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Meeting	Full Council
Date	7 <sup>th</sup> April 2009
<b>Subject</b>	<b>Icelandic Banks Scrutiny Working Group – Final Report</b>
Report of	Scrutiny Office
Summary	This report presents the findings of the Working Group as set out in a report on the review of Icelandic Banks

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Officer Contributors	Scrutiny Office
Status (public or exempt)	Public
Wards Affected	All
Enclosures	Appendix A –Report of the Icelandic Banks Scrutiny Working Group
For Decision By	OSC
Function Of	OSC
Contact for Further Information:	Jeremy Williams Overview and Scrutiny ☎ 020-8359-2042

## **1. RECOMMENDATION**

**1.1 That Full Council consider the recommendations of the review.**

## **2. RELEVANT PREVIOUS DECISIONS**

2.1 Extraordinary Full Council, 4<sup>th</sup> November 2008 (agenda item 4).

2.2 Resources Performance and Partnerships Overview & Scrutiny Committee, 19<sup>th</sup> November 2008 (agenda item 8).

2.3 Resources Performance and Partnerships Overview & Scrutiny Committee, 25<sup>th</sup> March 2009 (agenda item 5).

## **3. CORPORATE PRIORITIES AND POLICY CONSIDERATIONS**

3.1 The effectiveness of the Council's Treasury Management Strategy supports the Council's priority of more choice, better value as set out in the Corporate Plan..

## **4. BETTER VALUE/RISK MANAGEMENT ISSUES**

4.1 None specifically arising from this report.

## **5. EQUALITIES AND DIVERSITY ISSUES**

5.1 None specifically arising from this report.

## **6. FINANCIAL, STAFFING, ICT AND PROPERTY IMPLICATIONS**

6.1 None specifically arising from this report.

## **7. LEGAL ISSUES**

7.1 None

## **8. CONSTITUTIONAL POWERS**

8.1 The roles and terms of reference of all scrutiny committees are contained within Part 2, Article 6 of the constitution; and in the Overview and Scrutiny Procedure Rules (Part 4 of the constitution).

## **9. BACKGROUND INFORMATION**

9.1 The Resources, Performance and Partnership OSC resolved to set up a working group on Icelandic Banks. The final report is set out in **Appendix A**.

## **10. LIST OF BACKGROUND PAPERS**

17<sup>th</sup> March 2005 Cabinet Resources Committee report – Treasury Management

30<sup>th</sup> March 2006 Cabinet Resources Committee report – Treasury Management Business Strategy

13<sup>th</sup> March 2007 Cabinet Resources Committee report – Treasury  
Management Business Strategy  
13<sup>th</sup> March 2008 Cabinet Resources Committee report – Treasury  
Management Strategy  
23<sup>rd</sup> October 2008 Cabinet report - Council Deposits in Icelandic Banks  
19<sup>th</sup> January 2009 Cabinet Resources Committee report – Treasury  
Management Strategy  
Audit Commission Internal Review – Investment in Icelandic Banks  
(December 2008)  
Butlers Management Agreement (February 2007)  
Extracts from the CIPFA Code of Practice  
Local Government Act 2003 (Chapter 26 – Capital Finance Etc & Accounts)  
The Prudential Code for Capital Finance in Local Authorities  
Risk and Return: English Local Authorities and the Icelandic Banks, Audit  
Commission, published 26 March 2009

10.1 Any person wishing to inspect these documents should contact Jeremy  
Williams on 020 8359 2042.

LS: SS  
CFO: CM

## **APPENDIX A**

### **SCRUTINY WORKING GROUP ON ICELANDIC BANKS**

#### **FINAL REPORT**

#### **LIST OF ATTENDEES AND WITNESSES**

##### **Membership of the Working Group:**

Councillor Joan Scannell (Lead Member)  
Councillor Brian Gordon  
Councillor Robert Rams  
Councillor Claire Farrier  
Councillor Alan Schneiderman  
Councillor Duncan MacDonald

##### **Meetings of the Working Group:**

###### **9<sup>th</sup> February 2009**

Initial scoping meeting with Membership

###### **18<sup>th</sup> February 2009**

Assistant Director of Resources – Jonathan Bunt  
Treasury Manager - Patrick Towey

###### **5<sup>th</sup> March 2009**

Representative from Sector  
Representatives from Butlers  
Assistant Director of Resources – Jonathan Bunt  
Treasury Manager – Patrick Towey

