public and private sector partners agree a contract to build and maintain an asset for public sector use.

Public body pays an annual charge over the life of the asset to the contractor from its revenue budget.

Non-profit distributing contracts

Similar to PFI, but limits the profits that the private sector contractor may retain.

Public body pays an annual charge over the life of the asset to the contractor from its revenue budget.

Tax Incremental Financing

New capital financing method. Council borrows to invest in infrastructure projects which will deliver economic growth. Additional business rate income from the new business generated pays for borrowing charges.

Growth Accelerator Model

Public body borrows to invest in capital investment project.

Expected that additional business rates will accrue to Scottish Goverment owing to investment.

Scottish Government makes payment to public body, based on additional economic growth.

City deal

Agreement signed with UK and Scottish Governments by the 8 Glasgow and Clyde Valley councils. Currently the only deal in Scotland.

The deal involves the councils investing an additional £130 million to unlock additional grants of £1 billion from the UK and Scottish Governments combined.

Investment by councils will involve additional borrowing, with charges covered by additional grant income.

Note: £2.7bn includes finance leases. TIFs, GAM and City Deal are just introduced and are not yet fully operational.

Source: Audit Scotland

Part 1

Setting the scene

Key messages

1 Councils' outstanding debt was £14.8 billion at 31 March 2014, with borrowing making up £12.1 billion, 82 per cent of this.

2 Councils use borrowing to pay for assets such as schools and roads to provide local services and meet local priorities. This has an impact on future revenue budgets, as the council needs to pay interest on the borrowing. Total assets were £39 billion at 31 March 2014.

3 The Prudential Code was introduced in 2004 to provide greater flexibility for councils to manage and control their own capital investment activity following a period of government regulation. Councils' borrowing strategies, levels of borrowing and debt profiles differ widely.

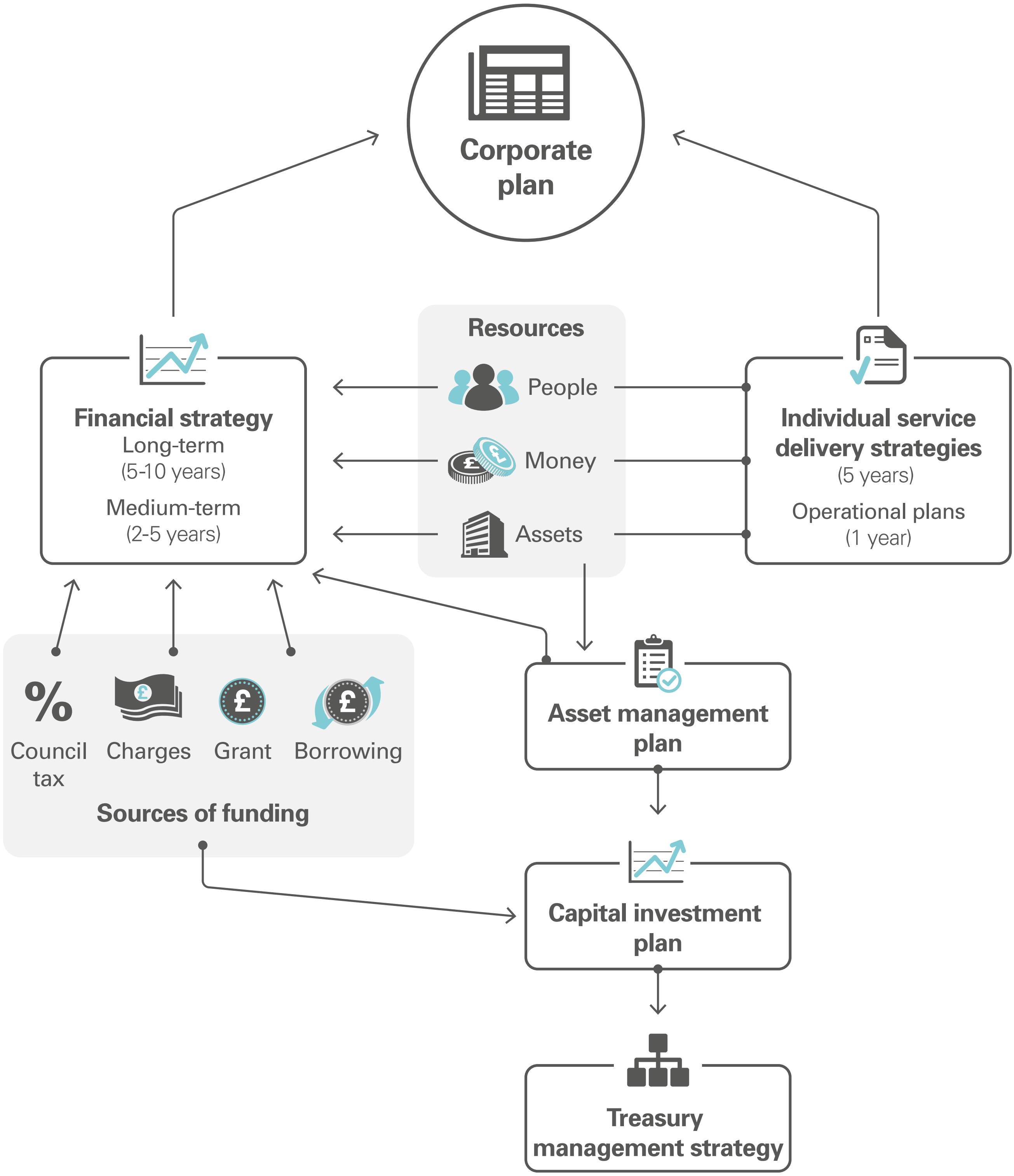
councils' ability to manage and control their own investment activity is reflected in borrowing levels and strategies

Councils invest in services for communities

9. A council has a corporate plan setting out its priorities and objectives and how it plans to achieve them (Exhibit 2, page 11). This may, for example, include the priority to build a new school to deal with an expected increase in demand as a result of significant new housing. These plans are often over the medium term, typically three to five years, but may be over a longer term, ie up to 15 years. The council targets its resources, that is people, money and assets, at its priorities and objectives. The corporate plan should feed into the asset management plan to identify what assets are needed to achieve its objectives. For example, this could be building new housing. The council, through a capital investment plan, sets out how it will finance the spending on these assets. This may be by using cash resources, for example cash reserves built up over time or capital grants, or through external finance.

10. Methods of external finance include borrowing, PFI schemes and other mechanisms including NPD schemes, TIF schemes, or the new GAM. Entering into external financing arrangements will create debt for the council, and means that the council needs to pay financing charges each year over the life of the arrangement, which may be up to 50 years. It is important for a council to assess the affordability of decisions in the context of the financing charges of its total debt.

Exhibit 2
Corporate and strategic influences on treasury management strategy



Source: Audit Scotland

11. Councils should also have medium (two to five year) and long-term (five to ten year) financial strategies. The council will estimate future funding and income, costs and demand for services, and how much it will need to spend to achieve its future objectives. The strategy should identify how the council will make up any shortfall between estimated funding and projected costs and demand. The financial strategy should include the financing cost of borrowing and other debt. This is the annual repayment of interest charged on borrowing or other external financing and any other associated costs. Councils make this repayment out of future budgets, so it decreases the level of available budget remaining and reduces flexibility in future budget decisions.

12. Borrowing involves accessing finance and then repaying it over a longer period of time. These periods can be for up to 50 years, so today's decisions can have a sustained impact on future generations. Borrowing decisions involve a careful balancing act between prioritising investment, and making sure the council can:

- manage the consequences of its decisions over the whole life of the borrowing
- provide evidence showing how it will manage these long-term consequences.

13. Borrowing therefore is set firmly within the framework of wider council activity and should be driven by the corporate plan, capital investment plan and medium and long-term financial plans (Exhibit 2, page 11).

Borrowing is the main element of total debt

Councils' outstanding borrowing is £12.1 billion and has been between £10.5 and £12 billion for the last six years

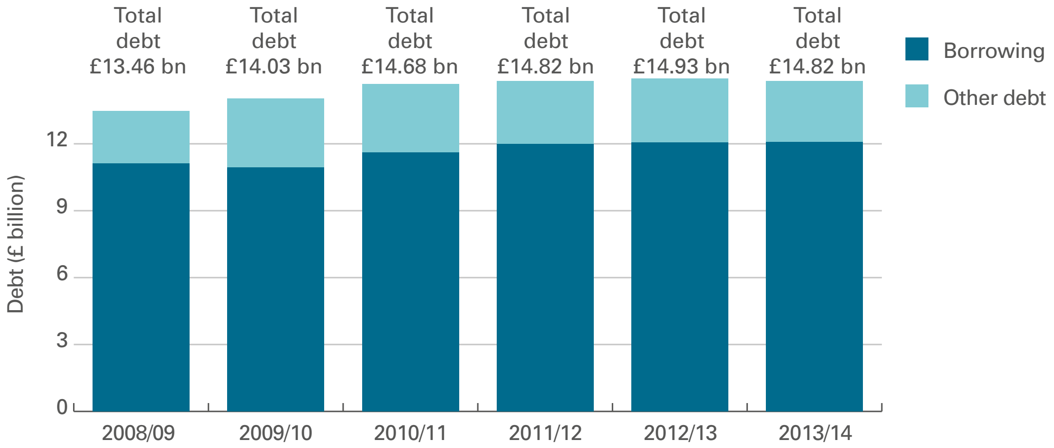
14. Councils spend around £20.8 billion a year. Of this, £18.6 billion is for day-to-day expenses including salaries, and £2.2 billion on buying, building and maintaining assets such as schools, housing and care homes.

