

AUDIT AND GOVERNANCE COMMITTEE



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Report of **Head of Finance Services**

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Wards Affected
All

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Adjustment to General Fund Balance 2008/09

Recommendations

- (a) *To note the contents of the report and the action taken to prevent any similar recurrence.*
- (b) *To note the impact on the Medium Term Financial Plan and the action proposed to bring the balances back to the minimum required level.*

1. Purpose of Report

- 1.1 The report informs the members of the Audit and Corporate Governance committee of an omission in the Statement of Accounts 2007/08 which resulted in the General Fund balance being over-stated. The report addresses the action to be taken to seek to prevent any similar future errors.
- 1.2 The report looks at the impact on the Council's Medium Term Financial Plan of the over-statement of the General Fund balance and makes proposals as to how to bring the Council's budget back in line with the requirements of the Chief Finance Officer - that balances should be at least 5% of the Council's annual budget requirement.

2. Relationship with Corporate Plan

- 2.1 This report complies with the Council's requirements for sound financial management and in doing so, supports all of the Council's strategic objectives.

3. Background

3.1 Identification of problem

- 3.1.1 A review of the Council's capital financing requirement in March 2009 identified that the Council appeared to have a need to borrow money for capital financing which should not have been the case as the Council has capital reserves and does not need to borrow money. Further examination revealed an error in the accounts and a detailed review of the closedown of capital for 2007/08 was carried out. This identified a missing entry in the accounts to reverse out the impact of grant funding on capital work which did not result in an increase to the Council's asset base.
- 3.1.2 In local authority accounting there is a category of expenditure called 'revenue expenditure funded from capital under Statute'. This new description replaces the former description 'deferred charge'. The treatment of these old year 'deferred charges' was different prior to the introduction of the Statement of Total Recognised Gains & Losses in that previously it was felt that the benefit of this expenditure could be received by the Council and that it would then be written out in the accounts over a period of time. With the introduction of the Statement of Total Recognised Gains & Losses the accounting treatment changed to avoid holding value on the balance sheet that was not value to the Council. Action now has to be taken to reverse out the deferred grant relating to this former category 'deferred charge'. This happened primarily in 2006/07.
- 3.1.3 However, in closedown for 2007/08 an additional two grants were identified as still being held in the balance sheet that should have been written out to the Income and Expenditure account - these two grants amounted to £129k for Housing Association funding and capital works to Faringdon Market place. Consequently, a credit of £129k was made to the income and expenditure account to reverse these grants out of the balance sheet.
- 3.1.4 Similarly, grant funding for revenue expenditure funded from capital under statute for 2007/08 expenditure was also transferred as a credit to the income and expenditure account. There were two such grants, Housing renovation grant income of £453k and flood defence grant income of £125k.
- 3.1.5 The income and expenditure account shows the council's actual financial performance for the year measured in terms of the resources consumed and generated over the last 12 months. However, the authority is required to raise council tax on a different accounting basis and consequently all capital expenditure which does not result in a Council owned asset (i.e. in an increase in value of the Council) has to be reversed out of the bottom line of the income and expenditure account in the Statement of Movement on the General Fund Balance.
- 3.1.6 The Statement of Recommended Practice (SORP) clearly identified the need to ensure that all such expenditure is reversed and checks were made to ensure that the expenditure was reversed out of the accounts. Similarly, the Council's auditors checked to ensure that expenditure had been reversed out of the accounts. Regrettably, because of changes to the SORP over the last two years, the need to reverse out the 'net' expenditure funding was not stated in this part of the SORP but referred to in another part of the SORP relating to the changes in the treatment of deferred grants on the balance sheet.
- 3.1.7 Consequently, during closedown we failed to identify that the net expenditure was to be reversed out with the result that the expenditure reversed out of the accounts exceeded

the net expenditure by £707k - the value of the grant funding. This inappropriately increased the transfer of funding to the General Fund by £707k. The final approved 2007/08 account incorrectly overstated the General Fund by £707k.

3.2 Action taken

- 3.2.1 As soon as the omission was identified the Council's auditors were informed and asked to confirm our understanding of the problem and the solution required. The auditors sent it to their technical team for their opinion and their response confirmed the error and the required amendment. Their view was that it would not have created a fundamental misunderstanding of the 2007/08 accounts and as such was not a prior period adjustment. A letter detailing the Audit Commission view of events is attached as Appendix A. Consequently, an adjustment has been made in the 2008/09 closedown process transferring £707k through the Statement of the Movement on the General Fund Balance to the Capital Adjustment Account on the balance sheet. Full details are disclosed in the note to the Income and Expenditure Account on pages 14 - 15 of the Statement of Accounts.
- 3.2.2 To try to prevent any similar occurrence in the closedown process for 2008/09 both the Capital Accountant and the Chief Accountant have reviewed all the capital closedown entries passed through the Income and Expenditure account. A summary of the entries associated with the capital movements in and out of the revenue account will be attached to the working file and maintained for future years.