###### **8<sup>th</sup> March 2009**

Chairman of Audit Committee – Councillor Jeremy Davies  
Director of Resources – Clive Medlam  
Assistant Director of Resources – Jonathan Bunt

###### **11<sup>th</sup> March 2009**

Director of Resources – Clive Medlam  
Assistant Director of Resources – Jonathan Bunt

###### **16<sup>th</sup> March 2009**

Leader of the Council and Cabinet Member for Resources –

## 1. INTRODUCTION

- 1.1 Following the collapse of the Icelandic banks Glitnir and Landsbanki in autumn 2008, it came to light that £27.4 million of Council money had been deposited with these banks.
- 1.2 The Scrutiny working group on Icelandic Banks was set up to review the Treasury Management Strategy which led to this money being deposited.
- 1.3 The working group interviewed the following
  - Council's Treasury advisers
    - Sector
    - Butlers
  - Council Officers
  - Chairman of the Audit Committee
  - Leader of the Council & Cabinet Member for Resources

and found that although the circumstances which led to the collapse of the Icelandic Banks could not have been predicted, the Council had been in breach of its Treasury Management Strategy.

- 1.4 The group has set out recommendations for further investigation of the events which led to the policy being breached, and for strengthening Treasury Management procedures to ensure a more robust and effective operation in future.

## 2. KEY FINDINGS

- 2.1 The Council should not have invested in Icelandic banks as this was a breach of the approved policy.
- 2.2 A majority (89%) of the Council's deposits between 2006 and 2008 (including those in Icelandic banks) contravened the Council's Treasury Management Strategy.
- 2.3 The Council has been over reliant on credit ratings
- 2.4 Inadequate controls, monitoring, record keeping and internal review mechanisms were in place by officers.
- 2.5 Questions over the effectiveness of the internal and external auditing of financial procedures within the Treasury Management team and by the Audit Committee as they did not highlight any issues of non-compliance.

- 2.6 That the downgrading of the minimum investment criteria in the March 2008 Treasury Management Strategy, before the collapse of the Icelandic banks, was carried out without evidence to demonstrate the need for such a change.
- 2.7 Members have not been involved in day-to-day decisions on placing deposits with counterparties. Officers are expected to manage the policy as determined by Members as day-to-day involvement by Councillors is not appropriate. There was a failure by officers in the monitoring and supervision regarding the compliance of deposits.
- 2.8 Shortcomings were identified in the advice given by the external Treasury advisors.

### **3. THE SCOPE OF THE REVIEW**

3.1. At the Extraordinary Meeting of the Council on 4<sup>th</sup> November 2008, a request was made to the Resources, Performance and Partnerships Overview & Scrutiny Committee to conduct a review of the Treasury Management Strategy which led to the deposits in Icelandic banks. It was agreed:

- i) That a review be conducted of the Treasury Management Strategy which led to the deposits in Icelandic Banks, including inviting the Chairman of the Audit Committee to give evidence.
- ii) That the Resources, Performance and Partnerships Overview & Scrutiny committee concentrate on the risks to Council Taxpayers (in terms of Council Tax rises and service cuts) if the investment is not returned to the authority.
- iii) That the Resources, Performance and Partnerships Overview & Scrutiny Committee be requested to assess the effectiveness of the administration's plans to protect Council taxpayer's interests in the eventuality that the money is lost.

3.2 The Working Group held its first meeting on 9<sup>th</sup> February 2009. At this meeting the group agreed to focus on reviewing the Treasury Management Strategy which led to the deposits being placed in Icelandic Banks (point (i) above).

3.3 The group were of the opinion that point (i) should be the priority for this review and that points (ii) and (iii), related to a potential future situation given the ongoing uncertainties regarding the 'at risk' deposits and would therefore be considered by a separate review at a later date.

### **4. THE OPERATION OF THE REVIEW**

4.1 The group's second meeting was on 18<sup>th</sup> February 2009. Members received the report on Council Deposits in Icelandic Banks considered by Cabinet on 23<sup>rd</sup> October 2008, and the report on the Treasury Management Strategy considered by Cabinet Resources Committee on 19<sup>th</sup> January 2009.

4.2 At this meeting Members took evidence from the Treasury Manager and the Assistant Director of Resources. These officers set out the process around placing deposits with counterparties, and the codes and policies which governed this practice.

