Grant Thornton

The Audit Findings for Birmingham City Council

Year ended 31 March 2020

November 2020

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The contents of this report relate only to those matters which came to our attention during the conduct of our normal audit procedures which are designed for the purpose of expressing our opinion on the financial statements. Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify control weaknesses, we will report these to you. In consequence, our work cannot be relied upon to disclose all defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

Headlines

This table summarises the key findings and other matters arising from the statutory audit of Birmingham City Council ('the Council') and the preparation of the group and Council's financial statements for the year ended 31 March 2020 for those charged with governance.

Covid-19	The outbreak of the Covid-19 coronavirus pandemic has had a significant impact on the normal operations of the group and Council. The Council have been significantly impacted by Covid-19, with front-line challenges, administration of significant volumes of grants to businesses, closure of schools and car parks, and the additional challenges of reopening services under new government guidelines. The impact on the core finance team has been more limited with minimal changes to staff sickness rates. While arrangements for remote working were already in place, the wholesale move to home working has been a significant change for staff. Authorities are still required to prepare financial statements in accordance with the relevant accounting standards and the Code of Audit Practice, albeit to an extended deadline for the preparation of the financial statements up to 31 August 2020 and the date for audited financials statements to 30 November 2020.	We updated our audit risk assessment to consider the impact of the pandemic on our audit and issued an Audit Plan Addendum on 24 April 2020. In that addendum we reported an additional financial statement risk in respect of Covid-19 and highlighted the impact on our VfM approach. Further detail is set out on page 6. Restrictions for non-essential travel have meant both Council and audit staff have had to work remotely throughout the audit visit, utilising screen-sharing software in order to gain sufficient assurance over the data being provided to the audit team. In addition, alternative procedures (such as the use of photographic evidence for physical verification of assets) have been used where necessary. We have been in regular communication with key members of the finance team throughout the period of the pandemic, in order to ensure that the audit process remained as smooth as possible in these new circumstances. The Council provided draft financial statements for audit on 28 August 2020, within the extended deadline and our audit work commenced in earnest from the beginning of September.
Financial Statements	Under International Standards of Audit (UK) (ISAs) and the National Audit Office (NAO) Code of Audit Practice ('the Code'), we are required to report whether, in our opinion, the group and Council's financial statements: • give a true and fair view of the financial position of the group and Council and the group and Council's income and expenditure for the year; and • have been properly prepared in accordance with the CIPFA/LASAAC code of practice on local authority accounting and prepared in accordance with the Local Audit and Accountability Act 2014. We are also required to report whether other information published together with the audited financial statements (including the Annual Governance Statement (AGS) and Narrative Report), is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.	Our audit work was completed remotely during July to November 2020. Our findings are summarised on pages 5 to 19. We have identified 3 adjustments to the financial statements that have resulted in a £20.8m adjustment to the Council's Comprehensive Income and Expenditure Statement. Audit adjustments are detailed in Appendix C. We have also raised recommendations for management as a result of our audit work in Appendix A. Our follow up of recommendations from the prior year's audit are detailed in Appendix B. Our work is substantially complete and there are no matters of which we are aware that would require modification of our audit opinion or material changes to the financial statements, subject to the outstanding matters detailed on page 6; We have concluded that the other information to be published with the financial statements is consistent with our knowledge of your organisation. Our anticipated financial statements audit opinion will be unqualified, but will include paragraphs highlighting the uncertainties that the Council has disclosed in Note 3 to the financial statements in relation to property valuations and the valuation of the property and infrastructure assets included within the net pension liability, as well as the uncertainties that the Council has disclosed in Note 34 in relation to the volume and timing of any future equal pay claims and the determination of any settlements.

Headlines

Value for Money arrangements	Under the National Audit Office (NAO) Code of Audit Practice ('the Code'), we are required to report if, in our opinion, the Council has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources ('the value for money (VFM) conclusion').	We have completed our risk based review of the Council's value for money arrangements. We have concluded that Birmingham City Council has proper arrangements to secure economy, efficiency and effectiveness in its use of resources, except for in relation to the specific weaknesses detailed in pages 20 to 38. We have updated our VfM risk assessment, and documented our understanding of your arrangements to ensure critical business continuity in the current environment. We have not identified any new VfM risks in relation to Covid-19. We therefore anticipate issuing a qualified 'except for' value for money conclusion.
Statutory duties	The Local Audit and Accountability Act 2014 ('the Act') also requires us to: • report to you if we have applied any of the additional powers and duties ascribed to us under the Act; and • To certify the closure of the audit.	We have not exercised any of our additional statutory powers or duties. We have completed the majority of work under the Code and expect to be able to certify the completion of the audit when we give our audit opinion, subject to the completion of the work required on the Council's Whole of Government Accounts return.

Acknowledgements

We would like to take this opportunity to record our appreciation for the assistance and timely collaboration provided by the finance team and other staff during these unprecedented times.

Audit approach

Overview of the scope of our audit

This Audit Findings Report presents the observations arising from the audit that are significant to the responsibility of those charged with governance to oversee the financial reporting process, as required by International Standard on Auditing (UK) 260 and the Code of Audit Practice ('the Code'). Its contents have been discussed with management ahead of presentation to the Audit Committee.

As auditor we are responsible for performing the audit, in accordance with International Standards on Auditing (UK) and the Code, which is directed towards forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities for the preparation of the financial statements.

Audit approach

Our audit approach was based on a thorough understanding of the group's business and is risk based, and in particular included:

- An evaluation of the group's and Council's internal controls environment, including its IT systems and controls.
- An evaluation of the components of the group based on a measure of materiality and considering each as a percentage of the group's gross revenue expenditure to assess the significance of the component. This assessment was then used to determine the planned audit response. From this evaluation we determined that specified audit procedures were required for the following balances:
  - Net Pension Liability and Operating Expenditure of Birmingham Children's Trust, with work performed by Crowe UK LLP, as component auditor; and
  - Material transactions and balances within group entities other than the Authority and Birmingham Children's Trust, with procedures completed by the audit team.

  For other non-significant components included in the group financial statements, which make up the remainder of the group's income, expenditure and net assets, analytical procedures were performed to gain assurances for our audit.
- Substantive testing on significant transactions and material account balances, including the procedures outlined in this report in relation to the key audit risks.

We have had to alter our audit plan, as communicated to you on 24 April 2020, to reflect our response to the Covid-19 pandemic. In this Addendum, we detailed additional significant risks in relation to Covid-19 for the financial statements.

Our approach to materiality

The concept of materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to the monetary misstatements but also to disclosure requirements and adherence to acceptable accounting practice and applicable law.

We have revised our materiality levels from those reported in our Audit Plan to reflect the decrease in the Council's and group's gross expenditure on the provision of services for the 2019/20 year in the published draft financial statements.

Thresholds per our Audit Plan	Group Amount	Council Amount
Materiality for the financial statements	£37,000k	£36,950k
Performance materiality	£25,900k	£25,865k
Trivial matters	£1,800k	£1,800k

Revised thresholds based on draft accounts	Group Amount	Council Amount
Materiality for the financial statements	£34,400k	£34,350k
Performance materiality	£24,080k	£24,045k
Trivial matters	£1,700k	£1,700k

Audit approach

Conclusion

We have substantially completed our audit of your financial statements and subject to outstanding queries being resolved, we anticipate issuing an unqualified audit opinion following the Audit Committee meeting on 25 November 2020.

These outstanding items include:

- finalisation of sample testing in relation to the following areas:
  - capital additions;
  - operating expenditure;
  - completeness of both income and expenditure;
  - debtors and creditors;
  - journals highlighted as unusual through our risk-based review process;
- completion of detailed testing in relation to property valuations;
- confirmation of the existence of a sample of property, plant and equipment assets;
- receipt of outstanding confirmations for the Council's investment and borrowing balances;
- finalisation of our work in relation to the Council's PFI disclosures;
- review of the Council's accounting treatment for guarantees;
- completion of work on material items within the group, and review of the group consolidation schedules;
- agreement of disclosure-only elements of the financial statements;
- receipt and review of the assurance report provided by the auditor of the West Midlands Pension Fund;
- completion of final quality reviews by senior members of the audit team;
- receipt of management representation letter; and
- review of the final set of financial statements.

Significant audit risks

Risks identified in our Audit Plan	Auditor commentary
Covid-19 The global outbreak of the Covid-19 virus pandemic has led to unprecedented uncertainty for all organisations, requiring urgent business continuity arrangements to be implemented. We expected current circumstances would have an impact on the production and audit of the financial statements for the year ended 31 March 2020, including and not limited to: • Remote working arrangements and redeployment of staff to critical front line duties may impact on the quality and timing of the production of the financial statements, and the evidence we can obtain through physical observation; • Volatility of financial and property markets will increase the uncertainty of assumptions applied by management to asset valuation and receivable recovery estimates, and the reliability of evidence we can obtain to corroborate management estimates; • Financial uncertainty will require management to reconsider financial forecasts supporting their going concern assessment and whether material uncertainties for a period of at least 12 months from the anticipated date of approval of the audited financial statements have arisen; and • Disclosures within the financial statements will require significant revision to reflect the unprecedented situation and its impact on the preparation of the financial statements as at 31 March 2020 in accordance with IAS1, particularly in relation to material uncertainties. We therefore identified the global outbreak of the Covid-19 virus as a significant risk, which was one of the most significant assessed risks of material misstatement.	We have: • worked with management to understand the implications the response to the Covid-19 pandemic has had on the organisation's ability to prepare the financial statements and update financial forecasts, and assessed the implications for our materiality calculations; • liaised with other audit suppliers, regulators and government departments to co-ordinate practical cross sector responses to issues as and when they arose; • evaluated the adequacy of the disclosures in the financial statements that arose in light of the Covid-19 pandemic; • evaluated whether sufficient audit evidence could be obtained through remote technology; • evaluated whether sufficient audit evidence could be obtained to corroborate significant management estimates such as asset valuations and pension fund liability valuations; and • evaluated management's assumptions that underpin the revised financial forecasts and the impact on management's going concern assessment. The Council's valuer has prepared many of their valuations as at 31 March 2020. In their report, they have confirmed that the Covid-19 pandemic has created an element of uncertainty in determining valuations of non-current assets. As market activity is being impacted in many sectors, less weight can be given to market evidence for comparison purposes to inform opinions of value. The valuers' reports are on the basis of 'material uncertainty' in line with the RICS Valuation – Global Standards, effective from 31 January 2020. This does not mean that the valuations cannot be relied upon, merely that there is less certainty, and therefore a higher degree of caution attached to the valuations, than would normally occur. The Council has reflected this uncertainty in Note 4 to the financial statements. The Council has also included disclosures in Note 4 in relation to their pensions assets. As a result of the impact of Covid-19 on the global financial markets, the valuation of the Pension Fund's investment properties are also reported on the basis of material valuation uncertainty. The Council's share of these assets is £358.2m. We will refer to these material valuation uncertainties in our audit report. During our testing of a sample of the Council's expenditure transactions, we have selected several items relating to the Council's use of purchase cards. Due to the pandemic, the Council have been unable to access the supporting documentation for these transactions, which is kept in their offices. We have determined that the total value of similar transactions during the 2019/20 year was £11.5m, and so we do not consider that this gives rise to a risk of material misstatement in the financial statements. For the purposes of our audit, we have included this balance as an unadjusted error in Appendix C, as the Council cannot provide evidence to support these transactions. Our work to address the points above is substantially complete, and we have not identified any other issues or concerns to report.

Significant audit risks

Risks identified in our Audit Plan	Auditor commentary
Improper revenue recognition Under ISA (UK) 240 there is a rebuttable presumed risk that revenue may be misstated due to the improper recognition of revenue. This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.	Having considered the risk factors set out in ISA240 and the nature of the revenue streams, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because: • There is little incentive to manipulate revenue recognition. • Opportunities to manipulate revenue recognition are very limited. • The culture and ethical frameworks of local authorities, including the Council and Fund, mean that all forms of fraud are seen as unacceptable. **Therefore we do not consider this to be a significant risk for Birmingham City Council.** We have however: • evaluated the Council's accounting policy for recognition of revenues for appropriateness; • performed substantive testing on material revenue streams; and • reviewed unusual significant transactions. Our audit work to date has not identified any issues in respect of improper revenue recognition, although we are currently in the process of finalising our detailed testing of sampled revenue transactions.
Management override of controls Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities. The Council faces external scrutiny of its spending and this could potentially place management under undue pressure in terms of how they report performance. We therefore identified management override of control, in particular journals, management estimates and transactions outside the course of business as a significant risk, which was one of the most significant assessed risks of material misstatement.	We have: • evaluated the design effectiveness of management controls over journals; • analysed the journals listing and determined the criteria for selecting high risk unusual journals; • tested unusual journals recorded during the year and after the draft accounts stage for appropriateness and corroboration; • gained an understanding of the accounting estimates and critical judgements applied and made by management and considered their reasonableness with regard to corroborative evidence; • evaluated the rationale for any changes in accounting policies, estimates or significant unusual transactions; and • reviewed and tested consolidation adjustments and intra-group elimination entries. At the time of writing this report, detailed testing of individual journals identified as being unusual is ongoing. Our audit work to date has not identified any issues in respect of management override of controls.

