

The Annual Audit Letter for Birmingham City Council

Year ended 31 March 2015

October 2015

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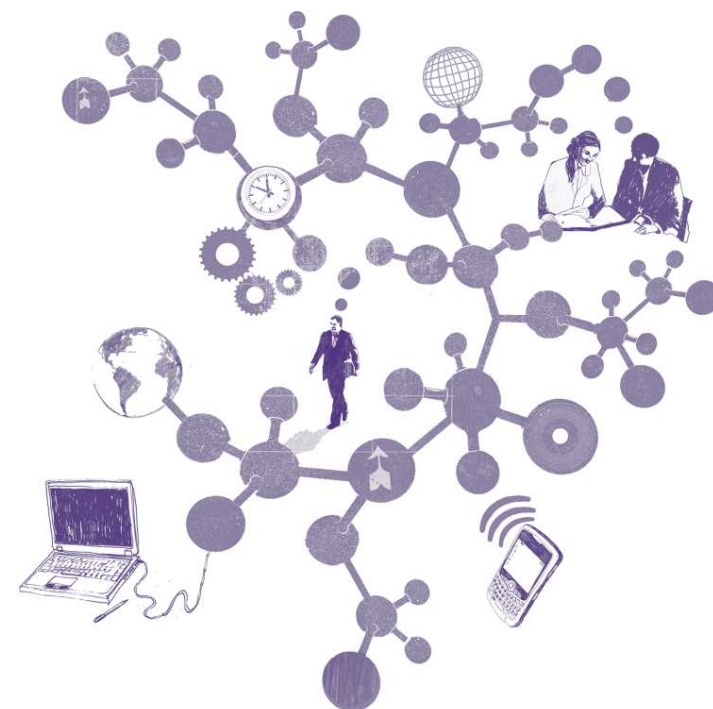
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Key messages

Our Annual Audit Letter summarises the key findings arising from the work that we have carried out at Birmingham City Council ('the Council') for the year ended 31 March 2015.

The Letter is intended to communicate key messages to the Council and external stakeholders, including members of the public. Our annual work programme, which includes nationally prescribed and locally determined work, has been undertaken in accordance with the Audit Plan that we issued on 30 June 2015 and was conducted in accordance with the Audit Commission's Code of Audit Practice, International Standards on Auditing (UK and Ireland) and other guidance issued by the Audit Commission and Public Sector Audit Appointments Limited.

Financial statements audit (including audit opinion)

We reported our findings arising from the audit of the financial statements in our Audit Findings Report on 29 September 2015 to the Audit Committee. This letter summarises the key issues we reported.

We received draft financial statements by the statutory deadline of 30 June 2015. This was the second year that the accounts were delivered on time. It is pleasing to report that the prompt delivery of the accounts and the support we had from the Financial Accounts Team enabled us to deliver our unqualified audit opinion on 30 September 2015, meeting the deadline set by the Department for Communities and Local Government. Our opinion included an emphasis of matter paragraph with regard to the Council's equal pay liability, due to the difficulties in accurately estimating equal pay liabilities.

The key messages arising from our audit of the Council's financial statements, concerned the:

- accounting treatment of the NEC assets;
- the equal pay provision;
- the accounting treatment of Voluntary Aided, Voluntary Controlled and Foundation schools land and buildings; and
- consideration of the going concern assessment.

We also noted that the Council's management of the change in its bankers was well managed and the transfer was implemented with minimal disruption to the Council's receipts and payments systems.

Accounting treatment of NEC assets

The Council signed a contract for the sale of the NEC on 16 January 2015. Delivering this sale was a challenging and complex process for the Council and this was well managed.

At 31 March 2015, although the contract to sell the NEC had been signed the transaction had not been completed. The sale agreement was subject to a three month period until the completion of the contract and transfer of assets to the purchaser on the 1 May 2015. We agreed with the Council's view that assets and liabilities relating to the NEC should be included on the Council's balance sheet in accordance with accounting standards.

The disclosure requirements for this unique transaction in the 2014/15 accounts were complicated and dependent on interpreting financial reporting standards relating to assets held for sale and financial instruments. On completion of our

Key messages (continued)

audit the following amendments were made to the accounts:

- disclosure of the £192 million of NEC loan stock (debentures) as short term investments, rather than assets held for sale in the Council's single entity balance sheet; and
- removal of a £17 million adjustment to the valuation of assets held for sale in the Council's group balance sheet.

Equal pay provision

The audited accounts include a provision for the Council's equal pay liability of £562 million, a decrease of £77 million compared to the 2013/14 accounts. This is the second year that the equal pay liability has decreased and reflects both the settlement of claims and the reduction in the volume of new claims. However, equal pay continues to be a major financial liability for the Council.

The accounting policy adopted by the Council is to recognise a provision for equal pay on receipt of a valid claim. Potential future claims are treated as a contingent liability. A significant number of variables impact the number and value of future claims. We included an emphasis of matter paragraph in our audit opinion to draw the readers' attention to the point at which claims are recognised and the variables impacting on the valuation of the equal pay liability.