15. Councils' total debt at 31 March 2014 was £14.8 billion, with total assets of £39 billion. Borrowing is the main form of debt for Scottish councils (Exhibit 1, page 9). Councils had overall borrowing of £12.1 billion at 31 March 2014 and other debt of £2.7 billion (Exhibit 3, page 13). Borrowing has remained between £10.5 and £12 billion for the last six years. Other debt levels have fluctuated between £2.2 billion and £2.8 billion over the last six years. Other debt comprises both PFI and NPD schemes and the new financing methods, including TIF, GAM and City Deal that are just being introduced.

16. Comparing council borrowing levels over the last ten years, between 2003/04 and 2013/14, shows that 17 of Scotland's 32 councils have increased borrowing levels in real terms, that is, including the effects of inflation (Exhibit 4, page 13). Changes in borrowing levels over this period reflect differences in councils' corporate priorities, capital investment plans, levels of cash resources and other available financing options, amongst other factors.

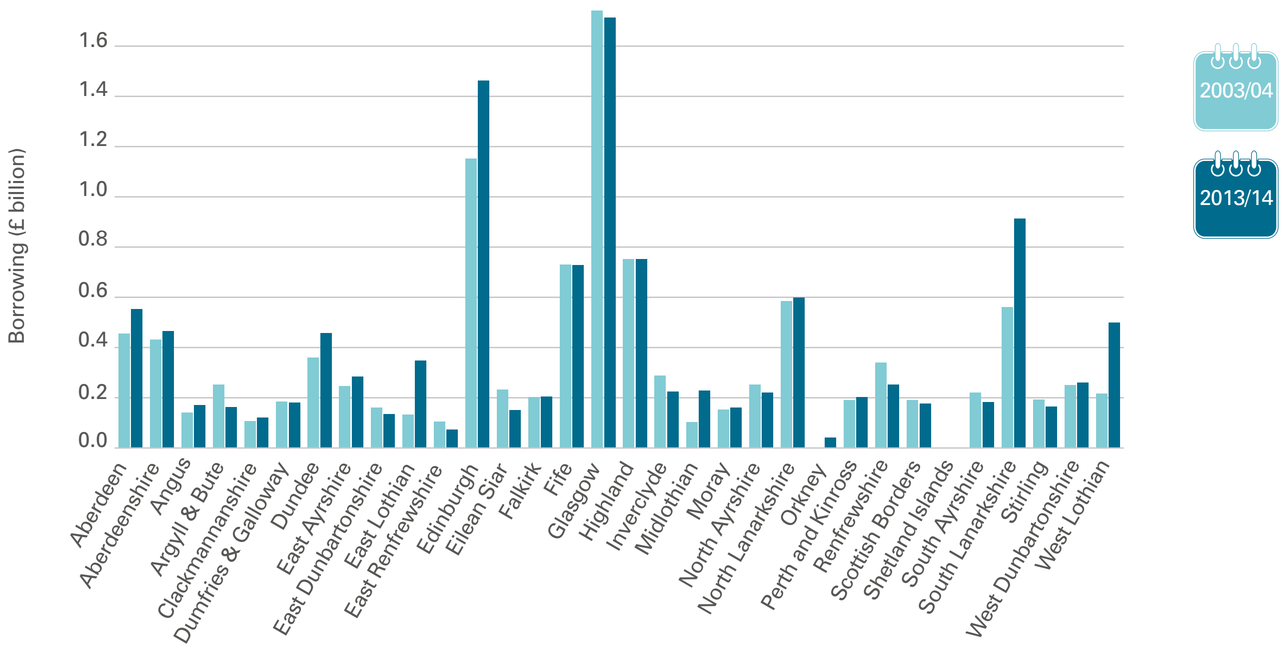
17. Councils do not always need to increase debt or borrowing if internal sources of finance are available to them. This includes using cash reserves that have been built up over time or capital grants.

Exhibit 3
Total debt of Scottish councils (2013/14 real terms prices)



Source: Council audited annual accounts 2008/09 to 2013/14

Exhibit 4
Comparison of total borrowing by councils in 2003/04 and 2013/14 (2013/14 real terms prices)



Source: Council audited annual accounts 2003/04 and 2013/14

18. Current interest rates are low, which is an advantage to councils that need to borrow for capital investment as interest charges are cheaper than when rates are higher. Our analysis shows that two-thirds of councils are currently borrowing, although fewer councils are borrowing now than ten years ago. Councils are borrowing shorter term, typically for less than 15 years, at fixed rates, from government-backed institutions such as the Public Works Loan Board (PWLB), as this has offered the most competitive rates.

Borrowing is a long-term commitment, with a third of current borrowing due to be repaid in over 40 years

19. The repayment of a council's borrowing influences its long-term financial planning and its assessment of whether it will be able to afford its existing borrowing in the future. To manage levels of borrowing we would expect to see a spread of borrowing with different maturity periods so that it is more manageable. We would also expect councils to avoid periods when high levels of repayments may impact on money available for other priorities. On maturity, councils can either decide to repay borrowing, or take a new loan to replace the old borrowing. Exhibit 5 (page 15) shows the profile of borrowing for 2009/10 to 2012/13 and highlights:

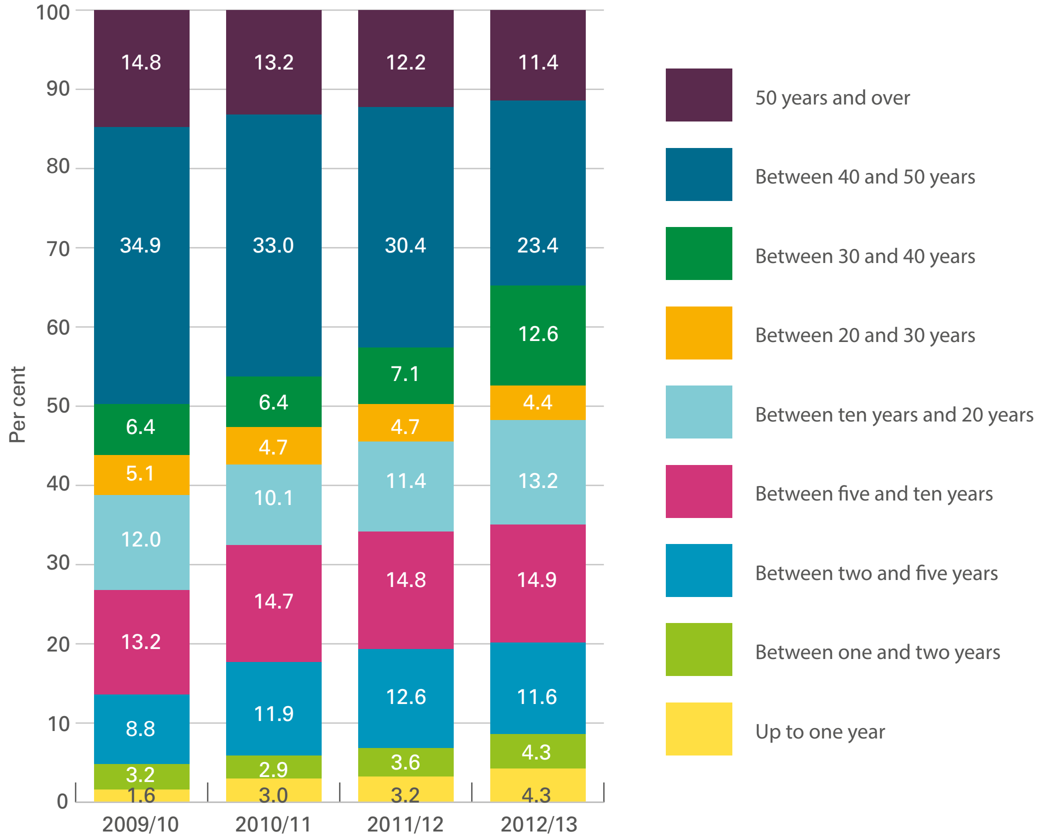
- the profile of borrowing is evening out and the percentage of loans maturing in over 20 years has fallen. At 2009/10, over 61 per cent of borrowing would mature in over 20 years; this decreased to 52 per cent by 2012/13
- councils have increased short-term borrowing. At 2009/10, around five per cent of borrowing was for less than two years, increasing to 8.5 per cent at 2012/13
- around a third of councils' borrowing is due to be repaid in the next ten years (35 per cent)
- around another third of borrowing will be due for repayment in over 40 years (34.8 per cent).