Significant audit risks

Risks identified in our Audit Plan	Auditor commentary
Valuation of land and buildings The Council revalues its land and buildings, including council housing, on a rolling five-yearly basis. This valuation represents a significant estimate by management in the financial statements due to the size of the numbers involved (£4.8 billion at 31 March 2019) and the sensitivity of this estimate to changes in key assumptions Additionally, where a rolling programme is used, management will need to ensure the carrying value in the Council and group financial statements is not materially different from the current value or the fair value (for surplus assets) at the financial statements date. We therefore identified valuation of land and buildings, particularly revaluations and impairments, as a significant risk, which was one of the most significant assessed risks of material misstatement, and a key audit matter.	We have: • evaluated management's processes and assumptions for the calculation of the estimate, the instructions issued to the valuation experts and the scope of their work; • evaluated the competence, capabilities and objectivity of the valuation experts; • written to the valuer to confirm the basis on which the valuations were carried out, and challenged the information and assumptions used by the valuer to assess completeness and consistency with our understanding; • engaged our own valuer to assess the instructions issued by the Council to their valuers, the scope of the Council's valuers' work, the Council's valuers' reports and the assumptions that underpin the valuations; • tested, on a sample basis, revaluations of the Council's operational properties and HRA properties during the year to ensure they have been input correctly into the Council's asset register and financial statements; • evaluated the assumptions made by management for any assets not revalued at 31 March 2020, including those in the HRA, and how management has satisfied themselves that the carrying value of these assets in the balance sheet is not materially different to their current value at year end. Our audit work is ongoing at the time of writing this report, but thus far we have identified errors in the valuation of the Council's property, plant and equipment, as follows: – An error within the Council's valuation process for HRA Dwellings led to a beacon property which had been correctly valued as a 3 bed maisonette being incorrectly incorporated into the workings as a 1 bed maisonette. Correcting this error confirmed that the HRA Dwellings valuation was overstated by £23.2m; – Tyseley Energy Recovery Facility, within other land and buildings, was understated by £2.4m due to a transcription error between the valuation report and the fixed asset register; We note that the financial statements contain a prior period adjustment. The Council disposed of two assets in 2017/18, but did not derecognise these in the accounts. This issue was identified by officers during the 2019/20 financial year, and processed retrospectively. In our view, as the transaction was not material, the disposal should have been transacted within the 2019/20 year, and not as a prior period adjustment. For further detail in respect of these issues, and the adjustments made to the financial statements, see Appendix C. The Council's valuer has confirmed in their report that the Covid-19 pandemic has created an element of uncertainty in determining valuations of non-current assets. As market activity is being impacted in many sectors, less weight can be given to market evidence for comparison purposes to inform opinions of value. The valuers' reports are on the basis of 'material uncertainty' in line with the RICS Valuation – Global Standards, effective from 31 January 2020. The Council have reflected this uncertainty in Note 4 to the financial statements, and we will refer to these material valuation uncertainties in our audit report.

Significant audit risks

Risks identified in our Audit Plan	Auditor commentary
Valuation of pension fund net liability The Council's pension fund net liability, as reflected in its balance sheet as the net defined benefit liability, represents a significant estimate in the financial statements and group accounts. The pension fund net liability is considered a significant estimate due to the size of the numbers involved (£2.6 billion in the Council's balance sheet at 31 March 2019) and the sensitivity of the estimate to changes in key assumptions. We therefore identified valuation of the Council's pension fund net liability as a significant risk, which was one of the most significant assessed risks of material misstatement, and a key audit matter.	We have: • updated our understanding of the processes and controls put in place by management to ensure that the Council's pension fund net liability is not materially misstated and evaluated the design of the associated controls; • evaluated the instructions issued by management to their management expert (an actuary) for this estimate and the scope of the actuary's work; • assessed the competence, capabilities and objectivity of the actuary who carried out the Council's pension fund valuation; • assessed the accuracy and completeness of the information provided to the actuary to estimate the liability; • tested the consistency of the pension fund asset and liability and disclosures in the notes to the core financial statements with the actuarial report from the actuary, including consideration of the experience loss recognised in-year following the triennial valuation at 31 March 2019; • undertaken procedures to confirm the reasonableness of the actuarial assumptions made by reviewing the report of the consulting actuary (as auditor's expert) and performing any additional procedures suggested within the report; and • obtained assurances from the auditor of the West Midlands Local Government Pension Fund as to the controls surrounding the validity and accuracy of membership data, contributions data and benefits data sent to the actuary by the pension fund, and the fund assets valuation in the pension fund financial statements. This assurance included the approach taken to the triennial valuation at 31 March 2019. During our work to assess the accuracy and completeness of the information provided to the actuary, we identified that the data initially submitted for April 2019 did not agree to payroll records. This was later corrected by the Council in a subsequent data submission to the actuary. During our work to confirm the consistency of disclosures in the notes to the actuarial report, it was identified that the pensions reserve note had omitted the unfunded teachers pension scheme benefits of £4.8m and contributions of £4.8m. This has no impact on the financial statements outside of this disclosure note. As a result of the impact of Covid-19 on the global financial markets, the valuation of the Pension Fund's investment properties are also reported on the basis of material valuation uncertainty. The Council's share of these assets is £358.2m. The Council have reflected this uncertainty in Note 4 to the financial statements. We will refer to this material valuation uncertainty in our audit report. Our audit work has not identified any other issues in respect of the valuation of the Council's pension fund net liability, however, at the time of writing this report, we have not yet received or considered the assurance report of the auditor of the West Midlands Pension Fund.

Significant audit risks

Risks identified in our Audit Plan	Auditor commentary
Valuation and completeness of equal pay liability Under ISA 540 (Auditing Accounting Estimates, including Fair Value Accounting Estimates and Related Disclosures) the auditor is required to make a judgement as to whether any accounting estimate with a high degree of estimation uncertainty gives rise to a significant risk. We identified the valuation and completeness of the Council's equal pay provision as a significant risk, which was one of the most significant assessed risks of material misstatement, and a key audit matter.	We have: • updated our understanding of the processes and controls put in place over the estimation of the equal pay liability, and evaluated the design of the controls in place; • evaluated the assumptions on which the estimate was based; • considered whether events or conditions exist that could have changed the basis of estimation; • on a sample basis, reperformed the calculation of the estimate; • assessed the accuracy and completeness of the information used to estimate the liability; • confirmed that the estimate has been determined and recognised in accordance with accounting standards; • determined how management have assessed the estimation uncertainty; and • considered the impact of any subsequent transactions or events. During our work we identified that the draft financial statements disclosed the net movement of the provision reversed unused of £7.0m and the additional provision made of £5.0m, rather than identifying these movements separately. This has been amended and has no impact on the provision value as at 31 March 2020. The Council has disclosed uncertainties in Note 33 in relation to the completeness of the equal pay provision. As in previous years, we will refer to this uncertainty in our audit report. Our audit work has not identified any other issues in respect of the valuation of the Council's equal pay liability.

Group audit

Risks identified in our Audit Plan	Auditor commentary
Along with full audit procedures on the Council's financial statements, we are required to complete specific procedures on transactions and balances within the financial statements of other bodies in the group, where those transactions and balances are material to the group's financial statements. We have not identified any significant risks in the group accounts that do not relate solely to the financial statements of the Council.	After preparation of the financial statements, the finance team identified that they had treated VAT amounts incorrectly within the intra-group adjustments in the consolidation process. The accounts have been amended for this, resulting in a reduction in group debtors and creditors of £3.8m, a reduction in group income and expenditure of £37.0m (the net impact of this was £nil), and a corresponding adjustment to the MIRS. For further detail see Appendix C. As set out in our audit plan, we have performed specified procedures on the following transactions and balances: • Expenditure and the Net Pension Liability of Birmingham Children's Trust CIC. We requested that specific audit procedures be completed by Crowe UK LLP, as component auditor. We have reviewed their findings and relevant audit documentation. No significant issues were noted. • Loan stock held by National Exhibition Centre (Developments) Plc. This work was completed by the audit team, with no issues noted. Upon receipt of the draft financial statements, we confirmed that audit procedures were not required on any specific balances in Acivico Limited's financial statements. For group entities other than Birmingham Children's Trust CIC and National Exhibition Centre (Developments) Plc, analytical procedures have been completed at a group level to give us the assurance required for our opinion on the group financial statements. Our work on the group accounts is ongoing, but we have not identified any other issues at the time of writing this report.

Significant findings – key estimates and judgements

Accounting area	Summary of management's policy	Auditor commentary	Assessment
Land and Buildings Council Housing Draft: £2,481.3m Final: £2,458.1m (TBC)	The Council owns 60,106 dwellings and is required to revalue these properties in accordance with DCLG's Stock Valuation for Resource Accounting guidance. The guidance requires the use of beacon methodology, in which a detailed valuation of representative property types is then applied to similar properties. The Council has engaged their internal valuer to complete the valuation of these properties, with all valuations being reviewed by Avison Young in order to ensure that the methodology used was reasonable. The year end valuation of Council Housing in the draft financial statements was £2,481.3m, a net increase of £36.3m from 2018/19 (£2,445.0m). Previously, the Council has instructed its valuer to provide valuations as at 1 April each year, and management have then considered the potential change over the course of the year to determine whether there has been a material change in the total value of these properties. For 2019/20, the Council changed this approach and instructed the valuer to provide valuations as at 10 January 2020, and has confirmed that these were materially accurate as at 31 March 2020. In line with RICS guidance, the Council's valuer has disclosed a material uncertainty in the valuation of the Council's land and buildings at 31 March 2020 as a result of Covid-19. The Council has included disclosures on this issue in Note 4.	• The assets have been valued on EUV-SH basis with a regional adjustment factor of 40%. This is in line with DCLG (now known as MHCLG) guidance. • The Council Dwellings have been grouped into archetypes which forms the basis of the beacon valuation method. The 28 Archetypes were determined by Savills. Two new Archetypes have been subsequently added in 2010/11 for the Birmingham Municipal Housing Trust (BMHT). • The Council has applied an archetype-specific adjustment to valuations in order to account for the number of bedrooms; • There have been no other changes to the valuation method this year. • We have considered the completeness and accuracy of the underlying information used to determine the estimate with no issues noted. • We have no concerns over the competence, capabilities and objectivity of the valuation expert used by the Council. Our consideration is supported by the use of an auditor's expert to review key documentation surrounding the valuation process. • We have considered the indices that the valuer has used in performing the valuation and have noted that the actual indices for February and March 2020 were significantly different to those assumed by the valuer in performing the valuation (extrapolated based on data from earlier in the year). Our work in this area is ongoing, we are actively engaging with the Council's valuer on these matters. • We are satisfied that the Council's judgement and estimation in relation to the valuation is adequate and is consistent with the requirements of the CIPFA Code and IAS 16. • Disclosure of the estimate in the financial statements is considered adequate. We will refer to the uncertainties disclosed in Note 4 in our audit report.	● (green) (TBC)

Assessment

- ● (red) We disagree with the estimation process or judgements that underpin the estimate and consider the estimate to be potentially materially misstated
- ● (amber) We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider optimistic
- ● (yellow) We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider cautious
- ● (green) We consider management's process is appropriate and key assumptions are neither optimistic or cautious

Significant findings – key estimates and judgements

Accounting area	Summary of management's policy	Auditor commentary	Assessment
Other Land and Buildings and Surplus Assets Draft: £2,482.3m Final: £2,484.7m (TBC)	Other land and buildings comprises £1,294.5m of specialised assets such as schools and libraries, which are required to be valued at depreciated replacement cost (DRC) at year end, reflecting the cost of a modern equivalent asset necessary to deliver the same service provision. The remainder of other land and buildings and surplus assets (£1,187.8m) are not specialised in nature and are required to be valued at existing use value (EUV) (or Fair Value for surplus assets) at year end. The Council has engaged its internal valuer to complete the valuation of properties as at 1 April on a five yearly cyclical basis. 25% of total assets (by value) were revalued during 2019/20. Management have considered the year end value of non-valued properties, and the potential change in assets valued prior to 31 March 2020. Where significant changes may be expected, specific valuations have been completed on these assets at 31 March 2020. Management's assessment identified no material change to the properties' values. The total year end valuation of other land and buildings and surplus assets in the draft financial statements was £2,482.3m, a net decrease of £46.9m from 2018/19 (£2,529.2m). In line with RICS guidance, the Council's valuer disclosed a material uncertainty in the valuation of the Council's land and buildings at 31 March 2020 as a result of Covid-19. The Council has included disclosure of this in Note 4.	• For those buildings valued on a DRC valuation basis, both those last formally valued in a previous financial year and those valued at 1 April 2019, are uplifted by the BCIS indices to reflect changes in build costs to 31 March 2020. The valuation uplift has been agreed to indices provided by the Royal Institution of Chartered Surveyors (RICS). • Other land and buildings are valued at 1 April 2019 and have been assessed to be not materially different to the current value at 31 March 2020. This has been reviewed in line with market data and we are satisfied this is reasonable. • We have considered the movements in the valuations of individual assets and their consistency with indices provided by Gerald Eve as our auditor's expert. At the time of writing this report, we are still discussing the appropriateness of the indices used by the Council's valuer with the valuer. • We have no concerns over the competence, capabilities and objectivity of the valuation expert used by the Council. Our consideration is supported by the use of an auditor's expert to review key documentation surrounding the valuation process. • There have been no changes to the valuation method this year. • We have considered the completeness and accuracy of the underlying information used to determine the estimate with no issues noted. • We are satisfied that the Council's judgement and estimation in relation to the valuation is adequate and is consistent with the requirements of the CIPFA Code and IAS 16. • Disclosure of the estimate in the financial statements is considered adequate. We will refer to the uncertainties disclosed in Note 4 in our audit report.	● (green) (TBC)

Assessment
- ● (red) We disagree with the estimation process or judgements that underpin the estimate and consider the estimate to be potentially materially misstated
- ● (amber) We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider optimistic
- ● (yellow) We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider cautious
- ● (green) We consider management's process is appropriate and key assumptions are neither optimistic or cautious

Significant findings – key estimates and judgements

Accounting area	Summary of management's policy	Audit Comments	Assessment
Net pension liability Draft: £2,591.3m Final: £2,591.3m	Given the significant value of the net pension fund liability, small changes in assumptions can result in significant valuation movements. There has been a £444.2m net actuarial gain during 2019/20. The Council's net pension liability at 31 March 2020 is £2,591.3m (PY £2,552.0m) comprising obligations under the West Midlands Pension Fund Local Government pension scheme. The Council uses Barnett Waddingham to provide actuarial valuations of the Council's assets and liabilities derived from these schemes. A full actuarial valuation is required every three years. The latest full actuarial valuation was completed in 2019. A roll forward approach is used in intervening periods, which utilises key assumptions such as life expectancy, discount rates, salary growth and investment returns. HM Treasury have undertaken a consultation following the legal ruling around age discrimination (McCloud) in the previous year. This consultation ran to 11 October 2020, and provides an indication of possible remedy. The Council have not amended their financial statements for the impact of this remedy, as a number of uncertainties remain. During the audit, the Council has added disclosures in Note 4 that as a result of the impact of Covid-19 on the global financial markets, the valuation of the Pension Fund's investment properties are reported on the basis of material valuation uncertainty. The Council's share of these assets is £358.2m.	• We have no concerns over the competence, capabilities and objectivity of the actuary used by the Council. • We have used the work of PwC, as auditor's expert, to assess the actuary and assumptions made by the actuary. See below for consideration of key assumptions in the West Midlands Pension Fund valuation:	(green)

Assumption	Actuary Value	PwC expected range	Assessment
Discount rate	2.35%	2.35%	●
Pension increase rate	1.90%	1.85% - 1.95%	●
Salary growth	2.90%	2.85% –2.95% scheme-specific	●
Life expectancy – Males currently aged 45 and 65	45: 23.8 65: 21.9	22.8 – 24.7 21.4 – 23.3	●
Life expectancy – Females currently aged 45 and 65	45: 26.0 65: 24.1	25.2 – 26.2 23.7 – 24.7	●

- No issues were noted with the completeness and accuracy of the underlying information used to determine the estimate. The issue that we identified during our early testing was rectified.
- There have been no changes to the valuation method since the previous year, other than the updating of key assumptions above.
- We have confirmed that the Council's share of the pension scheme assets is in line with expectations.
- We have considered the Council's treatment of the proposed McCloud remedy, and have no concerns to report.
- The Council's disclosure of the estimate in the financial statements is considered adequate. We will refer to the uncertainty disclosed in Note 4 in our audit report.

