

Tandridge District Council

**REPORT ON THE FORENSIC REVIEW AND FACT-FINDING
INVESTIGATION INTO A POTENTIAL BUDGET GAP FOR
2020/21 AND ITS IMPLICATIONS FOR 2021/22**

7 SEPTEMBER 2021

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For the attention of:
Anna D'Alessandro – Chief Finance Officer

7 September 2021

Dear Anna

FORENSIC REVIEW AND FACT-FINDING INVESTIGATION INTO A POTENTIAL BUDGET GAP FOR 2020/21 AND ITS IMPLICATIONS FOR 2021/22

We have pleasure in enclosing a copy of our report in accordance with our Engagement Letter dated 16 June 2021. This document (the **Report**) has been prepared by Grant Thornton UK LLP (**Grant Thornton**) for Tandridge District Council (the **Addressee** or the **Council**) in connection with the forensic review and fact-finding investigation of potential budget gap for 2020/21 and its implications for 2021/2022 (the **Purpose**).

We stress that the Report is strictly private and confidential and prepared for the Addressee only. We agree that an Addressee may disclose our Report to its professional advisers in relation to the Purpose, or as required by law or regulation, the rules or order of a stock exchange, court or supervisory, regulatory, governmental or judicial authority without our prior written consent but in each case strictly on the basis that prior to disclosure you inform such parties that (i) disclosure by them is not permitted without our prior written consent, and (ii) to the fullest extent permitted by law we accept no responsibility or liability to them or to any person other than the Addressee.

The report should not be used, reproduced or circulated for any other purpose, in whole or in part, without our prior written consent, such consent will only be given after full consideration of the circumstances at the time. These requirements do not apply to any information, which

is, or becomes, publicly available or is shown to have been made so available (otherwise than through a breach of a confidentiality obligation).

To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Addressee for our work, our Report and other communications, or for any opinions we have formed. We do not accept any responsibility for any loss or damages arising out of the use of the Report by the Addressee(s) for any purpose other than in relation to the Purpose.

PERIOD OF OUR FIELDWORK

Our fieldwork was performed in the period between 16 June 2021 and 10 August 2021. We have not performed any fieldwork since 10 August 2021 and, our Report may not take into account matters that have arisen since then. If you have any concerns in this regard, please do not hesitate to let us know.

SCOPE OF WORK AND LIMITATIONS

Our work focused on the areas set out in our Engagement Letter. Our assessment of the affairs of the Tandridge District Council does not constitute an audit in accordance with Auditing Standards and no verification work has been carried out by us and consequently we do not express an opinion on the figures included in the Report.

The scope of our work has been limited both in terms of the areas of the business and operations which we have assessed and the extent to which we have assessed them. There may be matters, other than those noted in the Report, which might be relevant in the context of the Purpose and which a wider scope assessment might uncover.

We would like to draw attention to the fact that we requested to have access to the Council's former Interim Chief Finance Officer, however we have had no contact with him and we have not been able to interview this individual. This is a limitation of scope.

FORMS OF REPORT

For your convenience, the Report may have been made available to you in electronic as well as hard copy format, multiple copies and versions of the Report may therefore exist in different media and in the case of any discrepancy the final signed hard copy should be regarded as definitive.

GENERAL

The Report is issued on the understanding that the management of the Tandridge District Council have drawn our attention to all matters, financial or otherwise, of which they are aware which may have an impact on our Report up to the date of signature of this Report. Events and circumstances occurring after the date of our Report will, in due course, render our Report out of date and, accordingly, we will not accept a duty of care nor assume a responsibility for decisions and actions which are based upon such an out-of-date report.

Additionally, we have no responsibility to update this Report for events and circumstances occurring after this date.

Notwithstanding the scope of this engagement, responsibility for management decisions will remain solely with the directors of the Council and not Grant Thornton. The directors should perform a credible review of the recommendations and options in-order-to determine which to implement following our advice.

Yours faithfully

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OVERVIEW

- 1.1 In April 2021 the Council's finance team identified an error in the 2020/21 budget that had been approved by Council in February 2020. The error resulted in an unplanned and unmitigated cost pressure of £920,500, which is a significant figure. We have been informed by Council finance officers that the budget gap may have arisen due to potentially incorrect accounting entries made during the budget preparation in 2020/21. This has potential implications for the accuracy of the 2021/22 budget, approved by Council in February 2021.
- 1.2 In accordance with our Engagement Letter, we have undertaken the investigation to identify the events that led to the budget gap for 2020/21 and describe the financial impact and implications for the budget position in both 2020/21 and 2021/22. We have also considered why the error was not mitigated by the Council's system of internal financial control, identified applicable control deficiencies relevant to the error, assessed the residual risk posed by these deficiencies and made recommendations which may to help prevent similar errors occurring in future (identified solely as result of performing our work under this engagement).
- 1.3 It should be noted that the findings set out in this Report are based on the documents made available for review, with key context provided by interviews of selected members of the finance team. Also, we requested to have access to the former Interim Chief Finance Officer, however we have had no contact with this individual.

