

External audit: progress report for Birmingham City Council

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

15 January 2024



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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.

Name: Mark Stocks
For Grant Thornton UK LLP
Date: 15 January 2024

Financial statements audits

2020/21 and 2021/22

As reported at previous Audit Committees, and as set out in more detail in our recent 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.

In our November update, we reported we had not been provided with the information necessary to undertake the work in September and October 2023 as initially planned. We also set out the additional work that we determined was necessary following further information coming to light, to mitigate the risk that the Council's draft accounts for the years in question may have been deliberately misrepresented.

We acknowledge that the Council's focus is on producing the budget for future years as well as to provide a financial outturn to inform its decision making, but equally it is important that sight is not lost of the importance of closing down the Council's open years of account. As such we meet with the s151 and other officers on a regular basis to discuss outstanding work.

This paper gives an update on progress against each of the outstanding items reported to you previously. More details are provided on the following pages.

With the retirement of Jon Roberts in December 2023 Mark Stocks has taken over responsibility for these audits.

Financial statements audit - 2020/21

Issue	September update	November update	January update
<p>Equal Pay provision (2020-21 and 2021-22)</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>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 have recently received the Council's accounting paper, which sets out the rationale for its assumptions and judgements to be applied within its accounting model. We are currently working through this paper and have yet to receive the Council's models, though we understand from officers that they are expected to be with us over the course of November with a model being provided each week for each year in question.</p>	<p>Models were received on 29 November for the years ending 31 March 2020, 31 March 2021, and 31 March 2022. We have been advised that these have subsequently been updated and will be provided to us in due course.</p> <p>We are working with officers to:</p> <ul style="list-style-type: none"> • Obtain assurance over the completeness and accuracy of the source data being used to feed the models • Understand and audit any judgements and assumptions that have been applied to the source data • Challenge the judgements and assumptions being applied, as set out in the Council's accounting paper referred to in our November update <p>We have engaged Grant Thornton modelling specialists to assist us in our work on the data transformations that feed the models, and to review the model being used to determine that it is operating as expected.</p> <p>On completion of the above, we will need to review the proposed amendments to and disclosures in the financial statements, which we anticipate requiring updates to the areas of provisions, events after the reporting period, critical judgements and estimation uncertainties.</p>
<p>AGS update (2020-21 and 2021-22)</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. Once management have completed the other areas of work, consideration should turn to updating the AGSs as necessary. We can then consider the completeness and appropriateness of the proposed updates.</p>		

Financial statements audit - 2021/22

Issue	September update	November update	January update
<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.</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>The Council's assessment and proposed treatment in relation to this issue was provided in early November. We are currently working through this paper.</p>	<p>We provided responses to the Council's proposed treatment in November. Officers are considering our queries.</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>A partial response was forwarded to us from the actuary on 1 November. The Council has considered the response and is in the process of requesting a further report from the actuary to inform any adjustments that might be necessary in the financial statements.</p>	<p>As November.</p>

Financial statements audit - 2021/22 (continued)

Issue	September update	November update	January update
Property valuations	A small number of queries remain outstanding to complete our work on the Council's property valuations in 2021/22.	Dialogue has taken place with relevant officers and the latest iteration of the information is now with the audit team to consider, but we anticipate that adjustments will be required to the financial statements.	The queries have now been resolved, but the work is not complete, pending quality review, and receipt of updated financial statements showing the agreed adjustments.
Capitalisation	N/A	We reported that we would be undertaking a more extensive review of the Council's approach to capitalisation, focussing on the risk that revenue expenditure had been deliberately capitalised as a means of reducing the pressure on the I&E account.	The Council has provided a first tranche of information from our initial requests which we are in the process of auditing and following up.
Housing Revenue Account	N/A	We will undertake a detailed review of the interface between the General Fund and the HRA to ensure that proper (and lawful) distinction had been made between those costs attributable to the Council's landlord function and those more appropriate to be categorised within the General Fund.	The Council has provided transaction listings of expenditure which has been applied to the Housing Revenue Account. Pending receipt of a response to a query we have on how payroll costs are treated and apportioned, we will provide a sample for testing.
Grants	N/A	We will be performing a detailed challenge of the Council's use of grants to ensure that they have been applied according to the conditions of grant. As part of this we will consider in detail the application of any grants which are ring-fenced, such as the Public Health Ring-fenced Grant.	We have selected a number of grants from both years in order that we can review the contract agreement and expenditure incurred. The Council is in the process of providing the information requested.

