The Audit Findings for Birmingham City Council

Year ended 31 March 2017

26 September 2017

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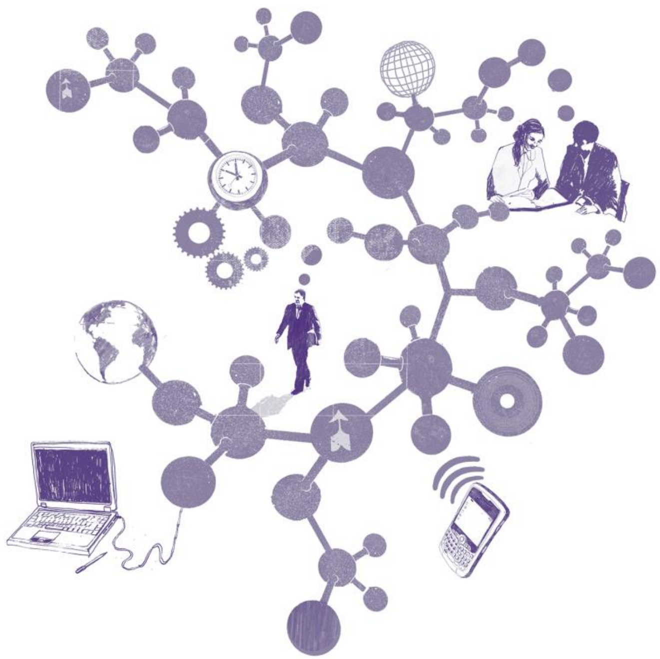

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26 September 2017

Dear Members of the Audit Committee

Audit Findings for Birmingham City Council for the year ending 31 March 2017

This Audit Findings report highlights the key findings arising from the audit that are significant to the responsibility of those charged with governance (in the case of Birmingham City Council, the Audit Committee), to oversee the financial reporting process, as required by International Standard on Auditing (UK & Ireland) 260, the Local Audit and Accountability Act 2014 and the National Audit Office Code of Audit Practice. Its contents have been discussed with officers.

As auditor we are responsible for performing the audit, in accordance with International Standards on Auditing (UK & Ireland) ('ISA (UK&I)'), 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.

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 primarily for the purpose of expressing our opinion on the financial statements and giving a value for money conclusion. 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 any control weaknesses, we will report these to you. In consequence, our work cannot be relied upon to disclose defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify. 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.

We would like to take this opportunity to record our appreciation for the kind assistance provided by the finance team and other staff during our audit.

Yours sincerely

Phil Jones

Phil W Jones

Engagement Lead

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Section 1: Executive summary

Purpose of this report

This report highlights the key issues affecting the results of Birmingham City Council ('the Council') and the preparation of the Group and Council's financial statements for the year ended 31 March 2017. It is also used to report our audit findings to management and those charged with governance in accordance with the requirements of ISA (UK&I) 260, and the Local Audit and Accountability Act 2014 ('the Act').

Under the National Audit Office (NAO) Code of Audit Practice ('the Code'), we are required to report whether, in our opinion, the Council's financial statements give a true and fair view of the financial position of the Council and its income and expenditure for the year and whether they have been properly prepared in accordance with the CIPFA Code of Practice on Local Authority Accounting ('the CIPFA Code') .

We are also required to consider other information published together with the audited financial statements (including the Annual Governance Statement (AGS) and Narrative Report), whether it is consistent with the financial statements, apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Council acquired in the course of performing our audit; or otherwise misleading.

We are not proposing to report any AGS issues in our opinion, but bring the following points to your attention.

- The management of schools has not been included as a significant governance issue in this year's AGS due to it being removed from the Council's risk register in response to the enhanced governance arrangements. Although we are not challenging this assessment we are proposing to qualify our value for money conclusion due to ongoing governance issues identified by internal audit's reviews of schools.
- We have also agreed a number of minor amendments to the AGS to enhance the clarity of the statement and to ensure compliance with the Code and CIPFA guidance.

We are required to carry out sufficient work to satisfy ourselves on whether the Council has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources ('the value for money (VfM) conclusion'). Auditor Guidance Note 7 (AGN07) clarifies our reporting requirements in the Code and the Act. We are required to provide a conclusion whether in all significant respects, the Council has put in place proper arrangements to secure value for money through economic, efficient and effective use of its resources for the year.

The Act also details the following additional powers and duties for local government auditors, which we are required to report to you if applied:

- a public interest report if we identify any matter that comes to our attention in the course of the audit that in our opinion should be considered by the Council or brought to the public's attention (section 24 of the Act);
- written recommendations which should be considered by the Council and responded to publicly (section 24 of the Act);
- application to the court for a declaration that an item of account is contrary to law (section 28 of the Act);
- issue of an advisory notice (section 29 of the Act); and
- application for judicial review (section 31 of the Act).

We are also required to give electors the opportunity to raise questions about the accounts and consider and decide upon objections received in relation to the accounts under sections 26 and 27 of the Act.

Status of the Audit

We are unable to conclude our work on the opinion for the statement of accounts and the VfM conclusion until we have completed our consideration of issues arising from the recent High Court decision on 20 September 2017 and matters relating to guarantees provided to Council subsidiaries.

In addition, we are also finalising our audit work in the following areas:
- review of the final version of the financial statements;
- obtaining and reviewing the management letter of representation;
- updating our post balance sheet events review, to the date of signing the opinion; and
- Whole of Government Accounts.

Key audit and financial reporting issues

In the conduct of our audit we have not had to alter or change our audit approach, which we communicated to you in our Audit Plan dated 14 March 2017.

We received draft financial statements on 2 June 2017 four weeks in advance of the statutory deadline. The draft accounts were well presented. The delivery of working papers was again improved compared to previous years. Most were available at the commencement of our audit, and the remainder were delivered in accordance with the agreed timetable.

We are pleased to report that the improvements made in the accounts production process resulted in closely meeting the required submission times that will be required for 2017/18. From 2017/18 the statutory deadline will be 31 May and the Financial Accounts Team are committed to delivering within this deadline.

We continue to work closely with the Financial Accounts Team and would like to express our gratitude and thanks for their hard work and support.

Financial statements opinion

We have identified two adjustments affecting the Council's overall reported financial position (details are recorded in section two of this report). The draft financial statements for the year ended 31 March 2017 recorded net expenditure of £795m; the audited financial statements have been amended to reflect net expenditure of £807m. Neither of these adjustments have any impact on the Council's usable reserves.

This change is primarily driven by amendments to property, plant and equipment. We identified £6.7m which had been incorrectly capitalised as Assets Under Construction (AUC) instead of Revenue Funded from Capital Under Statute (REFCUS), as it related to a capital grant to the West Midlands Combined Authority. In addition, we identified £5.3m of school expenditure which had been misclassified as AUC instead of buildings. As a result of the reclassification this expenditure was impaired which resulted in an equivalent adjustment to net expenditure.

We have also agreed a number of adjustments to improve the presentation of the financial statements.

We anticipate providing an unqualified audit opinion in respect of the financial statements (see Appendix B).

Further details are set out in section two of this report

Other financial statement responsibilities

As well as an opinion on the financial statements, we are required to give an opinion on whether other information published together with the financial statements is consistent with the audited accounts. This includes if the AGS and Narrative Report is misleading or inconsistent with the information of which we are aware from our audit

Controls

Roles and responsibilities

The Council's management is responsible for the identification, assessment, management and monitoring of risk, and for developing, operating and monitoring the system of internal control.

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 any control weaknesses, we report these to the Council.

Findings

Our work identified two control recommendations which we wish to highlight for your attention.

Further details are provided within section two of this report.

Value for Money

We propose issuing a qualified ‘adverse' conclusion on the Council’s arrangements for securing economy, efficiency and effectiveness in its use of resources.

This is because the weaknesses in arrangements which we have identified, are both significant in terms of their impact and numerous in terms of the number of different aspects of proper arrangements affected, that we are unable to satisfy ourselves that the Council has proper arrangements to secure VfM.

It became clear in the latter half of 2016/17 that the Council’s financial position had deteriorated significantly. The Council responded by strengthening its senior management capacity, which has resulted in a reassessment of the realism of savings plans developed in 2016/17. The new senior management arrangements have been in place for only six months. Whilst the new management team has initiated a further round of budget planning to deliver savings, it will take time for the plans to embed. Accordingly, our review has highlighted the following issues which give rise to our proposed qualified value for money conclusion:

- Budget Delivery and Reserves Management: due to the failure to deliver all of the planned savings in 2016/17 and, despite being on track to deliver 80% of planned savings as reported by the Council at Month 4, there are delivery difficulties associated with the remaining savings schemes in 2017/18;
- Future Operating Model (FOM): the FOM forms a key plank in the Council’s savings programme. Despite some FOM savings being on track for delivery, there were inadequacies in the original FOM savings methodology, resulting in the FOM not being delivered as planned in 2017/18. The Council will seek to deliver the required FOM savings according to the FOM principles;
- Improvement Panel: recent developments leading to the resignation of the Leader of the Council have highlighted that the failings in political leadership, identified by the Kerslake report, have still not been fully addressed;
- Services for Vulnerable Children: although Ofsted has acknowledged improvement following its monitoring visit, the Council is still rated as ‘inadequate’; and
- Management of Schools: Ofsted has identified some improvements in arrangements but Internal Audit reports suggest weaknesses in financial and other controls at 18% of schools visited.

Other statutory powers and duties

Section 24 recommendation follow up

We included a statutory recommendation under section 24 of the Local Audit and Accountability Act 2014 ('Section 24') in our 2015/16 Annual Audit Letter relating to the adequacy of budgetary arrangements. The recommendation stated that the Council needed to:

- ensure that there is Council-wide commitment to delivering alternative savings plans to mitigate the impact of the combined savings and budget pressure risks in 2016/17;
- demonstrate that it is implementing achievable actions to deliver its cumulative savings programme in the Business Plan 2017+ by:
  - revising savings programme from 2017/18 onwards to reflect the delayed on non-delivery of savings plans in 2016/17
  - ensuring that all savings plans are assessed for both lead time to implement and delivery risk; and
- re-assess the impact of the combined savings and budget pressure risks on the planned use of reserves for 2016/17 and the impact of this on the reserves position from 2017/18 onwards.

This recommendation and the Council's formal response were considered at the Council meeting on 10 January 2017. Following this, we wrote to the Acting Chief Executive of the Council on 15 March 2017 expressing concern about the Council's ability to deliver its challenging savings programme, particularly given the gaps in senior management capacity at that time and the proposals to further reduce senior management capacity within the finance department.

The Council subsequently responded to the issues of capacity set out in our letter by making a number of key interim appointments, in particular to the vacant positions of Chief Executive and Chief Finance Officer. In addition, a report was presented to the Audit Committee on 20 June 2017 outlining the Council's response to our Letter.

We have continued to monitor progress on delivery of the 2017/18 budget and the associated savings programme as well as following up progress made on the section 24 recommendation.

Our detailed findings in this regard are set out in the VfM section of this report.