KEY FINDINGS - FINANCIAL IMPACT

- 2.1 We have identified that there was an unfunded revenue deficit of £920,500 within the 2020/21 outturn position, that was not detected and reported during the year. The implications of this are that the Council's outturn position is £920,500 less favourable than had been expected, and the Council will have to fund this from corporate surpluses or reserves and adjust the opening reserves position for 2021/22, accordingly. For illustration, this deficit represents over 8.7% of the £10,559,732 net budget for 2020/21.
- 2.2 It also appears that this error was not identified during the 2021/22 budget setting process and was therefore rolled forward as part of the baseline budget for 2021/22, that was approved by Council in February 2021. This means that its impact will continue to be relevant for the general fund in each financial year, until it is resolved.
- 2.3 We note that the rolled forward General Fund Reserve level for 2021/22 was £3.4 million (excluding capital and reserves earmarked for specific uses). This was projected to increase to £4.8 million by the end of the financial year 2021/22. Therefore, the financial impact of these errors on the Council's ongoing financial resilience is potentially significant. An assessment of the Council's ongoing financial resilience is outside the scope of this report.

KEY FINDINGS – CHRONOLOGY OF KEY EVENTS

- 2.4 On 3 February 2020 the Council set a draft Budget of £11,264,732 for 2020/21 which was approved (subject to ratification by the full Council) by the Strategy & Resources Committee on 3 February 2020. This contained business rate income of £2.687m, an increase of £0.629m compared with the prior year's budget of £2.058m.
- 2.5 The increase was not identified or explained in a report setting out the Council's proposed budget for 2020/21, which was provided to the Strategy & Resources Committee on 3 February 2020. The Interim Chief Finance Officer was asked¹ why budget business rate income had increased against the prior year during a meeting of the Strategy & Resources Committee on 3 February 2020. He was unable to fully explain the increase.
- 2.6 The 2020/21 budget was prepared approximately between September 2019 and January 2020. During this period, a decision was made to re-state the way that figures were presented in the Medium-Term Financial Strategy (MTFS). We have not been able to confirm whether this was initiated by the Interim Chief Finance Officer or his predecessor. This period coincided with the departure of the incumbent Chief Finance Officer and the S151 Officer in November 2019, and the appointment of the then Interim Deputy Chief Finance Officer as the Interim Chief Finance Officer.
- 2.7 The restatement of the MTFS was questioned during the 3 February 2020 meeting². Our work has shown that the restatement was not done correctly, resulting in an overstatement of income of £705,000, and a corresponding error in the total net budget. A restated MTFS working paper was used to underpin the draft 2020/21 budget presented to the Strategy and Resources Committee on 3 February 2020. At that stage the budget figures for business rate income were challenged by a member of that Committee, however the draft budget was then approved³ subject to ratification by Full Council.
- 2.8 In the days following the 3 February Strategy and Resources Committee, the Interim Chief Finance Officer and his team reviewed the figures and made a correction to the budget, reducing business rate income in the draft budget by £705,000. The Interim Chief Finance Officer sent an email to members on 7 February 2020 to address this (and other changes) to the 2020/21 budget. The email referred to a "*review of the very latest forecasts*" but did not attach the forecasts or provide any further explanation for the change.