- 4.3 The group conducted a third meeting on 5<sup>th</sup> March 2009, where representatives from Sector and Butlers, the Council's Treasury Management Advisors, attended and gave evidence. Members were informed of their exact role in providing advice to the Authority on the placing of deposits. It was at this meeting that concerns were first raised as to the extent of the Council's compliance with its Treasury Management Strategy.
- 4.4 At a fourth meeting on 8<sup>th</sup> March 2009, the committee interviewed the Chairman of the Audit Committee.
- 4.5 The Committee then interviewed the Director of Resources & Chief Finance Officer, together with the Assistant Director of Resources. The Director tabled a report stating that the Treasury Management Strategy had been breached in terms of placing deposits in the 2005/06, 2006/07 and 2007/08 financial years.
- 4.6 Prior to the working group meeting of 11<sup>th</sup> March 2009, Members were informed that the Treasury Manager had resigned from his post. At this meeting, Members received further evidence from the Director of Resources together with the Assistant Director of Resources. The Leader of the Council had agreed to attend this meeting, but unfortunately was unable to attend.
- 4.7 The Committee formulated their conclusions and findings.
- 4.8 The final meeting of the group took place on 16<sup>th</sup> March 2009 to agree the draft report and the draft recommendations contained within. The Leader of the Council, who also holds the portfolio of Cabinet Member for Resources, attended this meeting to answer questions from the working group.



## **5. DRAFT RECOMMENDATIONS**

- 5.1 The Working Group agreed the following draft recommendations:
- 1. That comprehensive Treasury Management records be kept, including a note of all verbal advice given to Officers by Treasury Management advisors.**
  - 2. That a classification in respect of sovereignty outlook be included within the council's investment criteria in future.**
  - 3. That an external review be carried out into the advice given by the Treasury Management Advisors in light of the shortcomings highlighted by the working group.**
  - 4. That arrangements be made for the council to be provided with more comprehensive Treasury Management advice in the future and not be solely reliant on credit ratings.**
  - 5. That the working group's findings that council has been in breach of the Treasury Management Strategy in 2006/07 and 2007/08 be referred to the Chief Executive and Head of Paid Service for investigation and any appropriate action.**
  - 6. That a request be made for the co-operation of the Audit Commission in a full external investigation into auditing practices in respect of the Treasury Management team.**
  - 7. That in order to facilitate more robust treasury management scrutiny, in line with section 7.4 of the Constitution (Treasury Management Framework), the Cabinet Resources Committee should receive regular comprehensive reports on Treasury Management activity and practice.**

## **6. BACKGROUND**

### **6.1 Council Deposits**

- 6.1.1 The Council has £27.4m deposited in two Icelandic banks placed between November 2006 and September 2007. These deposits were due to be repaid between November 2008 and September 2010.
- 6.1.2 At the time the deposits were made, both banks had long term 'A' ratings with widely used industry credit rating agencies, although the individual ratings were B/C (below the Council's minimum level of A/B for placing deposits) The long term rating of Glitnir Bank reduced below 'A' (the Council's long term rating for dealing with a counterparty) in May 2008 and the Council placed no further deposits with this bank from this date. The long term rating of Landsbanki reduced below 'A'

<sup>th</sup> September 2008. However, deposits would not have been placed in either Glitnir or Landsbanki if the Council's agreed minimum individual rating had been adhered to.

- 6.1.3 From enquiries made after the collapse of the Icelandic banks, the Council established that it would have been unable to recover the funds, even after the banks had been downgraded, as it had entered long term contracts with the banks and would have been subject to significant penalties for making the withdrawal.
- 6.1.4 A joint statement from the Government and Local Government Association on 9<sup>th</sup> October 2008 stated that there was no evidence of recklessness by local authorities. They also agreed that local authorities were correct to strike an appropriate balance between security of deposits and returns. The joint statement referred to Icelandic deposits in general and did not consider the decisions or practices of Barnet or other individual authorities.
- 6.1.5 The Audit Commission were among the depositors in the Icelandic Banks, with funds totalling £10million invested in Glitnir and Heritable, another Icelandic bank. As part of their investigations, the working group received the Commission's internal audit review of the deposits.
- 6.1.6 In the report to the Cabinet meeting of 23<sup>rd</sup> October 2008, Officers stated that it was important to emphasise that the situation did not impact on the Council's ability to pay its staff and suppliers in the short term.