Borrowing is a key part of treasury management

20. Treasury management is the process that councils use to ensure cash is available when needed. This includes day-to-day expenses like paying salaries or electricity bills, and building new assets, such as a new school, or improving existing ones, such as roads. It also involves ensuring that any temporary surplus cash is safely invested. Borrowing is one of the larger cash flows that a council needs to manage, so borrowing is a central part of treasury management. Exhibit 6 (page 16) shows examples of the typical cash flows in a council together with their timing.

21. Councils have two types of budgets to finance and to balance: revenue and capital. Revenue expenditure pays for daily activities like salaries or electricity bills. Capital expenditure is what councils spend on premises, equipment and vehicles; on improvements like roads repairs; and on providing new assets like schools or council houses. Councils can borrow to finance capital expenditure but not revenue expenditure, unless approved by Scottish ministers. Borrowing charges are revenue expenditure. Councils that own council houses must keep a separate budget and account for revenue and capital expenditure on the housing stock.

Exhibit 5
Scottish councils–maturity of total borrowing 2009/10 to 2012/13
Percentage of borrowing due to be repaid in the periods shown.



Source: *Capital Expenditure and Treasury Management,* CIPFA Statistics, June 2014

Borrowing to invest in housing must be repaid from the future housing budget, and therefore funded from future housing rental income.

Councils must comply with borrowing and treasury management rules and regulations

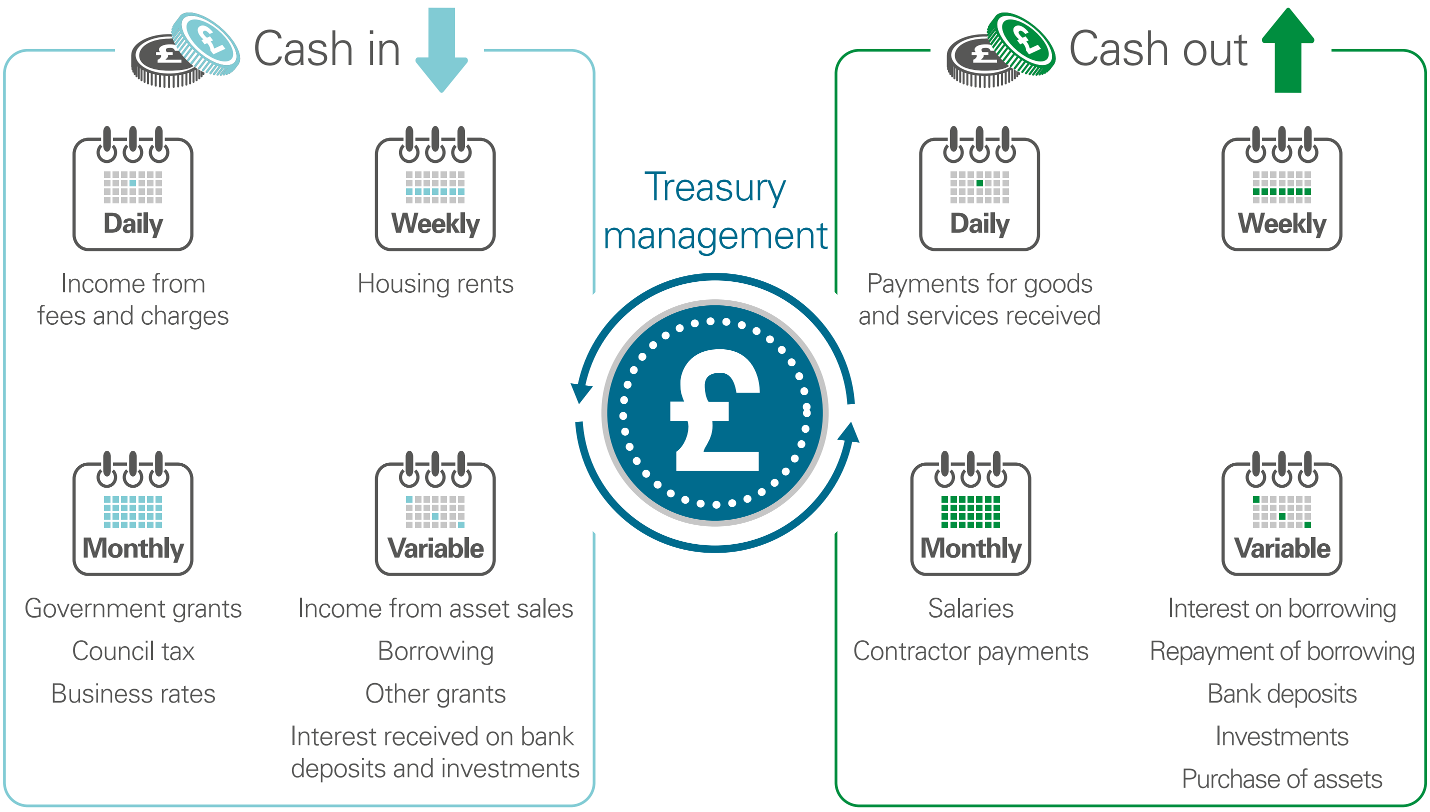
22. In recognition of the importance of capital investment in assets and treasury management to council activities, CIPFA and the Scottish Government set codes of practice and regulations for councils to follow. These ensure that councils have effective processes and practices in place to control, manage and govern capital investment decisions, that include borrowing, and treasury management practices (Exhibit 7, page 17).

23. The Prudential Code was introduced in 2004 as a framework to support councils and help them show effective control over levels of, and decisions relating to, capital investment activity, including borrowing. Before this, capital investment levels in councils were government-regulated.

Exhibit 6

Treasury management activities

An example of a council's cash flows with their timing to demonstrate their variability and predictability.



Source: Audit Scotland

24. This self-regulating approach has enabled councils to adopt borrowing and treasury management strategies that fit with their corporate plans and objectives. The framework allows for councils themselves to judge what is affordable and sustainable and will differ depending on local circumstances. The Prudential Code sits alongside CIPFA's treasury management code, which sets out the requirements for professional treasury management practice.

25. A key requirement of the codes is for councils to produce an annual treasury management strategy before the start of each financial year. CIPFA and the Scottish Government recommend that this is a single integrated strategy that combines plans for capital investment, including borrowing, treasury management, and investment. It also recommends that the strategy includes prudential indicators that are set out within the Prudential Code. These form a set of 12 limits and ratios that all councils must calculate and use to show to councillors and the public that capital investment plans are affordable and sustainable.

Exhibit 7
Codes of Practice and Regulations

The Prudential Code for Capital Finance in Local Authorities–CIPFA	A professional code of practice to help councils with capital investment decisions by providing a framework. The Prudential Code sets out indicators that councils must use to help demonstrate public accountability. It also recommends that councils have an integrated treasury management strategy within which its borrowing and investments are managed.
Treasury management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes–CIPFA ('the CIPFA treasury management code')	Adopting this code is a requirement of the Prudential Code. This makes recommendations to provide a basis for councils to create clear treasury management objectives and to structure and maintain sound treasury management policies and practices. A key recommendation is for a treasury management strategy before the start of the year, a mid-year report and an end-year review report.
Finance Circular 5/2010–The investment of money by Scottish local authorities	Provides Scottish ministers' consent for councils investing money and sets out the recommendations and requirements they must meet when making investments. It requires local authorities to 'have regard' to the Prudential Code and the Treasury Management Code and recommends that the strategy form part of a wider single annual strategy covering capital investment, treasury management and prudential information.
Local Government (Scotland) Act 1975	Sets out the statutory basis on which councils can borrow and lend.

Source: Audit Scotland

26. This report focuses on borrowing, to finance capital investment, and treasury management. Most of the indicators are not specific to borrowing but relate to total capital investment and are calculated using figures for total finance costs, total capital expenditure or total debt. This allows councils to assess the affordability of borrowing in the context of the total debt position of the council. The indicators relating specifically to borrowing are the estimated and actual capital financing requirement. This calculates the amount of capital investment that needs to be met from borrowing or other method of external finance.

27. The prudential indicators are designed to help councils make and record local decisions. They are not designed to be comparative performance indicators across councils as they are set according to the individual needs of each council. In particular, councils had widely different debt positions when the Prudential Code was introduced. These differences are likely to increase over time as councils' choices reflect local priorities. The system is designed specifically to help councils take local decisions in ways that are publicly accountable.

