

External audit landscape for Birmingham City Council

**Audit years 2020-21, 2021-22,
2022-23 and 2023-24**

6 September 2023



Contents

Section	Page
Financial statements audits	03
Overarching VFM and additional powers Equal Pay	09
Overarching VFM and additional powers Financial Sustainability	10
Overarching VFM and additional powers Oracle	11
Appendix - Recommendations and powers available	12

The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our audit planning process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect the Council or all weaknesses in your internal controls. 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.

This progress 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.

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For Grant Thornton UK LLP
Date: 6 September 2023

Financial statement audits

2020/21 and 2021/22

As reported to the previous Audit Committees, and as set out in more detail in our first External Audit Landscape document, the financial statements of the Council for the years ending 31 March 2021 and 31 March 2022 both remain open. The most significant outstanding factor from both is the Council's Equal Pay liability.

The most recent Cabinet Report at the time of writing, (*Medium Term Financial plan (MTFP) Refresh – update to Cabinet at Quarter 1 of the 2023/24 Financial Year*) reports a liability of Equal Pay claims of between £650m and £760m (unaudited figures) which has led to the implementation of “mandatory spending controls to give the Council time to further review financial pressures.” We note that the Council has received correspondence that would significantly increase this liability.

Due to the Council's necessary focus on putting in place an appropriate Job Evaluation process little progress has been made on these audits.

We note that due to the size of the equal pay claims that both sets of accounts are materially misstated. We are in discussion with officers as to whether the accounts will be amended. If the accounts are not amended we will need to issue a qualification on the financial statements.

It is important that these accounts are closed at the earliest opportunity. We suggest that a target date of 30 November is set and that the Audit Committee monitor progress to ensure that the accounts are completed.

More details are provided on the following pages.

Financial statements - 2020/21

Issue	Progress since June update	Work to complete
<p>Equal Pay provision</p> <p>A fresh analysis of the Council's equal pay liability has been conducted which will give a more accurate estimate of the financial position and will require significant adjustments to be made to the financial statements.</p>	<p>Several meetings have been held between key members of the audit team and key individuals at the Council, including initial discussions with the Council's modelling team, to discuss the process that has been undertaken and the progress that the Council has made.</p> <p>We have not yet received the Council's revised model. We expect to receive this shortly for consideration, which is later than initially planned.</p>	<p>Upon receipt of the Council's revised model, we will consider the approach taken by the Council, the completeness and accuracy of the underlying data, and any key judgements and estimates that management have made. We will be supported in this work by modelling specialists from within Grant Thornton.</p> <p>Given our expectation that the provision currently reflected in the draft accounts is materially understated, we will then consider the implications of the anticipated material misstatement (if uncorrected in the draft accounts) for our audit opinion</p> <p>We are aiming to complete this work by the end of October 2023.</p>
<p>Investment property classification</p> <p>The Council is unusual in that it only holds one asset as an investment property on its Balance Sheet. We have challenged the classification of a sample of operational properties.</p>	<p>Officers have provided additional information linking the assets we have selected for our review to place-shaping and strategic regeneration aims.</p> <p>So far, we do not consider the information provided to be sufficient, and so we have requested additional audit evidence.</p>	<p>Officers are actively considering the specific assets that we have challenged the classification of, and are providing additional information.</p> <p>We are aiming to complete this work by the end of September 2023.</p>
<p>AGS update</p> <p>The Annual Governance Statement will need to be updated to the date that it is signed.</p>	<p>We have not received any updates on the AGS, as the work on significant governance issues (which would inform a revised AGS) is still ongoing, eg Equal Pay/Financial Sustainability –s114/Oracle.</p>	<p>Once management have completed the other areas of work, consideration should turn to updating the AGSs as necessary.</p> <p>We can then consider the completeness and appropriateness of the proposed updates.</p>

Financial statements - 2021/22

Issue	Progress since June update	Work to complete
<p>Matters from 20/21: Equal pay, Investment property classification, AGS</p> <p>As above, the resolution of matters from our 20/21 audit in all three areas set out in slide 3 above will also have a bearing on the 21/22 audit of accounts.</p>	<p>As for 20/21</p>	<p>As for 20/21</p>
<p>Oracle impairment assessment</p> <p>The Code requires that assets are carried at no more than their recoverable amount (recoverable through sale or use).</p>	<p>Officers have not yet provided us with this information on the grounds that focus has been on Equal Pay matters. It is anticipated that this will be provided in September 2023.</p>	<p>We have requested that management document their consideration of whether any impairment is required in relation to the capitalised costs of the new ledger system.</p> <p>We are aiming to complete this work by the end of October 2023.</p>
<p>Actuarial valuation under IAS 19</p> <p>The LGPS underwent a full triennial valuation at 31 March 2022, the results of which are now available and are a more accurate estimate of the Council's pension liability at that date than the previous roll-forward estimate.</p>	<p>The actuary has provided us with initial responses on queries raised on review of the assumptions applied in the revised IAS 19 report, based on our review of the pension liability.</p> <p>Our work on the pension asset is ongoing as at the time of writing.</p>	<p>We have asked officers to confirm with the actuary to what extent the Equal Pay liability will need to be reflected in the IAS 19 valuation.</p> <p>We have also asked officers to consider the impact of the triennial valuation on the Children's Trust, given that it is a significant consolidated component in the group accounts.</p> <p>Upon receipt of this information, the Council will need to amend the financial statements accordingly, for us to audit any adjustments arising.</p> <p>We are aiming to complete this work by the end of September 2023.</p>