## **6.2 Treasury Management Strategy**

- 6.2.1 The Council's Treasury Management Business Strategy is intended to ensure effective treasury management supports the achievement of the Council's corporate priority of 'more choice, better value'. The strategy is committed to the principles of achieving value for money in treasury management, and to employing suitable performance management techniques, within the context of effective risk management.
- 6.2.2 The Treasury Management Strategy since 2006/07 has used assessment criteria based on the information available from the main credit rating agencies (Fitch, Moodys and Standard & Poors) and supplied to the Council by its treasury management advisors – initially Sector and subsequently Butlers with Sector in a secondary role. These criteria are
- Short term – place emphasis on the capacity for timely payment of financial commitments within the next twelve months.
  - Long term – similar but looking at the credit risk over a longer period of between one year and five years.
  - Individual – designed to assess how a bank would be viewed if it were entirely independent and could not rely on external support.

- Support – do not look at the credit quality of banks but is a judgement on whether the bank would receive support should this become necessary.

6.2.3 These criteria for the past four years as approved by the Cabinet Resources Committee have been:

Rating*	2005/06	2006/07	2007/08	2008/09**
Short term	F1	F1	F1	F1
Long term	A	A	A	A
Individual	A/B	A/B	A/B	C
Support	3	3	3	3

### Notes

An individual rating of 'A/B' indicates a 'very strong' or 'strong' bank with 'no major concerns'.

An individual rating of 'C' indicates 'an adequate bank, which however, possesses one or more troublesome aspects. There may be some concerns regarding its profitability and balance sheet integrity, franchise, management, operating environment or prospects'.

\* Though the Council uses the ratings of multiple agencies, they are on different bases and therefore, for ease of reading, just the Fitch ratings are included in this table as those have been the most explicit historically in the TMS.

\*\* Since October 2008 there have been a number of updates to the TMS credit criteria but the table shows that originally approved in March 2008

6.2.4 As part of the development of the TMS annually, the document is provided to the appointed treasury management advisors for review and comment. Based on the approved TMS, the advisors draft a list of appropriate counterparties that meet the Council's minimum credit criteria, which is used day to day by the treasury management team. The list is provided by Butlers at the start of each month and updates are sent throughout the month where credit ratings are changed for the team to make the amendments. As part of the paperwork for the placing on deposits, the Treasury Manager is required to review the credit rating of the counterparty against that of the TMS and signs to say that it is met.

6.2.5 Information given to the Resources, Performance and Partnerships meeting of 25<sup>th</sup> March 2009 shows that Butlers highlighted that Individual ratings were the least important when depositing funds.

## 7. FINDINGS

### 7.1 Evidence from Treasury Advisers

#### Sector

- 7.1.1 The group received evidence from Sector, the primary provider of Treasury Advice to the Council until April 2007 when they were replaced by Butlers. At this point, Sector took on the role of providing secondary advice.
- 7.1.2 During their role as primary Treasury Advisors, Sector would hold regular meetings with Council Officers. These meetings were not attended by Members and Sector indicated that this was similar practice in most other Authorities.
- 7.1.3 Sector would provide the Council with a coloured matrix of counterparties to allow the Treasury Management Team to consider the range of depository options available to them. Sector stated at the meeting that they would not give advice on making specific deposits.
- 7.1.4 The working group were provided with Matrixes prepared by Sector; these were general matrixes including all known institutions available for depositing funds and were not tailored to the Council's Treasury Management Strategy.
- 7.1.5 A dialogue took place between Sector and Treasury Management Officers on a regular basis, although no notes were taken of these conversations by either party.
- 7.1.6 Officers indicated that individual deposits had been discussed with Sector but again no records were kept by either party.
- 7.1.7 Members recommended that in future, full records should be kept of conversations between the Authority and its Treasury Advisors.

**Recommendation 1:**  
**That comprehensive Treasury Management records be kept, including a note of all verbal advice given to Officers by Treasury Management advisors.**

- 7.1.8 Members of the Council were not involved directly in discussion regarding specific deposits, although the Cabinet Member for Resources held regular meetings with the Director of Resources. These discussions were around the budget implications of debt and treasury management; the impact of the credit crunch including the emerging difficulty in finding suitable counterparties and the need to

consider tightening the minimum rating criteria; discussions on tactics proposed as a result of the downgrading of sovereign and counterparty ratings where we had existing deposits in place; and discussion on alternative vehicles for making deposits that were being put forward by Butlers for us to consider (e.g. money market funds).