Our conclusions overall are that progress has been made in developing a more realistic medium-term financial plan, but that key elements of the plan remain at risk. At Month 4, the Council forecast a net revenue overspend of £15.7m in 2017/18. This was an increase from a forecast of a projected revenue overspend of £13.4m at Month 2, but a reduction in the Month 3 overspend of £20.2m

The total overspend of £15.7m at Month 4 was primarily related to the Place Directorate (£4.4m), Children and Young People's Directorate (£4.8m) and the Future Operating Model (FOM) (£15.7m), offset by corporate and other mitigations of £9.2m. This is of concern, particularly as the largest area of savings under-delivery relates to the FOM, where, at Month 4, it was forecast that the cumulative under-delivery of savings in respect of the FOM would rise to £34.2m by 2019/20. The Council is exploring other ways of replacing the FOM savings.

The Council needs to continue to take action to manage the emerging trend of under-delivery of savings against plan to date, specifically to mitigate current directorate plans which are not achieving anticipated savings targets, but also to ensure that further non-delivery of savings does not occur in other planned areas currently shown as on track. This would have the effect of further increasing the overall forecast revenue overspend.

Section 24 recommendation follow up (continued)

The events surrounding the waste strike in recent weeks has affected capacity to focus on corporate budget and governance monitoring. The officer and political leadership need to work together to ensure that the Council's financial stability remains a top priority. If the waste strike continues, the additional expense arising will add to cost pressures.

We will continue to review budget monitoring reports over the coming months to determine whether sufficient progress is being made, and if not, what other formal audit action might be appropriate, whether by the issue of a report in the public interest or some other audit action.

Objections

We cannot formally conclude the audit and issue an audit certificate until we have completed our consideration of matters brought to our attention by local authority electors in relation to (a) certain education PFI schemes and (b) the Council's Lender Option Borrower Option (LOBO) loans. We are also in receipt of a whistle-blower reference in relation to the Council, which we will be following up with the Council's assistance. We are satisfied that these outstanding issues do not prevent us from issuing our audit opinion and VfM conclusion on the 2016/17 accounts.

Grant certification

In addition to our responsibilities under the Code, we are required to certify the Council's Housing Benefit subsidy claim on behalf of the Department for Work and Pensions. At present our work on this claim is in progress and is not due to be finalised until 30 November 2017.

Whilst performing our initial testing on welfare benefit expenditure one claim was identified where the frequency of earnings had been incorrectly applied leading to an overpayment. Our initial extrapolation figures led the Council to undertake testing of 100% of all Rent Allowance claimants with earned income (7,238 cases) in order for the Council to quantify the exact level of over or under payment.

The 'fails' that were identified have been evaluated and the amendment, being below a 'trivial' level, does not have a material impact on the financial statements. A contingent liability has been disclosed in note 33 of the Council's accounts and we are satisfied this is adequate.

We will report the finalised outcome of this certification work through a separate report to Audit Committee which is due in February 2018

Other matters

Senior Management Exit Packages

The Council has made a number of significant commitments during 2016/17 in relation to exit packages for senior officers, to facilitate the reshaping of the Council, to enable it to respond to the complex challenges going forward. These have ranged from payments for compensation of loss of office through to enhanced arrangements to support an early retirement. We have received a question from a Councillor regarding one of the exit package arrangements.

Accordingly we have reviewed the arrangements for these exit packages and concluded that each of the exit payments reflected different circumstances. We were however satisfied that the Council had in each instance taken legal and financial advice before finalising each arrangement. The Council also involved Members appropriately in the decisions in accordance with its procedures for Member authorisation of such payments, via the Independent Remuneration Panel ('the Panel').

There may however be scope to improve the governance around these arrangements, specifically by:

- ensuring that all reports to the Panel clearly articulate the legal, financial and operational rationale for each arrangement and in particular the likely cost implications of different options. For instance, dismissal may be an appropriate course of action in some instances, but this may prove costly if the grounds for dismissal have not been adequately evidenced;
- re-emphasising the importance of ensuring that details of emerging exit pay arrangements are maintained in strict confidence to safeguard the Council against the possibility of legal action by individuals who might consider that they have suffered damage by any 'leaks'; and
- strengthening performance management procedures for senior officers through better documentation of such processes to ensure a consistent approach.

Commonwealth Games Bid 2022

The Commonwealth Games Delivery Unit has decided that Birmingham should be recommended as a Candidate City to host the 2022 Commonwealth Games following the decision earlier in the year to strip Durban of the event. A final decision will be made by the Government as to whether to support a formal bid to the Commonwealth Games Federation to host the event. The Council has pointed to the economic, sporting and other benefits that the Games could yield for the City and the region.

We have not seen or reviewed any information associated with the projected costings or benefits associated with the bid, but it is clear that the Council will need to carry out a robust options analysis to ensure that the costs of delivering the Games, should the bid be successful, can be adequately supported within the context of its medium-term financial plan.

Other matters (continued)

Waste Dispute

The Council has sought to introduce changes to the running and organisation of its waste service with the aim of providing a high quality service and improving efficiency. In response, industrial action was commenced by waste staff from 30 June 2017 and has continued, with one short break, since. This has resulted in disruption in service to local citizens but also considerable extra costs, running at some £0.3m per week. Discussions are on-going to resolve the dispute.

The strike was suspended on 16 August 2017 following discussions under the auspices of ACAS. It has now been re-instated, following clarification by the Council that it remains committed to delivering the reorganisation in the original form agreed by cabinet on 27 June 2017. Selective details relating to the unfolding of these events have appeared in the public media. These have not served to enhance confidence in the Council's systems of governance. Whilst a clear picture is yet to emerge, we will be discussing with the Council, in the context of our formal duties, whether any breaches of governance have occurred, particularly as they relate to:

- Lawfulness of decision making
- Conduct
- Member-Officer relations

Members will recall that a key strand of the Kerslake report related to the need to re-set member-officer relations. It is of concern that initial improvements in this area may not have been sustained.

We note however that robust officer action has ensured that the breach of governance was detected and addressed.

In the wake of these events, the Leader of the Council announced his resignation on 11 September 2017. The Deputy Leader will act as Leader pro tem to provide stability.

Children's Trust

The Children's Trust will be established in 2018 and is currently operating in shadow form. We will monitor developments as the new organisation comes into being. An issue has arisen nationally in relation to the ability of such Trust's, as a private sector entities for tax purposes, to recover VAT for services supplied, which could have considerable financial implications for Local Authorities.

The Council has however received a letter from the DfE on 11 July 2017 stating that "in the interim, the Secretary of State has agreed to meet any additional costs arising from the VAT treatment of the Birmingham Children's Trust". We will continue to monitor this position going forward although we are satisfied this risk has been sufficiently mitigated in the short to medium term.

Other statutory powers and duties

We have not identified any issues that have required us to apply our statutory powers and duties under the Act.

Grant certification

In addition to our responsibilities under the Code, we are required to certify the Council's Housing Benefit subsidy claim on behalf of the Department for Work and Pensions. At present our work on this claim is in progress and is not due to be finalised until 30 November 2017.

Whilst performing our initial testing on welfare benefit expenditure one claim was identified where the frequency of earnings had been incorrectly applied leading to an overpayment. Our initial extrapolation figures led the Council to undertake testing of 100% of all Rent Allowance claimants with earned income (7,238 cases) in order for the Council to quantify the exact level of over or under payment.

The 'fails' that were identified have been evaluated and the amendment, being below a 'trivial' level, does not have a material impact on the financial statements. A contingent liability has been disclosed in note 33 of the Council's accounts and we are satisfied this is adequate.

We will report the finalised outcome of this certification work through a separate report to Audit Committee which is due in February 2018.

The way forward

Matters arising from the financial statements audit and our review of the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources have been discussed with the Interim Chief Finance Officer.

We have made a number of recommendations, which are set out in the action plan at Appendix A. Recommendations have been discussed and agreed with the Interim Chief Finance Officer and the wider finance team.

Acknowledgement

We would like to take this opportunity to record our appreciation for the assistance provided by the finance team and other staff during our audit.

Grant Thornton UK LLP
September 2017

Section 2: Audit findings

Materiality

In performing our audit, we apply the concept of materiality, following the requirements of ISA (UK&I) 320: Materiality in planning and performing an audit. The standard states that 'misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements'.

As we reported in our audit plan, we determined overall materiality (the amount above which the accounts would be deemed to be misstated in relation to our audit opinion) to be £43.19m (being 1.5% of gross revenue expenditure). We have considered whether this level remained appropriate during the course of the audit and have made no changes to our overall materiality.

We also set an amount below which misstatements would be clearly trivial and would not need to be accumulated or reported to those charged with governance because we would not expect that the accumulated effect of such amounts would have a material impact on the financial statements. We have defined the amount below which misstatements would be clearly trivial to be £2.16m. We report all individual misstatements above this level within this report and also consider such items cumulatively to ensure they do not exceed materiality in total. This remains the same as reported in our audit plan.

As we reported in our audit plan, we identified the following items where we decided that separate materiality levels were appropriate. These remain the same as reported in our audit plan.

Balance/transaction/disclosure	Explanation	Materiality level
Disclosures of officers' remuneration, salary bandings and exit packages in notes to the statements	Due to public interest in these disclosures and the statutory requirement for them to be made.	£20,000
Related party transactions	Due to public interest in these disclosures	Materiality is set at £100,000. However, errors will be assessed individually with due regard given to the nature of the error and its potential impact on the materiality of the other party.

Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements; Judgements about materiality are made in light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both; and Judgements about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered. (ISA (UK&I) 320)

Audit findings against significant risks

In this section we detail our response to the significant risks of material misstatement which we identified in the Audit Plan. As we noted in our plan, there are two presumed significant risks which are applicable to all audits under auditing standards

Risks identified in our audit plan	Work completed	Assurance gained and issues arising
The revenue cycle includes fraudulent transactions Under ISA (UK&I) 240 there is a 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 at Birmingham City Council, 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; and • the culture and ethical frameworks of local authorities, including Birmingham City Council, mean that all forms of fraud are seen as unacceptable.	Our audit work has not identified any issues in respect of revenue recognition.
Management over-ride of controls Under ISA (UK&I) 240 it is presumed that the risk of management over-ride of controls is present in all entities.	• Review of entity level controls; • Review of journal entry processes and selection of unusual journal entries for testing back to supporting documentation; • Review of accounting estimates, judgements and decisions made by management; and • Review of unusual significant transactions.	Our audit work has not identified any evidence of management over-ride of controls. In particular the findings of our review of journal controls and testing of journal controls and testing of journal entries has not identified any significant issues.

"Significant risks often relate to significant non-routine transactions and judgmental matters. Non-routine transactions are transactions that are unusual, due to either size or nature, and that therefore occur infrequently. Judgmental matters may include the development of accounting estimates for which there is significant measurement uncertainty." (ISA (UK&I) 315) . In making the review of unusual significant transactions "the auditor shall treat identified significant related party transactions outside the entity's normal course of business as giving rise to significant risks." (ISA (UK&I) 550)

Audit findings against significant risks (continued)

We have also identified the following significant risks of material misstatement from our understanding of the entity. We set out below the work we have completed to address these risks.