Financial statements - 2021/22(cont)

Issue	Progress since June update	Work to complete
<p>SAP IT audit</p> <p>We had reported in previous years that we had identified deficiencies relating to user access permissions. These deficiencies continued to be in place when we undertook our review of SAP for the purposes of our audit of the 31 March 2022 financial statements. Management responses to our recommendations were received in September 2022 noting that recommendations were accepted, and that the situation would not be repeated in the Oracle Cloud system.</p>	<p>We subsequently performed a follow up review of the Oracle system in March 2023 to identify whether the deficiencies previously identified in SAP had been addressed. This included a review of the Council's data migration processes in implementing the new system. Management responses to the recommendations raised were received week commencing 7 August 2023.</p>	<p>Findings from this review will feed into our overall work Value for Money work being undertaken on Oracle, as set out later in this document.</p>
<p>Property valuations</p> <p>A small number of queries remain outstanding to complete our work on the Council's property valuations in 2021-22.</p>	<p>A full audit trail of evidence remains outstanding in respect of the floor areas of three assets selected for review. We have been advised by officers that they are being reviewed as part of the 22-23 valuations process, the outcome of which may not be known for a further 2-3 weeks from the time of writing, but will inform considerations.</p>	<p>Officers are actively addressing queries. For the assets in question we will also consider the 2022-23 valuations for indications of potential issues in the 2021-22 valuations.</p> <p>We are aiming to complete this work by the end of September 2023.</p>

Financial statement audits

2022/23

Background

The audit of the 2022/23 financial statements is significantly delayed. This is primarily due to 2 reasons:

- Equal pay – as outlined in the previous slides the Council’s equal pay liability is significant and the focus of the Council has been on putting in place an appropriate Job Evaluation process.
- Oracle - the Council has experienced significant problems from the implementation of its new Enterprise Resource Planning (ERP) IT system, Oracle Cloud, leading to anticipated additional costs of (total costs of £100m compared to an initial budget of £38.7m as approved by Cabinet in March 2021). This has significantly impacted on the Council’s ability to operate business-as usual activities, due to the workarounds and manual interventions needed to operate the system.

Due to these issues the Council has been unable to produce

- An outturn position for 2022/23
- A set of financial statements for 2022/23.

We have discussed these matters with officers and note that:

- Implementation - the Oracle system was rated as ‘red’ before going live and included a significant number of items requiring a solution. The finance system had several adaptations that had not operated effectively. As such, the system is not able to fully meet the reporting needs of Council including human resources, finance and schools.
- Security - the Oracle risk cloud and other security systems were not implemented and there is an inadequate segregation of duties in the system. Due to these and other matters there is no record of IT changes to Oracle or segregation of duties re IT processes.
- Compliance - there are a number of compliance issues with regard to data.
- Finance system - the financial system has not operated as planned. Financial reporting is still not fully operational. Financial system integrations were not in place as at April 2022 but some were integrated during the year. Data was held in feeder systems until this integration occurred. Where financial system integrations had not taken place the financial information had been transferred via journal. The Council has asserted that controls were in place to ensure data was appropriately transferred.

Financial statement audits

2022/23 cont.

Background cont.

- Cash - the cash posting system is not operational. A number of mis-postings and issues occurred during 2022/23 that impacted the reconciliation process. These have now been undertaken manually off system. There was a backlog of cash transactions but these have largely been resolved through manual processing for 2022/23.
- Accounts receivable and Payables – both systems had significant delays in the processing of transactions. However, the Council have not identified any deficiencies in control as a result of the Oracle implementation.
- Payroll – the Council has not flagged any significant risks to us
- Journals - some issues occurred with authorisation during the year. This was resolved in November 2022.

Audit Approach

Given the complex nature of the Council and the level of customisation that has been made to Oracle, the issues identified give rise to significant uncertainty over the effective operation of the standard and non-standard functionality within the system. It is not possible to determine at this stage whether we will be able to undertake an effective audit of the Council's accounts. In particular, we are concerned re the lack of IT and cash controls.

