

# Review of Capital Expenditure

## Salford City Council

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## Introduction

During 1999/2000 the Authority experienced significant financial problems when overspends on children in care reduced the general reserves to nil. Since 1999/2000 the Council has been implementing a recovery plan to restore balances to an acceptable level. This recovery plan has largely been adhered to and balances are expected to reach £5m by 31 March 2003.

The Council has set a target of £8m (3% of revenue expenditure) as the minimum level needed to provide a working balance and to act as a cushion against any unforeseen events. It is intended that the remaining £3m contribution needed to meet this target will be made over the next three years.

Part of the Authority's recovery plan has been to capitalise certain 'grey' areas of expenditure that could be viewed as being either capital or revenue. It was always intended that this would be done as a short-term measure and that the amount capitalised would reduce from 2003/2004 onwards. However the recent tight revenue support grant settlement means that this will no longer be possible although the medium term financial plan aims to de-capitalise from 2004/2005 onwards.

## Background

Our examination of capital expenditure as part of the 2001/2002 final accounts audit showed that the capitalisation of these 'grey' areas has now been extended to the limit of what is reasonably allowable for such items. The 2001/2002 accounts included fixed assets with a value of £838m and in the year £52m of new assets were added.

A considerable amount of expenditure, over £2,000,000, was capitalised at the end of the closure process and was all categorised as land and buildings. A brief review of the items capitalised showed that some of the expenditure could have been revenue and that some of the items were not land and buildings.

We also identified two items charged as assets, a £0.305m contribution to the GMPTA and a £0.060m contribution to risk management, which were clearly not fixed assets and agreed that the accounts would be amended to charge them to revenue instead.

As outlined above, because the Council's overall financial position is going to remain tight for the foreseeable future, the opportunities to de-capitalise as originally planned are going to be limited. We therefore agreed that we would carry out a more in-depth review of the 2001/2002 capitalisations early in 2003 so that we could give the Authority our initial view on any future proposals in this area.

## Audit approach

We obtained a breakdown of the fixed asset additions in 2001/02. We reviewed this list and from it selected for a more detailed examination the following items which appeared to be those most likely to fall outside the definition of capital :-

Description	Detail	Amount (£)
Capitalisation of Revenue	Highway Maintenance	527,408
	Property Maintenance	498,781
Structural Maintenance of Minor Roads		250,000
Contribution to Eccles Relief Road		250,000
		<b>1,526,189</b>

We then obtained prints from the main accounting system and copy invoices or job details to provide us with more information on the individual items included within the above expenditure.

In order to assess whether the items should be classified as revenue or capital we compared the details of the work carried out with the definition of capital contained in the CIPFA: Code of Practice on Local Authority Accounting in Great Britain: A Statement of Recommended Practice: Guidance Notes for Practitioners. An extract from the Code is given in Appendix 1.

Essentially this says that expenditure on a tangible asset, or expenditure which adds to, and not merely maintains, the value of an existing asset, should be classified as a fixed asset, provided that the fixed asset yields benefits to the authority and the services it provides for more than one year.

## Detailed findings

A summary of our findings is given in Appendix 2. This is supported by a more detailed analysis of Highways Maintenance in Appendix 3 and Property Maintenance in Appendix 4.

The appendices show that within the capitalised expenditure there are items that should more correctly be classified as revenue. This is because they relate to general maintenance rather than enhancements or additions to existing assets. The main examples of this type of expenditure are footpath resurfacing and the patching of carriageways.

Other areas such as those within property maintenance are less clear cut. However, when carrying out our analysis, we have only included as revenue those items that we feel are clearly revenue. If there is some doubt and the matter is open to interpretation we have classified the expenditure as capital for the purposes of our analysis.

On this basis we found that of the £1.526m of expenditure examined, £0.735m was clearly revenue, £0.715m appeared to be capital and for the remaining £0.076m we could not find sufficient information to classify it as either capital or revenue.

## Main conclusions and recommendations

As part of the 2001/2002 audit we agreed that the accounts would be amended for two items of capital expenditure (contribution to GMPTA £0.305m and contribution to risk management £0.060m) that should more correctly have been charged to revenue. Our subsequent, more detailed, review of the 2001/2002 capitalisations has shown that a further £0.748m of expenditure should have been classified as revenue.

We are not suggesting that the 2001/2002 accounts are reopened to correct this accounting treatment. However, in our view, it would be contrary to proper accounting practice to continue to capitalise this type of expenditure in the future. We therefore recommend that such capitalisations cease in 2002/2003 and future years.