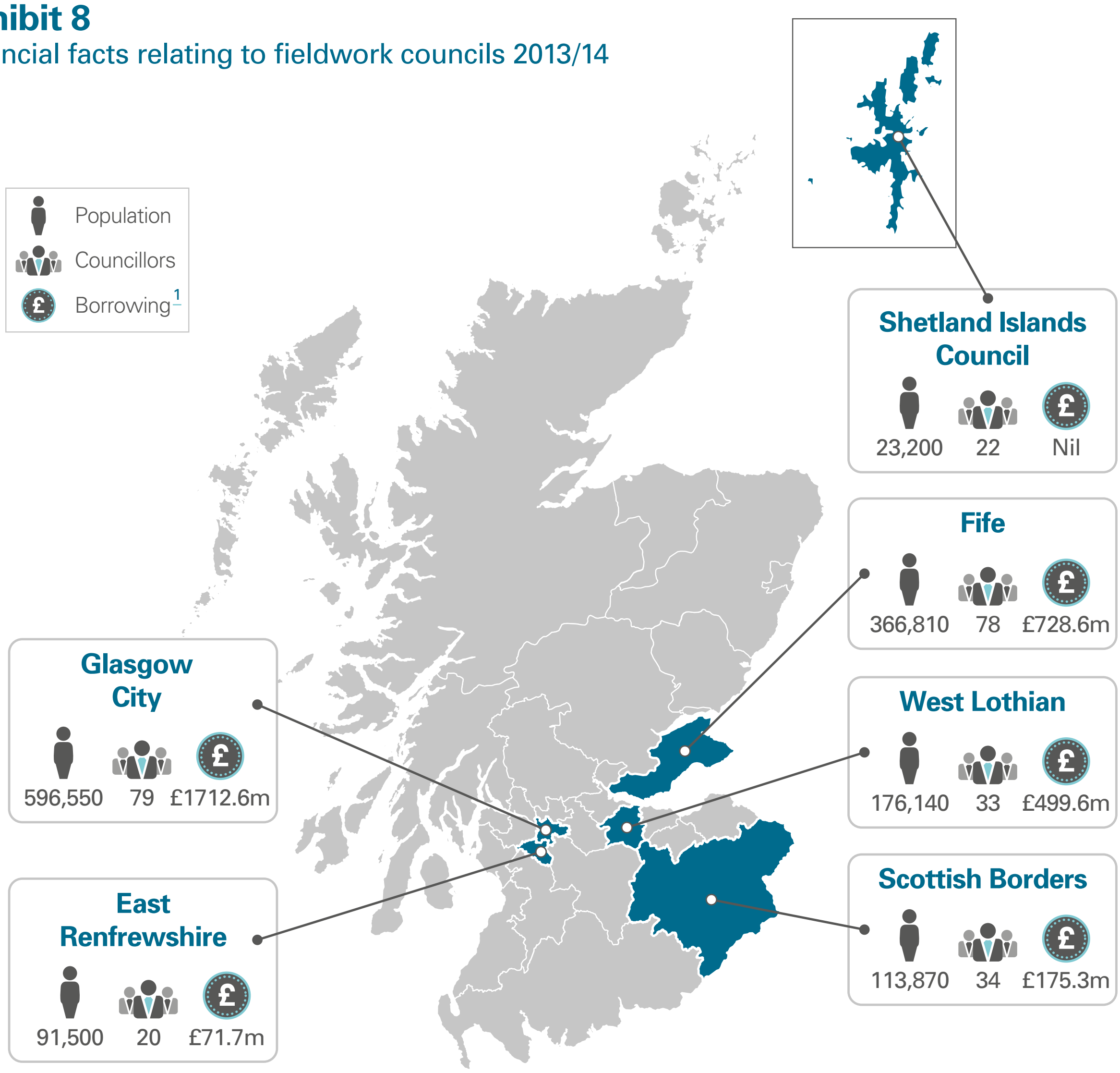
Our fieldwork sites reflect the variation in councils' borrowing and treasury management strategies

28. We reviewed the strategies of 12 councils to give us a better indication of the variation in local circumstances, the need for borrowing and the resulting treasury management strategy. We selected six councils out of the 12 to undertake more detailed fieldwork, including interviews.

29. Our six fieldwork sites reflect the level of variation in councils' borrowing and treasury management strategies, and therefore their levels of borrowing (Exhibit 8, page 19 and (Exhibit 9, pages 20 and 21). Although interest rates are currently low and expected to increase, not all councils have set their strategy to borrow for future capital investment. For example, East Renfrewshire Council has not borrowed externally for five years, but it has previously financed a higher proportion of investment through other methods of external financing such as the PFI scheme, and therefore has a higher proportion of other debt. Shetland Islands Council had never borrowed until July 2014. This change in strategy was as a result of appraising whether using internal cash reserves or borrowing at low interest rates represented the best value for the council.

30. Councils have different sizes of capital investment programmes to finance. Some councils have no housing stock to improve and add to, while others must consider how to invest in their housing stock without placing too high a burden on future housing budgets and rents. Councils must repay the borrowing and interest charges for investment in housing from the housing revenue budget; whereas investment in other assets must be repaid from the general budget.

Exhibit 8
Financial facts relating to fieldwork councils 2013/14



	Shetland Islands	East Renfrewshire	Scottish Borders	West Lothian	Fife	Glasgow City
Fixed assets [2]	£406m	£770m	£416m	£1,346m	£2,151m	£4,367m
Investments [3]	£211.4m	£45.1m	£13.7m	£117.1m	£3.1m	£136.5m
Cash reserves [4]	£240.9m	£53m	£25.7m	£114.8m	£90.6m	£135m
General capital programme [5]	£69.5m (2014-19)	£100.7m (2014-22)	£271.4m (2014-24)	£277.3m (2013-18)	£532.2m (2013-23)	£455.7m (2013-18)
Housing capital programme [5]	£5.8m (2014-19)	£17.2m (2014-19)	No housing	£202.9m (2013-18)	£390.4m (2013-23)	No housing

Notes:
1. Borrowing is long and short-term borrowing from council audited accounts at 31 March 2014. 2. Fixed assets is the value of long-term tangible fixed assets, such as buildings and equipment, and long-term intangible assets such as software, from the audited accounts at 31 March 2014. 3. Investments includes long and short-term investments, investment property where relevant, and cash and cash equivalents from the audited accounts at 31 March 2014. 4. Cash reserves is the total usable reserves of the council, from the audited accounts at 31 March 2014. 5. The length of councils' capital programmes can vary and spending is phased over the length of the programme. The timeframe of each council's programme is given in brackets.

Source: Council audited annual accounts 2013/14; *Mid 2013 Population Estimates Scotland*, National Records of Scotland, June 2014

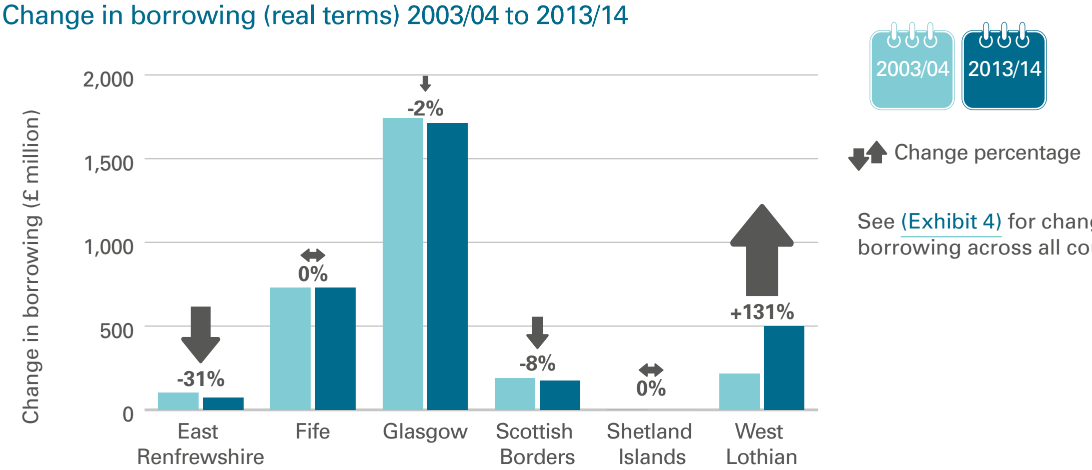
Exhibit 9
Key borrowing facts for our six fieldwork councils

Graph A
2013/14 debt levels

See (Exhibit 3) for overall picture and councils' debt levels

Source: Council audited annual accounts 2013/14; *Mid 2013 Population Estimates Scotland*, National Records of Scotland, June 2014