3.3 Impact on the level of Revenue Balances in the Medium Term Financial Plan

- 3.3.1 Whilst the income and expenditure account was not compromised during the 2007/08 closedown process and showed accurately the Council's financial performance for the year, the impact on the general fund balance is of serious concern to the authority in that the Council ensures in its medium term plan that general fund balances are maintained over the period of the medium term at a level no lower than 5% of the estimated annual budget requirement.

Impact on Medium Term Plan before 2008/09 closedown

- 3.3.2 The impact on the Council's 2009/10 budget-setting process would be to re-state the planned balances as follows:

Table 1: Revenue Balances as per Medium Term Plan to 2013/14

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
<u>General Fund</u>						
At start of year	2,954,000	2,080,970	334,270	17,610	210,220	626,420
(Use)/contribution to general fund	(166,030)	(1,746,700)	(316,660)	192,610	416,200	437,110
Reversal of capital grants	(707,000)					
End of year	2,080,970	334,270	17,610	210,220	626,420	1,063,530
<u>Other revenue reserves *</u>						
Earmarked but available for returning to General Fund	412,501	457,501	150,501	260,501	325,501	310,501
Total available revenue balances	2,493,471	791,771	168,111	470,721	951,921	1,374,031

* Election Equalisation, Local Development Framework, Rent Deposit, Rent advance, Reservoir, Lottery grant matched funding

This clearly brings the General Fund balance into an unfavourable position from 2009/10 to 2012/13 when they will be less than 5% of budget requirement. Given the availability of other revenue reserves, the worst years are 2010/11 and 2011/12. Had the error been known at budget-setting time then further savings would have been required to bring the balances back in line with the 5% rule.

- 3.3.3 At the time the Council set the budget for 2009/10 officers of the Council were forecasting an overspend on the budget for 2008/09 of £800k. This predicted overspend was prudently built into the Medium Term Financial Plan.

Impact on Medium Term Plan after 2008/09 closedown

- 3.3.4 Since the Council's budget was set, management action has been taken to bring the predicted overspend down. This has had a positive impact and the overspend forecast as £800k in December 2008 was reduced to £450k by the end of March 2009. In addition to this, the Council has been awarded an amount of £109k in compound interest lost to the Council as a consequence of VAT payments on excess parking charges which have now been returned by H.M. Revenues and Customs. Unfortunately these positive outcomes have been largely negated by a £260k budget overspend due to double-counting the use of prior years' planning delivery grant in the 2008/09 budget, plus future year double-counting. The net impact of these various outturn variances and corrections is as follows:

Table 2: Adjusted Revenue Balances following closedown 2008/09

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
<u>General Fund</u>						
At start of year	2,954,000	2,255,150	353,450	(8,210)	174,400	585,200
(Use)/contribution to general fund	(166,027)	(1,746,700)	(316,660)	192,610	416,200	437,110
Reversal of capital grants	(707,000)					
Double-counting planning grant	(258,750)	(155,000)	(45,000)	(10,000)	(5,400)	
Reduction in budget overspend	323,820					
Receipt of compound interest	109,107					
End of year	2,255,150	353,450	(8,210)	174,400	585,200	1,022,310
<u>Other revenue reserves *</u>						
Earmarked but available for returning to General Fund	455,962	500,962	193,962	303,962	368,962	353,962
Total available revenue balances	2,711,112	854,412	185,752	478,362	954,162	1,376,272

* Election Equalisation, Local Development Framework, Rent advance, Reservoir, Lottery Grant matched funding

- 3.3.5 There is no immediate shortfall as total available revenue balances will still exceed 5% of budget requirement at the end of this year (2009/10). However, action will be needed to replenish reserves in order to meet the 5% rule throughout the medium term. This will commence immediately to generate the maximum possible underspend by the end of 2009/10 without compromising the Corporate Plan objectives. Further measures will be proposed in the 2010/11 budget-setting process.
- 3.3.6 Section 4 addresses the corrective action that is proposed to be taken to avoid the projected shortfall in the general fund and other revenue balances.