Assessment
- ● We disagree with the estimation process or judgements that underpin the estimate and consider the estimate to be potentially materially misstated
- ● We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider optimistic
- ● We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider cautious
- ● We consider management's process is appropriate and key assumptions are neither optimistic or cautious

Significant findings – key estimates and judgements

Accounting area	Summary of management's policy	Auditor commentary	Assessment
Equal Pay Provision Draft: £153.2m Final: £153.2m	Note 33 (Provisions) includes a £153.2m provision for the payment of Equal Pay claims. The Council has based its estimate on: • the number of claims received; • historical information on settlement of similar claims; and • the current negotiations of claimants' representatives.	We have challenged the Council on the judgement made to classify this liability as a provision, to ensure it met the definition under the accounting standards. We are satisfied that the Council has provided sufficient evidence to conclude this has been correctly recognised. We are satisfied that the Council's judgement and estimation in relation to Equal Pay is adequate and is consistent w ith the requirements of the CIPFA Code and IAS 37. Whilst the provision reflects the forecast impact of claims made to date, there remain a number of uncertainties regarding any additional liabilities that the Authority may face. There are uncertainties surrounding the volume and timing of any future claims and the determination of any settlements. We consider that this is appropriately disclosed in Note 34 – Contingent Liabilities and Contingent Assets. We w ill refer to this disclosure in our audit report. We have concluded that there is no other risk of material misstatement in relation to the Equal Pay provision.	(green)

Assessment

- We disagree with the estimation process or judgements that underpin the estimate and consider the estimate to be potentially materially misstated
- We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider optimistic
- We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider cautious
- We consider management's process is appropriate and key assumptions are neither optimistic or cautious

Significant findings – going concern

Our responsibility

As auditors, we are required to "obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern" (ISA (UK) 570).

Going concern material uncertainty disclosures

It has been a challenging year due to the Covid-19 pandemic, with the Council encountering front-line challenges, administration of significant volumes of grants to businesses, closure of schools and car parks, and the additional challenges of reopening services under new government guidelines.

The Council is facing significant challenges, although it has reported an underspend for the 2019/20 year. Management have undertaken an analysis of the potential financial implications of Covid-19 together with additional funding being provided. The Council's forecasting contains indicative provisional funding gaps in the coming years and may therefore require further use of its financial reserves to pay its expenses. Given the sensitive nature of these disclosures, we have identified this as an area of focus in our audit.

Going concern commentary	Auditor commentary
Management's assessment process	Management have undertaken their own assessment of going concern, taking into account Paragraph 2.1.2.9 of the Code of Practice on Local Authority Accounting, which states that "*An authority's financial statements shall be prepared on a going concern basis; that is, the accounts should be prepared on the assumption that the functions of the authority will continue in operational existence forthe foreseeable future*". We have discussed the assessment with finance staff, and have been provided with the following to support the assessment: • Cash flow forecasts covering a period of 10 years from the end of 2019/20; • The Council's refreshed Medium Term Financial Plan, as at November 2020, which was a new development this year; • Detailed assessments of the financial viability of other significant entities in the group; and • Narrative commentary regarding the impact of Covid-19 on the Council and its operations. We will review the documentation referred to above, but we are satisfied that the Council's approach is reasonable.
Work performed	We are in the process of reviewing the Council's financial assessment of the impact of Covid-19, future financial plans and cash flow forecasts, and the Council's level of reserves. We have not identified any material uncertainties in relation to going concern at the time of writing this report.
Concluding comments	We expect to be able to conclude that we are satisfied that the Council's financial statements are appropriately prepared on a going concern basis, and that no further disclosure is required.

Other matters for communication

We set out below details of other matters which we, as auditors, are required by auditing standards and the Code to communicate to those charged with governance.

Issue	Auditor commentary
Matters in relation to fraud	We have previously discussed the risk of fraud with the Audit Committee. We have not been made aware of any incidents in the period and no issues have been identified during the course of our audit procedures.
Matters in relation to related parties	We are not aware of any related parties or related party transactions which required disclosure in the financial statements but have not been disclosed.
Matters in relation to laws and regulations	You have not made us aware of any significant incidences of non-compliance with relevant laws and regulations and we have not identified any incidences from our audit work.
Written representations	A letter of representation has been requested from the Council, including specific representations in respect of the group. Specific representations have been requested from management in respect of the significant assumptions used to make accounting estimates.
Confirmation requests from third parties	We requested from management permission to send confirmation requests to each of the Council's counterparties. This permission was granted and the requests were sent. The majority of these requests were returned with positive confirmation, however some of these requests have not yet been received. We will work to gain the assurances that we required, and may undertake alternative procedures.
Disclosures	Our review found no material omissions in the financial statements.
Audit evidence and explanations/significant difficulties	All information and explanations requested from management was provided.

Other responsibilities under the Code

Issue	Commentary
Other information	We are required to give an opinion on whether the other information published together with the audited financial statements (including the Annual Governance Statement and Narrative Report), is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. No inconsistencies have been identified. We plan to issue an unmodified opinion in this respect.
Matters on which we report by exception	We are required to report on a number of matters by exception in a numbers of areas: • If the Annual Governance Statement does not meet the disclosure requirements set out in the CIPFA/SOLACE guidance or is misleading or inconsistent with the other information of which we are aware from our audit • If we have applied any of our statutory powers or duties We have nothing to report on these matters.
Specified procedures for Whole of Government Accounts	We are required to carry out specified procedures (on behalf of the NAO) on the Whole of Government Accounts (WGA) consolidation pack under WGA group audit instructions. As the Council exceeds the specified group reporting threshold of £500m, we examine and report on the consistency of the WGA consolidation pack with the Council's audited financial statements. This work is not yet completed at the time of drafting this report, but we plan to finalise this prior to issuing our audit opinion.
Certification of the closure of the audit	We intend to certify the closure of the 2019/20 audit of Birmingham City Council in the audit report, subject to the completion of the work required on the Council's Whole of Government Accounts return.

Value for Money

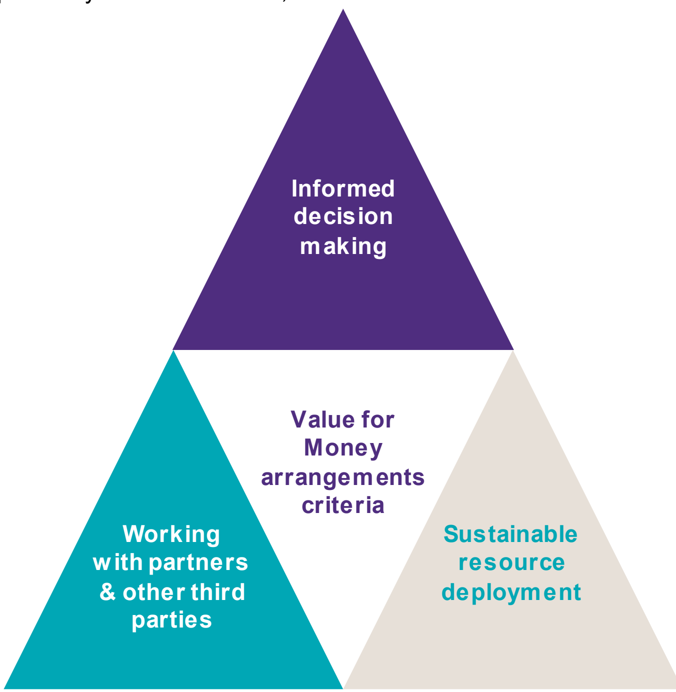
Background to our VFM approach

We are required to satisfy ourselves that the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. This is known as the Value for Money (VFM) conclusion.

We are required to carry out sufficient work to satisfy ourselves that proper arrangements are in place at the Council. In carrying out this work, we are required to follow the NAO's Auditor Guidance Note 3 (AGN 03) issued in April 2020. AGN 03 identifies one single criterion for auditors to evaluate:

"In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people."

This is supported by three sub-criteria, as set out below:



Risk assessment

We carried out an initial risk assessment in February and March 2020 and identified a number of significant risks in respect of specific areas of proper arrangements using the guidance contained in AGN03. We communicated these risks to you in our Audit Plan dated March 2020.

We have continued our review of relevant documents up to the date of giving our report, and have not identified any further significant risks where we need to perform further work.

We carried out further work only in respect of the significant risks we identified from our initial and ongoing risk assessment. Where our consideration of the significant risks determined that arrangements were not operating effectively, we have used the examples of proper arrangements from AGN 03 to explain the gaps in proper arrangements that we have reported in our VFM conclusion.

Value for Money

Our work

AGN 03 requires us to disclose our views on significant qualitative aspects of the Council's arrangements for delivering economy, efficiency and effectiveness.

We have focused our work on the significant risks that we identified in the Council's arrangements.

We have set out more detail on the risks we identified, the results of the work we performed, and the conclusions we drew from this work on pages 22 to 38.

Recommendations for improvement

We discussed findings arising from our work with management and have agreed recommendations for improvement.

Our recommendations and management's response to these can be found in the Action Plan at Appendix A.

Significant difficulties in undertaking our work

We did not identify any significant difficulties in undertaking our work on your arrangements which we wish to draw to your attention.

Significant matters discussed with management

There were no matters where no other evidence was available or matters of such significance to our conclusion or that we required written representation from management or those charged with governance.

Overall conclusion

Based on the work we performed to address the significant risks, we have identified the following matters:

- During 2019/20 the Council has identified cost pressures of over £90m with regard to the Perry Barr Regeneration Scheme which had an original planned capital expenditure cost of £492.6m in June 2019. We have concluded that the projected cost overruns (more than 20% higher than the original planned cost) reported to Cabinet in March 2020, only nine months after the original FBC was approved, are demonstrative of inadequate financial planning in the development of the original FBC for the PBRS, which had been put together over a relatively short time period.

  In accordance with the definitions with the NAO's Code of Audit Practice, we have concluded that these matters are evidence of weaknesses in proper arrangements for understanding and using appropriate and reliable financial and performance information to support informed decision making and performance management.

- During 2019/20 the Council has been working with Birmingham Highways Limited to progress the retendering of BHL's subcontract for service delivery relating to the Council's Highways PFI agreement. At the end of the financial year it was confirmed that the affordability gap in the contract was significantly more than had initially been thought. During 2019/20, and until the scale of the affordability gap was confirmed, the Council was making significant decisions regarding this issue knowing that the extent of the full financial challenge facing BHL was uncertain.

  In accordance with the definitions with the NAO's Code of Audit Practice, we have concluded that these matters are evidence of weaknesses in proper arrangements for understanding and using appropriate and reliable financial and performance information to support informed decision making and performance management.

We are satisfied that, except for the matters we identified above, the Council had proper arrangements for securing economy, efficiency and effectiveness in its use of resources. We therefore propose to give a qualified 'except for' conclusion.

Value for Money

Key findings

We set out below our key findings against the significant risks we identified through our initial risk assessment and further risks identified through our ongoing review of documents.

Significant risk	Work performed & Findings
Council resilience and financial sustainability	
At the time we completed our planning we considered that there was a risk that the proposed 2019/20 savings plans would not deliver the required recurrent savings, or would take longer to implement than planned. In addition, the Council's medium term financial plan for 2020-21 to 2023-24 needed to incorporate realistic and detailed savings plans, while at the same time maintaining an adequate level of reserves to mitigate the impact of risks including the PFI contract, Commonwealth Games, Equal Pay and Paradise Circus. Following years of budget restrictions and limited investment, many of the Council's operational assets are in poor condition. The Council's strategy to address this is key, and should link in to its capital plan. We also note that the Council has undergone a significant level of change in senior leadership positions in recent years. There is a risk that the governance arrangements in place have not kept up with the changes in management structure, and are no longer suitable.	<u>Work performed by the Council to address recommendations from previous years:</u> We have reviewed the Council's progress in addressing the weaknesses that were the subject of our Statutory Recommendation in March 2019. This included three elements which were as follows: • continue to reduce the likelihood of non-delivery of savings plans for 2019/20 and beyond through the delivery of clear plans and robust programme management arrangements. • broaden transformational work across the Council's financial plan for 2019/20 to 2022/23, to help deliver savings at scale to address the impact of the combined savings and budget pressure risks. • keep under close review the potential impact of one-off budget risks, such as the Commonwealth Games, Equal Pay and Amey, by: – continuing to strengthen its level of reserves; and – completing the development of contingency plans to minimise the effects of these risks should they crystalise. The third point above is considered through our work on other specific VFM risks, detailed in the following pages. We have reviewed the Council's progress in addressing the first two parts of the recommendation during the 2019/20 year, as part of our work on the Council's in-year financial monitoring, and forward planning arrangements, detailed on the following pages. In addition, we have considered the work that the Council has completed to address the findings of the financial management review that was completed by CIPFA during the latter part of the 2018/19 year. This review graded the Council's financial management arrangements as 1.9 out of 5 stars, where 2 stars equates to an organisation with "basic financial management capability" providing "functional capability in the short term, a minimum level of support in the delivery organisational outcomes but does not support organisational transformational change". Level 2 equates to our expectation of 'adequacy' under the Code. Following receipt of the draft CIPFA Financial Management Capability Review report in March 2019, the Council began a Finance Improvement Programme (FIP) in June 2019, tasked with addressing the Review findings and improving the Council's financial management capability. The Council's view is that significant progress was made during the 2019/20 financial year, with revised processes implemented in several key areas. Work on the remaining FIP measures is ongoing with further improvements planned for implementation in the next few months. In addition, the FIP is closely aligned with the Council's ERP Programme, in order to ensure that the issues identified are reflected in the design and implementation of the new ERP system. This view is supported by that of the Non-Executive Advisor for Financial Resilience, who stated in July 2020 "The Council is successfully delivering the Financial Improvement Plan with a dedicated team to support the implementation of the plan following the one-star rating from the CIPFA review, with a number of the improvements now transferred to Business as Usual"