Accounting treatment of voluntary aided and voluntary controlled schools

The accounting requirements for voluntary aided, voluntary controlled and foundation schools (VA/VC/FS) schools was clarified by CIPFA for 2014/15 accounts. As typically a local authority does not own either the land or buildings relating to these schools the key issue is whether these assets should be included on their balance sheet or not. In the draft accounts the Council had included both land and buildings relating to these assets on its balance sheet.

A thorough approach was taken by the Council's Financial Accounts Team to reviewing the evidence supporting the accounting treatment and documentation for over 80 schools was examined. On completion of this review land totalling £58 million was removed from the balance sheet value of property, plant and equipment. Our testing confirmed that this was appropriate.

The Financial Accounts Team is planning to continue with this review to reduce the number of schools with insufficient evidence to support their accounting treatment. They anticipate that this will result in more land being included on the balance sheet.

Consideration of the going concern assessment

Going concern is a fundamental principle in the preparation of financial statements. A key consideration of going concern is that the local authority has the cash resources to meet its obligations as they fall due in the foreseeable future. This is usually considered to be a year after the date of issue of the audit opinion.

We have considered whether it is appropriate for the Council to prepare its accounts on a 'going concern' basis. In making our assessment we considered the Council's financial forecast for 2016/17 and the need for the Council to fund the claims made against it with regard to equal pay in 2015/16 and 2016/17. We have also considered the risk of the Council's level of borrowing and its pension liability.

On the basis of our review we are satisfied that the Council remains a 'going concern'.

Key messages (continued)

Value for Money conclusion

The Code of Audit Practice 2010 (the Code) describes the Council's responsibilities to put in place proper arrangements to:

- secure economy, efficiency and effectiveness in its use of resources;
- ensure proper stewardship and governance; and
- review regularly the adequacy and effectiveness of these arrangements.

We are required to give our VfM conclusion based on two criteria specified by the Audit Commission which support our reporting responsibilities under the Code.

These criteria are:

- The Council has proper arrangements in place for securing financial resilience - the Council has robust systems and processes to manage effectively financial risks and opportunities, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.
- The Council has proper arrangements for challenging how it secures economy, efficiency and effectiveness - the Council is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

We issued a qualified value for money conclusion on an 'except for' basis. This means that we are satisfied that in all significant respects the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2015. We have summarised the issues relevant to our qualified value for money conclusion on the following pages

Securing financial resilience

The Council continues to face a major financial challenge, with further savings of £359 million needing to be delivered by the end of 2017/18. Although the track record of savings delivery is good, it is clearly increasingly difficult to make the scale of savings required. Responding to the Council's financial challenge is a key part of the Future Council Programme, with a fundamental re-think of the Council's operating model and approach to the development of savings plans.

The settlement of equal pay claims continues to have a negative impact on the Council's financial resilience. Although the volume of new claims has now reduced significantly the outstanding equal pay liability as at 31st March 2015 was £562 million. The Council has generated significant capital receipts to settle its equal pay liability, but still needs to generate more. It continues to be heavily reliant on the sale of major assets to meet these payments and to manage its cash and revenue position.

The Improvement Panel reported that it was concerned about slow progress being made to develop the financial strategy to deliver a balanced financial position in the period up to 2017/18. However, the Panel also recognised that the Council is taking a thorough and professional approach to the development of its financial strategy and that it had recently got back on track with the challenging delivery timetable. We have considered the development of savings plans over the next two financial years. For 2015/16 the Council has a savings requirement of £105 million and detailed implementation plans are not yet in place in all instances. The annual savings requirement increases to £167 million for 2016/17 and plans have not yet been developed for the majority of this.

Key messages continued

Challenging economy, efficiency and effectiveness

The following three issues were relevant to our conclusion on challenging economy, efficiency and effectiveness.

Responding to the Kerslake Report and the Improvement Panel

The Secretary of States decision to appoint an Improvement Panel is indicative of the scale of concerns identified by Lord Kerslake's report. The Panel has so far issued two progress reports and held two public meetings.

The Council is re-shaping itself through its Future Council Programme as it responds to the issues identified by Lord Kerslake's report. The Programme is very ambitious in both its scope and scale and is recognised by the Improvement Panel as an appropriate approach to delivering change. In its July 2015 report the Panel commended the "energy and commitment demonstrated by the Chief Executive and his team". The Panel, however concluded that it was "not yet seeing the radical shifts necessary to address the starkest of Lord Kerslake's criticisms relating to the Council's culture."

The Panel also expressed concerns about slow progress in three areas in particular; developing a City Partnership and an agreed vision for the City, securing sufficient senior management capacity to deliver the required changes, and developing the financial strategy.

As part of its response to this challenge the Council announced the appointment of the Strategic Director for Change and Corporate Services and the appointment of the new Assistant Chief Executive in October 2015. Two other roles, Director of HR and Assistant Director – Organisation Development, are also in the process of being filled .