Financial statements audit - 2021/22 (continued)

Issue	September update	November update	January update
Land and property sales	N/A	We will consider whether proper consideration has been obtained and has the impact of any related parties been appropriately dealt with.	We identified asset sale losses for testing. Supporting evidence has been received from the Council, which we are in the process of auditing.
Highways PFI	N/A	Given the Council's communication with Government regarding its Highways PFI we will need to consider whether there are any accounting implications (adjusting or disclosure) that have not been reflected in the accounts, such as impairment of valuations or contract liabilities.	Officers are preparing a paper considering the accounting implications.
Regulator of Social Housing	N/A	The Council will need to consider whether there are any adjusting or non-adjusting Post Balance Sheet events attributable to the Regulator of Social Housings assessment of the Council's performance against the Decent Home Standard.	Officers are preparing a paper considering the accounting implications.
Related Parties	N/A	We will extend our consideration of related parties, particularly in relation to procurement and contracting.	This is being considered where relevant as part of all the workstreams set out above. Additionally, the Council is reviewing the list of all related parties, and comparing to the contract register to ensure disclosure is complete and accurate.
Management override of control	N/A	To reflect the risks set out above, we have reopened our journals work and selected further transactions to test, which officers are in the process of providing evidence for. We are seeking assurance of what the journal is for, that it is appropriately authorised and that therefore it has relevant business rationale.	

Financial statements audit - 2022/23

Background and Audit Approach

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 outlined to previous committees that we would undertake our audit in two phases:

Phase 1 – this comprises of a consideration of IT controls and security, Data Migration, 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.

Financial statements audit - 2022/23

Progress to date

We have not been able to significantly progress our work on Phase 1 of the audit. To date we have formed the following conclusions:

IT controls and security

Segregation of duties, Change in Key Personnel and Scale of unresolved issues – we reported to the last Audit Committee that we do not consider that we can place reliance on the Council's IT control environment.

Management override – we reported to the last Audit Committee that we were reviewing the journals control environment. We have not been able to progress this work.

Data migration - Due to the lack of evidence support the resolution of data migration issues and the lack of segregation of duties within Oracle Cloud we have been unable to gain assurance that the data migration is free of error or fraud.

Core processes

Our work has not substantively progressed from our last updated.

We have begun documenting our understanding for the key financial systems of cash; journals; holding and control accounts; housing benefit, council tax and business rates expenditure; payroll; and property, plant and equipment. The work is still underway but initial findings indicate that there are processes that have been negatively impacted by Oracle and weaknesses that will need to be explored further to ascertain the level of additional substantive work that will be required.

We are waiting for information from officers in order to progress work in the areas of accounts payable, accounts receivable, revenue and grants.

We have arranged a controls workshop with finance officers on 19 January 2024. The workshop will focus on reaching a consensus regarding the operation of financial controls during 2022/23 and whether we can rely on the controls in place.

Summary

As outlined above, we do not have assurance over IT controls and security, or with regard to data migration. Our work on controls is ongoing but indicates significant weaknesses.

We will report our full findings to members of Phase 1 following the controls workshop. Phase 2, if undertaken, will take place across 2024.

At present, we consider that the risk of a disclaimed audit opinion is high.

Financial statements audit - 2023/24

Update

The matters impacting the 2022/23 financial statements are equally applicable to 2023/24.

As outlined for 2022/23, we do not have assurance over IT controls and security, or with regard to data migration. Our work on controls is ongoing but indicates significant weaknesses.

We have arranged a controls workshop with finance officers on 19 January 2024. The workshop will focus on reaching a consensus regarding the operation of financial controls during 2023/24 and whether we can rely on the controls in place.

We will report our full findings to members of Phase 1 following the controls workshop.