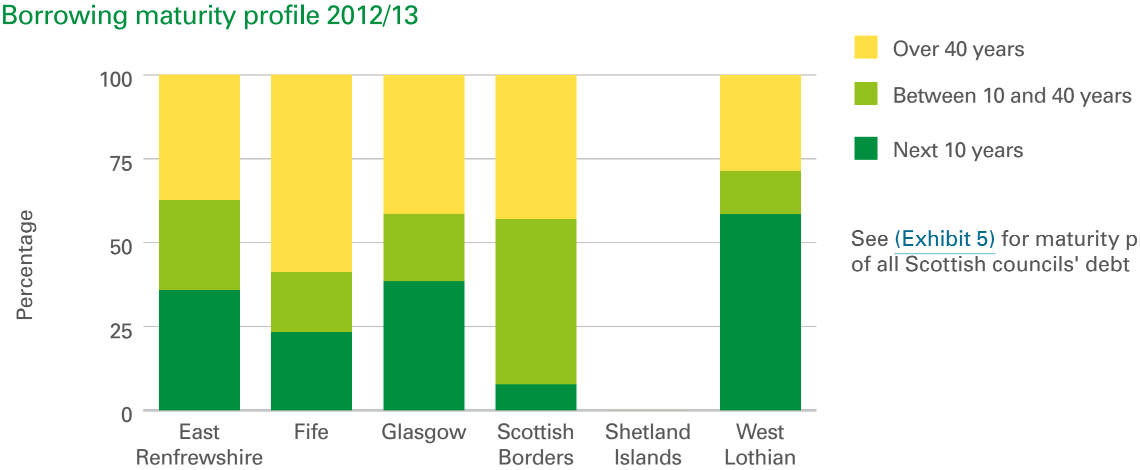
Graph B
Change in borrowing (real terms) 2003/04 to 2013/14



See (Exhibit 4) for change in borrowing across all councils

Source: Council audited annual accounts 2013/14

Graph C
Borrowing maturity profile 2012/13



See (Exhibit 5) for maturity profile of all Scottish councils' debt

Source: *Capital Expenditure and Treasury Management*, CIPFA Statistics, June 2014

Exhibit 9 (continued)

East Renfrewshire Council

- Just over half of East Renfrewshire's debt relates to PFI/PPP schemes for schools and roads **(Graph A)**.
- The council has not undertaken any external borrowing since 2009/10. The overall level of borrowing has been reduced by 31 per cent compared to ten years ago **(Graph B)**.
- The borrowing maturity profile generally follows the national profile with approximately one-third of borrowing to be repaid in next 10 years and one-third over 40 years **(Graph C)**.
- Capital investment requirements are currently being met with cash from reserves, cash balances and cash flow.
- The council will need to borrow to participate in the City Deal project.

Fife Council

- Borrowing makes up 90 per cent of the council's total debt **(Graph A)**.
- The council has borrowed £165m since 2008/09. The level of borrowing has remained static compared to ten years ago **(Graph B)**.
- Almost two-thirds of borrowing needs to be repaid in 40 years or more **(Graph C)**.
- The council uses a combination of cash, council reserves and borrowing to meet capital investment requirements.
- The council is a pilot site for a TIF scheme which will involve an element of borrowing.

Glasgow City Council

- Borrowing makes up 90 per cent of the council's total debt **(Graph A)**.
- The council has taken out loans of £677m since 2008/09. The overall level of borrowing has decreased slightly, by two per cent, compared to ten years ago **(Graph B)**.
- The borrowing maturity profile is broadly aligned with the national profile **(Graph C)**.
- The council uses funds and reserves, and has a preference for cheaper short-term borrowing for capital investment purposes.
- The council will need to borrow to participate in the City Deal project.

Scottish Borders Council

- Borrowing makes up 75 per cent of the council's total debt **(Graph A)**.
- The council has taken out loans of £7.5m since 2008/09. Overall level of borrowing has fallen by eight per cent compared to ten years ago **(Graph B)**.
- It has a small proportion of borrowing maturing in the next ten years when compared to other councils **(Graph C)**.
- The council has been using reserves cash balances and cash flow for capital investment.
- It has received consent to borrow for lending to support the National Housing Trust and Registered Social Landlords.

Shetland Islands Council

- The council borrowed for the first time in 20 years in summer 2014. Borrowing is only planned to fund the new Anderson High School, the council is using cash balances or reserves to fund other capital expenditure.
- It will borrow for capital expenditure if interest rates are lower than average investment return.

West Lothian Council

- Borrowing makes up around 90 per cent of the council's total debt **(Graph A)**.
- Has taken out £371m in new loans since 2008/09. Overall level of borrowing has increased compared to ten years ago **(Graph B)**.
- Over half (59%) of the council's borrowing is due to mature in the next ten years **(Graph C)**.
- Will continue to borrow externally while interest rates remain low.

Source: Audited accounts 2003/04–2013/14, Audit Scotland; CIPFA Statistics

Part 2

Demonstrating the affordability and sustainability of borrowing

Key messages

1 The six councils in our sample are following the general principles and framework of relevant codes and regulations.

2 Councils are using the prudential indicators to demonstrate and monitor the short-term affordability of borrowing. But councils are not clearly analysing and reporting their assessment of the longer-term affordability and sustainability of borrowing. Officers present the repayment profile of borrowing to councillors, but are not presenting this together with other information such as different budget scenarios, interest rates scenarios, or capital investment strategies. This is important to inform councillors of the future risks to the affordability and sustainability of current and new borrowing.

3 Long-term financial planning will help councils develop more detailed analysis on the longer-term affordability and sustainability of borrowing.

4 Councils could present information more clearly to councillors. Some councils are not presenting councillors with all the relevant information at one time to support borrowing decisions, for example in the treasury management strategy. This is important to ensure that decisions made are based on an assessment of all the relevant analysis and risks.

clear reporting to councillors on affordability and sustainability is important for sound decision making

Councils assess the short-term affordability of borrowing

31. Councils should have short, medium and long-term financial strategies that include the financing cost of borrowing and other debt and show the impact on the revenue budget. Decisions on borrowing and other debt need to be taken on the basis of affordability.

32. Our evidence shows that councils demonstrate the short-term implications of borrowing and other debt financing on the revenue budget through use of the prudential indicators. There are 12 prudential indicators that councils must set for each year. Eleven of them must be set for a minimum of three years ahead. Two of these 11 indicators specifically highlight the affordability of capital investment decisions, including borrowing (Exhibit 10, page 23). These indicators cover all debt and are not specific to borrowing.

Exhibit 10
Affordability prudential indicators

Indicator	What it means	What it is used for
Financing cost to net revenue stream: actual and estimated for next three years	The percentage of the revenue budget set aside each year to pay debt financing costs	• Assesses the risk to future budgets, eg from changing interest rates • Provides comparisons over time • Measures the impact of changing financing costs on the financial strategy
Impact of capital investment decisions on council tax and housing rents	This estimates the impact of new capital investment decisions on council tax and on the average weekly housing rent	• Allows councillors to consider all the council's plans at budget setting time • Allows comparison of different capital financing options by assessing the potential impact on council tax or housing rents

Source: CIPFA Prudential Code

33. The Prudential Code requires councils to estimate the impact of capital investment on the budget for the next three years, as a minimum. No councils in our sample reported estimates for a longer timeframe, and no councils had developed their own indicators to assess affordability. The Prudential Code suggests that councils use their own additional indicators, and this would be a good option for councils to monitor an impact that was important and relevant to their strategy.

34. The indicator 'financing costs to net revenue stream' is used to show how much of council income would be used to pay borrowing and debt charges. For councils with housing, they must separately calculate this indicator showing how much of housing rents income will be required to finance housing-related borrowing and debt charges. Exhibit 11 (page 24) shows the data published by West Lothian Council to provide an example of how this indicator is used.

Exhibit 11

An example of a council's ratio for 'financing costs to net revenue stream'

West Lothian Council is planning to invest in its assets over the next three years, including a council house new build programme. This is shown by the increasing capital financing requirement. Its strategy is to borrow in order to finance this capital investment. The impact of this is to increase the ratio of 'financing costs to net revenue stream' for both the general revenue budget, and the housing budget. This example shows that there is an expected increase in the proportion of income used to finance capital investment over the next three years. It will increase from 7.3 pence of every £1 to 8.6 pence. In relation to investment in housing the expected increase is from 20.8 pence in every £1 of housing rent income to 31.2 pence.

	2013/14 actual	2014/15 estimate	2015/16 estimate	2016/17 estimate
Capital financing requirement				
General Fund	£438,788	£444,404	£446,834	£446,534
Housing	£148,885	£174,561	£200,871	£226,174
Ratio of financing costs to net revenue stream				
General Fund	7.3%	7.8%	8.3%	8.6%
Housing	20.8%	25.4%	28.9%	31.2%

Source: West Lothian Council treasury management annual and prudential indicator reports

Councils are not making good use of all prudential indicators

35. The indicator for the ‘impact of capital investment decisions on the council tax/housing rents’ is a good example of how councils demonstrate, to councillors and the general public, what the financial implications of council decisions could be for members of the public. This could be an increase or decrease in council tax or housing rents.