- 7.1.9 Sector stated that following the collapse of the Icelandic Banks, Members were becoming increasingly involved in decisions of this nature.
- 7.1.10 The sovereignty rating of Iceland had been downgraded to a negative outlook in January 2008, prior to the downgrading of Glitnir and Landsbanki banks. Sector confirmed that comments about countries were now included in their matrices, and Members recommended that sovereignty outlook be included as part of the Council's investment criteria in future.

**Recommendation 2:**  
**That a classification in respect of sovereignty outlook be included within the Council's investment criteria in future.**

### **Butlers**

- 7.1.11 Butlers were appointed Treasury Advisors to the Council from April 2007, and acted as the main provider of credit ratings. Butlers stated that they were only able to provide publicly available information in line with FSA guidelines, and were unable to pass on rumour or hearsay. Advice given was general rather than specifically regarding possible counter-parties to deposit with.
- 7.1.12 Representatives from Butler addressed the working group, who informed them that their Treasury Management role consisted of providing guidance on the Council's investment structure and credit rating information from the three main agencies – Fitch, Standards & Poors and Moodys.
- 7.1.12 Officers indicated that individual deposits had been discussed with Butlers but that the Council did not keep any records and transcripts of telephone conversations are only kept by Butlers for 12 months and conversations regarding the Icelandic deposits are therefore no longer available.
- 7.1.13 The financial crisis which led to the collapse of the Icelandic banks was an unprecedented and unpredicted event. The timing of the downgrading of the ratings for Glitnir (May 2008) and Landsbanki (September 2008), being relatively close to the banks' respective collapses, were symptomatic of the unpredictable nature of the financial crisis.

7.1.14 Glitnir and Landsbanki did not meet the Council's strict A/B individual rating criteria. However, the other three criteria had been met by Glitnir and Landsbanki at the time of the deposits being placed.

7.1.15 In light of this discovery, the working group recommended that a review take place, highlighting what advice had been given to the Council on placing deposits which were in breach of its own Treasury Management Strategy.

**Recommendation 3:**  
**That an external review be carried out into the advice given by the Treasury Management Advisors in light of the shortcomings highlighted by the working group.**

7.1.16 In light of the findings, Members of the working group also believed that the Council should be receiving more comprehensive advice from their Treasury Advisors in order to minimise risks when making deposits.

**Recommendation 4:**  
**That arrangements be made for the Council to be provided with more comprehensive Treasury Management advice in the future from their Treasury Advisors and not be solely reliant on credit ratings.**

## **7.2 Evidence from the Chairman of the Audit Committee**

7.2.1 Following a recommendation of the Full Council meeting which requested the establishment of the Working Group on 4<sup>th</sup> November 2008, the Working Group called the Chairman of the Audit Committee, to give evidence before it on March 9<sup>th</sup> 2009.

7.2.2 The Chairman of the Audit Committee informed the working group that the role of the Audit Committee was not a 'roving' investigative one and that it was decided at the Full Council meeting of 4<sup>th</sup> November 2008 that a Scrutiny Working Group was the most appropriate forum for an investigation of the issues relating to Treasury Management for this reason. It was noted that at no point had the Treasury Management Strategy come before the Audit Committee, as it had not been identified as a risk area.

7.2.3 The Council's constitution delegates the setting of the Treasury Management Strategy to the Cabinet Resources Committee, The Strategy set the boundaries within which the Council's deposits could be carried out; however, its day-to-day operation and issues of compliance were the responsibility of Officers.

- 7.2.4 The Audit Committee's role was reliant on managers identifying risk in their own areas of responsibility; this had not occurred in relation to the Treasury Management Strategy, and thus it had not been considered by the Committee. Additionally, no issues with the internal audit of the relevant area had been raised by the external auditors Grant Thornton.
- 7.2.5 The Chairman of the Audit Committee was of the opinion that greater officer support for risk management and assessment could be beneficial in terms of enhancing the Council's self-assessment and self-monitoring framework.