Value for Money

Significant risk	Work performed & Findings
Council resilience and financial sustainability (continued…)	In-year financial monitoring reports and year-end outturn report: The Council set a net budget of £851.6m for 2019/20 at its meeting on 26 February 2019. This net budget was after assuming savings of £58.3m, which included approving a savings programme of £46.2m and required a further £12.1m savings to be delivered that were previously achieved on a one-off basis in 2018/19. The GF revenue outturn position for 2019/20 showed an underspend of £11.5m, however this included overspends in Neighbourhoods (£19.3m) and Education & Skills (£8.6m), with undelivered savings totalling £17.9m. These overspends were offset by areas of underspend and one-off cost mitigations. The outturn position also included a correction leading to the release of £12.8m from Earmarked Reserves. The Council is aware of Neighbourhoods and Education & Skills as two areas of recurrent overspend, and work is ongoing in the current financial year, and was incorporated into the 2020/21 financial plan, to address this. We have reviewed the Council's savings plans and savings trackers, and have not identified any other areas of concern or any pervasive issues that would indicate wider financial monitoring and management issues during the 2019/20 financial year. 2020/21 budget and 2020-24 Plan: The 2020-24 Financial Plan and 2020/21 budget was approved by Council on 25th Feb 2020, prior to the UK government's actions in response to the Covid-19 pandemic. This approved budget was for net expenditure of £853m for 2020/21 inclusive of a savings requirement of £22m. The Non-Executive Advisor for Financial Resilience stated in July 2020 "The budget process itself has been strengthened with challenge on new and existing savings through Star Chambers. These require services to provide detailed savings implementation plans and remove undeliverable savings as well as the corresponding contingency." The budget for the 2020/21 year has considered the issues and known cost drivers within the Neighbourhoods directorate that resulted in the overspend in 2019/20, and has looked to resolve these by incorporating additional funding into the budget, increasing the planned spend for the 2020/21 year by £23.3m. Within the Education & Skills directorate, Birmingham Children's Trust continues to be a key driver of costs due to a significant increase in the number of children in care requiring support from the Trust (nearly a 7% increase between April 2018 and March 2020), however early reporting (Q2 2020/21) indicates that any areas of potential overspend are being actively managed and mitigated. The impact of Covid-19: Management consider that the Council has been pro-active in assessing and mitigating the impact of Covid-19, a view that was supported by the Non-Executive Advisor for Financial Resilience in July 2020, who said "In the immediate period comprehensive weekly reporting of the financial position with regard to the COVID19 Incident has been in progress from the start of the incident. These include expenditure, loss of income, impact on delivery of savings as well as fully costed financial risks with probability factors attached to these risks."

Value for Money

Conclusion

We have reviewed the Council's progress in addressing the weaknesses that were the subject of our Statutory Recommendation in March 2019, and the weaknesses identified by CIPFA in their Financial Management Capability Review, the draft report for which was issued in March 2019.

We have considered the progress made by the Finance Improvement Programme, and are satisfied that progress has been made during the 2019/20 year, and continues to be made beyond the end of the financial year.

We have considered the Council's outturn against its budget for the 2019/20 year, and the actions taken to address key areas of overspend and under-delivery of savings, as well as the impact of these findings on the Council's forward planning.

We have considered how the Council began responding to the impact of Covid-19 at the beginning of the pandemic, and have gained assurance that work in this area commenced as early as was reasonably possible.

We are satisfied that the Council has made sufficient progress in addressing the weaknesses relating to financial management that were the subject of both our Statutory Recommendation and CIPFA's Financial Management Capability Review in March 2019 to mitigate the risk in 2019/20.

Developments in 2020/21

We will consider the below, and subsequent developments, as part of our VFM work during the 2020/21 financial year. These developments do not form part of our conclusion for the 2019/20 year.

Work on the Finance Improvement Programme is ongoing. Elements of this, in particular those relating to the finance workforce, are being addressed through the implementation of the new Finance Target Operating Model. A delivery partner, KPMG, has recently been appointed to increase capacity to accelerate this work, with the aim of delivering all of the products within the FIP in the early part of 2021. This in turn will allow the Council to commission a further Financial Management Capability reassessment with confidence.

The Council is aware of Neighbourhoods and Education & Skills as two areas of recurrent overspend, which are being addressed as follows:

- Neighbourhoods – CIPFA have been commissioned to complete a review of the directorate's finances, in order to assess where the issues lie, and to enable better financial planning, monitoring and management in future years. The outcome of this review is expected shortly.
- Education & Skills – Overspends in 2019/20 predominantly related to Birmingham Children's Trust, due to its services being demand-led. The Council are looking to strengthen contract management arrangements in this area going forwards, to enable a greater understanding of the financial challenges being faced.

The Council refreshed its medium term financial plan, in light of the pandemic and we understand that this introduction of a mid-year MTFS update will now become an ongoing arrangement at the Council, to provide a valuable control to the Council's financial management and planning functions. The 2020 refresh was reported to Cabinet in November 2020, and identified funding gaps (after emergency government funding) of approximately £100m per year from 2021/22 onwards. The initial assessment of the funding gap in the 2020/21 year was £10.8m, and actions have already been identified to close this gap.

We recommend that the Council continue to plan for future years and proactively identify and mitigate cost pressures and financial risks as they arise.

Value for Money

Significant risk	Work performed & Findings
Financial impact of the Commonwealth Games	
In our 2018/19 VFM work, we identified the VFM risk that the cost of hosting the Commonwealth Games (the Games) could impact on the Council's future financial sustainability. At the time of giving our VFM conclusion in September 2019, we noted that the Council had strengthened its governance arrangements relating to the delivery of the Games over the previous 12 months, and had clarified the governance framework under which partner bodies would report and work. Work to identify sources of funding for the Council's share of the costs was ongoing at the time we completed our initial risk assessment. We therefore still considered this to be a significant risk for the purposes of our VFM work in 2019/20.	<u>Governance structure and supporting arrangements:</u> We have reviewed the Council's latest governance arrangements for the delivery of the XXII Commonwealth Games in 2022 and the associated funding arrangements, to establish how the Council is identifying, managing and monitoring the related risks. The Council issued the 2022 Commonwealth Games Cross Partner Governance Framework in February 2019. The framework sets out the reporting lines for the various Boards, Groups and indicative cross partner working groups. These include: the Commonwealth Games Strategic Board (CGSB); the Commonwealth Games Chief Executives Group (CGCEG), which reports to the CGSB; the Security Board, which reports to the CGSB; and the Finance Group, the Budget Oversight Group and the Cross Partner Programme Group (CPPG), which all report to the CGCEG. The 10 indicative cross partner working groups then report to the CPPG, or the CGCEG in the case of escalated issue resolution and setting of operational/tactical direction. We consider that this framework provides the Council with robust governance arrangements for the Games. The Games Project Director left the role in December 2019 and was replaced by an interim Games Project Director from January 2020 until May 2020 when a permanent replacement took over. In addition, we note that there have been two high profile departures from the CGSB since the year end, but neither of these individuals were executive decision makers. None of these changes have had an adverse impact on the adequacy of the overall governance arrangements during the year. The Council has continued to further develop its governance arrangements to support the delivery of the Games. This includes a greater focus on internal accountability and ownership across the whole of the Council's Executive team, driven by the terms of reference and Programme Board to ensure a collective sense of prioritisation and greater cohesion across the Council regarding the Games. Further evidence of the importance placed by Central Government on ensuring effective governance arrangements are in place is that the Secretary of State for the Department for Digital, Culture, Media and Sport (DCMS) is now a member of the CGSB. The Chief Executive of the Commonwealth Games Federation is also a member of the CGSB. <u>The funding arrangements for the Games:</u> Substantial work has been undertaken by the Council to secure the required partner contributions of £75.0m, with £50.0m secured to date including £25.0m from West Midlands Combined Authority (agreed at WMCA Board in November 2019) and £20.0m from Greater Birmingham and Solihull LEP (agreed by service-level agreement in April 2020). This funding is attached to the redevelopment of the Alexander Stadium. £5.0m of Community Infrastructure Levy was agreed in February 2020 for use on a suitable Games project, with Public Realm being the natural fit. The Council is continuing to work with various potential games partners to ensure that the remaining £25.0m of required partner contributions is secured. This includes ongoing discussions with the following: Coventry & Warwickshire LEP, Black Country LEP, Midlands Engine, local Universities and the NEC.

Value for Money

Significant risk	Work performed & Findings
Financial impact of the Commonwealth Games (continued…)	The Council's remaining share of £109.4m, which is built in to its Medium Term Financial Plan, is split: • £39.0m revenue funding, the majority of which (£36.8m) is due in 2022/23 • £70.4m capital funding, of which £13.0m (of existing capital resources) had been incurred by the end of 2019/20 and a further £29.2m is due to be incurred in 2020/21. This is split £22.6m corporately funded prudential borrowing and £6.6m existing capital resources. <u>Identifying, managing and monitoring risks relating to the financial impact of the Games:</u> Our work in this area has focussed upon the proposed Athletes Village for the Games, which was included in the Perry Barr Regeneration Scheme (PBRS). The Outline Business Case (OBC) was approved by Cabinet on 26 June 2018 and the Full Business Case (FBC) was approved through delegated authority by the Cabinet Member for Finance and Resources and Chief Officer on 6 June 2019. This FBC included the provision of 6,500 bed spaces for athletes and officials required by the Birmingham Organising Committee for the 2022 Commonwealth Games Limited (OC). The total of the capital expenditure programme for the PBRS was £492.6m and included the delivery of 1,415 residential units post-Games. In October 2019, the Financial Monitoring Report 2019/20 Quarter 2 flagged to Cabinet an unquantified potential risk of material cost increases to the PBRS. In December 2019, an Emergency Cabinet Report flagged a substantial increase in costs associated with the relocation of the National Express Bus Depot, and that the detailed prices for the construction of individual plots within the PBRS were higher than originally budgeted in the FBC. In February 2020, the Financial Monitoring Report 2019/20 Quarter 3 again highlighted to Cabinet the still unquantified risk of material costs pressures to the PBRS. An update on the PBRS FBC, including a revised FBC, was reported to Cabinet in March 2020 and the revised FBC was approved. Substantial progress had been made with the delivery of the PBRS, with more than 90% of the land required for either accommodation or wider infrastructure improvements under Council control. Contracts were also in place for the construction of 72% of the 6,500 bed spaces. However, cost pressures had emerged as a result of the overheated local market, through construction cost price inflation, the demand for construction workers in the Perry Barr area, and the fixed delivery date. To mitigate this, design changes had been made that would ensure that the scheme would deliver 97% of the bed spaces and the OC had stated that it should be possible to manage this small shortfall in beds through effective scheduling of sporting activities. The funding pressures before mitigation totalled £91.8m which included the increased cost of relocating the National Express bus depot (£15.7m), increased housing costs (£48.4m), increased contingency (£19.7m in addition to the £10.3m in the original FBC) and other minor variations (£8m). This was offset by removing £25m of the preparation for legacy retrofit and demolition / remediation costs from the scope of the PBRS core proposals, and funding this element post-Games from enhanced disposal proceeds. Further mitigation, and the redirection of other Council budgets, totalling £46.8m including de-scoping of plot 11 (£7.0m), funding National Express bus depot overspend from capital contingency (£15.7m), non-funded BCC items (£7.0m), use of contingency (£15.0m) and the consequential reduction in borrowing costs (£2.1m) resulted in a residual gap of £20.0m. The residual funding gap of £20.0m is planned to be covered by windfall capital receipts.

Value for Money

Significant risk	Work performed & Findings
Financial impact of the Commonwealth Games (continued…)	We note that the Council had a significantly shorter time period between the award of the Games to Birmingham and the date of the Games than would normally be the case for the lead time to deliver a project of this size. This resulted in the requirement to put approvals in place to be able to commence the developments for the PBRS, which is why an FBC was approved in June 2019. The revised FBC approved by the Cabinet in March 2020 included fully costed projections for the PBRS and had been subjected to considerable external stakeholder engagement and scrutiny during its development, including the Ministry of Housing, Communities and Local Government (MHCLG) and the DCMS. It also included plans for a reduction of one dwelling from 1,415 to 1,414 residential units post-Games. However, there have been some amendments to the planned development timetable which means that some of the residential units will now be developed later than originally planned. We are informed that currently 1,026 (of 1,414) residential and 4 (of 9) commercial units are planned to be completed to the Council's original timetable, with the remaining units being completed post-Games.

Conclusion

We have reviewed the Council's governance structure and arrangements in place to support the delivery of the Games to assess whether they are adequate. Despite some challenges during the last twelve months the Council has continued to develop its governance arrangements.

We are satisfied that the Council has put in place appropriate governance arrangements to oversee the delivery of the Games.

We have assessed the Council's progress to secure funding from games partners in order to mitigate the financial impact of the Games. The Council has been unable to confirm £25.0m of the total required partner funding of £75.0m. Whilst there is still some way to go to close the partner funding gap, the magnitude of the gap, the length of time available to achieve this and the availability of potential contingencies means we are not concerned at this stage that it will not be achieved. We will, however, continue to keep the matter under review in our subsequent audits, as the Games approach.

We are satisfied that the Council has secured sufficient funding from games partners in order to mitigate the financial impact of the Games.

During our initial risk assessment, we identified that the identification, management and monitoring of the costs of hosting the Games were a risk to the Council's arrangements for securing value for money. The FBC for the PBRS was approved in June 2019 setting out planned capital expenditure of £492.6m, with this FBC having been put together over a relatively short period (based on income and expenditure estimates from professional advisors) to reflect the limited time available to deliver the accommodation in time for the Games. Following the approval of the FBC, commercial negotiation in relation to both construction costs and land values resulted in the emergence of substantial cost pressures (of more than 20% of the original planned costs) that exceeded the level of contingency included within the FBC, resulting in the requirement for a revised FBC to be reported to Cabinet only nine months later, in March 2020. We have concluded that this is demonstrative of inadequate financial planning in the development of the original FBC for the PBRS and, as a result, we are not satisfied that the Council has fully mitigated this risk during 2019/20.