Risks identified in our audit plan	Work completed	Assurance gained and issues arising
Going Concern The Council faced significant financial challenges and forecasted a significant deficit position for 2016/17. This raised doubts over the completeness and adequacy of the going concern disclosures in the accounts, particularly in relation to material uncertainty.	• Review of management's assessment of going concern assumptions and supporting information, e.g. 2017/18 and 2018/19 budgets and cash flow forecasts and associated sensitivity analysis; and • Review of completeness and accuracy of disclosures on material uncertainties in the financial statements.	We have considered whether there is evidence of material uncertainty that the Council will continue as a going concern for 12 months from the date of our audit report. We are satisfied that the Council's financial statements have been appropriately prepared on a going concern basis.
Valuation of property, plant and equipment The Council revalues its assets on a rolling basis over a five year period. The CIPFA Code requires that the Council ensures that the carrying value at the balance sheet date is not materially different from the current value. This represents a significant estimate by management in the financial statements.	• Review of controls in place to ensure that revaluation measurements are correct; • Testing of revaluations including instructions to the valuer and the valuer's report; • Review of management's processes and assumptions for the calculation of the estimate; • Review of the competence, expertise and objectivity of any management experts used; • Discussions with the Council's valuer about the basis on which the valuation was carried out, challenging the key assumptions; • Review and challenge of the information used by the valuer to ensure it was robust and consistent with our understanding; • Testing of revaluation when assets are brought into use; and • Review of the procedures used to ensure that assets not revalued during the year (due to the Council's rolling 5 year revaluation programme) that these were not materially different to current value.	The valuation date within the valuer's report for General Fund land and buildings is 1 April 2016, but is accounted for as if the valuation was at 31 March 2017, subject to the adjustment noted below. To ensure the valuation is not materially misstated, the valuer reviewed the potential movement in values for the year. As part of this, the valuer also carried out a desktop review of all DRC (Depreciated Replacement Cost) valued assets not subject to formal revaluation, to assess whether they were materially misstated. He concluded that the carrying values of these assets needed to be adjusted. This resulted in an increase of £10.9m for assets fully revalued in 2016/17, and £94.3m for assets not revalued during 2016/17. We are satisfied that the accounts are consistent with the valuation and assessment and that this demonstrates there is a low risk of material misstatement. Our audit work has not identified any other significant issues in respect of valuation of property, plant and equipment.

Audit findings against significant risks (continued)

Risks identified in our audit plan	Work completed	Assurance gained and issues arising
Valuation of pension fund net liability The Council's pension fund asset and liability, as reflected in its balance sheet, represents a significant estimate in the financial statements.	• Identifying the controls put in place by management to ensure that the pension fund liability is not materially misstated and assessing whether those controls were implemented as expected and whether they were sufficient to mitigate the risk of material misstatement; • Review of the competence, expertise and objectivity of the actuary who carried out the Council's pension fund valuation; • Gaining an understanding of the basis on which the IAS 19 valuation was carried out, undertaking procedures to confirm the reasonableness of the actuarial assumptions made; and • Review of the consistency of the pension fund asset and liability disclosures in notes to the financial statements with the actuarial report from your actuary.	Our audit work has not identified any issues which we wish to bring to your attention.

Audit findings against significant risks (continued)

Risks identified in our audit plan	Work completed	Assurance gained and issues arising
Changes to the presentation of local authority financial statements CIPFA has been working on the 'Telling the Story' project, for which the aim was to streamline the financial statements and improve accessibility to the user and this has resulted in changes to the 2016/17 CIPFA Code. The changes affect the presentation of income and expenditure in the financial statements and associated disclosure notes. A prior period adjustment (PPA) to restate the 2015/16 comparative figures is also required.	• Documentation and evaluation of the process for the recording the required financial reporting changes to the 2016/17 financial statements; • Review of the re-classification of the Comprehensive Income and Expenditure Statement (CIES) comparatives to ensure that they are in line with the Council's internal reporting structure; • Review of the appropriateness of the revised grouping of entries within the Movement In Reserves Statement (MIRS); • Tested the classification of income and expenditure for 2016/17 recorded within the Cost of Services section of the CIES; • Tested the completeness of income and expenditure by reviewing the reconciliation of the CIES to the general ledger; • Tested the classification of income and expenditure reported within the new Expenditure and Funding Analysis (EFA) note to the financial statements; and • Review of the new segmental reporting disclosures within the 2016/17 financial statements to ensure compliance with the CIPFA Code.	We identified that the column 'expenditure reported to cabinet' within the Expenditure and Funding Analysis note had been constructed using budget figures instead of the actual figures as reported to Cabinet. This has been included as a disclosure change to the financial statements and amendments have been agreed by the Council. Our audit work has not identified any further issues which we wish to bring to your attention.

Audit findings against other risks

In this section we detail our response to the other risks of material misstatement which we identified in the Audit Plan. Recommendations, together with management responses are attached at appendix A

Transaction cycle	Description of risk	Work completed	Assurance gained & issues arising
Operating expenses	Non-pay expenditure represents a significant percentage of the Council's gross expenditure. Management uses judgement to estimate accruals of un-invoiced non-pay costs. We identified the completeness of non-pay expenditure in the financial statements as a risk requiring particular audit attention: • Creditors understated or not recorded in the correct period (Operating expenses understated)	We have undertaken the following work in relation to this risk: • Documented our understanding of processes and key controls over the transaction cycle; • Undertaken walkthrough of the key controls to ensure those controls were in line with our documented understanding and that controls in place ensured operating expenses were not understated and were recorded in the correct period; • Reviewed the application of the year-end closedown process for capturing creditor accruals; and • Undertaken substantive testing of year end creditors including after date payments.	We tested a sample of payments made in April and May 2017 to identify whether there were items relating to goods/services received in 2016/17 which had not been appropriately accrued for (whether via system/manual accruals or the forecast accrual process). Two out of the seven school invoice payments selected within our sample related to services received prior to 31/3/17, but processed for payment after year-end, which were not manually accrued by the school on their submission to BCC. The total value of such school invoices paid in April and May amount to £9.8m, and this value is expected to include invoices for goods and services relating to both 2016/17 and 2017/18. Therefore, we are satisfied there cannot be a material risk of under-accrual of school invoices relating to 2016/17. We recommend that the Council review their processes for ensuring schools expenditure includes appropriate accruals. Our audit work did not identify any other issues which we wish to bring to your attention.

"In respect of some risks, the auditor may judge that it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures. Such risks may relate to the inaccurate or incomplete recording of routine and significant classes of transactions or account balances, the characteristics of which often permit highly automated processing with little or no manual intervention. In such cases, the entity's controls over such risks are relevant to the audit and the auditor shall obtain an understanding of them." (ISA (UK&I) 315)

Audit findings against other risks (continued)

Transaction cycle	Description of risk	Work completed	Assurance gained & issues arising
Property, plant and equipment (PPE)	Risk that property plant and equipment activity is not valid	We have undertaken the following work in relation to this risk: • Documented our understanding of processes and key controls in place to ensure that PPE activity was valid; • Undertaken a walkthrough of the process to ensure controls were in line with our documented understanding; • Tested the agreement of the fixed asset register to the accounts and supporting notes; and • Tested a sample of PPE additions and disposals as well as ensuring compliance with capitalisation requirements.	Our testing identified two errors which have been adjusted in the Statement of Accounts. These related to incorrect capitalisation of £6.7m spend on the Midland Metro which should be treated as REFCUS and £5.3m spend on one school which came into use in 2016/17 but was not transferred out of Assets Under Construction (AUC). We identified some issues relating to capital spend recorded by schools: • One item selected for testing related to IT support for April 2016 - March 2017. This was capitalised as spend on buildings which is incorrect as this appears to be a revenue cost. We understand that this issue relates specifically to Devolved Formula Capital (DFC) and that the DFC applied in year totals £2.6m. As this is the maximum possible error (and any actual error would be expected to be lower), we are therefore satisfied that there is not a material risk. • All DFC is capitalised as buildings spend, but one item selected for testing related to playground equipment which would be better classified as 'equipment'. This is a misclassification issue only, with no impact on the total net book value of PPE. We identified some issues relating to the way the system records settlements in terms of classification between transfers from AUC and additions: • A £5m manual adjustment is required in Note 22 to both the value shown as transfers out of AUC and additions to AUC, to ensure that the transfers out of AUC balance to nil overall and the values reconcile in total. The majority of this relates to Housing Revenue Account (HRA) assets which are not shown as a transfer out of AUC but rather taken straight to additions. • We identified that when the system transfers spend from AUC to assets in use in some cases, it shows prior year spend as an in-year addition. This appears to relate to the treatment of prior year accruals which is not material. • We are satisfied that both of the points above relate to adjustments within Note 22 only, with no net impact on the gross book value or net book values of PPE. There is no specific requirement in the CIPFA Code to disclose transfers out of AUC separately to additions so the current layout of the note is more transparent. We identified that all spend on HRA additions is fully settled in year, with nothing being retained in AUC at year-end. While for spend relating to renewals to existing properties, any AUC element is unlikely to be material at year end, in recent years the Council has undertaken significant construction of new properties, and where construction spans year-end the spend should properly be included in AUC until brought into use. We are satisfied that the estimated potential impact would be trivial due to the need to impair the spend to reflect social housing factors and any impact on depreciation would also be trivial. We recommend this is reviewed in future years if the Council continue to expand their house building programme, to ensure there is no risk of material misstatement. We identified no other issues that we wish to bring to your attention.

Audit findings against other risks (continued)

Transaction cycle	Description of risk	Work completed	Assurance gained & issues arising
Employee remuneration	Payroll expenditure represents a significant percentage of the Council's gross expenditure. We identified the completeness of payroll expenditure in the financial statements as a risk requiring particular audit attention: • Employee remuneration accruals understated (Remuneration expenses not correct)	We have undertaken the following work in relation to this risk: • Documented our understanding of processes and key controls over the transaction cycle; • Undertaken walkthrough of the key controls to assess whether those controls were in line with our documented understanding and were in place to ensure payroll expenses were not understated and were included in the correct period; • Reconciled the annual payroll to the ledger and to the segmental analysis note in the accounts; • Completed a trend analysis of monthly and weekly payroll payments covering 2016/17 and compared these to 2015/16 to determine whether additional substantive testing was required; and • Agreement of employee remuneration disclosures in the financial statements to supporting evidence.	Our audit work did not identify any issues that we wish to bring to your attention.