4. Planned corrective action

- 4.1 In purely accounting terms, the necessary adjustments have been made to correct the errors in the council's ledger and accounts. This has created unexpected financial pressure on the council's medium term financial plan, which will leave revenue balances lower than predicted and lower than the minimum level considered to be prudent. If left unaddressed this would expose the Council to unacceptable financial risks. Therefore the following corrective actions will be taken to reduce the risks by replenishing revenue balances:
- 4.1.1 There is a further earmarked revenue reserve, the Private Estates Fund, which has always been assumed to be unavailable for General Fund support. It has accumulated a significant balance (£357k at 31 March 2009). Officers will research the statutory position to determine any regulatory constraints and the opportunity for General Fund support. Members could then determine whether a proportion of the balance should be returned to the General Fund.
- 4.1.2 Table 2 above includes amounts totalling £60,400 for 'double-counting planning grant' in 2010/11 – 2012/13. This is on the basis that those amounts were earmarked for planning expenditure purposes (included the funding of at least one post). Should the Council decide to forego those purposes, the grant could be credited to the General Fund, saving £60k. Members will be asked to determine this for the 2010/11 Budget.
- 4.1.3 Salary budgets were inflated by 2.5% for 2009/10. Actual costs will depend upon the nationally negotiated local government pay settlement. Current estimates vary but we may find these budgets have been over-provided, which will help to achieve an under-spend by the end of 2009/10, which would increase revenue balances.
- 4.1.4 Contract budgets were inflated by 4.8% for 2009/10 as that was the reported inflation in September 2008. Actual contract cost increases will depend upon the precise inflation formula in each contract. But as general inflation is currently running very low, close to 0%, we may find these budgets have been over-provided. If so, this would again help to increase revenue balances.
- 4.1.5 Management action in the final quarter of 2008/09 was successful in slowing expenditure and restricting spend to essential activities only. This will now be reinstated for the whole of 2009/10, focusing chiefly on those services not directly contributing to Corporate Plan priorities. Instead of taking one-off savings, officers will seek to make recurring budget savings wherever possible, to provide greater and more sustainable contributions to revenue balances. We will monitor our effectiveness through monthly budget monitoring.
- 4.1.6 Management Team's aim will be to restore the Council's revenue balances back to the 5% minimum requirement using the above measures. If this proves impossible, any remaining shortfall will be highlighted during the 2010/11 budget-setting process and further cost reduction ideas will be proposed to Members. Officers will seek to avoid this option given the other, external pressures which will need to be addressed in subsequent budgets.

5. Planned Preventative action

- 5.1 To ensure that there is no repeat of the accounting and budgeting errors outlined above the following preventative actions will be taken:

- 5.1.1 The error in the 2007/08 statement of accounts chiefly arose due to the incomplete nature of the section of the regulatory guidance (the 'Statement of Recommended Practice') relating to transactions that should go through the Statement of Movement on the General Fund Balance. New clearer guidance has been issued and the correct treatment is recognised by the relevant accountant and the chief accountant.
- 5.1.2 Over the next couple of years, with the need to comply with International Financial Reporting Standards, the statement of accounts is to become even more complex increasing the potential risk of misinterpretation of guidance. To mitigate against this the relevant accountants will attend the necessary training courses. The regular staff appraisals will focus heavily on the accountants' ongoing training and development needs. In addition, whenever it is practical to do so, the accountants at this council and South Oxfordshire District Council will check each others' work. There will also continue to be a high level review of the statements of accounts by the Head of Finance and the council's section 151 officer.
- 5.1.3 The second error relating to incorrect budgeting of planning delivery grant was occurred during a review of the medium term financial plan (MTP) and came about due to the use of two different accounting conventions relating to the application of earmarked reserves. In future the compiler and owner of the MTP, the chief accountant, will have the final say over its composition. The chief accountant will only accept changes to the MTP if they are totally satisfied that the changes are correct, taking into account all other entries. The onus therefore is for the chief accountant to fully understand and maintain the integrity of the MTP. The MTP will be regularly reviewed and checked throughout its compilation.
- 5.1.4 The 2009/10 closedown and accounts preparation process will mirror that at SODC where applicable in order for each accountancy team to cross-check the other council's working papers. This should provide an additional safety net, enabling accountants to spot and correct any errors before Members are asked to approve the statement of accounts.
- 5.1.5 The 2010/11 budget-setting process will mirror that at SODC in order for each accountancy team to cross-check the other council's working papers. This should provide an additional safety net, spotting and correcting any errors before Members are asked to rely on them in order to determine the Council's budget.

6. Financial, legal and any other implications

- 6.1 Under the Local Government Act 2003 S25(1)(b) the chief finance officer (or 'Section 151 officer') is required to be satisfied of the adequacy of the council's financial reserves. Where the general fund balance falls below a level of 5% of the Council's budget requirement the chief finance officer is of the view that further savings are required to be found.
- 6.2 The chief finance officer will ensure the 2010/11 Budget and Medium Term Plan contains adequate measures to maintain balances in line with the 5% rule.

7. Conclusion

- 7.1 The accounting errors which caused the over-statement of the Council's general fund balances were very unfortunate. Whilst the error was a 'paper mis-statement' and

certainly did not result in any loss to the Council, it has caused a delay in addressing the Council's medium term budgetary pressures.

7.2 The chief finance officer has identified sufficient measures to address the resulting need for additional revenue balances.

Background Papers: Statement of Accounts 2007/08, Council Budget 2008/09 and 2009/10