In accordance with the NAO's VFM sub-criteria, we have concluded that these matters are evidence of weaknesses in proper arrangements for "understanding and using appropriate and reliable financial and performance information to support informed decision making and performance management" (IDM2).

We plan to qualify our Value for Money Conclusion in this regard.

Value for Money

Developments in 2020/21 (continued...)

We will consider the below, and subsequent developments, as part of our VFM work during the 2020/21 financial year. These developments do not form part of our conclusion for the 2019/20 year.

The impact of Covid-19 on the PBRS resulted in significant delays to development and meant that only c.2,700 bed spaces could be guaranteed in time for the Games. The OC approached local universities about their ability to provide the required bed spaces for the Games and in August 2020 the OC confirmed that this would be the approach taken. This decision was taken by the OC and supported by Central Government. We recognise the constructive engagement of all parties in securing this solution to the accommodation issue.

The Council inform us that progress with the PBRS has been regularly reported during 2020/21. We are told that the latest reporting framework include a project board with cross-partner representation including MHCLG, DCMS, Homes England and the Council. This meeting is held monthly and reporting includes financial and non-financial information.

The Council is still delivering the PBRS and is currently following the revised FBC agreed in March 2020, but as there are no longer plans to construct an Athletes Village this will not form part of the Games programme. An amended FBC is a work in progress and is planned to be submitted to Cabinet for approval in early 2021. A PBRS update report was presented to the Commonwealth Games, Culture and Physical Activity Overview and Scrutiny Committee in September 2020, including updates on Phase 1a, Phase 1b and Phase 2 of the project and reporting positive progress against the PBRS social value aspirational targets.

We are informed that currently 1,026 (of 1,414) residential and 4 (of 9) commercial units are planned to be completed to the Council's original timetable, with the remaining units being completed post-Games. The Council needs to effectively manage the PBRS construction programme to ensure that it is completed on time and is not detrimental to the delivery of the Games programme, which will be running in parallel.

The Council needs to continue to focus on the effective delivery of the Games by ensuring that it maintains the appropriate governance arrangements.

The Council still needs to take further action to address the current shortfall of £25.0m in partner funding due to fund the capital expenditure budget in the second half of 2021/22 and 2022/23, if it is going to fully mitigate the financial impact of the Games.

Value for Money

Significant risk	Work performed & Findings
Contractual arrangements relating to the highways PFI Scheme	
In our 2018/19 VFM work, we identified the risk that ongoing contractual disputes with Amey Local Government (Amey LG) (and other involved parties) in respect of the Highways PFI contract could have a significant impact on the Council's financial sustainability. At the time of giving our VFM conclusion in September 2019, a settlement agreement had been made between Birmingham Highways Ltd (BHL) and Amey LG, with financial risk to the Council. However, preparations were ongoing for Amey LG's exiting of the PFI contract. We therefore still considered this to be a significant risk for the purposes of our VFM work in 2019/20. In February, the Council announced the appointment of Kier as interim services provider, with work ongoing to identify a long-term maintenance and management partner to replace Amey LG.	Settlement with Amey LG: The Council was proactive in achieving a settlement which represented, in its opinion, the best possible outcome it could expect to receive, and mitigated its risks where possible. The majority of criteria set by Cabinet were achieved, while the remainder were in a position where they could be accepted with manageable risks and control measures. A report went to Cabinet on 25 June 2019 recommending that members approve the Council entering into a settlement agreement with Amey LG and BHL (formerly ABHL). This settlement agreement, for £215m, was accepted by all parties on 29 June 2019, and comprised the following payments from Amey LG to BHL: • £100m on agreement (paid 1 July 2019); • £30m by 30 September 2019; • £30m by 31 December 2019; • £55m deferred, payable on sale of Amey, or otherwise in five instalments between 2020 and 2025. The other key terms of the settlement were that Amey LG would exit the contract by 31 March 2020, and that BHL would procure an interim subcontractor to replace Amey LG as the service provider, while the remainder of the contract was re-tendered. At the end of the 2019/20 financial year, the balance owed by Amey LG to BHL was £55m. As part of the settlement arrangements, the Council's overpayment claim against BHL was converted into a loan agreement of £64m at an interest rate of 8% per annum, to be repaid over the remaining term of the contract. This loan ranks below BHL's lenders' secured amounts, meaning that if BHL becomes insolvent the other lenders would be repaid first, and the Council would only be repaid if sufficient funds remained. Whilst the risk remains that BHL's other lenders could withdraw their investment upon default, the Council has been working with BHL and these other lenders to reduce the number of ways that BHL could default on its loans, including reducing the amount of cash that BHL is required to maintain. Short term sub-contractor procurement process: We have been informed that the Council's objectives during the period between the settlement with Amey and the appointment of a long-term subcontractor by BHL were to ensure that service delivery continued (to meet statutory obligations) but with a focus on addressing any deterioration on the network, and on the successful procurement of a long-term subcontractor. The Council acknowledges that it is for BHL to procure a subcontractor, as the contract between the Council and BHL remains in place. There were disagreements between the Council and BHL relating to the form that the interim contract should take, but the structure of the resulting short term agreement is that the subcontracting has been split, with Kier taking the operational elements and the delivery of street lighting investment, and priority capital schemes and renewal works being subcontracted to Tarmac with novation of the rates provided for Amey LG.

Value for Money

Significant risk	Work performed & Findings
Contractual arrangements relating to the highways PFI Scheme (continued…)	Kier Highways was appointed in February 2020 and commenced mobilisation. The company took over provision of services on 1 April 2020 as planned, with no significant issues noted in the transfer process. <u>Long term sub-contractor procurement process:</u> No reports have been presented to Cabinet or Council since those relating to the settlement agreement in June 2019. Management's view is that, as the current position remains within the parameters approved by Cabinet at that time, no formal update is required. Initial discussions on the long-term re-procurement commenced in September 2019. Initial market feedback confirmed that BHL would be unable to attract a subcontractor on the same terms as the original contract with Amey. Discussions regarding the nature of the permanent agreement, and the relationship between the Council, BHL and a subcontractor, were in relatively early stages at the end of the 2019/20 financial year. <u>Affordability gap:</u> At the time of the Settlement Agreement in 2019, the estimated Core Investment Period (CIP) cost was considered to be affordable. The Council has explained that all parties knew that this was likely to be an inaccurate estimate, as it was based on a pavement model with known failings, which was the best information available at the time. From June 2019, the Council has continued to work with BHL to improve the accuracy of estimates of key elements of costs. There was a continual process of improving the accuracy of the pavement model through from the autumn of 2019 to the beginning of 2020. Once discussions on the form of the agreement going forward commenced in earnest in January 2020, the Council and BHL were still basing discussions on the original estimated cost. BHL presented the Council with a report dated 30 March 2020, setting out estimated costs that, due to condition information emerging over that period, were significantly higher than had previously been thought, creating an affordability gap. This estimate had been developed independently by BHL. The Council went on to review this estimate with its advisors, who concluded that, while there was disagreement on some assumptions made, the broad issue of the significant amount of work that was required and therefore the considerable increase to the affordability gap was agreed. The scale of the updated affordability gap has meant that the potential changes to the agreement between BCC and BHL are going to be more significant than had previously been thought. The Council has therefore had to move away from diluting the contractual requirements as a starting point for the procurement, as using the existing contractual standards would be unlikely to bridge a gap of that magnitude without resulting in unacceptably low standards and condition of the City's highways. Instead, a "bottom up" approach is being taken.

Value for Money

Conclusion

Overall, as in 2018/19, we are satisfied that the Council's arrangements for managing the PFI contract dispute and for securing the settlement between Amey LG and BHL were adequate. Whilst with any complex PFI contract settlement there will inevitably be financial and non-financial risks, the Council has mitigated these risks where possible and has managed the process effectively and with transparency between Officers and Members. From a financial perspective the Council has built up healthy reserve balances of £194.4m as a contingency plan and is prepared to step in as the interim PFI contractor if necessary under 'step in' rights.

We have noted no weaknesses in the arrangements surrounding the settlement with Amey LG and BHL for the 2019/20 year.

The Council's focus during 2019/20 has been on the continuity of delivery of statutory obligations and on the procurement of a long-term subcontractor. Kier was appointed as interim subcontractor by BHL for 15 months from 1 April 2020. We are not aware of any disruption due to the handover from Amey LG to Kier, and we are satisfied that an appropriate tendering process was followed, and the Council took appropriate advice on this.

The Council was proactive in confirming at an early stage in renegotiations that it would not be possible for BHL to attract a new subcontractor on the same terms as the original agreement with Amey, so discussions have been ongoing to work through the impact of this on the agreements between BCC and BHL and between BHL and a future subcontractor.

We have no concerns around the approach taken to these discussions. Whilst we have some concern regarding the significant length of time that discussions are taking, this is not considered an issue for our conclusion this year. At the end of the 2019/20 financial year, Kier's contract was in place for 15 months, and discussions have predominantly been held during the 2020/21 year.

We have noted no weaknesses in the arrangements in the 2019/20 year surrounding the retendering of the PFI subcontract.

Although the Council consider that issues with affordability of the PFI agreement are the responsibility of BHL, the fact remains that there is a significant financial gap in the contract, the full scale of which was not known to the Council until the very end of the 2019/20 financial year. After these figures were made available, the Council has had to fundamentally change its approach to discussions with BHL and is considering significant changes to the PFI arrangements going forward. In addition, this affordability gap has put additional strain on the finances of BHL, has made the original planned timeline of having a permanent subcontractor in place from July 2021 unachievable, and has contributed to the impairment of the Council's loan to BHL. During 2019/20, and until the scale of the affordability gap was confirmed, the Council was making significant decisions regarding this issue knowing that the extent of the full financial challenge facing BHL was uncertain.

In accordance with the NAO's VFM sub-criteria, we have concluded that these matters are evidence of weaknesses in proper arrangements for "understanding and using appropriate and reliable financial and performance information to support informed decision making and performance management" (IDM2).

We plan to qualify our Value for Money Conclusion in this regard.

Developments in 2020/21

We will consider the below, and subsequent developments, as part of our VFM work during the 2020/21 financial year. These developments do not form part of our conclusion for the 2019/20 year.

The terms of the contract between the Council and BHL is now (since 1 April 2020) subject to a Supplementary Agreement, which 'switches off' some of the requirements of the original Project Agreement. This means that the focus of all parties to the agreement is on addressing the requirements of the settlement agreement in the short term.

An update taken to Overview and Scrutiny on 8 July 2020 confirms that the Cabinet Member has formed an informal member working group to review changes to the contract arrangements. All members have considerable experience of highway issues and have provided feedback on the priorities that they wish to see addressed in a future contract.

We note that the interim subcontract was completed on a 'cost reimbursable' basis, meaning that the subcontractor takes little risk in relation to the contract, and the risk sits with BHL.

Value for Money

Developments in 2020/21 (continued…)

Subject to BHL agreeing its forecast cashflow and payments with the Council, the Council has agreed to ensure that BHL remains solvent by paying its reasonable operational costs during the interim period. Staff from the Council's corporate finance team are now embedded in the weekly management processes.

We recommend that the Council ensures proactive monitoring and management of the contract between BHL and Kier is taking place, in order to mitigate the financial risk to the Council created by their agreement to ensure that BHL remains solvent by paying its reasonable operational costs during the interim period.

Following the report from BHL at the end of March, we understand that the affordability gap continued to increase. A subsequent report issued by BHL in May 2020 showed a further increase to the estimated costs. Discussions between the Council and BHL have continued since this point, working to determine a level of service that is deliverable within affordability envelopes, but which is sufficient for the Council's purposes. Continued liaison with central government will be required.

Due to the extent of discussions still required between the Council and BHL, it looks increasingly unlikely that the subcontract can be re-tendered in June 2021, as originally planned, and so the Council and BHL are considering potential options to extend the interim agreement.

Kier's interim contract is for a 15 month period from 1 April 2020. This contract can be extended, on the same terms, for two 6-month periods. The second extension would require Kier's agreement. In addition, the current lending agreement between BHL and its investors expires on 30 June 2021, at which point the lenders may withdraw their investment. If this were to happen, BHL would fold, and the PFI agreement would cease, causing the Council to lose £51.9m of annual PFI grant. Discussions with the banks over the terms of an extension to their agreement have not yet commenced, neither have discussions with Kier regarding an extension to their contract. As such, there remains considerable risks in this area that we will continue to track as part of our future VFM audits.

Value for Money

Significant risk	Work performed & Findings
Waste service continuity and industrial relations	

In our 2018/19 VFM work, we identified the VFM risk that the Council would fail to implement adequate governance arrangements in relation to the waste dispute. This had been the subject of previous Statutory Recommendations issued by Grant Thornton in July 2018 and March 2019.
 	
At the time of giving our VFM conclusion in September 2019, the Council had commissioned an independent review of the Waste Service, but this had not concluded. The Council intended to wait for that report before making decisions about future options for the service. Our 2018/19 VFM conclusion was qualified on this basis.
 	
This report has since been received by the Council, and the previous Memorandum of Understanding ended in November 2019. We therefore still consider this to be a significant risk for the purposes of our VFM work in 2019/20.
	<u>Progress against the Statutory Recommendation issued in March 2019:</u>
	
	We have reviewed the Council's progress in addressing the weaknesses that were the subject of our Statutory Recommendation in March 2019. This included three elements which were as follows:
	
	• ensure that the terms of reference for the planned review of future options for the delivery of the refuse collection service, provide for the review to be carried out in a timely fashion, and include an examination of all options for delivering the refuse collection service going forward, in order that the service can demonstrate value for money in the delivery of its financial and service objectives; including, for instance:
	    - looking to best practice models across the sector
	    - examining different staffing and working arrangements
	    - combining collection and disposal functions
	    - other potential options, such as outsourcing.
	
	• build industrial relations capability within the Council to ensure that it is able to maintain consistent and effective relations with its trade union partners.
	
	• commission a review of the new working practices in place within the refuse service to ensure that they are embedded and monitored robustly to minimise the potential for further Equal Pay claims.
	
	Our findings in each of these areas are reported below.
	
	<u>The independent review of the Waste Service</u>
	
	The Council produced a detailed project specification for an independent review of waste collection and disposal services which included all the points raised in our Statutory Recommendation. This included an indicative timetable for the receipt and evaluation of bids (17 May 2019), the appoint of a contractor to undertake the review (27 May 2019), the delivery period for Phase 1 of the review (27 May – 30 August 2019), the public reporting of Phase 1 deliverables and the Cabinet Approval 'gateway' to commence Phase 2 (September 2019) and the delivery of Phase 2 (October 2019 onwards).
	