Group audit scope and risk assessment

ISA (UK&I) 600 requires that as Group auditors we obtain sufficient appropriate audit evidence regarding the financial information of the components and the consolidation process to express an opinion on whether the group financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

Component	Significant?	Level of response required under ISA 600	Risks identified	Work completed	Assurance gained & issues raised
NEC (Developments) PLC	No	Analytical	Subsidiary	Agreement of consolidation using audited accounts and analytical approach	Our audit work has not identified any material issues.
Innovation Birmingham Ltd	No	Analytical	Subsidiary	Agreement of consolidation using audited accounts and analytical approach	Our audit work has not identified any material issues.
Performances (Birmingham) Ltd	No	Analytical	Subsidiary	Agreement of consolidation using audited accounts and analytical approach	Our audit work has not identified any material issues.
Acivico Ltd	No	Analytical	Subsidiary	Agreement of consolidation using audited accounts and analytical approach	Our audit work has not identified any material issues.
Birmingham Museums Trust	No	Analytical	Subsidiary	Agreement of consolidation using audited accounts and analytical approach	Our audit work has not identified any material issues.
PETPS	No	Analytical	Subsidiary	Agreement of consolidation using audited accounts and analytical approach	Our audit work has not identified any material issues.
InReach (Birmingham) Ltd	No	Analytical	Subsidiary	Agreement of consolidation using audited accounts and analytical approach	Our audit work has not identified any material issues.
Paradise Circus Limited Partnership	No	Analytical	Joint Venture	Agreement of consolidation using audited accounts and analytical approach	Our audit work has not identified any material issues.
Service Birmingham Ltd	No	Analytical	Associate	Agreement of consolidation using audited accounts and analytical approach	Our audit work has not identified any material issues.
Birmingham Airport Holdings Ltd	No	Analytical	Associate	Agreement of consolidation using audited accounts and analytical approach	Our audit work has not identified any material issues.

Accounting policies, estimates and judgements

In this section we report on our consideration of accounting policies, in particular revenue recognition policies, and key estimates and judgements made and included with the Council's financial statements.

Accounting area	Summary of policy	Comments	Assessment
Revenue recognition	The Council has adopted the following revenue recognition policy: • Service activity is accounted for in the year it takes place, not simply when cash payments are made or received; • Revenue from the sale of goods is recognised when the Council transfers the significant risks and rewards of ownership to the purchaser and it is probable that economic benefits or service potential associated with the transaction will flow to the Council; • Revenue from the provision of services is recognised when the Council can reliably measure the percentage of completion of the transaction and it is probable that economic benefits or service potential associated with the transaction will flow to the Council; • Interest receivable on investments is accounted for as income on the basis of the effective interest rate for the relevant financial instrument rather than the cash flows fixed or determined by the contract; • When income has been recognised but cash has not been received, a debtor for the relevant amount is recorded in the Balance Sheet. Where debts may not be settled, the balance of debtors is written down and a charge made to revenue for the income that might not be collected.	We are satisfied that the Council's disclosure note on revenue recognition is adequate and is consistent with the requirements of the CIPFA Code.	● Green

Assessment
- ● Marginal accounting policy which could potentially attract attention from regulators
- ● Accounting policy appropriate but scope for improved disclosure
- ● Accounting policy appropriate and disclosures sufficient

Accounting policies, estimates and judgements (continued)

Accounting area	Summary of policy	Comments	Assessment
Judgements and estimates	Key estimates and judgements include: • Required level of provisions, specifically with respect to equal pay liabilities and business rates valuation appeals; • The valuation, impairment and remaining useful life of Property Plant and Equipment; • Assessment of PFI schemes and other arrangements as to whether they fall within the scope of IFRIC 12; • Valuation of long term liabilities for PFI and leasing; • Present value of pension obligations; • Estimate of provision required for bad debts.	Our findings from our review of judgements and estimates are set out below: We have reviewed the Council's accounting policies with regard to judgements and estimates and are satisfied that they are appropriate and in accordance with the recommendations of the CIPFA Code. Note 32 Provisions includes: • A £145m provision for the payment of Equal Pay claims. The Council recognises equal pay claims and estimates the potential cost when they are received. Due to the receipt of claims falling as the time limits imposed for claims reduces the Authority have included all provisions as short term as they propose to finalise all claims by 31 March 2018. The impact of claims received since 28 February 2017 were also assessed. New claims received between February and July totalled £450k. However, due to time limitations of claims as at 31 July 2017, £5.4m of the original provision is no longer a liability for the Council. • The Council has also identified additional claims of £8.5m. These amounts have not been amended in the financial statements and are not deemed to be material. • We concluded that there was not a risk of material estimation uncertainty from not including these claims in the provision. We are satisfied that the Council's judgement and estimation in relation to Equal Pay is adequate and is consistent with the requirements of the CIPFA Code. (continued)	● Green

Assessment
● Marginal accounting policy which could potentially attract attention from regulators
● Accounting policy appropriate but scope for improved disclosure
● Accounting policy appropriate and disclosures sufficient

Accounting policies, estimates and judgements (continued)

Accounting area	Summary of policy	Comments	Assessment
Judgements and estimates	Key estimates and judgements include: • Required level of provisions, specifically with respect to equal pay liabilities and business rates valuation appeals; • The valuation, impairment and remaining useful life of Property Plant and Equipment; • Assessment of PFI schemes and other arrangements as to whether they fall within the scope of IFRIC 12; • Valuation of long term liabilities for PFI and leasing; • Present value of pension obligations; • Estimate of provision required for bad debts.	• A £26 million provision for business rate valuation appeals. The settlement of business rate valuation appeals is determined by the Valuation Office Agency (VOA). We reviewed the Council's approach to estimating its provision including its consideration of the impact of the settlement of appeals since the balance sheet date. We are satisfied that the estimate has been made on a reasonable basis. Our consideration of property plant and equipment valuations issues is considered under "audit findings significant risks" on page 16. The Council has a number of Public Finance Initiative ('PFI') schemes. The finance liability is disclosed in the balance sheet at £440 million. Revenue and interests payments are also disclosed in Note 43. We are satisfied that the PFI liabilities are consistent with the Authority's financial models and that the allocation between interest, service and capital repayments is materially correct. The Council's estimated pension liability has increased by £783 million compared to the 2015/16 balance sheet. This change is largely due to the actuary's reassessment of the Council's future pension liability. Although the Council does not accurately classify housing benefit debtors between short and long term we are satisfied that this would not lead to a material misstatement in the financial statements. However, we recommend that the estimation of debt to be received after the year end should accurately reflect the time collection period.	● **Green**

Assessment

● Marginal accounting policy which could potentially attract attention from regulators ● Accounting policy appropriate but scope for improved disclosure ● Accounting policy appropriate and disclosures sufficient

Accounting policies, estimates and judgements (continued)

Accounting area	Summary of policy	Comments	Assessment
Going concern	The Interim Chief Finance Officer, s151 officer has a reasonable expectation that the services provided by the Authority will continue for the foreseeable future. Members concur with this view. For this reason, the Authority continue to adopt the going concern basis in preparing the financial statements.	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 Authority's financial forecast for 2017/18 and 2018/19 and the forecast savings within its business plan. Although we recognised that the Council has significant savings targets and pressures over the next two financial years we are satisfied the Councils remaining useable reserves (assuming 'worse case' scenario) could substantially cover the non-delivery of this savings total and budget pressures 2017/18 and 2018/19 and the going concern assumption is therefore appropriate.	● **Green**
Other accounting policies		We have reviewed the Council's policies against the requirements of the CIPFA Code. The Council's accounting policies are appropriate and consistent with previous years.	● **Green**

Assessment
- ● Marginal accounting policy which could potentially attract attention from regulators
- ● Accounting policy appropriate but scope for improved disclosure
- ● Accounting policy appropriate and disclosures sufficient

Other communication requirements

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	Commentary
1.	**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 other incidents in the period and no other issues have been identified during the course of our audit procedures.
2.	**Matters in relation to related parties**	From the work we carried out, we have not identified any related party transactions which have not been disclosed. We did identify that Optima Community Association was incorrectly included within Note 48 - Related Parties. Based on discussions with officers, there is no member or officer involvement, nor element of ownership. Optima has therefore been removed from the list of related parties as it does not meet the definition under IAS 24. We identified that the related party note is not fully compliant with IAS24 as the disclosures do not document all transactions with material related parties (to both the Council and the other entity). However, we are satisfied that the note is sufficient and the required work to disclose this information would not be proportionate to the value of information added to the reader of the accounts.
3.	**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.
4.	**Written representations**	A letter of representation has been requested from the Authority that includes specific representations on the following: • the receipt of the claim is the appropriate point to recognise a liability for equal pay; • it is not possible to accurately estimate the volume, type or value of future equal pay claims; • the fair values of property, plant and equipment, and the equal pay provision are appropriate; • there are no onerous contracts for Academy Schools with a PFI agreement in place at the transfer; • the Council holds no investment properties other than those disclosed on the balance sheet; • the Council does not consider that it needs to make additional provision for uncollected Council Tax or Non Domestic rates debt; • the Council considers that it remains a 'going concern' for the foreseeable future; and • The Council is satisfied that it will be able to deliver sufficient savings or utilise reserves to enable it to meet its 'financial duties'.

Other communication requirements (continued)

	Issue	Commentary
5.	**Confirmation requests from third parties**	We requested from management permission to send confirmation requests for bank and all material and a sample of non-material borrowings balances. This permission was granted and the requests were sent. All of these requests were returned with positive confirmation.
6.	**Disclosures**	We have summarised the disclosure amendments included in the final version of the accounts on pages 31 to 33.
7.	**Matters on which we report by exception**	We have not identified any issues we would be required to report by exception in the following 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 information of which we are aware from our audit; • The information in the Narrative Report is materially inconsistent with the information in the audited financial statements or our knowledge of the Council and Group acquired in the course of performing our audit, or otherwise misleading.
8.	**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 £350m we examine and report on the consistency of the WGA consolidation pack with the Authority's audited financial statements. At the time of drafting this report our audit work is not yet complete. We plan to complete the work before signing our audit opinion.
9.	**Audit evidence and explanations**	All information and explanations requested from management was provided.
10.	**Significant difficulties**	We did not encounter any significant difficulties during the audit.
11.	**Other matters**	There are no other matters we need to report to you.

Internal controls

	Assessment	Issue and risk	Recommendations
1.	● Amber	**Group Accounts** Group accounts have been produced from unaudited accounts for all group entities included in the consolidated Balance Sheet. Audited accounts are received by the finance team throughout the audit process. Due to information delay management accounts have been used to consolidate two of the subsidiaries. This issue has been reported in previous years but as the closedown timetable reduces the importance of timely information increases.	The Audit Committee needs assurance that group entities provide sufficient information by the end of April to ensure materially accurate group accounts can be produced and that audited accounts are received before the completion of the Authority's audit.
2	● Amber	**Housing Benefits** There have been two instances in the year where potential control weaknesses regarding the housing benefit system have been identified. The first related to a duplicate payment run which the Council manually prevented from being paid. However, it still continued to be recorded as duplicated within RBIS (Revenue and Benefits Information System) and therefore subsidy. We have obtained a list of affected claims and tested a sample of these to ensure the duplicated amount has been correctly removed from RBIS and the subsidy claim. The second related to two high value payments made in error, where on both occasions, an incorrect weekly rent figure had been manually entered in to the rent field of RBIS. These payments were stopped by the Council as they were identified as unusually large from the >£3k checks which are performed by the housing benefits team. This led to payments being recorded in RBIS in error and these have required manual amendment. We have tested both of these cases to ensure the correct adjustment have been processed in RBIS as well as the impact on subsidy. We are satisfied that there is no risk of material misstatement of the financial statements.	We are satisfied that the Council has correctly dealt with these issues noted. They have also taken steps to mitigate the risk of a similar thing happening again, for instance, by restricting the number of characters that can be entered into the rent field in RBIS. However, we recommend that the Council continues to strengthen its internal controls with regards to Housing Benefit payments in order to reduce the risk of incorrect payments being made and not being identified manually prior to payment.