¹ By Councillor Kevin Bourne

² By Councillor Kevin Bourne

³ Four Councillors voted against the budget

- 2.9 This correction created a funding gap in the budget that needed to be resolved before the budget was presented to full council on the 13 February 2021.
- 2.10 Between 3 February and 13 February 2020, selected cost lines appear to have been removed from the pensions related budgets to the value of £920,500. This had the effect of funding the £705,000 shortfall of income from business rates noted above and reducing the planned draw on reserves by £215,000.
- 2.11 The pensions 'cost' lines which appear to have been removed from the budget related to notional technical accounting entries and were directly related to a series of other 'income' lines which together netted off to zero. The removal of only the 'cost' side of these corresponding entries should not have occurred, as it had the effect of leaving in £920,500 of 'income' budget for which no real cash inflow could be obtained.
- 2.12 We have been advised that the relationship between the 'cost' and 'income' entries was not directly apparent in a list of cost centres used in the financial system and monitoring reports. Our interviews with finance officers, including the business partner responsible for the pensions budgets, indicated that the nature of these budget lines was not properly understood, following a number of changes in roles and key personnel within finance. There was an understanding that these lines were 'notional' budgets that were not required within the revenue budget, but this had become confused with them being 'unused' budgets that provided what seemed to be an opportunity to remove costs from the budget.
- 2.13 A revised budget of £10,559,732 was prepared based on the draft budget with two alterations⁴ to business rate income and pensions, as explained in a report to Full Council dated 13 February 2020. The revised budget was approved by Full Council on this date. The fact that adjustments had been made to business rate income, pension costs and reserves was disclosed to members in the report. The report explained that the reduction in forecast business rate income was based on "*the latest information*" but did not explain what additional or revised information had been applied to merit the change in the budget. During our review, the finance team was not able to identify what the reference to new information referred to, however the change in forecast business rate income appears to have been necessary because of the mathematical errors that had been identified in the MTFS.
- 2.14 We note that the reason for the reduction in pension costs given in the report to members on 13 February referred to a reduction in pension strain liabilities. Prior to the 13 February report, email correspondence dated 7 February 2020 between the former Interim Chief Finance Officer and members shows that the reduction in pension costs was linked to notification from the Surrey County Council pension fund.

⁴ The change in the use of General Fund Reserves being a balancing figure

- 2.15 The audio recording of the meeting on the 13 February, shows that, in response to questioning⁵, the Interim Chief Finance Officer spoke to justify the changes to the budget made since 3 February 2020, and in particular, that the adjustment to pensions was due to information provided by the Surrey County Council pension fund.
- 2.16 We have reviewed the letter from the Surrey County Council pension fund as well as other related financial information. The notification when considered in conjunction with other evidence does not provide justification for the reduction in pension fund costs of £920,500. Whether the letter from the Surrey County Council pension fund justified an ongoing reduction in annual costs was questioned⁶ on 13 February 2020 in a meeting of the full Council. The budget for 2020/21 was then approved.
- 2.17 The removal of pensions costs and the corresponding shortfall of budgeted pensions income of £920,500 was not detected as part of the budget monitoring process throughout 2020/21. This was because, as had been the convention in prior years, the budgeted notional pensions accounts were forecast to deliver to budget. As previously noted, the relationship between the 'cost' and 'income' sides of the notional pension entries was not clearly identifiable within the chart of accounts. Discussion with the finance team members involved in budget setting and monitoring during the period from 2019/20 and 2021/22, including the accountant with responsibility for these cost centres, indicates that these budget lines were not fully understood. While the entries netted off to zero, as they are said⁷ to have done prior to February 2020, they had no impact on the budget. However, the finance team remained unaware that the removal of one side of the entries in the 2020/21 budget had changed this dynamic.
- 2.18 In June 2020, the Interim Chief Finance Officer left the Council and the current Chief Finance Officer was appointed on secondment from Surrey County Council. Based on interviews with finance officers, including the current Chief Finance Officer, it appears that detailed corporate knowledge of the adjustments that had been made to the 2020/21 budget that was vested in the Interim Chief Finance Officer was lost and/or was not directly passed on to the new Chief Finance Officer in the form of working papers or other means.
- 2.19 Between September 2020 and February 2021, the finance team prepared the budget for 2021/22. The lead officer preparing the budget was new to the Council, having been brought in on secondment from Surrey County Council in common with the current Chief Finance Officer. The lead officer and the Chief Finance Officer were not aware of the potential issues within the 2020/21 budget as they had not been directly involved, nor were they informed of the potential issue by existing members of the finance team, who

⁵ Councillor Kevin Bourne

⁶ Councillor Kevin Bourne

⁷ TDC has been unable to locate historic working papers which show precisely how TDC's budget was calculated

were also unaware of the problem at this point. The notional pensions 'income' lines had been reported with a forecast outturn equal to budget during the year, so the issue was not detected through this process.

- 2.20 The decision was therefore made by the Chief Finance Officer to use the 2020/21 budget as the starting point for the 2021/22 budget, as from the finance team's perspective, there was no reason to doubt the validity of the figures. The 2021/22 budget was duly prepared and approved by Full Council in February 2021. This budget also included the over estimation of income of £920,500 which had been carried forward.
- 2.21 In April 2021, the finance team started to prepare the 2020/21 year end outturn report and at this point it was noted that the pensions budget was £920,500 overspent. This had crystallised because in contrast to what had been forecast, by the end of the year there was no actual income to set against this notional 'income' budget.