	Wood Environment and Infrastructure Solutions UK Ltd (Wood) were appointed to undertake the review on 28 June 2019, with the work to be undertaken and reported in two distinct phases:
	
	• Phase 1 covered the following aspects: Data discovery and current state assessment; Best practice review and benchmarking; Identification of immediate improvements and efficiencies; and Future Strategic Operating Model Options; and
	
	• Phase 2 of the review is focused on modelling (appraising) some potential strategic level changes to overall service delivery in Birmingham.

Value for Money

Significant risk	Work performed & Findings
Waste service continuity and industrial relations (continued…)	Wood issued a draft report for Phase 1 of the review in November 2019 which was finalised in January 2020 and a report summarising Phase 1 findings, data, and analysis was reported to Cabinet on 11 February 2020. This advised that the Waste Management Services (WMS) current Service Improvement Plan should be updated to include the recommendations that were made in the report, and that progress should be monitored by the Cabinet Member for Street Scene and Parks, and the Assistant Director for Street Scene. The report also clarified that Phase 2 of the review would be undertaken, and that the assessment of strategic level options would be the subject of a further report to Cabinet in Summer 2020, along with the final report. The Council's own report to Cabinet on 11 February 2020 recommended that its Service Improvement Plan was updated to include the recommendations in Wood's Phase 1 report and that Phase 2 of the review be undertaken by Wood to include the modelling of the following recommended options: • model existing baseline services along with the introduction of a separate weekly food waste collection; • weekly food waste collections along with fortnightly residual collections and fortnightly recycling collections; and • weekly food waste collections along with three weekly residual collections and fortnightly recycling collections. Phase 2 of the review was approved by Cabinet and commenced in March 2020. The data for Phase 2 has been produced and the findings need to be tested in consultation with key stakeholders. The consultation stage of key stakeholders has been put on hold due to Covid-19. <u>Update on industrial relations between the Council and its trade union partners</u> We have gained an understanding of the progress made during the 2019/20 financial year, and the current status of industrial relations. We have also considered the work of the Strategic Programme Board, as well as the updates to the Secretary of State from the Non-Executive Advisor for Waste Management and Industrial Relations. The Memorandum of Understanding (MOU) was due to end in November 2019 but it was agreed by all parties to continue to operate under the conditions of the MOU. All parties have continued to work closely together to improve industrial relations culminating in an agreement to relax the conditions of the MOU during March 2020 as result of the impact of Covid-19. The relaxation in conditions relates to the make up of a collection crew and was agreed to support the health and safety of staff whilst ensuring the effective provision of waste services during Covid-19. The MoU states that each collection crew should be made up of a grade 4, 3 and 2 but it was agreed to amend that to a collection crew of a grade 4, 2 and 2 if there were insufficient grade 3 staff available to enable waste collections to take place. The situation will continue to be monitored and, as soon as is practicable, the full principles as set out in the MOU will recommence. There have been a series of depot meetings led by the Assistant Director for Street Scene and the Cabinet Member for Street Scene and Parks. Discussions were held around moving from a four day to five day working week, which was expected to meet with resistance. However, staff were encouraged to embrace the change and have done so accordingly. Shorter working days have been identified by staff as one of the pros of the arrangement.

Value for Money

Significant risk	Work performed & Findings
Waste service continuity and industrial relations (continued…)	There have been significant improvements in the performance of the waste service, reductions in sickness absence levels and the public confidence in the waste service during the second half of 2019/20, which have continued to be the case throughout 2020/21 to date. The Non-Executive Adviser for Waste Management and Industrial Relations stated in July 2020 "Waste and street cleaning services have benefitted from improved relationships with trade unions and improved performance on the ground and in the depots, both before and during the recent Covid-19 crisis. The teams have relaxed the terms of their memorandum of understanding during the Covid-19 response period and this has resulted in much improved feedback from service users and residents. The work that has been done to improve relationships has included strong leadership and agility from the cabinet and the portfolio holder. There are, however, key decisions that remain to be made. The Council has not yet concluded its review of waste collection services and the independent review is long overdue. In addition, the Council needs to make decisions around its future capital programme in general and specifically in relation to its future waste disposal contracts and assets. The Council needs to ensure that the lessons that have been learned from closer collaboration are carried forward so that tensions that have been deferred do not reverse the good progress that has been made so far." These comments reflect the progress made by the Council during 2019/20 whilst acknowledging that there still some significant decisions which still need to be made in the near future about the provision of the waste service. <u>Effectiveness of new working practices</u> The Council changed its working practices in September 2018. Previously the Council operated a 4-day (nine hours and 15 minutes day) structure. The new approach operates a 5-day working structure, which includes collections being undertaken from Monday to Friday each week with staff working a seven hours and 18 minutes day. The Council also updated the job description for the role of the WRCO in July 2019. Wood's report for Phase 1 of the independent review concluded that the 4-3-2 staffing arrangement on the collection crews should not create a fundamental issue and, as a result, did not propose a change to this approach. Adding that the grade 3 member of the crew (WRCO) being responsible for the communications aspects of the rounds appeared to be a reasonable approach to resourcing assuming that: • any communication undertaken by the WRCO does not lead to the undue delay of the collections; • the WRCOs report any issues during the rounds in a timely and consistent manner; and • all collection crews still have the appropriate H&S training and are aware that they still retain H&S responsibilities. We consider that these findings coupled with the improvements in the performance of the waste service during the last twelve months are indicative of effective working practices during 2019/20.

Value for Money

Conclusion

We have reviewed the Council's progress in addressing the weaknesses that were the subject of our Statutory Recommendation in March 2019 and the qualified VFM conclusion in 2018/19.

We have assessed the progress made in Phase 1 of the independent review undertaken by Wood and we are satisfied that, as part of the options appraisal, this has taken in to account best practice models across the sector and considered combining collection and disposal functions. Phase 2 of the review, which is in progress, will examine different staffing and working arrangements.

We have considered the relationship between the Council and its trade union partners throughout 2019/20 and have concluded that there has been a significant improvement in the effectiveness of the arrangements. We also note there has been no industrial action during the year and there have been a number of improvements in key performance measures for the waste service.

We have considered the effectiveness of the new working practices implemented by the Council in September and taken in to account the findings of Phase 1 of the independent review by Wood. These findings coupled with the improvements in the performance of the waste service during the last twelve months are indicative of effective working practices during 2019/20.

We are satisfied that the Council has made sufficient progress in addressing the weaknesses relating to waste service continuity and industrial relations that were the subject of our Statutory Recommendation in March 2019 and the qualified VFM conclusion in our previous audit to mitigate the risk in 2019/20.

Developments in 2020/21

We will consider the below, and subsequent developments, as part of our VFM work during the 2020/21 financial year. These developments do not form part of our conclusion for the 2019/20 year.

Phase 2 of the independent review by Wood commenced in March 2020 and is currently ongoing. The majority of data has been produced but the consultation stage of key stakeholders has been put on hold due to Covid-19. Whilst Covid-19 has been a major contributor for the delay to Phase 2, the consultation stage is essential to inform any changes. Given the importance of getting Phase 2 of the review completed a consultation package is now being developed by Wood. This will be delivered through technology and the meetings are proposed to be held virtually. Wood are looking at making this as interactive as possible and are considering the possibility of having polls and weightings to questions to allow everyone to have an input. The proposal is to schedule these meetings early in the new year.

The other reason for the delay is the lack of information from Central Government with regard to food waste collections. There were indications that food waste collection was going to be mandatory by 2023. If food waste is mandatory then any associated support costs will have a significant impact on predicted models.

We recommend that the Council continues to work closely with Wood to ensure that Phase 2 of the independent review is completed as soon as is practically possible and ensures that it can maintain effective and consistent relations with its trade union partners regardless of any future changes to the waste service delivery model.

Value for Money

Significant risk	Work performed & Findings
Contract monitoring and management	
During our initial risk assessment, we noted that the Council's internal audit function, Birmingham Audit, issued two separate reports that highlighted substantial issues and weaknesses relating to the management and monitoring of significant contracts.	<u>Work done by the Council to address the findings raised by Birmingham Audit:</u> In July 2019, Birmingham Audit issued (in draft) a 'red rated' report on the Travel Assist programme. This report identified significant issues in relation to the monitoring and management of this contract. Key recommendations from this report were given short implementation dates, with many being prior to the finalisation of the report due to their significance. In the previous financial year, another red rated report had been issued on the Early Years Health and Wellbeing Contract. Through discussion with Birmingham Audit, and review of formal Progress Review documents, we have confirmed that key contract management recommendations from these reports had been addressed by the end of the 2019/20 financial year, but as a result of Covid-19, Birmingham Audit had been unable to verify this for all recommendations. We are therefore satisfied that these findings were addressed in a timely manner. <u>Consideration of any potential wider impacts of the weaknesses identified:</u> We considered that there was a risk that the issues identified were indicative of wider contract management and monitoring issues. We therefore discussed general contract management arrangements with Birmingham Audit and separately with finance staff, and identified no such concerns. We met with members of finance staff and discussed the significant work that was undertaken during the 2019/20 year in relation to contracts and procurement. This has included a thorough review of the Council's contract register, and development of the contract 'pipeline', with procurement officers working more closely with directorates to improve understanding of procurement processes. A review of the procurement practices across the Council was completed, including a maturity assessment of the arrangements in place. This review of efficiency and effectiveness then fed into a piece of work at the beginning of 2020 to identify possible future operating models for the service. We are aware that Birmingham Audit issued a further red rated report in July 2020 in relation to contract extensions, highlighting instances of contracts being extended without evidence of appropriate authorisation. We have considered this report for the purposes of our conclusion as, despite it being issued in the 2020/21 year, it reflects the arrangements that would have been in place during 2019/20.

Conclusion

Through discussions with Birmingham Audit, and review of its progress reporting, we are satisfied that all key contract management and monitoring recommendations in the two reports identified in our initial risk assessment had been addressed by the end of the financial year.

Value for Money

Conclusion (continued…)

The Council is actively working to improve the quality and efficiency of its procurement service, with significant work having been completed during the 2019/20 financial year to improve this going forward. We consider that the work that the Council has undertaken demonstrates a good awareness of the issues in this area.

We note that a further red rated report has been issued by Birmingham Audit in July 2020, in relation to contract extensions, however we consider that the speed at which Birmingham Audit's previous recommendations were addressed, and the proactive attempts to improve these areas, demonstrate adequate mitigation of this risk

We have concluded that the Council has mitigated this risk and has worked proactively to improve both its procurement processes and contract monitoring and management, in order to effectively support informed decision making.

We are satisfied that the arrangements in place during the 2019/20 year were adequate, and are not qualifying our Value for Money Conclusion in this regard.

Developments in 2020/21

We will consider the below, and subsequent developments, as part of our VFM work during the 2020/21 financial year. These developments do not form part of our conclusion for the 2019/20 year.

We are aware that work relating to the possible future operating models for the procurement service was halted due to the Covid-19 pandemic, but has recently recommenced. Management should ensure that unnecessary delays to this review are avoided. We also recommend that the findings of Birmingham Audit's reviews in recent years are taken into consideration when any operational changes are made.

Independence and ethics

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. The firm, its partners, senior managers, managers and network firms have complied with the Financial Reporting Council's Ethical Standard and confirm that we are independent and are able to express an objective opinion on the financial statements.

We confirm that we have implemented policies and procedures to meet the requirements of the Financial Reporting Council's Ethical Standard and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements.

Further, we have complied with the requirements of the National Audit Office's Auditor Guidance Note 01 issued in May 2020 which sets out supplementary guidance on ethical requirements for auditors of local public bodies.

Details of fees charged are detailed in Appendix D.

Audit and Non-audit services

For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Council. The following non-audit services were identified which were charged from the beginning of the financial year to October 2020, as well as the threats to our independence and safeguards that have been applied to mitigate these threats.

Service	£ Fee	Threats	Safeguards
Audit related:			
Certification of 2018/19 Housing Benefits Subsidy claim	29,500	For these three audit-related services, we consider that the following perceived threats may apply: • Self-Interest (because this is a recurring fee) • Self Review • Management	The level of recurring fees taken on their own are not significant in comparison to the confirmed scale fee for the audit and in particular relative to Grant Thornton UK LLP's turnover overall. Further, each is a fixed fee and there is no contingent element to any of them. These factors mitigate the perceived self-interest threat to an acceptable level.
Certification of 2018/19 Teachers' Pension return	7,250		Our team have no involvement in the preparation of the form which is certified, and do not expect material misstatements in the financial statements to arise from the performance of the certification work. Although related income and expenditure is included within the financial statements, the work required in respect of certification is separate from the work required to audit the financial statements, and is performed after the audit of the financial statements has been completed.
Certification of 2018/19 Housing capital receipts grant	5,250		The scope of the work does not include making decisions on behalf of management or recommending or suggesting a particular course of action for management to follow. Our team perform these engagements in line with set instructions and reporting frameworks. Any amendments made as a result of our work are the responsibility of informed management.
Education Skills Funding Agency agreed upon procedures 2018-19	5,000	Self-Interest (because this is a recurring fee)	The level of this recurring fee taken on its own is not considered a significant threat to independence as the fee for this work is £5,000 in comparison to the confirmed scale fee for the audit and in particular relative to Grant Thornton UK LLP's turnover overall. Further, it is a fixed fee and there is no contingent element to it. These factors mitigate the perceived self-interest threat to an acceptable level.