We therefore plan to take a phased approach to our audit. If we are unable to gain sufficient assurance during phase 1 we will issue a qualified opinion on the Council's financial statements. If we are able to gain sufficient assurance at phase 1 we move to a substantive approach for phase 2. We note that the resources from both ourselves and the Council will be significant during both these phases but particularly for Phase 2.

The phases are:

Phase 1 – this comprises of a consideration of Data Migration, IT controls and security, and core processes. These core processes are: system controls; journal controls (because they're associated with the significant risk of management override of controls and fraud); control account reconciliations (as a fundamental financial reporting control); and cash (due to the failures in the cash posting system and the significant backlog that arose). We estimate that this will take c3 months to complete

Phase 2 – this will comprise of detailed testing on all integrated and non integrated systems. It will require substantive testing of transactions within those systems. We estimate as a minimum that this will take a period of 12 months to complete.

Summary

There are significant failures in the control environment such that we are unable to take a standard approach to the audit. It is uncertain whether we can gain sufficient assurance that the accounts, once produced, are free from material error or fraud.

Overarching VFM and additional powers

Equal Pay

The Council's current Equal Pay (EP) agenda is one of the most significant challenges that any Council in England has ever faced. Previous historical EP claims at the Council have been significant (exceeding £1 billion) and, over the last year, we have become aware of factors that have arisen since 2017, that have driven further claims, with a value currently estimated by officers of up to £760 million.

Officers have identified that, putting in place an effective Job Evaluation (JE) methodology and implementing subsequent collective agreement with the Trade Unions by 1 April 2025 is essential if the Council is to continue as a going concern (see following slide on Financial Sustainability). They have also identified that the matter is highly time-sensitive, as the liability is estimated to grow by c£14 million for every month until JE is implemented. The Council's Business Management Committee (CMBC) of 1 September made a key decision as to the JE option the Council would now pursue.

Our work in this area will:

- independently assess the Council's revised estimate of its current EP liability and consider the effectiveness of its emerging proposals to mitigate any further financial pressures;
- consider the process that has recently been followed to arrive at the option for JE that the CMBC decided upon and comment on the governance that has underpinned this current process;
- examine the historical background to the issue since 2017, including the key decisions made that have driven this liability since that time;
- reflect on the adequacy of the industrial relations arrangements in place between political leadership, management and the Trade Unions in the context of addressing the Council's longstanding EP challenges.

Given the nature of the issues under consideration, we will be assessing whether we need to apply one or all of our additional powers and duties under the Local Audit and Accountability Act 2014, as set out in the Appendix to this document.

Overarching VFM and additional powers

Financial Sustainability

The Council has Earmarked Reserves of £383m and Unearmarked Reserves of £230m. These are available to the Council. Earmarked reserves have been set aside to meet particular liabilities, or for particular purposes. Unearmarked reserves are available for use.

Given the additional financial pressures of EP referred to in the previous slide of up to £760 million, the Council has recently put in place a series of cost control measures to help it to stay solvent in the short-term. However, a number of further financial pressures have also been identified, including the costs of putting right the Oracle financial ledger system issues referred to in the following slide. As a result, the Council's Finance Director (s151 officer) issued a 'Section 114 report' on 5 September 2023, regarding the adequacy of the Council's reserves and future sources of additional funding it is likely to be able to secure, to ensure that the Council continues as a going concern.

This report dealt with the risks that the Council would exhaust its levels of usable reserves and be unable to generate sufficient funding to sustain its revenue expenditure commitments (through savings, additional Government support, permitted capitalisation direction and borrowing, or asset sales). In that scenario, it would cease to be viable and would be in breach of its statutory duty to have a balanced budget, or the imminent prospect of one.

- Our work in this area will consider:
- the likely effectiveness of the Council's proposals for cost control and for securing additional funding (including asset sales and capitalisation direction from the Government) in meeting the financial gap created by the identified additional cost pressures;
- the impact on future spending requirements of the decisions currently being sought for JE; and
- the role of statutory officers at this time.

Consistent with our approach to EP, set out on the previous slide, we will also be assessing whether we need to apply one or all of our additional powers and duties under the Local Audit and Accountability Act 2014 in this area.

Overarching VFM and additional powers – Oracle

The Council has experienced significant problems from the implementation of its new Enterprise Resource Planning (ERP) IT system, Oracle Cloud, leading to anticipated additional costs of (total costs of £100m compared to an initial budget of £38.7m as approved by Cabinet in March 2021). This has significantly impacted on the Council's ability to operate business-as usual activities, due to the workarounds and manual interventions needed to operate the system. Due to these issues the Council has been unable to produce

- An outturn position for 2022/23
- A set of financial statements for 2022/23.