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.

"The purpose of an audit is for the auditor to express an opinion on the financial statements.

Our audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control.

The matters being reported are limited to those deficiencies that the auditor has identified during the audit and that the auditor has concluded are of sufficient importance to merit being reported to those charged with governance." (ISA (UK&I) 265)

Assessment
- ● Significant deficiency – risk of significant misstatement
- ● Deficiency – risk of inconsequential misstatement

Adjusted misstatements

A number of adjustments to the draft accounts have been identified during the audit process. We are required to report all non trivial misstatements to those charged with governance, whether or not the accounts have been adjusted by management. The table below summarises the adjustments arising from the audit which have been processed 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.

	Detail	Comprehensive Income and Expenditure Statement £m	Balance Sheet £m	Impact on total net expenditure £m
1	In our additions testing we identified £6.7m of spend which was capitalised as AUC but related to a capital grant to the West Midlands Combined Authority for expenditure on the Midland Metro extension. This is not a Birmingham City Council asset and should therefore be accounted for as REFCUS.	6.7	(6.7)	£6.7
2	Testing identified spend totalling £5.3m relating to one school which had been included in AUC at year-end. £0.8m of the value related to spend in 2016/17 and the remainder to spend from previous years. We understand this should have been settled to 'buildings' during 2016/17 as the asset came into use. This also results in an increase in the charge to CIES relating to downwards revaluation of the asset.	5.3	(5.3)	5.3
	Overall impact	**£12.0**	**(£12.0)**	**£12.0**

It should be noted that none of the adjustments above have any impact on the Council's usable reserves.

Misclassifications 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.

	Adjustment type	Value	Account balance	Impact on the financial statements
1	Disclosure	£66.3m	Comprehensive Income and Expenditure Statement (CIES)	2015/16 restated figures - the impairment of the NECD investment was placed against Place directorate for the entity EFA rather than Corporate Resources. This is incorrect and has been adjusted.
2	Disclosure	n/a	Narrative Report	Detail within the Narrative Report relating to the year-end outturn and reserve movements has been enhanced to improve clarity to the reader of the accounts. Additionally the Council's officers identified that an amendment was required to the disclosure of the length of the pension deficit recovery plan in the Narrative Report and in Note 21 - Defined Benefit Pension Schemes.
3	Disclosure	n/a	Various	A number of improvements have been made to the narrative disclosures relating to restatements of 2015/16 figures. The improvements include additional detail relating to the value and nature of such restatements.
4	Disclosure	n/a	Note 1 Accounting Policies	An amendment has been made to accounting policies 'xvii Interests in Companies and Other Entities' and 'xxvii Jointly Controlled Operations and Jointly Controlled Assets' to update these to new IFRS terminology. 'Jointly controlled entities' has been amended to 'joint operations' as the Council only holds Paradise Circus Limited Partnership which is defined as a joint operation. An amendment has also been made to accounting policy 'xi. Property, Plant and Equipment' to clarify that Tyseley Energy Recovery Facility is the only item within the vehicles, plant, furniture and equipment category not valued using the depreciated historical cost method.

Misclassifications and disclosure changes (continued)

	Adjustment type	Value	Account balance	Impact on the financial statements
5	Disclosure	Various	Note 5 Expenditure and Funding Analysis and Note 6 Note to the Expenditure and Funding Analysis	We identified that the draft accounts used budgeted figures rather than actuals in Note 5 column one ('Net expenditure reported to Cabinet'). The accounts have been updated to reflect actuals which also affects the adjustments shown in Note 5 column two ('Adjustment to arrive at the Net Amount Chargeable to the General Fund and HRA Balances') and the related analysis in Note 6. Additional narrative has also been added to explain the material 'other adjustments' in column three of Note 6.
6	Misclassification	£134.8m	Note 8 Expenditure and Funding Analysis by Nature of Activity	The accounts have been adjusted to correct a £134.8m misclassification between Fees, Charges and Other Services Income and Government Grants and Contributions lines. (Fees, Charges and Other Services Income was understated, Government Grants and Contributions was overstated). This issue was identified by Council officers.
7	Disclosure	n/a	Note 9	Minor amendment made to include reference to the £66.3m impairment made in 2015/16.
8	Disclosure	n/a	Note 18 Usable Reserves, Balance Sheet	The Council has decided to make an amendment to disaggregate usable reserves on the face of the balance sheet into four subsections (unearmarked, earmarked, ring-fenced and capital). In addition, Note 18 disclosures have been enhanced. No amendments have been made to the total values disclosed, simply to the presentation.
9	Misclassification	£57.1m	Note 22 Property, Plant and Equipment – Movements in Balances table	An amendment has been made to other land and buildings to remove the £57.1m previously shown as an impairment and to include this on the 'depreciation written out to the surplus or deficit on provision of services' line instead. This is because the £57.1m does not reflect true impairment, but simply depreciation written out on downward revaluation. The 2015/16 figures have been restated on the same basis to ensure consistency.

Misclassifications and disclosure changes (continued)

	Adjustment type	Value	Account balance	Impact on the financial statements
10	Misclassification	£4.3m	Note 30 Cash and Cash Equivalents,	The accounting policy for cash states that cash must be available the next day, otherwise it is classified as short term investments. Our testing of chequebook schools cash (ledger code 5TA4) identified one school with £2m cash held in an investment account which matured in April 2017, and £507k in a 32 day notice account. Therefore these accounts did not meet the definition of cash as per the accounting policy. Council officers have subsequently reviewed all schools accounts included in code 5TA4 and identified that a total reclassification of £4.3m is required from cash and cash equivalents to short term investments. The accounts have been updated to reflect this.
11	Disclosure	£28,460 (M Rogers) £3,546 (C Gibbs) £99,055 (P Hay)	Note 45 Officers' Remuneration	The pension fund strain figure shown for Mark Rogers was estimated as the final calculation was not available at the time of preparing the draft accounts. The actual pension fund strain figure has now been provided by the West Midlands Pension fund and is £28,460 higher than estimated. Council officers also identified that values shown in the draft accounts excluded an 'acting up allowance' of £3,546 paid to Chris Gibbs in arrears in April 2017, which related to 2016/17. A further payment of £99,055 was made to P Hay. This was part of his original settlement but was held back until signatures were finalised. The Statement of Accounts have been corrected to reflect both of these amendments.
12	Disclosure	n/a	Note 48 Related Parties	We identified that Optima Community Association was incorrectly disclosed as a related party. Based on discussions with officers, there is no member or officer involvement, nor element of ownership. Optima has therefore been removed from the list of related parties as it does not meet the definition under IAS24.
13	Disclosure	n/a	Note G1 Group Accounting Policies	The reference to carrying investments in associates at cost has been clarified to confirm this refers to the single entity rather than the group accounts.
14	Disclosure	n/a	Various	In addition to the items identified above, a number of other minor improvements have been made to disclosures within the accounts. None of these are deemed significant enough to bring to your attention individually.

Uncertainties

The Council has transferred services to other entities where TUPE provisions apply and in doing so has entered into contractual arrangements to guarantee the pension obligations or contributions of the entity. They have disclosed these guarantees as contingent liabilities in the financial statements. However, our view is that where these guarantees are contractual they will fall outside of the scope of IAS37 Provisions, Contingent liabilities and Contingent Assets and so we would not expect to see a contingent liability.

The accounting for these guarantees should then be determined with reference to the nature of the agreement between the parties involved and consideration as to whether these are derivative financial liabilities under IAS39 Financial Instruments: Recognition and Measurement or insurance contracts under IFRS 4 Insurance Contracts, dependent on the risks involved, therefore bringing the liability onto the balance sheet. Management judgement is therefore required as to whether non-financial risks (results in IFRS4 treatment) of financial risk (result in IAS39 treatment) are greater.

Following our initial discussions, management have further considered these guarantees and concluded that they are insurance contracts and have estimated the unrecorded liability in the financial statements to be £7.8m.

Management have decided not to amend the 2016/17 financial statements as the sum is not material to the financial statement and more work is required by the Council to understand the exact nature of these arrangements and the correct accounting treatment. This will be given further consideration by management in 2017/18.

It is also worth noting that there is currently no specific sector guidance on this issue, so we will be raising the issue with CIPFA for further consideration in 2017/18.

Section 3: Value for Money

Background

We are required by section 21 of the Local Audit and Accountability Act 2014 ('the Act') and the NAO Code of Audit Practice ('the Code') to satisfy ourselves that the Authority has put in place 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 Authority. The Act and NAO guidance state that for local government bodies, auditors are required to give a conclusion on whether the Authority has put proper arrangements in place.

In carrying out this work, we are required to follow the NAO's Auditor Guidance Note 3 (AGN 03) issued in November 2016. 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.*

AGN03 provides examples of proper arrangements against three sub-criteria but specifically states that these are not separate criteria for assessment purposes and that auditors are not required to reach a distinct judgement against each of these.

Risk assessment

We carried out an initial risk assessment in December 2016 - January 2017 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 VfM Plan dated January 2017.

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.

Significant qualitative aspects

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. It became clear in the latter half of 2016/17 that the Council's financial position had deteriorated significantly. In arriving at our conclusion, our main considerations were:

- Budget Delivery and Reserves Management: due to the failure to deliver all of the planned savings in 2016/17 and, despite being on track to deliver 80% of planned savings as reported by the Council at Month 4, there are delivery difficulties associated with the remaining savings schemes in 2017/18;
- Future Operating Model (FOM): the FOM forms a key plank in the Council's savings programme. Despite some FOM savings being on track for delivery, there were inadequacies in the original FOM savings methodology, resulting in the FOM not being delivered as planned in 2017/18. The Council will seek to deliver the required FOM savings according to the FOM principles;
- Improvement Panel: recent developments leading to the resignation of the Leader of the Council have highlighted that the failings in political leadership, identified by the Kerslake report, have still not been fully addressed;

(continued)

- Services for Vulnerable Children: although Ofsted has acknowledged improvement following its monitoring visit, the Council is still rated as 'inadequate'; and
- Management of Schools: Ofsted has identified some improvements in arrangements but Internal Audit reports suggest weaknesses in financial and other controls at 18% of schools visited.

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 37 to 44.

Overall conclusion

Based on the work we performed to address the significant risks, we concluded that:

- because of the pervasive significance of the matters we identified in respect of Budget Delivery and Reserves Management; FOM; Improvement Panel; Services for Vulnerable Children and Management of Schools, we are not satisfied that the Council has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. We therefore propose to give a qualified 'adverse' conclusion.

The text of our proposed report can be found at Appendix B.