We also recommend that when the Authority is determining which items of expenditure to capitalise in 2002/2003, care is taken to ensure that they meet the definition of capital contained in the CIPFA Code. In order to assist the Council in this exercise we would be pleased to review the proposed capitalisations as soon as they are known so that we may raise any concerns at an early stage. However we would stress the importance of building our review into the closure timetable so that we have sufficient time to carry out the exercise.

## Status of our reports to the Trust/Council

*Our reports are prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission. Reports are prepared by appointed auditors and addressed to non-Executive Directors/Members or officers. They are prepared for the sole use of the audited body, and no responsibility is taken by auditors to any Director/Member or officer in their individual capacity, or to any third party.*

## Extract from: CIPFA Code of Practice on Local Authority Accounting in Great Britain: A Statement of Recommended Practice: Guidance Notes for Practitioners

### Fixed Assets

- 3.15 All expenditure on the acquisition, creation or enhancement of fixed assets should be capitalised on an accruals basis. Expenditure on the acquisition of a tangible asset, or expenditure which adds to, and not merely maintains, the value of an existing asset, should be capitalised and be classified as a fixed asset, provided that the fixed asset yields benefits to the authority and the services it provides for a period of more than one year.
- 3.16 Expenditure that should be capitalised will include expenditure on the:
- acquisition, reclamation, enhancement or laying out of land
  - acquisition, construction, preparation, enhancement or replacement of roads, buildings and other structures
  - acquisition, installation or replacement of movable or immovable plant, machinery, apparatus, vehicles and vessels.
- 3.17 In this context, enhancement means the carrying out of works which are intended to:
- lengthen substantially the useful life of the asset
  - increase substantially the open market value of the asset
  - increase substantially the extent to which the asset can or will be used for the purposes of or in conjunction with the functions of the local authority concerned.
- 3.18 Under this definition, improvement works and structural repairs should be capitalised, whereas expenditure to ensure that the fixed asset maintains its previously assessed standard of performance should be recognised in the revenue account as it is incurred. Expenditure on existing fixed assets should be capitalised in three circumstances:
- enhancement – see paragraph 3.17 above
  - where a component of the fixed asset that has been treated separately for depreciation purposes and depreciated over its individual useful life, is replaced or restored
  - where the subsequent expenditure relates to a major inspection or overhaul of a fixed asset that restores the benefits of the asset that have been consumed by the authority and have already been reflected in depreciation.

## Summary of Findings

Detailed below is a summary of our findings on the capitalisation of assets during 2001/2002.

			Total	Possible capital	Revenue	Insufficient Information	Invoice Detail	Evidence	Further detail
			£	£	£	£			
	C00059	Capitalisation of revenue:							
A		Highway Maintenance	527,408	150,351	323,794	53,263	Various	Orders and works details.	See appendix 3
B		Property Maintenance	498,781	315,156	160,982	22,643	Various	Cost centre and largest invoice for each project.	See appendix 4
C	CD00614	Structural Maintenance of Minor Roads	250,000	0	250,000	0	To supply and machine application of rumumac 2000 fibre reinforced micro asphalt surfacing on a large number of roads.	2 example invoices for £52,340.06 and £70,613.00.	Appears to be for general maintenance and therefore not capital
D	D00906	Contribution to Eccles Relief Road	250,000	250,000	0	0	Salford's contribution to a major redevelopment project. Balance financed by capital grants.	Minutes, details of ERDF and land reclamation grants.	Capital spend
			1,526,189	715,507	734,776	75,906			

## Detailed Findings on Highway Maintenance

Ref	Order number	Summary Details	£	Invoice Information	Comments
A1	EA014539	Allotment Road Irlam	8,989	Install lights	Revenue as not substantial amounts involved.
A2	EA015951	Gore Crescent Footway Repair	13,316	Reconstruction of Footway	Revenue as repair unless improvement can be proved.
A3	EA013148	Portland Road Structural Repairs	26,961	Footway Refurbishment	Revenue as repair unless improvement can be proved.
A4	AE013750	Cambrai Crescent Footway repairs	15,171	Footway resurfacing	Revenue as repair unless improvement can be proved.
A5	EA013301	Bury Old Road Carriage Works	7,672	Repairs to various locations - Patching	Revenue as repair.
A6	EA015126	Fredrick Road Carriageway Works	13,858	Carriageway repair	Revenue as repair unless improvement can be proved.
A7	EA013149	Winchester Road Structural Work	17,074	Footway work replace corbett pots with new 90l pots	Revenue as repair unless improvement can be proved.
A8	EA015155	Worsley Brow Column erection	24,174	Install & Cable 10m columns & T sign on roundabout	Revenue as lot of small items.
A9	EA009018	Parrin Lane Structural works	36,496	Structural maintenance Footway & Carriageway	Revenue as repair unless improvement can be proved.
A10	EA013318	Littleton Road	6,037	Patching various locations	Revenue as repair unless improvement can be proved.
A11	EA014728	Upper Park Road footway repairs	5,963	Dig down & investigate cause of carriageway collapse	Revenue as investigation.
A12	EA013722	Salteye Lay-by Drainage Works	11,042	Drainage Repairs/Ironwork Replacement	Revenue as repair unless improvement can be proved.
A13	D4064	Clifton Country Park Access Road	5,017	No info	
A14	G0121	Enville Road Structural works	7,434	No info	
A15	F2051	Overlay Woursly course Parks	11,590	No info	