Arrangements for children in need of help and protection, children looked after and care leavers

In May 2014 OFSTED reported that the most vulnerable children in Birmingham continue to be failed by the local authority and that there is an insufficient focus on children who need help and protection and who need to be cared for. A Children's Commissioner was appointed as part of the Secretary of State's response to this service failure with the primary purpose of overseeing the implementation of a single integrated plan. Lord Warner issued his final report in March 2015 and the improvement plan is now being implemented.

Services for vulnerable children continue to face significant challenges, not least of which is the recruitment and retention of social workers. Delivery of the improvement plan is closely monitored and managed by senior management and members.

Governance arrangements to oversee the management of schools within the City

Peter Clarke's report found significant failings in the Council's management of the governance of schools. As a result the Secretary of State appointed Sir Mike Tomlinson as Education Commissioner, to oversee the Council's implementation of improvements.

A Single Integrated Plan has been developed and is being implemented. Sir Mike Tomlinson continues to meet regularly with senior members and management to review progress. From September 2015 responsibility for school improvement has been handed over to the Birmingham Education Partnership (BEP). A Director of Schools Improvement has been appointed by the BEP but will not move on to a full time basis until January (interim arrangements are currently in place). Sir Mike Tomlinson's appointment has been extended to at least April 2016.

Key messages continued

Whole of Government Accounts	We reviewed the consolidation pack which the Council prepared to support the production of Whole of Government Accounts. We reported that the Council's pack was consistent with the audited financial statements.
Certification of housing benefit grant claim	We have not yet certified the Council's 2014/15 housing benefit grant claim. We completed sufficient work to support our audit opinion and anticipate completing our certification audit before the 30 November 2015 deadline.
Audit fee	Our fee for 2014/15 was £417,420 , excluding VAT which was in line with our planned fee for the year and was the same as the previous year. Further detail is included within appendix B.

Appendix A: Key issues and recommendations

This appendix summarised the significant recommendations identified during the 2014/15 audit.

No	Issue and recommendation	Priority	Management response
1.	<p>The Council's continued financial resilience is dependent on the delivery of its 2015/16 and 2016/17 savings targets.</p> <p>Recommendation</p> <p>The Council needs to ensure that detailed implementation plans are in place and monitored for all of the £105 million 2015/16 and £167 million 2016/17 savings requirement.</p>	High	<p>The savings programme is actively monitored through the revenue budget monitoring process. Regard is also had as part of this process to the step-up in savings from 2016/17 onwards within existing plans as well as the further requirement for additional savings. Experience of delivery issues has been taken into account in financial planning for future years.</p> <p>Responsible Officer: Assistant Director – Financial Strategy</p> <p>Timescale: On-going</p>
2.	<p>The Council needs to continue to generate significant capital receipts to settle its equal pay liability.</p> <p>Recommendation</p> <p>The Council needs to ensure that its asset strategy is delivered and report progress on delivery to Members.</p>	High	<p>The Council keeps its equal pay payment and financing strategy under regular review to inform its plans for asset disposals. Issues are considered by the (officer) Governance Group, with periodic reports to the Audit Committee and the Council's Leadership. The costs of equal pay settlements and the policy implications of the financing strategy are explicitly referred to in the Council's budget report each year, and EMT are regularly appraised as part of medium-term financial updates.</p> <p>Responsible Officer: Director of Finance.</p> <p>Timescale: On-going</p>

Appendix A: Key issues and recommendations

This appendix summarised the significant recommendations identified during the 2014/15 audit.

No	Issue and recommendation	Priority	Management response
3.	<p>The Future Council programme includes a fundamental review of financial strategy and the actions needed to secure financial resilience.</p> <p>Recommendation</p> <p>The Council needs to ensure that it has a clear and detailed financial strategy to deliver a balanced financial position up to and including 2017/18.</p>	High	<p>The Council's approach to its financial planning for 2016/17 and onwards is in the context of a business plan for a sustainable Future Council 2020. There has been a particular focus on options arising from demand management considerations. Additional resources, both internal and external, have been devoted to the business planning task, within a clear governance structure. Options for changes and new ways of working to deliver the medium-term financial strategy are being evaluated and, following an initial period of public engagement, these will be the subject of consultation in December and January. The budget will be approved by the City Council on 1 March 2016.</p> <p>Responsible Officers: Chief Executive and Director of Finance</p> <p>Timescale: 1 March 2016</p>

Appendix B: Reports issued and fees

We confirm below the fees charged for the audit and non-audit services.

Fees for audit services

	Per Audit plan £	Actual fees £
Authority audit	417,420	417,420
Grant certification fee	26,600	TBC
Total audit fees	444,020	TBC

Reports issued

Report	Date issued
Audit Plan	June 2015
Audit Findings Report	September 2015
Annual Audit Letter	October 2015

Fees for other services

Service	Fees £
Certification of grant Claims (outside the PSAA requirements)	11,250
Group Governance Review	33,000
Finance Birmingham (tax advice, due diligence support and secondment)	97,100
Innovation Birmingham (tax advice)	8,000



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