Recommendations for improvement

We discussed findings arising from our work with management and have agreed recommendations for improvement as follows. The Council needs to:

- deliver the identified mitigating actions to offset the undeliverable planned savings in 2017/18 and maximise the delivery of the remaining savings plans for 2017/18 to reduce the use of additional reserves to achieve a balanced budget position;
- develop realistic savings plans for future years which take full account of any delivery issues that are identified;
- deliver management and support services changes following the redevelopment of the FOM on a timely basis to ensure that it delivers the required financial and operational outcomes;
- demonstrate that the pace of change and the impact of new political and corporate leadership arrangements are sufficient and sustained to address the concerns previously raised by the Panel;
- continue to demonstrate measurable improvements in services for vulnerable children through successfully implementing the Children's Trust; and
- continue to increase the pace of improvement in schools governance arrangements to ensure that it can demonstrate to Ofsted that it has addressed the issues that it raised.

Management's response to these can be found in the Action Plan at Appendix A.

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 to address	Findings and conclusions
Budget Delivery and Reserves Management Information when we completed our initial risk assessment indicated that the Council were facing a significant overspend against budget for 2016/17. There were plans to use £37m of reserves in order to balance the final outturn for 2016/17. Given the recognised difficulties associated with the Council's 2016/17 savings programme, an independent review of 2017/18 budget setting process and an evaluation of the deliverability of the proposed budget has taken place. Overall the savings plan outlined in the Council's Business Plan 2017+ needed to deliver 100% recurrent savings (£148m) by the end of 2018/19 to maintain a workable reserves position. The key risk is that the proposed schemes will not deliver the required recurrent savings, or will take longer to implement than planned.	We have reviewed the project management and risk assurance frameworks established by the Council in respect of the more significant projects, to establish how the Council is identifying, managing and monitoring these risks.	The Council reported a 2016/17 revenue budget overspend of £29.8 million on a net revenue budget of £835.3 million. The outturn overspend is in the context of demanding savings targets of £123.2 million including finding 2016/17 solutions for £35.0 million largely for savings achieved on a non-recurrent basis in 2015/16. The Council has used £30.0 million of corporate funding (made up of use of the Capital Fund and the Organisation Transformation reserve) to address the year end pressure. The Council's Business Plan 2017+ identifies continuing savings pressures, with a requirement of £171.4 million of savings to be delivered by the end of 2020/21; 2017/18 (£70.9 million) and 2018/19 (£62.7 million) are the two years with the greatest savings demand. The Business Plan includes a detailed analysis of savings schemes across the four year period. We focused our work on the delivery risks for the major savings schemes. In addition, there are a further £14.4 million of savings that were delivered on a non-recurrent basis in 2016/17 which need to be delivered in 2017/18. The Month 4 Corporate Revenue Budget Monitoring report position up to the end of July 2017/18 identifies the following: • At the end of July 2017 a net revenue overspend of £15.7 million in 2017/18 is being forecast. This consists of an underspend of £2.3 million in the base budget delivery and £18.0 million of savings delayed or not deliverable in 2017/18 after identified mitigations. • The total forecast overspend of £15.7 million is primarily related to Place Directorate (£4.4 million), Children and Young People (£4.8 million) and the Future Operating Model (£15.7 million), offset by planned mitigations from Budget Planning work of £4.0 million and Corporate mitigations of £5.2m. • In the case of the Place Directorate, this relates largely to savings delivery challenges and base budget pressures on Waste Management services. • CYP relates largely to savings delivery challenges and pressures on the base budget for Travel Assist.

Key findings (continued)

Significant risk	Work to address	Findings and conclusions
Budget Delivery and Reserves Management (continued)	We have reviewed the project management and risk assurance frameworks established by the Council in respect of the more significant projects, to establish how the Council is identifying, managing and monitoring these risks.	We identified in our initial risk assessment that the key risk was that the major savings schemes would not deliver the required recurrent savings, or would take longer to implement than planned. The £14.4 million shortfall in recurrent savings brought forward from 2016/17 and the delivery difficulties associated with the largest savings schemes in 2017/18 means that this risk is not sufficiently mitigated. In our view savings planning arrangements did not sufficiently take into account the impact of the level of non-recurrent savings or adequately assess the vulnerability of the largest proposed savings scheme. We have concluded that these weaknesses in the Council's arrangements relate to the adequacy of financial planning VfM criteria as part of informed decision making.

Key findings (continued)

Significant risk	Work to address	Findings and conclusions
Future Operating Model The re-structure of the Council to meet its vision for the future will affect all Birmingham City Council Employees and will require a significant amount of detailed planning to deliver. The overarching purpose of the new model is to achieve more for less. Not just to manage on less money but to deliver on new expectations. The key risk is that the planned changes to the Council's operating model do not fully deliver the desired outcomes or take longer than planned to implement.	We have reviewed the project management and risk assurance frameworks established by the Council in respect of the more significant projects, to establish how the Council is identifying, managing and monitoring these risks.	The FOM is planned to prioritise public facing services, consolidate and optimise support services and bring consistency to the spans and layers of management within the Council. In January 2017 a report was presented at Cabinet setting out the proposals to strengthen the leadership capacity of the Council, reshape the strategic leadership and initiate the implementation of the FOM. To ensure that the Council can deliver the FOM, it is imperative that the organisation adjust its structures, spans and layers of management to align with the model. At its centre the organisation requires a streamlined, disciplined operating centre that supports delivery departments to achieve the priorities of the organisation. The implementation of the FOM was expected to deliver savings in 2017/18 of £14.6 million in the Council's Business Plan 2017+. However, due to significant delays in its implementation the Month 4 Corporate Revenue Budget Monitoring report shows that there will be undelivered savings of £15.4 million in 2017/18, rising to £34.2 million in future years before mitigations of £4 million that are expected to be achieved from the Budget Planning work. The Council is currently redeveloping the FOM to ensure that it includes the appropriate management and support service changes to deliver the required financial and operational outcomes. We identified in our initial risk assessment that the key risk is that the planned changes to the Council's operating model do not fully deliver the desired outcomes or take longer than planned to implement. This has clearly been the case with the FOM and, on that basis, we have concluded that these weaknesses in the Council's arrangements relate to managing risks effectively and maintaining a sound system of internal control, demonstrating and applying the principles and values of sound governance, and planning, organising and developing the workforce effectively to deliver strategic priorities.

Key findings (continued)

Significant risk	Work to address	Findings and conclusions
Improvement Panel The Improvement Panel ('the Panel') has been in place since January 2015, following the publication of Lord Kerslake's report on the Council's governance. The Panel has reported to the Secretary of State on the progress made by the Authority, but has also noted its concerns. The key risk is that the Panel will conclude that the Council is not making sufficient progress in implementing the changes needed.	We have considered the Panel's reports and discussed the progress made and key issues with the Panel's Vice Chair.	We have met with the Vice Chair of the Panel on a frequent basis throughout the year and been briefed on the Panel's view of the progress being made. The Panel has written to the Secretary of State several times since 1 April 2016, most recently in August 2017. The Panel's August 2017 letter stated that its assessment overall is that the Authority's direction of travel is positive. The Panel noted that: "…. There have been significant changes in the council's senior management arrangements. A new interim Chief Executive and interim Chief Finance Officer joined the Council in April. Both have considerable experience of achieving improvement and turnaround. Further changes and additions have been made to strengthen the top team, some of them on an interim basis. However, the Council intends to recruit permanently to all the remaining and newly created interim senior management posts during 2017 and early 2018." The Panel's letter also refers to financial challenges facing the Council and its new future operating model but it concludes that: "In light of the good prospects for improvement and bearing in mind the highly experienced capacity and capability in the current management team and the Leader's strong resolve to continue to make the necessary changes that will promote good governance we suggest that the Panel should suspend its current operation with only the Vice Chair and the Panel's adviser staying in touch with the Council." However, we understand that the Panel is currently liaising with the Council in respect of matters emerging in relation to the recent waste dispute and that the Secretary of State has written to the Panel requesting an "urgent update" so that he can consider the "next steps" for the Council. The Panel was scheduled to meet with the Leader of the Council and the Deputy Leader on 12 September 2017 but the Leader of the Council resigned on 11 September 2017. We identified in our initial risk assessment that the key risk is that the Panel will conclude that the Council is not making sufficient progress in implementing the changes needed. We have considered the latest findings of the Panel including its suggestion to suspend its current operation, but, recent developments have led us to conclude that these weaknesses in the Council's arrangements do not support informed decision making.

Key findings (continued)

Significant risk	Work to address	Findings and conclusions
Services for Vulnerable Children The Council's services for Vulnerable Children were assessed as inadequate by Ofsted and are subject to an Improvement Notice. Ofsted have continued to rate Children's services as inadequate overall. The Secretary of State has appointed a Children's Commissioner. Plans are in place for a Children's Trust to be run in shadow form from 1 April 2017. The key risk is that the service does not show demonstrable improvement and continues to be subject to external intervention. Until such time as Ofsted has confirmed that adequate arrangements are in place this remains a significant risk to the Council's arrangements.	We reviewed the project management and risk assurance frameworks established by the Council in respect of the more significant projects, to establish how the Council was identifying, managing and monitoring these risks.	The Council was subject to an Ofsted monitoring visit in May 2017 and the inspector wrote to the Council summarising his findings on 13 June 2017. The visit was the first monitoring visit since the Council was judged inadequate in November 2016. The areas covered by the visit were help and protection, with a particular focus on referral and assessment arrangements, the application of thresholds for intervention, and services to children at risk of sexual exploitation and those who go missing from home. The inspector's letter stated that "since the last inspection, leaders and managers have worked hard to make a range of necessary improvements including successfully embedding some well-established strength-based approaches to practice within an overall relationship-based model of social work. Although substantial further progress is required before services are consistently good, in a number of areas Birmingham are receiving better and timelier services. Against a long-standing history of failing to provide good services for children, this represents notable progress." The report of the Improvement Quartet to the Council on 11 July 2017 highlighted the progress made with the establishment of the Children's Trust. In particular, the appointments of the following: • Andrew Christie as the Trust Chair; • a Chief Executive who started on 14 August 2017; and • six non-executive directors. These appointments and the Trust's governance arrangements provide the Council with a strong platform to deliver the further improvements required for children's services in the near future. We identified in our initial risk assessment that the key risk was that services for vulnerable children do not show demonstrable improvement and continue to be subject to external intervention. The findings of the Ofsted monitoring report means that this risk is not sufficiently mitigated. We concluded that these weaknesses in the Council's arrangements relate to managing risks effectively and maintaining a sound system of internal control, demonstrating and applying the principles and values of good governance, as part of informed decision making and planning, organising and developing the workforce effectively to deliver strategic priorities as part of strategic resource deployment.