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Independence and ethics

Service	£ Fee	Threats	Safeguards
Audit related (continued):			
AMSCI reasonable assurance engagements (undertaken in August and December 2019)	15,800	Self-Interest (because this is a recurring fee)	The level of recurring fees on their own is not considered a significant threat to independence as the fee for this work is £15,800 in comparison to the confirmed scale fee for the audit and in particular relative to Grant Thornton UK LLP's turnover overall. Further, it is a fixed fee and there is no contingent element to it. These factors mitigate the perceived self-interest threat to an acceptable level.
Certification of 2019/20 Housing Benefits Subsidy claim	27,500	For these two audit-related services, we consider that the following perceived threats may apply: • Self-Interest (because this is a recurring fee) • Self Review • Management	The level of recurring fees taken on their own are not significant in comparison to the confirmed scale fee for the audit and in particular relative to Grant Thornton UK LLP's turnover overall. Further, each is a fixed fee and there is no contingent element to any of them. These factors mitigate the perceived self-interest threat to an acceptable level. Our team have no involvement in the preparation of the form which is certified, and do not expect material misstatements in the financial statements to arise from the performance of the certification work. Although related income and expenditure is included within the financial statements, the work required in respect of certification is separate from the work required to audit the financial statements, and is performed after the audit of the financial statements has been completed. The scope of the work does not include making decisions on behalf of management or recommending or suggesting a particular course of action for management to follow. Our team perform these engagements in line with set instructions and reporting frameworks. Any amendments made as a result of our work are the responsibility of informed management.
Certification of 2019/20 Teachers' Pension return	7,500		
Non-audit related:			
CFO insights subscription (2018/19)	10,000	Self-Interest (because this was a recurring fee)	The level of this recurring fee taken on its own is not considered a significant threat to independence as the fee for this work is £10,000 in comparison to the confirmed scale fee for the audit and in particular relative to Grant Thornton UK LLP's turnover overall. Further, it is a fixed fee and there is no contingent element to it. These factors mitigate the perceived self-interest threat to an acceptable level. This service ceased from March 2020 following the introduction of the 2019 FRC Ethical Standard.
CFO insights subscription (2019/20)	10,000		
CASS reporting 2019 (Finance Birmingham)	7,000	Self-Interest (because this is a recurring fee)	The level of this recurring fee is lower than the audit fee for this entity. The service is an audit related service which is permitted for the subsidiary of a public interest entity under ES 5.40, and does not cover the same ground as the audit of this entity. Any findings in our report will be agreed with management before we issue it to the FCA.

These services are consistent with the group's policy on the allotment of non-audit work to your auditors. All services have been approved by the Audit Committee. None of the services provided are subject to contingent fees.

Action plan

Controls

- High – Significant effect on control system
- Medium – Effect on control system
- Low – Best practice

We have identified recommendations for the group as a result of issues identified during the course of our audit. We have agreed our recommendations with management and we will report on progress on these recommendations during the course of the 2020/21 audit. The matters reported here are limited to those deficiencies that we have identified during the course of our audit and that we have concluded are of sufficient importance to merit being reported to you in accordance with auditing standards.

Assessment	Issue and risk	Recommendations
(high)	**Council resilience and financial sustainability** The Council's forecasting contains significant indicative provisional funding gaps in the coming years (approximately £100m per year after the 2020/21 year). Although the Council has identified actions to close the funding gap in the 2020/21 year, work in this area is likely to continue as councils across the country adjust to the true impacts of the Covid-19 pandemic.	The Council need to continue to plan for future years and proactively identify and mitigate cost pressures and financial risks as they arise. **Management response** TBC
(high)	**Independent review of the Council's waste service** The Non-Executive Adviser for Waste Management and Industrial Relations stated in July 2020 "The Council has not yet concluded its review of waste collection services and the independent review is long overdue." Although progress has been made by the Council during 2019/20, there still some significant decisions which still need to be made in the near future about the provision of the waste service.	We recommend that the Council continues to work closely with Wood to ensure that Phase 2 of the independent review is completed as soon as is practically possible and ensures that it can maintain effective and consistent relations with its trade union partners regardless of any future changes to the waste service delivery model. **Management response** TBC
(high)	**Long term Highways PFI solution** The scale of the affordability gap in the long term PFI arrangements may lead to delays in agreeing revised arrangements between the Council and BHL, and therefore may lead to delays in BHL securing a new, permanent subcontractor. There is a risk that the current arrangements are not delivering the best possible value for money, and that these arrangements may need extending beyond the term of the current agreement.	The Council should work towards completing negotiations with BHL as a matter of priority, in order to ensure that a new, permanent solution can be put in place as soon as reasonably possible to achieve best value for money. **Management response** TBC

Action plan

Controls

- ● High – Significant effect on control system
- ● Medium – Effect on control system
- ● Low – Best practice

Assessment	Issue and risk	Recommendations
● (medium)	**Interim Highways PFI subcontracting arrangements** The interim subcontract was completed on a 'cost reimbursable' basis, meaning that the subcontractor takes little risk in relation to the contract, and the risk sits with BHL. Subject to BHL agreeing its forecast cashflow and payments with the Council, the Council has agreed to ensure that BHL remains solvent by paying its reasonable operational costs during the interim period.	We recommend that the Council ensures proactive monitoring and management of the contract between BHL and Kier is taking place, in order to mitigate the financial risk to the Council created by their agreement to ensure that BHL remains solvent by paying its reasonable operational costs during the interim period. **Management response** TBC
● (medium)	**Partner funding for the Commonwealth Games** Substantial work has been undertaken by the Council to secure the required partner contributions of £75.0m, with £50.0m secured to date. The Council is continuing to work with various potential games partners to ensure that the remaining £25.0m of required partner contributions is secured, but this is not currently in place.	The Council should take further action to address the current shortfall of £25.0m in partner funding due to fund the capital expenditure budget in the second half of 2021/22 and 2022/23, if it is going to fully mitigate the financial impact of the Games. **Management response** TBC
● (medium)	**Pensions data provided to the actuary** During our work to assess the accuracy and completeness of the information provided to the actuary, we identified that the data initially submitted for April 2019 did not agree to payroll records. There is a risk that providing incorrect information to the actuary will impact on the actuarial valuation provided for the financial statements, and lead to a misstatement of the Council's liabilities.	This was later corrected by the Council in a subsequent data submission to the actuary. We recommend that management put controls in place to ensure that data issues such as this are picked up prior to submission in future. **Management response** TBC
● (medium)	**Incorrect capitalisation of revenue expenditure funded by capital under statute (REFCUS)** Our testing of items within Property, Plant and Equipment during 2019/20 identified items of REFCUS spend that had been incorrectly included in Assets Under Construction in the draft financial statements. While we have gained assurance that this does not represent a material risk to the financial statements in for 2019/20, incorrect treatment of the Council's spend will have a knock-on impact on budget monitoring activity if it is inaccurate.	Management should ensure that processes are in place to differentiate between spend that can be capitalised and spend that is being treated as REFCUS. **Management response** TBC

Action plan

Controls

- ● High – Significant effect on control system
- ● Medium – Effect on control system
- ● Low – Best practice

Assessment	Issue and risk	Recommendations
● (medium)	**Incorrect capitalisation of revenue spend by schools** Our testing of items within Property, Plant and Equipment during 2019/20 identified items of revenue spend that had been incorrectly capitalised by schools in the draft financial statements. While we have gained assurance that this does not represent a material risk to the financial statements in for 2019/20, incorrect treatment of the Council's spend will have a knock-on impact on budget monitoring activity if it is inaccurate.	Management should ensure that processes are in place to ensure that the capital spend submitted by schools is reviewed for accuracy before it is incorporated into the Council's financial records. **Management response** TBC
● (low)	**Intra-group consolidation adjustments** After preparation of the financial statements, the finance team identified that they had treated VAT amounts incorrectly within the intra-group adjustments in the consolidation process. This led to material misstatement of the group financial statements.	Management should ensure that sufficient time is built into the closedown processes to enable a robust management and quality review to be completed prior to the financial statements being submitted for audit. **Management response** TBC
● (low)	**Open purchase orders in the general ledger** During our work on the completeness of the Council's expenditure in the 2019/20 year, we have identified that there are a significant number of open purchase orders in the general ledger that relate to previous years. Some of these date back to prior to the implementation of the current ledger system. The volume of open orders on the system means that management cannot glean any useful information from this data for their monitoring purposes.	We recommend that management look to reduce the number of historic purchase orders still open in the general ledger system, in order to make this a useful report for their consideration of the completeness of expenditure within the financial year. **Management response** TBC

Follow up of prior year recommendations

Assessment
- ✓ Action completed
- WIP Action in progress
- X Not yet addressed

We identified the following issues in the audit of Birmingham City Council's 2018/19 financial statements, which resulted in recommendations being reported in our 2018/19 Audit Findings report. We have followed up on the implementation of our recommendations below.

Assessment	Issue and risk previously communicated	Update on actions taken to address the issue
WIP	**Under-accrual of expenditure** Our testing of the completeness of expenditure in 2018/19 identified several items which were paid after 31 March 2019 but should have been accrued into the 2018/19 financial year. The Council performed extended analysis covering payments made during the period to 22 August 2019 which identified £9.6m of invoices (inclusive of associated VAT) which relate to 2018/19 but were not accrued. In previous years, similar issues around the completeness of expenditure had been noted.	**Recommendation** The Council should investigate why these invoices were not appropriately accrued and implement additional controls to reduce the risk of such omissions in the future. **Update 2019/20** As part of the Council's closedown process, in advance of preparing the outturn report and the financial statements, a review of outstanding purchase orders and invoice clearance was undertaken to ensure appropriate entry into the accounts. Major payments made in April and May 2020 were reviewed to check the financial year in which the expenditure should be recorded and whether accruals had been made. As part of our testing in the 2019/20 year, we again identified transactions that had not been recorded in the correct year, and additional testing has had to be performed. We will continue to follow up on this recommendation in future years.
✓	**Feeder systems posting into the wrong financial year** The Council identified that eight separate feeder files from two subsidiary systems relating to 2019/20 were posted in period 16 of the 2018/19 general ledger in error. These entries were not reflected in the accounts and have been appropriately reversed out of the ledger, so there was no impact on the 2018/19 or the 2019/20 accounts.	**Recommendation** The Council should investigate this incident and implement appropriate controls to ensure a similar situation cannot occur again in the future. **Update 2019/20** The Council has concluded that an automatic solution to prevent this issue from reoccurring isn't viable, as it increases the risk of process failures in other aspects of the feeder file process. Monitoring of files will therefore continue as before. Transactions through the ledger after the year end are monitored to ensure that only journal transactions are recorded. The Council did not identify any such transactions in relation to the 2019/20 year, and no issues have been noted through the completion of our audit.

Follow up of prior year recommendations

Assessment
✓ Action completed
WIP Action in progress
X Not yet addressed

Assessment	Issue and risk previously communicated	Update on actions taken to address the issue
WIP	**Errors noted in property valuations** We identified errors in the work of the valuer relating to the valuation of secondary schools, and a valuation where expenditure was used instead of profit as the basis of the valuation.	**Recommendation** Appropriate review should be included as part of the valuation process to ensure that any errors in valuation are identified and resolved. **Update 2019/20** A two-tier checking system has been put in place with a peer review by an appropriately qualified surveyor followed by a management review by the Head of Service. An independent professional review of all cyclical valuations undertaken by in-house valuers has been carried out by Avison Young's valuation team who specialise in valuations of this nature. Our audit work in 2019/20 has again identified issues in relation to the valuations performed for the purposes of the financial statements. We will continue to follow up on this recommendation in future years, as the steps that the Council has taken to address this risk have not been completely effective.
WIP	**Disposals omitted from the prior year** An asset with a net book value of £9.4m was disposed of in 2017/18 but this was not accounted for until 2018/19. We were satisfied that this was an isolated incident due to the unusual nature of the arrangement, and there was no material risk to the 2018/19 accounts.	**Recommendation** The Council should ensure there are appropriate controls in place to ensure all disposals are accounted for in the correct year. **Update 2019/20** The Council informed us that the Legal, Finance and Property teams have met, with a view to tightening procedures and the sharing of information. Processes have been implemented to ensure that completion memos are recorded on IPMS and subsequently reconciled with cash receipts, with any differences highlighted at the earliest opportunity. Where external legal support is used the agreement will include the requirement to provide a completion memo for ensuring property records are maintained appropriately. All transactions are monitored on a monthly basis by Property Services Officers at each Capital Receipts meeting. Our testing of disposals recorded in the 2019/20 financial statements has again identified an asset that should have been derecognised in the previous financial year. At the time of writing this report, further testing is in progress to assess the potential impact of this on the financial statements. We will continue to follow up on this recommendation in future years, as the steps that the Council has taken to address this risk have not been completely effective.

Follow up of prior year recommendations

Assessment
✓ Action completed
WIP Action in progress
X Not yet addressed

Assessment	Issue and risk previously communicated	Update on actions taken to address the issue
✓	**Adjustments to Council Dwelling valuations** As part of the valuation of Council Dwellings we identified that the valuer applied a £5k adjustment rate for bedrooms to the majority of archetypes. On further review, the £5k was based on the approach taken in previous years and it was not clear that a review had been carried out to check if this value was still appropriate.	**Recommendation** The Council should ensure that assumptions used in the valuation of property, plant and equipment, including council dwellings, are reviewed for appropriateness each year and updated where appropriate. In particular, a review of the actual impact of the number of bedrooms on the valuation of council dwellings should be carried out in order to support the value of the adjustment. **Update 2019/20** A full beacon review has been undertaken for 2019/20, including a review of the valuation methodology adopted. Beacon properties for 2019/20 have been identified to ensure a fair representation of the City area, and a more nuanced approach has been taken to adjusting the valuations for the number of bedrooms in a property. Based on our testing of the Council's HRA Dwelling valuations, we are satisfied that this approach is appropriate.
WIP	**Multiple accounts assigned to a single user** We identified a high number of users with multiple accounts within SAP. Whilst some of these are required for FireFighter ID purposes, it appears that some are unnecessary.	**Recommendation** Management should consider which users need multiple accounts within SAP and remove access to those where this function where is it not required. **Update 2019/20** The Council's view is that the level of access identified in the recommendation is required to ensure that system functionality can be maintained. Regular reviews of access are undertaken and the new Governance, Risk and Compliance tool is being used to support the monitoring of access.
WIP	**General IT controls** As part of our review of IT controls, we identified an excessive number of users with inappropriate access to high risk T-codes within SAP. Our IT audit identified 109 users with potentially inappropriate access out of 668 users tested due their higher risk nature. The risk is that an excessive number of users have access to critical transactions at high level of authorisation, which we would normally expect to be restricted to system administrators. We noted this is primarily due to the current Firefighter setup and the fact that 8 users have SAP ALL access.	**Recommendation** Management should review all access and reassign the relevant transactions in accordance with business need and current job duties only. **Update 2019/20** The Council's view is that the level of access identified in the recommendation is required to ensure that system functionality can be maintained. Regular reviews of access are undertaken and the new Governance, Risk and Compliance tool is being used to support the monitoring of access.

Audit adjustments

We are required to report all non trivial misstatements to those charged with governance, whether or not the accounts have been adjusted by management.