36. We found that all councils are reporting this indicator. Out of our sample, three of the 11 councils that we reviewed did not report any impact of capital investment on council tax.[1] The main reason for councils not doing this is that there is currently a freeze on councils’ ability to increase council tax. We acknowledge that while the council tax freeze remains, council tax may not increase, but the indicator can still be used to demonstrate what the potential impact of capital investment plans would be. The council tax freeze makes it more important to show how much of the budget is being used to finance capital investment. Councils may also seek to reduce any impact on the budget through making savings. In these cases, we would expect this to be clear in the narrative to the indicator.

Councils are not clearly analysing and reporting the long-term affordability and sustainability of borrowing decisions

37. Councils face reducing revenue budgets and increasing demand for services. As a result many councils have projected funding gaps and need to generate recurring long-term savings. Councils' existing borrowing commitments extend for up to 50 years, and while any current decisions to borrow allow the council to invest in services they also place more pressure on revenue budgets. Councils therefore need to clearly set out how current and past borrowing decisions impact on the future revenue budget over the life of the borrowing term. The Prudential Code sets out a minimum three years for reporting prudential indicators. Borrowing commitments can extend up to 50 years and, in our view, three years is inadequate to demonstrate to councillors the affordability of borrowing.

38. We found that, while councils were demonstrating the impact of borrowing decisions over a three-year period using prudential indicators, none of the councils in our sample presented councillors with a longer-term view. The Prudential Code provides a minimum framework for councils to demonstrate and monitor the impact of their capital financing decisions on their future budget and income streams. In our view councils could extend the use of the framework and provide an extended analysis to demonstrate the longer-term affordability of borrowing. Officers could provide us with: information on capital investment requirements for up to ten years, when borrowing is due to be repaid and what this will cost, and interest rate forecasts, but there was no analysis bringing this together with budget scenarios to assess affordability. Councillors are not therefore always provided with information on the future affordability of new borrowing and the potential risks. This analysis should bring together the financing charges for all debt, to consider peaks in charges, and the additional risks of new borrowing or debt to this affordability profile.

Demonstrating the affordability and sustainability of borrowing needs effective long-term planning

39. Our report on *Scotland's public finances: Progress in meeting the challenges* [PDF] highlighted a lack of long-term financial planning. Long-term financial planning should include scenario planning to outline the different options available to the council based on a range of different assumptions about income, expenditure and activity. The borrowing and treasury management analysis could expand on this financial planning to look at the impact on affordability of using borrowing or different finance methods within each of the options. It could also add external assumptions including changes in interest rates to look at future risk factors to the affordability of borrowing. Exhibit 12 (page 26) highlights how the information in a long-term financial plan can be used to inform detailed analysis on borrowing and treasury management.

40. This more detailed analysis and scenario planning would allow officers and councillors to be clear about the evidence supporting decisions on borrowing. It would highlight all the financing options available and the risks and affordability of each option. Councillors would be aware of any risks when making a decision. As councils are required to produce an annual treasury management strategy, such analysis could be included in the strategy. The strategy would bring together all the key information and set out the supporting evidence. As a public document this would increase the transparency of council decisions.

Councils' treasury management strategies need to clearly demonstrate a more integrated approach

41. The treasury management strategy provides the council with an opportunity to set out its approach and rationale to borrowing, and to provide assurance on how borrowing and treasury management activity will help the council to meet its objectives. Strategies should clearly demonstrate the links to other council

Exhibit 12
The key components of long-term borrowing analysis

Components of long-term financial planning	Essential elements to inform a long-term borrowing analysis	Example
Scenario planning Scenario planning to outline the best, worst and most likely scenarios of the financial position and the assumptions used	• Projections for financial settlements, both revenue and capital • Long-term economic forecasts and inflation rates • Projections for interest rates	The council develops scenario plans for the revenue budget based on a range of assumptions about future revenue streams. This is compared with projected borrowing charges to highlight potential periods of pressure on the revenue budget
Assets and reserves Details of assets and reserves and how these will change over time	• Borrowing profile and schedule of repayments • Future reserves policy and contingency levels • Projected reserve levels (based on scenario planning above) • Future impact of asset management plans	A council is currently using reserves to finance capital investment. It could use different combinations of borrowing and reserves to finance projected capital investment needs. The council should model these different combinations to show the impact on reserve levels and the revenue budget. This would highlight the risks and benefits of each combination
Capital investment activity Details of investment needs and plans and how these will be paid for	• The impact of future service demands on capital investment needs. There may be a range of options • Estimated cost of the capital investment options • Future available funding options • Projected borrowing rates	A council has a range of existing borrowing and wider debt, including PFI. The council should prepare analysis showing the combined financing charge to the revenue and service level budget over the life of the asset or borrowing term. This would be based on different scenarios of interest rates or inflation. If the council wants to invest in more capital, it can model the additional impact of borrowing or debt onto this analysis

Source: Audit Scotland

strategies and plans such as the capital programmes, short, medium and long-term financial strategies, reserves policies, etc. The strategy enables councils to bring together this key information and to show how borrowing decisions fit into this bigger picture.

42. We evaluated strategies against the requirements and good practice recommendations of the Prudential Code, Treasury Management Code and Scottish Government investment regulations. The codes and regulations largely cover operational practice, and councils generally met their requirements. We found the language of the codes and regulations difficult to interpret. Strategies that followed the good practice recommendations as well as the requirements were clearer and told a better story about the council's intended direction for borrowing and treasury management. Scottish Borders Council presents this wider story within its strategy and it is a good example of a clearer strategy.

Not all strategies clearly show the link to corporate and capital plans

43. None of the strategies of our fieldwork councils refers directly or provides links to corporate objectives. This is important to demonstrate how the proposed strategy will help the council to meet its overall aims and objectives and improve services to communities.

44. Councils' treasury management strategies link plans for future capital investment, the financing and affordability of those plans and how cash will be safely managed to meet a council's financial commitments. We acknowledge that there is a wider process within councils to consider and agree capital investment programmes and plans. This includes the use of capital working groups or committees, usually comprising a mix of officers and councillors. These are not usually public forums and the associated reports and papers are not usually public documents. As outlined at paragraph 41, the treasury management strategy is the public document that should bring together capital investment plans and the financing of those plans, including borrowing. In our view, it is the appropriate document for councils to use to demonstrate that other options have been considered. Some councils choose not to approve annual capital investment plans, for example Glasgow City Council approved a two-year capital plan for 2013/14 and 2014/15. It is important therefore for councils to reflect the links to capital investment plans in their annual strategy.

45. Councils do not borrow for specific projects but consider how to finance their whole capital investment programme each year. In identifying the capital expenditure for the year they identify internal sources available before considering borrowing. The Prudential Code requires councils to calculate their 'capital financing requirement', which is the capital expenditure that they need to finance from other sources, that is, through borrowing or other method of external finance.

46. References to the capital programme and capital investment plans vary in detail within strategies. Councils are making better links between treasury management and capital investment at operational level through closer working between treasury management and capital functions but this link is not always reflected in strategies. Glasgow City and East Renfrewshire councils refer to the capital financing requirement and prudential indicators within their strategy, making the link to capital investment. The Scottish Borders Council strategy is clearer and provides a much wider perspective on its capital investment plans in the strategy including capital expenditure forecasts, capital financing assumptions, the predicted borrowing need and affordability. Relevant prudential indicators are used throughout the strategy.

47. We found little evidence of councils actively sharing strategies with each other to inform good practice, or different ways of presenting information. Some strategies, for example councils in the Lothian region, had similar sections and wording.

Councils are not always using the strategy to clearly explain the prudential indicators

48. We found variation in how councils link the prudential indicators with the treasury management strategy and how the strategy fits with the revenue budget setting process. Councils should use the prudential indicators to demonstrate affordability, prudence and sound treasury management in capital investment decisions. The local authority investment regulations recommend that the treasury management strategy will cover capital, investment and borrowing and the prudential indicators.

49. Only two of six fieldwork councils (Scottish Borders and Shetland Islands councils) included the prudential indicators as a key part of the strategy. Other councils included these indicators as an appendix, and East Renfrewshire Council reports the indicators separately in a different report.

50. We found that councils are setting and reporting on prudential indicators to the full council and appropriate committees but the level of commentary provided within reports is variable. References in reports to the indicators are based on the technical definitions, with few giving the overall context and implications. This is particularly the case where the prudential indicators are provided solely as an appendix to the treasury management strategy or a separate report. A lack of context means that the council is not providing an explanation of how it is actively using the indicators to measure and monitor the affordability of borrowing. Nor is it explaining what the indicators actually mean for the council and its communities, in terms of increasing or decreasing pressure on budgets, or any risks highlighted by the forecast indicators.