At present, we consider that the risk of a disclaimed audit opinion is high.

Overarching VFM and additional powers

Equal Pay

Background

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.

Update – Job evaluation methodology

The Council has now put in place a Job Evaluation (JE) methodology. It is planning to implement a new pay and grading system by 1 April 2025. We have not taken any additional work on this matter since the last Audit Committee.

We currently reviewing the chosen JE methodology and the revised 2023 Addendum to the Job Evaluation Joint Principles Document. We are awaiting management's responses to the queries raised.

Update – historical review

We have now commenced our additional work on the Council's governance arrangements in relation to the management of equal pay claims. We reported our key lines of enquiry to the last Audit Committee.

We have undertaken a number of interviews as part of our work and have issued a data request to officers for additional documentation. We have agreed with officers that we will have access to legally privileged information. This release is subject to strict conditions and the information cannot be released into the public domain without the permission of the Monitoring Officer. We consider that these restrictions are reasonable.

We are in discussion with the DLUHC regarding the planned inquiry (announced by the Secretary of State in Autumn 2023) and how this impacts our own work.

Overarching VFM and additional powers

Financial Sustainability

Background

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) is giving active consideration to 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.

Should the Council 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) then 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. This would trigger the s151 officer's statutory duty to report under s114 of the Local Government Finance Act 1988 and could also trigger a s5 report from the Monitoring Officer under the Local Government and Housing Act 1989.

Update

We have determined that additional interviews are required to complete our work. These interviews are currently being arranged. We will report our findings on completion of these interviews.

Overarching VFM and additional powers

Oracle

Background

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 therefore determined that we need to undertake a review of the Oracle implementation.

Update

Our interim report on the current and future operations was reported as part of the agenda for the 29 November 2023 Audit Committee. Our final report on the current and future operations was issued in draft in January 2023 and is part of the January Audit Committee agenda.

Our backwards looking review re the implementation of the Oracle ERP system is ongoing.

Other work necessary to conclude our Statutory Audits for VFM 2020/21-2022/23

Background

We have already undertaken, or have in train, substantial risk-based work in the areas that the National Audit Office (NAO) has prescribed under its Code of Audit Practice and supporting auditor guidance. So far, we have completed work supporting our Statutory Recommendations, that was considered by the Extraordinary Full Council Meeting of 12 October 2023 and have issued separate reports on its Oracle implementation and its Financial Sustainability (the latter currently with officers in draft). In addition, work has now commenced on the governance implications of the Council's management of Equal Pay in recent years.

Update (no change from November Audit Committee)

To fulfil our statutory audit responsibilities, we also have to consider the implications of the completed work the adequacy of the Council's arrangements across the three 'Code Criteria' defined by the NAO:

- Financial Sustainability
- Governance
- Arrangements for supporting economy, efficiency and effectiveness.

In addition, we also consider whether there are other relevant risks of significant weakness in arrangements, relating to the period of audit not yet covered by the work above. At this stage we are reflecting on two additional areas where further audit attention may be required – namely the recent progress of the Council's Highways PFI retendering and its response to the breaches reported by the Regulator of Social Housing. We will discuss our considerations with officers and will inform the Audit Committee, should we determine whether further work in these areas is necessary.

Other matters

Continuation as auditor

In recent weeks we have become concerned regarding some of the discussions between ourselves and Council officers and members. In certain instances, we consider that this has created an unacceptable working environment. We note that this does not extend to the finance team where a professional relationship remains.

On 21 December 2023 we raised our concerns with the Chief Executive. We raised similar observations with regard to the working environment for the S151 officer and the finance team. Following discussions with the Chief Executive we have agreed additional safeguards to ensure an appropriate working environment is maintained. On this basis we have confirmed that we will continue as the Council's auditor.

We note that in response to our Statutory Recommendations and Value for Money work an external organisation has twice raised the possibility that it would raise a complaint with regard to our work. We are currently actively considering as a firm whether this constitutes an intimidation threat under the Financial Reporting Council Ethical Standards and whether this impacts on our:

- Independence and objectivity
- Ability to continue as the Council's auditors.