We have been monitoring the issues associated with the Oracle Fusion implementation, and the plans and further investment required for this programme's completion. The programme is currently going through a process of re-planning and there is a risk that weaknesses in the governance and management of the programme present significant risks to the effective use of resources. Until these are resolved that the Council is at risk of not having adequate governance arrangements in place to ensure that it can effectively discharge its statutory responsibilities and maintain its financial sustainability.

We have therefore determined that we need to undertake a review of the Oracle implementation. The lines of enquiry for our additional work will focus on Oracle in particular the following:

The Programme to date

A review of the full programme life cycle, and related governance arrangements and decision-making processes, from inception of the original programme through to the end of the Financial Year 2022/23 and then to 30 June 2023.

Programme remediation and issue resolution

A forward-looking assessment of the Council's plans for remediation and stabilisation of the delivered solution, through to an agreed steady state for the programme.

The proposed workstreams are: Operating Model, i.e. Business Requirements (Operating Model changes to be enabled by Oracle, incl. structure and core processes; by function and departments within BCC), Governance and Risk Management (incl. Corporate and Programme governance, roles & responsibilities and effectiveness of management and decision-making processes), Technology implementation and Programme Management (Programme structure and resourcing, and the effectiveness of programme management approach and tools incl. data cleansing, data migration, build, test, implement), and Change management approach (incl. change readiness assessment, training, and change adoption)

Appendix - Recommendations and powers available

Potential types of recommendations

A range of different recommendations could be made following the completion of our work, as follows:



Statutory recommendation

Written recommendations to the body under Section 24 (Schedule 7) of the Local Audit and Accountability Act 2014. A recommendation under schedule 7 requires the body to discuss and respond publicly to the report.



Key recommendation

The Code of Audit Practice requires that where auditors identify significant weaknesses in arrangements to secure value for money they should make recommendations setting out the actions that should be taken by the body. We have defined these recommendations as 'key recommendations'.



Improvement recommendation

These recommendations, if implemented should improve the arrangements in place at the body, but are not made as a result of identifying significant weaknesses in the body's arrangements

Power or duty

Auditors also have a range of additional powers and duties that can be brought to bear under particular circumstances, as follows:

- To apply to the court for a declaration that an item of account is contrary to law (Section 28 Local Audit and Accountability Act 2014)
- To consider whether to issue an advisory notice and to make an application for judicial review (Sections 29 and 31, Schedule 8 Local Audit and Accountability Act 2014.)
- Matters reported in the public interest (Schedule 7 Local Audit and Accountability Act 2014.)

In considering whether to exercise any of our additional powers and duties, and in determining the time and resource to be spent on dealing with matters that come to our attention, the Code of Audit Practice requires that we consider the relevant requirements of the Act and:

- the significance of the subject matter;
- whether there is wider public interest in the issues raised and/or whether it would be in the public interest for the auditor to comment publicly on an issue;
- whether the substance of the matter has been considered and/or reported upon previously by the body's auditor;
- whether the substance of the matter falls within the scope of work conducted by an inspectorate or other body;
- the costs of dealing with the matter when set against the sums involved and the size of the audited body, bearing in mind that these costs are borne by the taxpayer and so should be proportionate and in the public interest

Appendix - Recommendations and powers available (cont)

Advisory notices

These are rarely used and only where an authority is set on a course of action that the auditor is seeking to prevent

They are issued if the auditor thinks that the authority:

- is about to make or has made a decision which involves or would involve the authority incurring unlawful expenditure;
- is about to take or has begun to take a course of action which, if followed to its conclusion, would be unlawful and likely to cause a loss or deficiency; or
- is about to enter an item of account, the entry of which is unlawful.

While an advisory notice has effect, it is not lawful for the relevant authority concerned or any officer of that authority:

- if the notice relates to a decision, to make or implement the decision;
- if the notice relates to a course of action, to take or continue to take the course of action; or
- if the notice relates to an item of account, to enter the item of account.

Public interest reports and recommendations

Auditors issue reports in the public interest and written recommendations upon taking the following into consideration:

- the significance of the matter or weakness in arrangements which has come to their attention or which they have identified during the audit;
- whether the body itself recognises the need to address a concern and is taking appropriate action in a timely way;
- what information is already in the public domain and whether there is merit in bringing the matter to the attention of the public in the interests of openness, transparency and accountability or to facilitate dissemination of learning to other public bodies;
- which form of reporting is likely to be most effective in helping the audited body to understand the significance of the matter and the need to take action; and
- whether previous reporting has been acted upon and, if not, whether more prominent reporting – such as issuing a statutory recommendation or a report in the public interest – is now necessary.



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