Recommendations

Council officers should:

- use the treasury management strategy to present a wider strategic view of borrowing and treasury management. It should use clear and accessible language and be prepared for councillors as the key audience. It should include how the borrowing strategy is informed by corporate priorities and capital investment needs. The strategy should include:
  - links to capital investment plans and corporate objectives
  - all borrowing and other debt
  - prudential indicators as a core part of the strategy
  - a clear assessment of the affordability and the impact on revenue budgets both in the short and long term
- create more detailed and longer-term borrowing and treasury management analysis as informed by the council's financial strategy. It should include:
  - scenario planning to show the potential impact of different budget scenarios, income generation plans, and changes in external factors such as interest rates
  - analysis of capital financing options, to compare affordability and sustainability between different debt and borrowing options
  - the use of indicators over a longer period than the minimum three years set by the Prudential Code
- share strategies with other councils to help inform good practice and exchange of ideas.

Part 3

Effective management and scrutiny

Key messages

1 Treasury management is a professionally run function in councils with appropriately qualified officers. Joint planning with other councils, ongoing training and the availability of appropriate professional qualifications are important.

2 Scrutiny of borrowing and treasury management decisions could be improved. This involves officers providing clearer information to councillors to help them in their scrutiny role. In most councils the content and clarity of reports could be improved, particularly performance information in year-end reports. All reports need to be to be easily accessible to councillors and the public.

3 Councils need to provide a range of training and support to councillors to help improve scrutiny of treasury management. We found no additional formal arrangements in place specifically aimed at helping councillors in this complex area.

4 We found some examples where governance structures do not fully meet the codes' requirements and where there could be more consistency in reporting arrangements.

councillors need a combination of scrutiny skills and knowledge of treasury management to carry out their role effectively

Treasury management is a professionally run function

51. Treasury management staff in councils deal with the day-to-day treasury functions, including managing short-term cash. They also develop the treasury management strategy and related reports to councillors. The links between the capital investment function and treasury management functions have been strengthened over the last ten years in the councils we visited. The staffing structure within most councils deliberately brings the functions together. For example Scottish Borders Council has a structure that places capital investment and treasury management functions together. It also undertook a recent restructuring to separate out day-to-day transactions, allowing capacity for the development of forward planning and strategic development. In Fife Council the treasury management and capital investment functions are separate. However, staff from the capital investment function have been working in the treasury management function and this has strengthened the links between the two functions.

52. The size of the treasury management function is related to a council's size and budget. The number of personnel involved in treasury management in our sample varied from less than a full-time equivalent at East Renfrewshire Council to two full-time equivalents at Glasgow City Council. We would expect staff numbers to vary across councils according to the level of treasury management and borrowing activity, and the budget.

53. Officers involved in treasury management have relevant experience and qualifications, and some hold the CIPFA treasury management qualification. Training for new officers is currently provided by on-the-job experience, CIPFA treasury management network events, the treasury management forum, technical updates and toolkits, Capita seminars and training sessions.

54. Treasury management is an important function in councils and they need to actively plan for the succession of qualified staff members and other professional training needs that may arise. CIPFA do not currently provide the treasury management qualification owing to insufficient demand but have enhanced their treasury management network. Other treasury management qualifications are available for councils to consider.

55. Officers recognise that keeping in contact with other treasury managers and those involved in treasury management is critical. The CIPFA treasury management forum provides a source of information that enables officers to develop knowledge, discuss areas of concern and share information.

56. All councils use external treasury management advisers. The services provided include professional treasury management advice, seminars and training for officers and elected members and regular information on economic forecasts. Capita provides services to 28 Scottish councils, including all of those in our sample. There is an inherent risk in having a single provider of advice to so many councils, however, we found that all councils had bought services through open tendering processes within the last four years for terms of between three to five years. All council officers meet regularly with Capita to review their objectives, options, strategies and performance.

Council governance structures are in place but not all meet code requirements

57. The codes of practice and regulations place certain requirements on a council's governance structures:

- They recommend that the full council should approve the treasury management strategy.
- They require a specific committee to be responsible for scrutinising reports.
- They also require borrowing and treasury management activities to be structured and managed in a fully integrated manner and for responsibilities to be clear.

58. CIPFA considers that it is an essential part of a public service organisation's treasury management arrangements to have clearly defined responsibilities for approving and scrutinising borrowing and treasury management activities. Exhibit 13 (page 32) includes a summary of the main tasks involved in treasury management and suggested allocation of duties.

Exhibit 13
Allocation of responsibilities for scrutinising borrowing and treasury management activities

Full council	• Receives and reviews reports on treasury management policies, practices and activities • Approves annual strategy
Committee or panel with responsibility for scrutiny	• Approves or amends the organisation's treasury management policy statement and treasury management practices • Considers and approves budget • Approves the division of responsibilities • Receives and reviews regular monitoring reports and acts on recommendations • Approves the selection of external service providers and agrees terms of appointment • Reviews the treasury management policy and procedures and makes recommendations to the responsible body
The responsible officer	• Monitors the council's compliance with policy and practices • Submits regular treasury management policy reports • Submits budgets and budget variations • Recommends the appointment of external service providers

Source: Audit Scotland

59. For our sample of 12 councils we looked at the approval, recommendations and scrutiny for each report. Most councils fully met the requirements of the codes but we found the following arrangements that were not in line with the codes' requirements and other arrangements that may not give members the opportunity to scrutinise reports consistently:

- The treasury management strategy at Glasgow City Council is considered and approved by the Executive Committee. The full council considers and approves the minutes of the Executive Committee.
- The governance structure at Fife Council is such that the Executive Committee has responsibility for all budget and treasury management decisions. Full council then approves treasury management reports through the minutes.
- Shetland Island Council's Executive Committee approves the treasury management strategy but receives no other reports.

- In East Renfrewshire Council, the Audit and Scrutiny Committee approves the strategy but the Executive Cabinet scrutinises the mid-year, and year-end reports.

Councillors need further support to improve their scrutiny role

60. Borrowing and treasury management decisions are complex and involve a significant level of financial risk. It is essential that any decisions are effectively scrutinised to demonstrate sound financial management and help councils achieve their local outcomes and priorities. Councils' scrutiny committees are a vital part of a council's governance arrangements and it is important that these committees are effective. Councils have a responsibility to ensure that those charged with governance have access to the skills and knowledge they need to carry out their role effectively. The councillors on committees need to have a combination of technical knowledge and scrutiny skills for the committee to be most effective. Those charged with governance also have a personal responsibility to ensure that they have the appropriate skills and training for their role. We found that councils provide both scrutiny training and treasury management training to councillors. Scrutiny training tends to be provided at the start of a political term, or for new councillors, as part of the induction process.

61. In areas of high importance and complexity, such as treasury management, additional scrutiny arrangements can be put in place. For example:

- Councils seek members with appropriate expertise for the relevant scrutiny panel.
- Councils nominate lead members for borrowing and treasury management to help guide other members.
- Councils seek external expertise to help members on the scrutiny committee.

62. We found some examples where this was being applied. Scottish Borders Council appoints non-executive members to its Audit Committee to provide financial expertise. Fife Council has a lead member for finance. Some councillors on scrutiny committees have highly relevant financial experience but, apart from Scottish Borders Council, councils do not have formal processes in place for selecting councillors with relevant skills.

63. The most important aspect of scrutiny is the challenge of reports and information presented to councillors through asking questions. We found variation in the type of questions that councillors ask, from issues of detail to clarification of the meaning of phrases in reports. Some councillors told us that they are not always confident in challenging the strategy and framework for future decisions and asking questions about the content of reports. Many have built up trust and confidence in officers and look for officers to highlight issues or problems for them. All councillors we spoke to would welcome additional support in their scrutiny role. We have prepared a supplement to this report which includes questions to help councillors in their scrutiny role.[2]

Officers need to present clearer and fuller information to councillors to help them scrutinise treasury management activity and risks

64. CIPFA's Treasury Management Code states that councils or committees will receive regular monitoring reports on treasury management activity and risks. Regular reporting with a clear and full analysis of performance and activity helps members to:

- understand why officers are proposing decisions
- understand the risks
- ask relevant questions.

65. The Treasury Management Code sets out three minimum reporting requirements for councils:

- a strategy in advance of the year
- a mid-year review
- an annual report after the financial year-end.

66. We found that all councils meet these requirements. However, both Fife and Glasgow City councils prepare a single report covering both the annual report for the previous year and the mid-year review for the current year. In our view this does not meet the intention of the code. These mid-year and annual reports are an important source of information to help councillors effectively monitor and review treasury management activity. Councillors need time to consider any comments or make changes from scrutiny of the annual report to influence activity or performance for the following year.

67. No councils have reporting arrangements that go further than the minimum required by the code, for example quarterly performance or monitoring reports, or more detailed performance reports for the scrutiny committee.