KEY LEARNING POINTS AND RECOMMENDATIONS

- 2.22 We have reviewed the circumstances surrounding the errors identified above from the perspective of the exercise of financial controls. The purpose of this section is to consider the extent to which effective controls were in place or were executed appropriately, and where this was not the case, to make recommendations for improvement that could help the Council to mitigate the risk of similar issues arising in future.
- 2.23 We found certain weaknesses in the financial control environment that contributed to the errors arising in the first place, and subsequently prevented them being detected until after the end of the financial year 2020/21. Our recommendations for improvement fall into four key categories and are outlined in the tables below:

CONTROLS OVER THE PREPARATION OF THE BUDGET AND MTF5

No.	Recommendation
1	When the draft budget and MTF5 is being prepared, the opening budget baseline should be reconciled to the prior year's approved budget and any variances should be fully reconciled (e.g. to in year virements).
2	The current year proposed budget, and future projections in the MTF5, should be subject to analytical review at directorate and cost centre level, to ensure that all movements away from the baseline opening budget reconcile to known adjustments (e.g. savings and pressures).
3	Segregation of duties should be re-established between the calculation of all key budget items (such as business rates) with review and approval undertaken by the Chief Finance Officer.
4	The Council should ensure that the finance team includes or has appropriate access to sufficient skills and capacity to undertake key calculations, including calculation of business rates, to enable the Chief Finance Officer to function effectively in a review and approval role.
5	The Council should undertake a skills and training needs assessment of the finance team and provide targeted investment in staff development where it will have most impact. The Council should also consider whether skills gaps are best addressed through targeted recruitment.

THE BUDGET MONITORING PROCESS

No.	Recommendation
6	We recommend that the monthly budget monitoring information provided to budget holders is improved to incorporate greater focus on comparison to the prior year budget and the expected profile of the budget throughout the year, with greater focus on documenting and challenging the basis by which budget outturn has been forecast.
7	Within the monitoring information, the inclusion of budget lines that have zero budget in the current year, but did have budget in the prior year should be considered as a failsafe measure. This could provide a useful reference point to monitor the impact budget changes may be having on current year variances. (Note that this could have highlighted the removal of one half of the £920,500 pensions costs, enabling it to be questioned early in 2020/21).

STRENGTHENING CORPORATE BUDGET RESPONSIBILITY

No.	Recommendation
8	The list of cost centres should be reviewed to ensure that each one is assigned a responsible budget holder and Finance Manager, and that these responsibilities are fully communicated and understood by the named individuals. This can be augmented by asking budget holders to sign a written declaration that they have agreed and accept responsibility for their assigned cost centres (a Budget Accountability Statement).
9	The Council should make sure that the ownership of and responsibility for budgets, is fully enshrined in the Council's Constitution and Scheme of Delegation, so that individuals can clearly and directly be held accountable for budget management. To support this, the Council should consider the establishment of a separate Scheme of Financial Delegation that sets out the respective financial responsibilities of roles and grades in detail.
10	All budget holders and supporting finance business partners should review all the list of cost centres they are responsible for and ensure that the purpose and relevance of these is fully understood. Council policy should make clear that the onus is on the individual to make sure they have the level of understanding required.

No.	Recommendation
11	There are a number of ways that adjustments to the draft budget could have been subject to tighter financial control, where segregation of duties is difficult to maintain (for example, in regard to corporate items adjusted only at year end). We recommend, the implementation of a schedule of adjustments that requires dual sign-off by both Chief Finance Officer and Deputy Chief Finance Officer to confirm that all adjustments have been reviewed independently of the author (e.g. via an e-mail confirmation).
12	The Council should review its chart of accounts to make sure it properly reflects current operations and desired approach to financial control. In particular, we recommend that the list of cost centres is reviewed and unused or unnecessary cost centres are removed or rationalised as part of the 2022/23 budget setting process.
13	We recommend that within the next two years, the Council undertakes a targeted zero-based budgeting exercise to fully refresh the budget and its cost centres, to ensure they align to current needs and services, and to strengthen the ownership and responsibility among budget holders and responsible management accountants. This should initially focus on Strategy and Resources and Corporate budgets.

DEVELOPING A STONG FINANCIAL CULTURE

No.	Recommendation
14	The Council should consider how it can strengthen the Council's financial culture, building characteristics such as professional scepticism, self-review and empowerment to challenge management, starting with the finance team.
15	The Council should review and update its Financial Regulations, with particular focus on embedding the control improvements recommended in this report. This should be supplemented by detailed documented financial procedures where appropriate.

NEXT STEPS

3.1 The Council should consider the following next steps:

- Develop a strategy on the budget deficits identified in 2020/21 and 2021/22 can be mitigated, without depleting reserves to an extent that poses a risk to ongoing financial resilience.
- Consider whether the facts outlined in this report warrant further investigation or action and determine how this will be taken forward.
- Decide whether the design and implementation of the recommendations in this report require further support to deliver.
- In the context of the wider financial position and the financial impact of the removal of pensions budgets, consider whether a wider review of the Council's financial resilience is warranted.



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