### **7.3 Evidence from Officers of the Council**

- 7.3.1 The Authority places a number of deposits with counter-parties in accordance with Chartered Institute of Public Finance & Accountancy (CIPFA) guidance.
- 7.3.2 The amount of cash deposited comes from a range of sources, including: balances and reserves, council tax income, grant income, capital receipts unapplied and business rates income. It also includes amounts borrowed to fund future capital schemes. The amount borrowed includes £40m long-term borrowing for the Primary Schools Capital Investment Programme (PSCIP). This was undertaken in 2006 to take advantage of the very low market loan rate available at that time, and had been discussed with the external auditor prior to the decision being taken. Earmarking borrowing this way is not the norm for Barnet but was undertaken to protect the council from expected higher interest rates in the future which did indeed materialise, although have subsequently fallen back down again. However, it has had the effect of increasing the level of funds available for deposit in Icelandic banks and other institutions.
- 7.3.3 Initial deposits totalling £15,000,000 had been placed with Landsbanki bank and been repaid with interest to the authority. The first of the deposits which are now frozen was placed with Glitnir on 7<sup>th</sup> November 2006, totalling £7,000,000. A further £3,000,000 was placed on 24<sup>th</sup> January 2007 and £2,400,000 on 7<sup>th</sup> February 2007. These deposits remain frozen. A deposit totalling £15,000,000 was placed with Landsbanki on 28<sup>th</sup> September 2007; this also remains frozen.
- 7.3.4 The minimum investment criteria in the Treasury Management Strategy were downgraded in March 2008 before the collapse of the Icelandic banks. This meant that the Authority increased its exposure to risk when placing deposits with counterparties. There was no evidence to support the rationale for this decision.
- 7.3.5 However, in light of the rapid and unprecedented changes in the economic situation, the Council subsequently reduced its exposure to

risk through amendments to its Treasury Management strategy, agreeing new reduced limits for placing deposits with counterparties.

7.3.6 At the meeting of March 9<sup>th</sup> 2009, Officers tabled a paper setting out the position with regards to the lack of compliance with the Treasury Management Criteria.

7.3.7 The below paragraphs 7.3.8 to 7.3.17 contains some elements of this tabled officer paper.

7.3.8 At the meeting of the Resources, Performance and Partnerships Overview & Scrutiny Committee of 25<sup>th</sup> March 2009, officers advised Members that Sector and Butlers, as Treasury Advisors to the Council, did not raise any concerns regarding the Council's deposits when given the opportunity to do so.

### Analysis of Deposits Placed (April 2006 – October 2008)

7.3.8 A review of the deposits placed in 2006/07, 2007/08 and the first half of 2008/09 (up to the start of the current banking crisis) shows that 690 cash deposits were placed by the treasury management team, totalling £2.486bn. All met three of the four criteria set out in the Treasury Management Strategy (Short Term, Long Term and Support ratings) but, as the working group identified with the Icelandic deposits, the Individual rating was only met in 4% of the Council's deposits placed in 2006/07, 8.2% in 2007/08 and 7.3% in the first half of 2008/09. The analysis of the Individual rating of deposit counterparties is shown in the table below.

Rating*	2006/07 # number of deposits	%	2007/08 # number of deposits	%	April – Oct 2008	%
N/a**	19	6.9	7	2.5	18	13.1
A	0	0	0	0	0	0
A/B	11	4.0	23	8.2	10	7.3
B	205	74.3	211	75.1	90	65.7
B/C	16	5.8	10	3.5	18	13.1
C	25	9.0	30	10.7	1	0.8
C/D	0	0	0	0	0	0
<b>Total</b>	<b>276</b>	<b>100</b>	<b>281</b>	<b>100</b>	<b>137</b>	<b>100</b>

#### Notes

\* Not all organisations are rated in the same way by the three rating agencies so, for ease of analysis, only the Fitch rating has been used. Where Fitch have not rated an institution, this has been estimated based



on the rating given by the other agencies. Whilst this could impact on the accuracy of the analysis it is not considered significant

\*\* Incorporates deposits such as local authorities (not rated) and building societies (rated in a different way).

7.3.9 The cells highlighted in the table are the deposits which do not meet the criteria as approved in the TMS, which include the frozen Icelandic deposits. These reflect approximately 89% of all the deposits placed in those two years. It is apparent, therefore, that this rating was not being taken into account when counterparties were being selected and, instead, emphasis was exclusively being placed on the short term and long term ratings, which, as noted above, were in fact complied with.

7.3.10 At the working group meeting on 5 March 2009, Butlers agreed with Officer comments that an institution having an A/B individual rating could be incongruous with the other three ratings in the TMS. The review of deposits highlights that several organisations with Short Term 'F1' and Long Term 'A' ratings had Individual ratings of 'B', 'B/C' or 'C' and a minority had the TMS criteria of 'A/B' or higher. Officers implied that there was therefore an error in devising and putting forward the TMS for agreement by the Cabinet Resources Committee as officers believed that the individual rating was incongruous with the other three used. The TMS is a report of the Cabinet Member for Resources.