Key findings (continued)

Significant risk	Work to address	Findings and conclusions
Management of Schools The Council's management of the governance of schools was found to be weak and an Education Commissioner was appointed by the Secretary of State in 2014. The commissioner post ended in July 2016. However much work is still required and the Birmingham Education Partnership (BEP) has responsibility for implementing an improvement plan in conjunction with the West Midlands designated Regional Schools Commissioner. The key risk is that plan implementation will be slower than envisaged and underlying issues will not be effectively addressed.	We have focused on the BEP's management and reporting of the Single Integrated Plan. We have reviewed the progress made by Internal Audit within their coverage of schools governance.	The Council published its Education Services Delivery & Improvement Plan for 2016/17 in May 2016. The four key actions of the plan are: • to work with strategic partners to build a great education offer for all in a challenging landscape; • to improve safeguarding and resilience for all to keep all children safe from harm; • to champion fair opportunities for vulnerable children and young people; and • to ensure exceptional leadership across and beyond the education system. The report of the Improvement Quartet to the Council on 11 July 2017 highlighted the progress made with Education Services. In particular, it noted that: • over 90% of the education improvement plan had been delivered on time; • feedback from the department of Education, Ofsted and local stakeholders was positive; and • in view of the progress and capacity to improve further, the Education Commissioner’s tenure was ended by the Secretary of State in July 2016. However, as part of the assessment of schools governance improvement Birmingham Audit (internal audit) have been commissioned to carry out a programme of audits over a two year period. Their findings have continued to show that there are a range of governance issues to address across the schools visited, 17 of the 97 schools audits undertaken by internal audit in 2016/17 were assessed as ‘level 3’ assurance (specific control weaknesses of a significant nature noted, and/or the number of minor weaknesses noted was considerable). We identified in our initial risk assessment that the key risk was that plan implementation will be slower than envisaged and underlying issues will not be effectively addressed. Although it is clear that progress has been made with the implementation of the improvement plan there is still work to do. The pace of school improvement remains the key issue which is affecting our judgement. We concluded that these weaknesses in the Council's arrangements relate to managing risks effectively and maintaining a sound system of internal control, demonstrating and applying the principles and values of good governance, as part of informed decision making and planning, organising and developing the workforce effectively to deliver strategic priorities as part of strategic resource deployment.

Key findings (continued)

Significant risk	Work to address	Findings and conclusions
Working with Health Partners The Council has extensive partnership arrangements with Health bodies. Delivery of service outcomes is dependent on effective partnership working with Clinical Commissioning Groups. Deliverability of the Sustainability and Transformation Plan is now at risk due to budget pressures. The redesign of care commissioning is paramount to the achievement of overall public money budgets. The key risk is that partnership arrangements do not fully deliver service outcomes and improvements.	We have reviewed the project management and risk assurance frameworks established by the Council in respect of the more significant projects, to establish how the Council is identifying, managing and monitoring these risks.	We have considered the governance arrangements for the Better Care Fund (BCF) and other pooling agreements including improved Better Care Fund (iBCF). In particular, the clarity of lines of accountability to the Council. We have also considered the risk sharing arrangements in place and the partnership arrangements. The Birmingham iBCF totals £34 million for 2017/18, £47 million in 2018/19 and £60 million in 2019/20. The published policy framework outlines that the intended use of the iBCF is across three priority areas: • to meet adult social care need; • to provide support to the NHS (especially through application of the 8 High Impact Changes); and • to sustain the social care provider market. Whilst the Council is instrumental in the decision making process for how the iBCF money is allocated, ultimately the final decision remains the responsibility of the local Health and Wellbeing Board. The Council is working closely with its NHS partners and social care providers to develop new programmes of care to deliver more efficient and effective services following the deployment of the iBCF. For example, at the latest meeting of the Health and Wellbeing Board on 4 July 2017 the proposals for the use of the iBCF and dementia funding as part of the BCF were considered. We identified in our initial risk assessment that the key risk is that partnership arrangements do not fully deliver service outcomes and improvements. We have considered the Council's arrangements for the distribution of the BCF and the iBCF and are satisfied that they are appropriate. On that basis, we have concluded that the risk is sufficiently mitigated and that the Council has appropriate arrangements in place to work with third parties effectively to deliver strategic priorities and commission services effectively to support delivery of strategic priorities.

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.

Any other matters

There were no other matters from our work which were significant to our consideration of your arrangements to secure value for money in your use of resources.

Section 4: Fees, non-audit services and independence

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 have complied with the Financial Reporting Council's Ethical Standard and the Auditing Practices Board Ethical Standards as applicable 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 requirement of the Financial Reporting Council's Ethical Standard

We confirm below our final fees charged for the audit and provision of non-audit services charged from the beginning of the financial year to the current date.

Fees

	Proposed fee £	Final fee £
Authority audit	314,168	314,168
Audit of subsidiaries		
Acivico Limited	38,000	38,000
Innovation Birmingham Limited	22,800	22,800
NEC (Developments) PLC	30,000	35,000
PETPS (Birmingham) Limited	7,600	7,600
Finance Birmingham Limited	6,900	7,000
Marketing Birmingham Limited	13,900	13,900
Subsidiaries total	**119,200**	**124,300**
Housing Benefit Grant Certification	17,594	23,594*
Total audit fees (excluding VAT)	**450,962**	**462,062**

Fees for other services

Service	Fees £
Audit related services:	
• SFA Grant	4,500
• IMLT Grant	3,500
• Teacher's Pension	TBC
• Pooling Capital Receipts	TBC
• CFO Insights (fee per annum)	10,000
Other services	
• Innovation Birmingham – VAT	1,100
• Acivico Limited – management coaching	13,000
Non-audit services	**32,100**

The proposed fees for the year for the Council audit and the Housing Benefit Grant Certification were in line with the scale fee set by Public Sector Audit Appointments Ltd (PSAA).

Grant certification

Our fees for grant certification cover only housing benefit subsidy certification, which falls under the remit of Public Sector Audit Appointments Limited. Fees in respect of other grant work, such as reasonable assurance reports, are shown under 'Fees for other services'.

*The final fee for Housing Benefits Grant Certification is pending agreement of fee variation by PSAA, but is expected to be in the region of £6,000.

Independence and other services

We have considered whether other services might be perceived as a threat to our independence as the Council's auditor and have ensured that appropriate safeguards have been applied to mitigate these risks.

	Service provided to	Fees	Threat identified	Safeguards
Audit of subsidiary companies	Acivico Limited Innovation Birmingham Limited NEC (Developments) PLC PETPS (Birmingham) Limited Finance Birmingham Limited Marketing Birmingham Limited	38,000 22,800 35,000 7,600 7,000 13,900	No	Separate commercial audit teams. As such, we do not consider the audit of Birmingham City Council's subsidiaries to be a threat to our independence.
Grant claims - Housing Benefits - SFA - IMLT - Pooling capital receipts	Birmingham City Council	31,594	No	The fee for this work is negligible in comparison to the total fee for the audit and in particular the overall turnover of Grant Thornton UK LLP and the Public Sector Assurance service line. As such, we do not consider this grant assurance work to be a threat to our independence.
VAT	Innovation Birmingham	1,100	No	Separate VAT team. As such, we do not consider this work to be a threat to our independence.
CFO Insights	Birmingham City Council	10,000	No	The fee for this work is negligible in comparison to the total fee for the audit and in particular the overall turnover of Grant Thornton UK LLP and the Public Sector Assurance service line. The annual fee is fixed with no contingent element. As such, we do not consider CFO Insights to be a threat to our independence.

None of the above services were provided on a contingent fee basis.

For the purposes of our audit we have made enquiries of all Grant Thornton teams within the Grant Thornton International Limited network member firms providing services to the Council. No other threats to independence have been identified.

This covers all services provided by us and our network to the Authority, its Members and senior management and its affiliates, and other services provided to other known connected parties that may reasonably be thought to bear on our integrity, objectivity or independence. (ES 1.69)

Section 5: Communication of audit matters

Communication to those charged with governance

ISA (UK&I) 260, as well as other ISAs, prescribe matters which we are required to communicate with those charged with governance, and which we set out in the table opposite.

This document, The Audit Findings, outlines those key issues and other matters arising from the audit, which we consider should be communicated in writing rather than orally, together with an explanation as to how these have been resolved.

Respective responsibilities

The Audit Findings Report has been prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by Public Sector Audit Appointments Limited (http://www.psaa.co.uk/appointing-auditors/terms-of-appointment/)

We have been appointed as the Authority's independent external auditors by the Audit Commission, the body responsible for appointing external auditors to local public bodies in England at the time of our appointment. As external auditors, we have a broad remit covering finance and governance matters.

Our annual work programme is set in accordance with the Code of Audit Practice ('the Code') issued by the NAO (https://www.nao.org.uk/code-audit-practice/about-code/). Our work considers the Authority's key risks when reaching our conclusions under the Code.

It is the responsibility of the Authority to ensure that proper arrangements are in place for the conduct of its business, and that public money is safeguarded and properly accounted for. We have considered how the Authority is fulfilling these responsibilities.

Our communication plan	Audit Plan	Audit Findings
Respective responsibilities of auditor and management/those charged with governance	✓	
Overview of the planned scope and timing of the audit. Form, timing and expected general content of communications	✓	
Views about the qualitative aspects of the entity's accounting and financial reporting practices, significant matters and issues arising during the audit and written representations that have been sought		✓
Confirmation of independence and objectivity	✓	✓
A statement that we have complied with relevant ethical requirements regarding independence, relationships and other matters which might be thought to bear on independence Details of non-audit work performed by Grant Thornton UK LLP and network firms, together with fees charged Details of safeguards applied to threats to independence	✓	✓
Material weaknesses in internal control identified during the audit		✓
Identification or suspicion of fraud involving management and/or others which results in material misstatement of the financial statements		✓
Non compliance with laws and regulations		✓
Expected modifications to auditor's report, or emphasis of matter		✓
Unadjusted misstatements and material disclosure omissions		✓
Significant matters arising in connection with related parties		✓
Significant matters in relation to going concern	✓	✓
Matters in relation to the group audit including: Scope of work on components, involvement of group auditors in component audits, concerns over quality of component auditors' work, limitations of scope on the group audit, fraud or suspected fraud.	✓	✓

Appendices

Appendix A. Action plan

Rec no.	Recommendation	Priority	Management response	Implementation date and responsibility
1	**Budget Delivery and Reserves Management** The Council needs to deliver the identified mitigating actions to offset the undeliverable planned savings in 2017/18 and maximise the delivery of the remaining savings plans for 2017/18 to reduce the use of additional reserves to achieve a balanced budget position. The Council needs to develop realistic savings plans for future years which take full account of any delivery issues that are identified.	High		
2	**Future Operating Model** The Council needs to deliver management and support services changes following the redevelopment of the FOM on a timely basis to ensure that it delivers the required financial and operational outcomes.	High		
3	**Improvement Panel** The Council needs to demonstrate that the pace of change and the impact of new political and corporate leadership arrangements are sufficient and sustained to address the concerns previously raised by the Panel.	High		

Priority
- High
- Medium
- Low

Appendix A. Action plan (continued)

Rec no.	Recommendation	Priority	Management response	Implementation date and responsibility
4	**Services for Vulnerable Children** The Council needs to continue to demonstrate measurable improvements in services for vulnerable children through successful implementation of the Children's Trust.	High		
5	**Management of Schools** The Council needs to continue to increase the pace of improvement in schools governance arrangements to ensure that it can demonstrate to Ofsted that it has addressed the issues that it raised.	High		
6	**Cut-off of operating expenditure in Schools** We tested a sample of payments made in April and May 2017 to identify whether there were items relating to goods/services received in 2016/17 which had not been appropriately accrued for (whether via system/manual accruals or the forecast accrual process). Two out of the seven schools invoice payments selected within our sample related to services received prior to 31/3/17, but processed for payment after year-end. We are satisfied there cannot be a material risk of under-accrual of schools invoices. However, we recommend that the Council review their processes for ensuring schools expenditure includes appropriate accruals.	Medium		