Ref	Order number	Summary Details	£	Invoice information	Comments
A16	EA014208	Belvedere Road Carriageway works	8,247	Patching per work sheet	Revenue as repair.
A17	EA015113	St Mary's Road Carriageway work	7,434	Carriageway repatching	Revenue as repair.
A18	EA017552	Brackley Street footway works	11,741	F/way RPR flags M/works	Revenue as repair.
A19	EA017555	Lewis Street Structural works	16,123	Replace existing speed hump	Revenue as unlikely to be improvement.
A20	EA017543	Victory Road Structural Works	19,708	Footway refurbishment	Revenue as repair unless improvement can be proved.
A21	EA013775	Westwood Estate Traffic Improvement Scheme	29,222	No info	
A22	EA016801	Moor Lane Traffic Improvement Scheme	6,446	Dig trial hole & find ducting in footway	Revenue as investigation.
A23	EA015952	Gare Avenue Footway works	14,660	Resurfacing	Revenue as repair unless improvement can be proved.
A24	EA015866	Chorley Road Structural Works	18,997	Resurfacing	Revenue as repair unless improvement can be proved.
A25	EA017230	Singleton Road Structural work	13,004	Construct a bidmac unit and install ACO drain	May be classed as improvements and therefore capital.
A26	EA015851	Langley Road Carriageway works	11,613	Provide and lay HRA as marked on site	Revenue as number of small patches therefore repairs.
A27	EA013773	Duchy Road Traffic Improvement	9,710	6'6"width restriction	Revenue as detail indicates large number of small items eg signs and resurfacing.
A28	EA014893	Manchester Road East Carriageway works	12,362	Provide and lay HRA, wearing course and yellow lines	Revenue as repatching schedule attached.



Ref	Order number	Summary details	£	Invoice information	Comments
A29		Southbank systems & Dell Products	102,607	Various computer equipment	Accept as capital.
A30		Miles Macadam refurbishment to lay-bys	34,740	Hardicrete treatment to lay-bys	May be classed as extending the life and therefore capital.
			527,408		
		<b>Possibly capital</b>	<b>150,351</b>		
		No information	53,263		
		Revenue	323,794		

## Detailed Findings on Property Maintenance

Ref	Order Number	Summary details	£	Invoice info	Comments
B1	E6568	Broughton Pool Refurbishment/programmed Repairs	131,868	Broughton pool P2	Full copy of tender provided. A review indicates major refurbishment. Accept as capital as improvements.
B2	E6571	Clarendon Pool Heating System/programmed repair	134,427	New Boiler	As it is a new boiler would assume £129,877 is correctly capitalised. Per Final a/c £129,877 boiler £4,550 utilities.
B3	F2054	Rabbit Hill changing rooms	51,142	Sap print describes as Building work Resp Rprs.	Specification indicated a large number of small jobs. As repairs unlikely to be capital.
B4	F2052	New football changing rooms	24,641	New football changing rooms	Capital as new.
B5	E6577	Cadishead rec major alterations	15,345	Bar Alterations	Invoice details work done which looks like a refit of the bar and kitchen. Possibly increases the value of the asset therefore probably capital.
B6	D3203	Civic Centre Roofing works & Programmed repairs	72,700	Penthouse Roof repairs and new doors	New doors amounting to £19,927 replacing existing doors to aid disabled access. Roof repairs not replacement. As no increase in life or value most likely revenue.
B7	D3210	Crompton House Major repairs	32,590	Contract states minor alteration work.	As minor unlikely to increase life or value of building therefore not capital.
B8	D3201	Civic Centre Tank replacement	13,425	Tank replacement	As new tank would assume capital.
B9	Turnpike	Turnpike major programmed repairs	22,643	No info provided except cost centre report	
			498,781		
		<b>Possibly Capital</b>	<b>315,156</b>		
		No information	22,643		
		Revenue or unsupported	160,982		