7.3.11 Officers believe, though it is difficult to prove this long after the event, that the Council may not have been able to place in excess of £300m deposits at any one time had it been limited to only A/B counterparties. Part of the difficulty is that some banks would not always be looking for deposits every day, and some would not have been interested in taking deposits on the scale the council had to place on regular occasions, as they sometimes only dealt in larger sums. For example, in 2007/08 only £108.2m in total was placed with organisations that fully met the TMS criteria. It is likely that, if limited to A/B counterparties, additional acceptable counterparties could have been identified and further funds would have been placed with existing counterparties but it is highly probable that the £15m individual counterparty limit would have had to have been reviewed to enable the placing of such significant balances. This view was supported by Butlers at the working group meeting on 5<sup>th</sup> March 2009.

7.3.12 Nonetheless, it is clear that the TMS was breached in placing deposits throughout 2006/07 and 2007/08, thus demonstrating that the controls and/or arrangements for monitoring of the controls for placing deposits were not robust enough and the monitoring regime was not sufficient. The main control relating to this area is, as noted above, for one of the Treasury Management team, usually the Treasury Manager, to review the credit ratings of the institution against the approved credit criteria and initial the relevant part of the paperwork to record that it complies. This is in addition to the officer arranging the deposit checking the

ratings as part of that process.. The implication of the results above are that:

- This was not being done at all; or
- Reliance was being placed on the Butlers list as being a completely accurate reflection of the approved TMS; or
- Only short and long term ratings were being reviewed.
- If the TMS had not been breached, the Council would not have made any deposits in Icelandic banks and no money would be at risk

7.3.13 In terms of monitoring, whilst there were regular meetings between the Deputy Director of Resources & Chief Finance Officer (now Acting Director of Resources), Head of Strategic Finance (now Acting Assistant Director of Resources) and the Treasury Manager. These focused on the timing of cash flows, the term of future deposits, alternative vehicles for making deposits, opportunities for undertaking borrowing etc. Although it did not occur at every meeting, there was a review of existing deposits but that did not consider compliance with the TMS criteria. The listings of existing deposits that were reviewed only listed the short term and long term credit ratings rather than all four that are contained within the TMS.

7.3.14 Treasury Management has been subject to review by Internal Audit every year since 2002/03 and specific audits of the area has produced a satisfactory assurance opinion. The full systems reviews included compliance with legislation, policies and procedures and the recording of deposits made. The most recent audit in 2007/08 (followed up in 2008/09) was wider in scope as it picked up the end-to-end cash management process. This audit produced an overall limited assurance though this was predominantly as a result of risks highlighted within services that handle cash and no adverse comments or risks were highlighted with regard to Treasury Management. It should be noted, however, that this was not as thorough compliance review as had been undertaken previously. There is also a degree of review by external audit, partly through the Statement of Accounts audit and partly through the Use of Resources assessment. No adverse comments have been made or concerns raised.

#### **Other Local Authorities' Credit Criteria**

7.3.15 The strategies and credit criteria of other local authorities have been briefly reviewed by Officers. Although the sample size has been very small so far, just ten authorities across London, it has highlighted some interesting points:

- Some authorities do not use the individual rating, e. g. Westminster, Kensington & Chelsea, Wandsworth, Southwark.
- Out of the sample, all those who do use it all go as low as at least B/C (the individual rating of Landsbanki and Glitnir), e.g. Enfield, Kingston, Hammersmith & Fulham, Bromley.
- A minority of authorities in the sample use a lower long term rating than Barnet has historically (A), e.g. Kingston, Bromley (both A-).

### **Summary**

7.3.16 The main issues identified from the paper presented to the working group on 9<sup>th</sup> March 2009 are:-

- The majority of deposits (89% ) in 2006/07 and 2007/08 contravened the TMS, and that the TMS criteria were not reviewed by the Treasury Management Team in identifying counterparties and that the lists provided to the council by Butler's did not take in the approved individual rating either

Officers have implied, although with no evidence, that over the last few years, the TMS criteria for Individual ratings were set in error

- The monitoring and internal and external audit review mechanisms in place were not sufficient to identify that the individual ratings were not being adhered to or to identify the requirement for an amendment to the TMS

### **Actions Taken or In Progress**

7.3.17 The following actions have already occurred or been initiated:

- Revisions to the TMS by Cabinet in October 2008 and by two Leader delegated powers reports (December 2008 and March 2009) to mitigate the risks of less robust counterparties.
- Continued reiteration to the Treasury Management team to continually update and review the eligible counterparty listing.
- Revision of the deposit detail form to cross reference counterparty credit rating against TMS credit criteria.
- The Director of Resources has secured a part-time secondment of a Treasury Manager from another borough to review detailed control processes within the Treasury Team and to comment on the draft 2009/10 TMS that will be going to Cabinet Resources Committee at the end of March.