Priority
- High
- Medium
- Low

Appendix A. Action plan (continued)

Priority

Rec no.	Recommendation	Priority	Management response	Implementation date and responsibility
7	**HRA Assets under construction** We identified that all spend on HRA additions is fully settled in year, with nothing being retained in AUC at year-end. While for spend relating to renewals to existing properties any AUC element is unlikely to be material at year-end, in recent years the Council has undertaken significant construction of new properties, and where construction spans year-end the spend should properly be included in AUC until brought into use. We are satisfied that the estimated potential impact would be trivial due to the need to impair the spend to reflect the social housing factors, and any impact on depreciation would also be trivial. We recommend that this is reviewed in future years if the Council continues to expand its house building programme, to ensure there is no material misstatement.	**Medium**		
8	**Housing Benefits** There have been two instances in the year where potential control weaknesses regarding the housing benefit system have been identified. The first related to a duplicate payment run which the Authority manually prevented from being paid. However, it still continued to be recorded as duplicated within the RBIS and therefore subsidy. The second related to two high value payments made in error, where on both occasions, an incorrect weekly rent figure had been manually entered in to the rent field of RBIS. These payments were manually stopped by the Council as they were identified as unusually large from the >£3k checks which are performed by the housing benefits team. However, we recommend that the Council continues to strengthen its internal controls with regards to Housing Benefit payments in order to reduce the risk of incorrect payments being made and not being identified manually prior to payment.	**Medium**		

Priority
- High
- Medium
- Low

Appendix A. Action plan (continued)

Priority

Rec no.	Recommendation	Priority	Management response	Implementation date and responsibility
9	**Capitalisation of expenditure in Schools** We identified a number of issues relating to capital spend recorded by schools: - 1 item selected in our sample which had been capitalised related to IT support for April 2016 – March 2017 which had been funded by DFC. This was capitalised as spend on buildings which is incorrect as this appears to be a revenue cost. - All DFC is capitalised as buildings spend, but 1 item selected related to playground equipment which would be better classified as equipment. This is a misclassification issue only with no impact on the total value of PPE. Although we are satisfied there is no risk to material misstatement for the above noted issues, we recommend that the Council continues to review the procedures for ensuring capital expenditure by schools is recorded completely and accurately in the accounts.	**Medium**		
10	**Group Accounts** Group accounts are drafted using unaudited financial information provided by group entities. In future the Audit Committee need assurance that group entities provide sufficient information by the end of April to ensure materially accurate group accounts can be produced and that audited accounts are received before the completion of the Council's audit.	**Medium**		

Priority
- High
- Medium
- Low

Appendix A. Action plan (continued)

Priority

Rec no.	Recommendation	Priority	Management response	Implementation date and responsibility
11	**Exit Packages** We recommend that the Council reflects on the advice given by the Department of Communities and Local government in relation to member consideration of exit packages. This advice suggests that authorities should report all exit payments over £100k to Full Council. Whilst Birmingham City Council is not alone in not following the advice, it may wish to consider whether this could be a useful enhancement to strengthen the transparency of its arrangements	**Low**		

Priority
- High
- Medium
- Low

Appendix B: Draft audit opinion

We anticipate we will provide the Authority, including the Group with an unqualified audit report for the financial statements and a modified audit report in relation to Value for Money.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF BIRMINGHAM CITY COUNCIL

We have audited the financial statements of Birmingham City Council (the "Council") for the year ended 31 March 2017 under the Local Audit and Accountability Act 2014 (the "Act"). The financial statements comprise the Comprehensive Income and Expenditure Statement, the Group Comprehensive Income and Expenditure Statement, the Movement in Reserves Statement, the Group Movement in Reserves Statement, the Balance Sheet, the Group Balance Sheet, the Cash Flow Statement, the Group Cash Flow Statement, the Housing Revenue Account Income and Expenditure Statement, the Movement on the Housing Revenue Account Statement, the Collection Fund Statement Income and Expenditure Account and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2016/17.

This report is made solely to the members of the Council, as a body, in accordance with Part 5 of the Act and as set out in paragraph 43 of the Statement of Responsibilities of Auditors and Audited Bodies published by Public Sector Audit Appointments Limited. Our audit work has been undertaken so that we might state to the Council's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Council and the Council's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of the Interim Chief Financial Officer and auditor

As explained more fully in the Statement of Responsibilities, the Interim Chief Financial Officer is responsible for the preparation of the Statement of Accounts, which includes the financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2016/17, which give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law, the Code of Audit Practice published by the National Audit Office on behalf of the Comptroller and Auditor General (the "Code of Audit Practice") and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of whether the accounting policies are appropriate to the Council and Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Interim Chief Financial Officer; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Narrative Report, the Group Narrative Report and the Annual Governance Statement to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion:

- the financial statements present a true and fair view of the financial position of the Council and Group as at 31 March 2017 and of the Council's and Group's expenditure and income for the year then ended; and
- the financial statements have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 and applicable law.

Opinion on other matters

In our opinion, the other information published together with the audited financial statements in the Narrative Report, the Group Narrative Report and the Annual Governance Statement for the financial year for which the financial statements are prepared is consistent with the audited financial statements.

Matters on which we are required to report by exception

We are required to report to you if:

- in our opinion the Annual Governance Statement does not comply with the guidance included in 'Delivering Good Governance in Local Government: Framework (2016)' published by CIPFA and SOLACE; or
- we have reported a matter in the public interest under section 24 of the Act in the course of, or at the conclusion of the audit; or
- we have made a written recommendation to the Council under section 24 of the Act in the course of, or at the conclusion of the audit; or
- we have exercised any other special powers of the auditor under the Act.

We have nothing to report in respect of the above matters.

Conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources

Respective responsibilities of the Council and auditor

The Council is responsible for putting in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to review regularly the adequacy and effectiveness of these arrangements.

We are required under Section 20(1)(c) of the Act to be satisfied that the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. We are not required to consider, nor have we considered, whether all aspects of the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

Appendix B: Draft audit opinion (continued)

Scope of the review of the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources

We have undertaken our review in accordance with the Code of Audit Practice, having regard to the guidance on the specified criteria issued by the Comptroller and Auditor General in November 2016, as to whether the Council had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. The Comptroller and Auditor General determined this criteria as that necessary for us to consider under the Code of Audit Practice in satisfying ourselves whether the Council put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2017.

We planned our work in accordance with the Code of Audit Practice. Based on our risk assessment, we undertook such work, as we considered necessary to form a view on whether in all significant respects the Council has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

Basis for qualified conclusion

In considering the Council's arrangements for securing efficiency, economy and effectiveness, we identified the following matters:

Budget Delivery and Reserves Management including the Future Operating Model

The Council's Business Plan 2017+ included the requirement to deliver £148 million of recurrent savings by the end of 2018/19.

The planned delivery of recurring savings is not being achieved, resulting in £14.4 million of the total savings target of £123.2 million in 2016/17 being achieved from one-off or non-recurrent sources. The Council's Corporate Revenue Monitoring report for July 2017 identified that, despite a number of mitigations, £18 million of the total planned savings for 2017/18 will either be delayed or not delivered. In particular, the Business Plan 2017+ included the implementation of the Future Operating Model, an approach to prioritise public facing services, consolidate and optimise support services and bring consistency to the spans and layers of management within the Council, which was expected to save £14.6 million in 2017/18. However, due to significant delays in the implementation of the Future Operating Model, the Council is forecasting that that there will be undelivered savings of £15.4 million in 2017/18, rising to £34.2 million in future years.

These matters are evidence of weaknesses in proper arrangements for sustainable resource deployment in:

- planning finances effectively to support the sustainable delivery of strategic priorities and maintain statutory functions; and
- planning, organising and developing the workforce effectively to deliver strategic priorities.

Improvement Panel

The Secretary of State for Communities and Local Government appointed an Improvement Panel ("the Panel") in January 2015 to oversee improvements in the Council's governance arrangements.

The Panel is currently liaising with the Council in respect of matters emerging in relation to the recent waste dispute, and the Secretary of State has written to the Panel requesting an urgent update so that he can consider the next steps for the Council. The Panel was scheduled to meet with the Leader of the Council and the Deputy Leader on 12 September 2017 but the Leader of the Council resigned on 11 September 2017. At the date of issuing our opinion, the Deputy Leader is acting as Leader on an interim basis to provide stability.

This matter is evidence of weaknesses in proper arrangements for informed decision making in acting in the public interest, through demonstrating and applying the principles and values of sound governance.

Services for Vulnerable Children

In May 2014 and November 2016 the Office for Standards in Education (Ofsted) issued reports on its inspections of services for children in need of help and protection, children looked after and care leavers in Birmingham. The reports assessed the services as inadequate and identified a number of serious weaknesses in the Council's arrangements for looking after vulnerable children and young people.

An Ofsted monitoring visit was completed in May 2017 and its subsequent report highlights that the Council requires substantial further progress to address the weaknesses identified.

This matter is evidence of weaknesses in proper arrangements for informed decision making and sustainable resource deployment in:

- acting in the public interest, through demonstrating and applying the principles and values of sound governance;
- managing risks effectively and maintaining a sound system of internal control; and
- planning, organising and developing the workforce effectively to deliver strategic priorities.

Management of Schools

Significant failings in the Council's management of schools were identified in a review by Peter Clarke in July 2014. Since this review the Council has taken and continues to take action to improve its management of schools through the implementation of its improvement plan.

However, as part of the assessment of the improvements to schools governance Birmingham Audit (internal audit) have been commissioned to carry out a programme of audits over a two year period. Their findings have continued to show that there are a range of governance issues to address across the schools visited. 17 of the 97 schools audits undertaken by internal audit in 2016/17 were assessed as 'level 3' assurance (specific control weaknesses of a significant nature noted, and/or the number of minor weaknesses noted was considerable).

This matter is evidence of weaknesses in proper arrangements for informed decision making and sustainable resource deployment in:

- acting in the public interest, through demonstrating and applying the principles and values of sound governance;
- managing risks effectively and maintaining a sound system of internal control; and
- planning, organising and developing the workforce effectively to deliver strategic priorities.

Appendix B: Draft audit opinion (continued)

Adverse value for money conclusion

On the basis of our work, having regard to the guidance issued by the Comptroller and Auditor General in November 2016, because of the significance of the matters described in the basis for adverse value for money conclusion paragraphs above, we are not satisfied that, in all significant respects, the Council put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2017.

Delay in certification of completion of the audit

We cannot formally conclude the audit and issue an audit certificate for the Council for the year ended 31 March 2017 in accordance with the requirements of the Act and the Code of Audit Practice until we have completed our consideration of objections brought to our attention by local authority electors under Section 27 of the Act. We are satisfied that these matters do not have a material effect on the financial statements or on our conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2017.

Phil Jones

for and on behalf of Grant Thornton UK LLP, Appointed Auditor

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XX September 2017