Impact of adjusted misstatements

All adjusted misstatements are set out in detail below along with the impact on the key statements and the reported net expenditure for the year ending 31 March 2020.

Detail	Comprehensive Income and Expenditure Statement £m	Balance Sheet £m
Valuation of HRA Dwellings		
An error within the Council's valuation process for HRA Dwellings led to a beacon property which had been correctly valued as a 3 bed maisonette being incorrectly incorporated into the workings as a 1 bed maisonette. Correcting this error confirmed that the HRA Dwellings valuation was overstated by £23.2m, and the financial statements have been amended as follows:		
Dr Revaluation decrease recognised in the Revaluation Reserve	23.2	
Cr Gross book value of Council Dwellings		(23.2)
This adjustment has no impact on the Council's general fund balance.		
Valuation of Other Land and Buildings		
Tyseley Energy Recovery Facility, within other land and buildings, was understated by £2.4m due to a transcription error between the valuation report and the fixed asset register. The financial statements have been amended to show the correct valuation, with the impact as follows:		
Dr Gross book value of Other Land and Buildings		2.4
Cr Revaluation increase recognised in the Revaluation Reserve	(2.4)	
This adjustment has no impact on the Council's general fund balance.		
Adjustment to the Financial Outturn		
At its meeting on 10 November 2020, Cabinet agreed an amendment to its previously reported outturn report to reflect the replacement of £8.7m of Direct Revenue Financing of Capital by increasing the Council's Capital Financing Requirement. This amendment had the following impact on the financial statements:		
Dr Unearmarked Reserves (Usable Reserves)		8.7
Cr Capital Adjustment Account (Unusable Reserves)		(8.7)
Overall impact	**£20.8m**	**(£20.8m)**

Audit adjustments

Misclassification and disclosure changes

The table below provides details of misclassification and disclosure changes identified during the audit which have been made in the final set of financial statements.

Disclosure Reference	Detail	Adjusted?
Balance Sheet	The Council has a net deficit balance of £8.5m on its non-schools Dedicated Schools Grant. Our view is that this balance should form part of the unearmarked general fund balance. The Council has accounted for this balance in line with our expectations, however this amount has then been disclosed separately on the face of the Balance Sheet. We have requested that the reserves be rearranged on the face of the Balance Sheet so that this DSG balance is more clearly linked to the other unearmarked reserves. The balance is not material to the financial statements.	✓
Standards Issued but Not Adopted (Note 3)	Additional information has been added to the narrative around IFRS 16 for clarity. The new standard will come into effect on 1 April 2021 for Local Government bodies, including the Council.	✓
Sources of Estimation Uncertainty (Note 4)	The Council has included disclosures in Note 4 in relation to its pensions assets. As a result of the impact of Covid-19 on the global financial markets, the valuation of the Pension Fund's investment properties are also reported on the basis of material valuation uncertainty. The Council's share of these assets is £358.2m.	✓
Events after the Reporting Period (Note 5)	Additional disclosures have been added to Note 5 with regards to the following: • The outturn amendment agreed by Cabinet to reflect the replacement of £8.7m of Direct Revenue Financing of Capital by increasing the Council's Capital Financing Requirement; and • The impact of the Covid-19 pandemic on Birmingham Airport Holdings Limited, in which the Council owns a 18.68% share.	✓
Pensions Reserve (Note 20)	In the draft financial statements, the figures for 'reversal of items relating to retirement benefits debited or credited to the surplus/deficit on the provision of services in the CIES' and 'employer's pensions contributions and direct payments to retirees payable in the year' were both understated by £4.8m, due to the omission of the unfunded element of the pension liability. These balances should have been £206.7m and £153.9m respectively. The net impact on the pension reserve is £nil, and this is the only place in the financial statements where these figures are shown separately rather than being shown net.	✓
Provisions (Note 33)	The narrative around Equal Pay claims has been updated to reflect the wording agreed in previous years, and clarify that the position is as at 31 March 2020 rather than 28 February 2020.	✓
Borrowing (Note 35)	£2.0m of borrowing has been moved from long-term to short-term to correctly reflect the position at 31 March 2020. This adjustment has no impact on the Council's overall borrowing balance.	✓

Audit adjustments

Disclosure Reference	Detail	Adjusted?
Financial Instruments (Note 40)	The following amendments have been made to the Council's disclosures: Categories of Financial Instruments: • £8.5m of debtor balances have been reclassified from 'fair value at amortised cost' to 'debtors that are not financial instruments'. This balance relates to housing benefits, and does not meet the definition of a financial instrument. • Amendments have been made to the split of short term and long term borrowings to reflect the adjustment included on the previous page of this report. Income, Expenses, Gains and Losses: • The total shown for 2019/20 in the draft accounts was £204.7m but should have been £187.9m to accurately reflect the balances above. Financial Liabilities – Fair Value Hierarchy: • The fair value of the PFI/leasing element of other long term labilities has been decreased by £61.2m to £618.1m. • The fair value of the bonds has been decreased by £13.6m to £496.5m. • The fair value of the PWLB liability has been amended to disclose a fair value of £3,203.8m, instead of the £3,408.4m disclosed in the draft financial statements. Financial Assets – Fair Value Hierarchy: • Balance in relation to long term debtors have been corrected to show a carrying amount of £90.4m and a fair value of £98.6m. These figures were inconsistent with other disclosures in the draft financial statements. None of the above adjustments have any impact on other areas of the financial statements.	✓
Financial Instruments (Note 41)	Disclosure of the sensitivity analysis in relation to the fair value of fixed rate borrowing liabilities has been corrected to show an impact of (£517.7m). This figure was inconsistent with other disclosures in the draft financial statements.	✓
Service Concessions (Note 44)	Disclosure of contingent rentals has been added, as this was omitted from the draft financial statements.	✓
Officers' Remuneration (Note 46)	Additional narrative has been added to Note 46, in order to provide the reader of the accounts with more clarity regarding the disclosures that are being made.	✓
Related Parties & Pooled Budgets (Note 49)	Disclosure of the contributions made to aligned budgets by both the Council and the CCGs have been updated to reflect more accurate information. The CCGs' contributions in particular were estimated based on data from several years ago. At the time of writing this report, our work to consider the revised figures is ongoing.	✓

Audit adjustments

Disclosure Reference	Detail	Adjusted?
Collection Fund (Note C1)	The tax base information disclosed in the draft financial statements was the information that is relevant to the 2020/21 financial year, not the 2019/20 financial year. This has been amended to show the tax base at January 2019, on which the Council Tax for 2019/20 was set.	✓
Various	A number of other minor changes have been made to disclosure notes and accounting policies throughout the financial statements to improve accuracy, clarity and user understanding.	✓

Impact of unadjusted misstatements

The table below provides details of adjustments identified during the 2019/20 audit which have not been made within the final set of financial statements. The Audit and Performance Committee is required to approve management's proposed treatment of all items recorded within the table below:

Detail	Comprehensive Income and Expenditure Statement £m	Balance Sheet £m	Reason for not adjusting
Incorrect capitalisation of spend Our testing of a sample of assets transferred out of Assets Under Construction and into operational categories of Property, Plant and Equipment identified assets that should never have been recorded as capital spend, as they should have been treated as either revenue expenditure or REFCUS. We have extrapolated the errors that we identified in order to arrive at an estimated impact of similar transactions. The extrapolated error would impact on the financial statements as follows:			Adjustment is an estimate, and was not material to the financial statements.
Dr Expenditure	7.7		
Cr Property, Plant and Equipment		(7.7)	
Expenditure for which the Council was unable to provide supporting documentation During testing of a sample of the Council's expenditure transactions, we selected several items relating to the Council's use of purchase cards. Due to the pandemic, the Council have been unable to access the supporting documentation for these transactions, which is kept in their offices. We have determined that the total value of similar transactions in the 2019/20 year was £11.5m, and so we do not consider that this gives rise to a risk of material misstatement in the financial statements If all such expenditure did not occur, the resulting adjustment would be			This is not necessarily an error in the financial statements, but instead is documentation that was inaccessible due to Covid-19.
Dr Cash and Cash Equivalents		11.5	
Cr Expenditure	(11.5)		
Overall impact	**(£3.8m)**	**£3.8m**	

Audit adjustments

Unadjusted misclassification and disclosure changes

The table below provides details of misclassification and disclosure changes identified during the audit which have not been made in the final set of financial statements.

Disclosure Reference	Detail	Reason for not adjusting
Material IAS 19 entries (Note 10)	The CIPFA Code requires expenditure to be allocated to service segments. The Council has made a judgment that material one-off changes to pension costs in 2018/19, mainly due to settlements and the impact of the McCloud judgement, should be shown separately on the face of the Comprehensive Income and Expenditure Statement as a 'superannuation adjustment'. The Council has included additional disclosures within Note 10 to explain the nature of this entry and ensure that the judgement regarding presentation has been made clear to the reader of the accounts. Our view is that the past service cost should be allocated to the Council's individual service segments, as presented in the Comprehensive Income and Expenditure Statement, however we are satisfied that the Council's judgement does not result in a material misstatement to the accounts.	The Council is of view that this is a material item that should be reported separately.
Prior Period Restatement (Note 23)	The Council has completed a retrospective adjustment to the financial statements, to incorporate the disposal of two assets during 2017/18 which had not previously been processed. In our view, this adjustment was not necessary, as the accounting standards only require the correction of material errors in prior periods. We therefore consider that the correct treatment would be to dispose of these items in the year in which the issue was noted, being the 2019/20 financial year. The treatment has no impact on the Council's balances as at 31 March 2020.	Restatement is material to the Council using its own internal materiality threshold
Debtors (Note 30) and Creditors (Note 32)	There was a change in the Code from 2018/19 to remove the requirement to disclose debtors and creditors by type of counterparty, but the Council has adopted the previous format based on a judgement that an analysis by customer is most appropriate for the nature of the Council's balances. This does not strictly meet the IAS 1 requirement to disclose based on size, nature and function. We are satisfied this would not make a material difference to the reader of the accounts.	The Council's view is that their presentation provides the best information for readers to draw judgements on the recoverability of debt.
Provisions (Note 33)	The Council has assessed its pension guarantees under IAS 37, IFRS 4 and IFRS 9. The Council has made a judgement that its current pension guarantees relating to contribution rates should be accounted for under IAS 37 Provisions, Contingent Liabilities and Contingent Assets and have recognised a provision of £8.9m, as well as a related contingent liability. We are satisfied that the valuation basis is reasonable, but in our view IAS 37 is not applicable to these contractual guarantees and so they would be more appropriately disclosed as an 'other liability' within the Balance Sheet. This is a presentation issue only and is immaterial to the financial statements.	The Council's view is that these guarantees are onerous elements of a contract and therefore covered by IAS 37.

Audit adjustments

Impact of prior year unadjusted misstatements

The table below provides details of adjustments identified during the prior year audit which had not been made within the final set of 2018/19 financial statements.

Detail	Comprehensive Income and Expenditure Statement £m	Balance Sheet £m	Reason for not adjusting
Equal Pay Provision			Adjustment was not material to the financial statements.
The differential used in an element of the calculation was incorrect, so the provision was overstated.			
Correcting this would have had the following impact:			
Dr Provisions		4.3	
Cr Unusable Reserves		(4.3)	
Completeness of expenditure (capital and revenue)			Adjustment was not accurate, and was not material to the financial statements.
Following errors identified in sample testing, the Council reviewed payments made between 1 April 2019 and 22 August 2019, and identified £5.2m of capital expenditure and £4.6m of revenue expenditure which related to 2018/19 but was not appropriately accrued. Linked to this the council also identified £1.3m of income which related to some of these invoices and was also not accrued.			
Note that these figures include associated VAT so the actual impact on the Council's accounts is likely to be lower, but the impact was assessed as follows:			
Dr Debtors		1.3	
Cr Cost of Services	(1.3)		
Dr Property, plant and equipment		5.2	
Dr Cost of Services	4.4		
Cr Creditors		(9.6)	
Overall impact	**£3.1m**	**(£3.1m)**	

Fees

We confirm below our final fees charged for the audit and provision of non-audit services:

Audit fees	Proposed fee	Final fee
Council Audit	333,659	*TBC*
Audit of subsidiary companies:		
• Acivico Limited	35,000	35,000
• NEC (Developments) plc	35,000	35,000
• PETPS subsidiaries	37,500	37,500
Total audit fees (excluding VAT)	**£404,909**	***TBC***

We have given consideration to additional fees for the impact of Covid-19 on our audit processes, and have determined that an additional fee of £36,250 is appropriate.

Note that at the time of writing this report, neither this, nor the additional audit fees of £55,500 initially proposed for the 2019/20 year (per our Audit Plan) have been agreed. All fee variations are subject to approval by PSAA in line with the Terms of Appointment.

The Council does not separately disclose group audit fees in the notes to the group accounts. The fees for the Council as a single entity reconcile to the financial statements as follows:

- **Fees disclosed per financial statements** **£289k** (rounded to £0.2m)
- Less fee variation in relation to 2018/19 (£47k)
- **2019/20 fees per financial statements** **£242k** **(PSAA Scale Fee)**
- Additional fees for 2019/20 per our Audit Plan £56k
- Additional fees for 2019/20 due to Covid-19 £36k
- **Total Council fees per table to the left** **£334k**

Non-audit fees for other services	Proposed fee	Final fee
Audit Related Services:		
• Certification of 2018/19 Housing Benefits Subsidy claim (undertaken June-November 2019)	22,000	29,500
• Certification of 2018/19 Teachers' Pension return (undertaken October-November 2019)	7,250	7,250
• Certification of 2018/19 Housing capital receipts grant (undertaken January 2020)	5,250	5,250
• Education Skills Funding Agency agreed upon procedures 2018-19 (undertaken July 2019)	5,000	5,000
• AMSCI reasonable assurance engagements (undertaken in August and December 2019)	15,800	15,800
• Certification of 2019/20 Housing Benefits Subsidy claim (commenced August 2020)	27,500	*TBC*
• Certification of 2019/20 Teachers' Pension return (commenced October 2020)	7,500	*TBC*
Non-Audit Related Services:		
• CFO insights subscription (2018/19)	10,000	10,000
• CFO insights subscription (2019/20 - to 31 March 2020 only)	10,000	10,000
• CASS reporting for Finance Birmingham 2019 (undertaken April-July 2019)	7,000	7,000
Total non-audit fees (excluding VAT)	**£117,300**	***£TBC***