## **7.4 Evidence from the Leader of the Council**

- 7.4.1 The Leader of the Council attended the working group meeting of March 16<sup>th</sup> 2009.
- 7.4.2 He clarified the division of responsibility between officers and the Cabinet Member with regard to the placing of counterparties by officers, and confirmed that the list of counterparties was not considered at the Cabinet Resources Committee.
- 7.4.3 The Leader provided the working group with electronic correspondence from the Director of Resources from the time of the Icelandic crisis, stating that the deposits had been made in accordance with the Treasury Management Strategy. The Director of Resources surmised that this advice was based on advice given to him by the Treasury Manager at the time.
- 7.4.4 The Leader informed the working group that he first became aware that the criteria for deposits had not been met was following the working group meeting of March 9<sup>th</sup> 2009.

## **7.5 Outcomes from Evidence Sessions**

- 7.5.1 The working group concluded that the Council had been in breach of its Treasury Management Strategy since 2005/06, and that the most appropriate course of further action was investigation by the Chief Executive and Head of Paid Services.

**Recommendation 5:**  
**That the working group's findings that Council has been in breach of the Treasury Management Strategy since 2005/06 be referred to the Chief Executive and Head of Paid Services for investigation and any appropriate action.**

- 7.5.2 The working group found out through a statement (see 7.5.3 below) issued to the press by the Leader of the Council and Cabinet member for Resources that the Treasury Manager resigned from his post on March 9<sup>th</sup> 2009.

- 7.5.3 The matter was brought to the attention of the Leader of the Council by the Director of Resources. The Leader of the Council issued the following statement on March 10<sup>th</sup> 2009:-.

*Despite previous assurances from Barnet Council Officers that correct treasury management controls were applied to Icelandic deposits it has now come to light that in fact this was not the case. On Monday 9<sup>th</sup> March I was presented with a scrutiny working group report which makes clear that officers did not in fact follow the correct procedures despite having repeatedly told me both verbally and in writing that they had done so.*

*The lead officer responsible for this failure resigned his post prior to the scrutiny meeting on Monday 9<sup>th</sup> March and I have now written formally to the Chief Executive asking for a full investigation into how I as Leader of the Council was misled by officers in this matter.*

*An external investigation will be carried out to identify why our external auditors did not pick up these issues in their previous audit work. I would like however to reassure residents that at this point the Icelandic deposits remain frozen by the administrators of the two banks involved and discussions around the return of this money remain positive and ongoing.*

- 7.5.4 The failure of auditing in the Treasury Management Team gave the working group cause for concern, and they thus recommended that a full investigation of these practices take place.

<p><b>Recommendation 6:</b> <b>That a full external investigation into auditing practices in the Treasury Management team be initiated.</b></p>
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- 7.5.6 The Treasury Management Framework as set out in article 7.4 of the Financial Regulations section of the Council's constitution states:-

*Cabinet Resources Committee will receive reports on its treasury management policies, practices and activities, including an annual strategy and plan in advance of the year, and an annual report after its close in the form prescribed in the TMPs. These reports will incorporate the prudential borrowing limits and performance indicators.*

- 7.5.7 The working group believe that the Cabinet Resources Committee's monitoring of Treasury Management Treasury Management activity in line with the Council's constitution should be more robust.

**Recommendation 7:**

**That in order to facilitate more robust treasury management scrutiny, in line with section 7.4 of the Constitution (Treasury Management Framework), the Cabinet Resources Committee should receive regular comprehensive reports on Treasury Management activity and practice.**

**8. CONCLUSION**

- 8.1 The working group found that the Council had been operating in breach of its Treasury Management Strategy, including through its placement of deposits in the Icelandic banks.
- 8.2 The working group has recommended an investigation into the breach of the Treasury Management strategy, and an external review of auditing practice and the advice provided to the authority.
- 8.3 The working group has also recommended action to strengthen the Council's Treasury Management procedures.
- 8.4 It is anticipated that the issues highlighted by the review and its recommendations assist the Council in the future effective operation of Treasury Management within the authority.