68. We found that councils do not hold separate risk registers for treasury management but they are included in their wider finance risk registers. Reports on the wider finance risks may not be considered by the same committee considering treasury management reports. This means that councillors are not informed of any relevant treasury management risks.

Councils could improve the content and clarity of reports

69. We found that both the layout and content of treasury management reports could be improved, particularly year-end reports on performance. Annual reports are the main performance report and vary in quality. Performance monitoring, including information on the actual figures for the prudential indicators against forecast figures, is not reported fully or consistently across all councils. Some councils only report against indicators and some do not report performance at all. Some of the reports we reviewed did not provide any comparative data. This meant that readers could not reach an objective opinion on performance.

70. From the review of the councils in our sample, we found the following:

- Clackmannanshire, East Lothian, Midlothian, Scottish Borders, Shetland Isles, West Dunbartonshire and West Lothian councils all provided comparative information in their annual reports on all indicators.
- East Renfrewshire, Fife and Renfrewshire councils provided comparative information on some of their indicators.
- Glasgow City Council provided information only on the actual performance without any estimates.
- City of Edinburgh Council did not include any detail on indicators in the annual report, but some are reported in capital monitoring reports.

71. Most treasury management reports are publicly available, although they were not always easy to find on councils' websites. This lack of clear and accessible information means that it is difficult for members of the public to understand how borrowing and treasury management activity is contributing to their council's priorities, and to understand what the performance of the council has been.

72. Officers must use accessible language when reporting on borrowing and treasury management but many strategies and reports contain a lot of technical language. This does not help councillors scrutinise effectively as any questions they ask are more likely about clarity rather than challenge. Exhibit 14 (page 36) shows how Shetland Islands Council used worked examples to explain to councillors why it was recommending to borrow for the first time.

Councils should provide a wider range of training and support to improve councillor attendance and help them in their scrutiny role

73. All councils provide training on treasury management to councillors. This consists of courses provided once or twice a year and, in West Lothian Council, when a new administration is formed as a minimum. Attendance is voluntary although it has been generally poor (varies between 40 and 100 per cent attendance for these sessions), (Exhibit 15, page 37). Attendance at training events is focused mainly towards councillors who sit on relevant scrutiny committees rather than all councillors.

74. Councillors' views on the training they attend are positive. Councillors also felt officers gave them extra support if required, for example by providing additional information or responses to any questions they had.

75. Training and support for councillors should aim to equip all councillors with a minimum level of knowledge and understanding. We found councillors' experience varied, for example from councillors who had been accountants or finance directors to those with little or no previous finance experience.

76. Councillors told us that it was often difficult to attend training owing to other commitments. In their view, a full-day training course was a substantial commitment. Regular training will be required to keep councillors up to date with economic developments. As councillors only consider treasury management issues, on average, three times a year, the timing of the training is important. Councils should consider different ways to provide training including courses, short briefings and perhaps online training.

Exhibit 14
How officers at Shetland Islands Council explained why it was recommending the council borrow

The economic case for borrowing externally, or using the council's own reserves to finance capital expenditure, is essentially down to whether interest rates are higher or lower than the long-term average return on the council's external investments.

If interest rates are higher than the long-term average return on the council's investments (currently 5.75%) then it means the cost of borrowing is higher than the lost income forgone by using reserves. So it would make financial sense to use reserves for capital expenditure.

For example, if interest rates were 10% for a £1m loan:

- Annual interest payable on £1m at 10% = £100,000
- Investment income of 5.75% generated on £1m = £57,500.

In this example to borrow would cost £100,000 a year, and to use reserves would present an opportunity cost of £57,500 in lost investment income. In this example, using reserves would present a saving of £42,500 per year over using borrowing.

However, the reverse is true if interest rates are lower than the long-term average return on the Council's investments (currently 5.75%).

For example if interest rates were 2% for a £1m loan:

- Annual interest payable on £1m at 2% = £20,000
- Investment income of 5.75% generated on £1m = £57,500.

In this example, to borrow would cost £20,000 a year and to use reserves would present an opportunity cost of £57,500 in lost investment income. In this example borrowing would save the council £37,500 per year.

Therefore when interest rates are lower than long-term investment returns, the default position of the council should be to borrow in order to achieve a Best Value outcome.

Source: Shetland Islands Council Borrowing Strategy 2014/15

Exhibit 15
Councillor attendance at treasury management training

	East Renfrewshire	Fife	Glasgow City	Scottish Borders	Shetland Islands	West Lothian
Date of last training	2014	2014	2013	2012	2014	2011
Frequency	Annually	Biannually	Annually	Biannually	Annually	Each administrative term
Offered to	Full council	Full council - but target Executive Committee members	Members of Executive Committee and members of Finance and Audit Scrutiny Committee	Audit Committee	Full council	Full council
% attendance full council	40%	11.5%	22.8%	91%	Not available	46.8%
% attendance Scrutiny committees	57% Scrutiny 37.5% Cabinet	40.9%	66.7% Scrutiny 40% Executive	100%	Not available	Not available Committee structure changed

Source: Audit Scotland

Recommendations

Council officers involved in borrowing and treasury management should:

- carry out joint planning with other councils to identify future qualification and training needs and enhance their capacity, in order to negotiate with training providers

- review the content of year-end reports to ensure they provide an assessment of the effectiveness of the year's borrowing and treasury management activities and the performance of the treasury management function. This should include appropriate indicators, comparative figures, and appropriate explanations.

Council officers and councillors involved in treasury management should:

- review governance arrangements, and update as necessary, to ensure they provide:
  - the treasury management strategy, mid-year and year-end reports to the same council committee, and that the full council has access to them
  - councillors with mid-year reports by the end of December each year
  - councillors with the wider picture, that is, make the links to capital investment decisions and revenue budgets
  - councillors with access to all reports relating to borrowing and treasury management activity including risk registers

- ensure scrutiny arrangements are robust by:
  - considering widening the range of training options to councillors on borrowing and treasury management activities and whether this training should be mandatory
  - considering whether training for councillors provides a balance of scrutiny skills and knowledge of treasury management.

Endnotes

◀ 1 Glasgow City Council, Renfrewshire Council and West Lothian Council. As Shetland Islands Council did not borrow until 2014/15, we would not expect this indicator to be set for 2013/14.

◀ 2 *Borrowing and treasury management in councils: Scrutiny guidance and questions for councillors,* [PDF] Audit Scotland, March 2015.

Appendix 1

Audit approach

Our audit looked at councils' strategies for borrowing and treasury management and whether councils can demonstrate the affordability and sustainability of their borrowing decisions over the short and long term. Councillors have a crucial role in holding officers to account and this report also evaluates this. We did not evaluate day-to-day cash, investment and borrowing transactions.

Methodology

To achieve our aim and objectives, our audit included reviewing documents, analysing data and interviews. The audit had three main components:

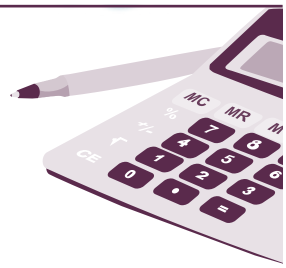
Data analysis: We analysed information on borrowing and debt from councils' audited accounts, CIPFA statistics and the Scottish Government in order to inform a selection of 12 councils for further desk research. The 12 that were selected were City of Edinburgh, Clackmannanshire, East Lothian, East Renfrewshire, Fife, Glasgow City, Midlothian, Renfrewshire, Scottish Borders, Shetland Islands, West Dunbartonshire and West Lothian councils. The councils were selected to include a mix of council size and to reflect initial thoughts, based on our financial analysis, that they had different approaches and strategies to borrowing and treasury management.

Desk research: We reviewed a range of relevant written material on borrowing and treasury management, focusing on the treasury management strategies for our 12 councils. We also looked at the committee arrangements for consideration of these and other treasury management reports. This informed our sample of six councils for interview. We selected the sample so that it included large, small, urban and rural councils and reflected different levels of borrowing and other forms of debt.

Interviews with councils and stakeholders: We visited six councils to find out more about their approach and strategy for treasury management, their governance arrangements and scrutiny and training for councillors. We spoke to council leaders and councillors about their role in scrutinising borrowing and treasury management and their experience of the training and support received. We also interviewed representatives from organisations including the Scottish Government, CIPFA and the CIPFA Scottish Treasury Managers' forum.

Appendix 2

Membership of the project advisory group



We would like to thank members of the advisory group for their input and advice throughout the audit.

Member	Position
Andy Witty	Policy Officer, COSLA
David Robertson	Chief Financial Officer, Scottish Borders Council
Gareth Davies	Policy and Technical Officer, CIPFA Scotland
Hazel Black	Head of local authority accounting, Scottish Government
Innes Edwards	Treasury Manager, City of Edinburgh Council

Note: Members of the project advisory group sat in an advisory capacity only.

Borrowing and treasury management in councils

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