

Extraordinary Auditor's Report - Statutory Recommendations made under Section 24 Local Government and Accountability Act 2014

Report of the Section 151 Officer and Cabinet Member for Finance and Resources

1. Background

- 1.1 In July 2018, District (external) Auditor undertook the relatively unusual step of issuing a number of Statutory Recommendations under Section 24 of the Local Audit and Accountability Act 2014. This measure was a strong warning to the Council of the Auditor's concerns but stops short of a public interest report.
- 1.2 This was the second such report issued to Birmingham City council in three years.
- 1.3 A S24 notice requires Full Council to agree its response to the points included within the recommendations within 1 month of issue and to publish how it proposes to address the issues raised.
- 1.4 As permitted in the legislation, an extension was sought from the Auditor to 11th September 2018 to align with the Council meeting schedule and this was granted.
- 1.5 The 7 recommendations made at that time are set out below: -

Finance

1. *Deliver its savings plans in 2018/19, in particular by identifying alternatives where existing plans are not deliverable, to mitigate the impact of the combined savings and budget pressure risks.*
2. *Develop a realistic medium term financial plan for 2019/20 to 2021/22 which incorporates realistic and detailed savings plans and takes account of key budget and service risks.*
3. *Ensure that it maintains an adequate level of reserves to mitigate the impact of budget risks, in particular one-off risks such as the Commonwealth Games and Equal Pay.*

Transparency and Governance

4. *Ensure that its financial monitoring and budget reports are clear, transparent, and timely particularly in relation to the use of reserves, whether in-year or at year-end.*

5. *Report governance failures and emerging issues promptly and clearly to Members and local citizens.*

Subsidiary Bodies

6. *Ensure that appropriate arrangements are implemented in relation to the Council's subsidiary bodies, including regular financial reporting and Council nominees on subsidiary body boards, to ensure that emerging risks are monitored, reported and managed promptly.*

Place Directorate

7. *Ensure that robust management and governance arrangements are put in place within the Place Directorate, particularly to ensure effective oversight of the waste service, to ensure that it delivers its financial and service objectives.*

- 1.6 These recommendations were duly considered by Full Council on 11th September 2018 and the Council's progress in meeting the Council's response to the recommendations is being monitored by Audit Committee.
- 1.7 Significant progress is being made in relation to addressing six of the seven recommendations with only one, recommendation 7, being restricted in terms of progress as a result of industrial action in the waste service.
- 1.8 Audit Committee has been kept updated throughout on the positive progress against the agreed plan at each subsequent meeting.
- 1.9 In spite of this, the external auditor has now concluded that it is appropriate to issue further Section 24 recommendations out of the normal annual audit cycle and ahead of any 2018/19 audit work being undertaken. These will be the third in four years and the recommendations do not relate to any particular year.
- 1.10 Whilst the auditor notes the progress made against the seven previous recommendations considered by Full Council on 11 September 2018, he considers that two issues require a further report: Governance & waste Services and the council's financial challenges.
- 1.11 The possibility of further Statutory Recommendations was first flagged up in writing on 14th January 2019, just 4 months after the council agreed its plan for the previous recommendations.
- 1.12 The City Council recognises its responsibility in responding to the Statutory Recommendation under section 24 of the Local Audit and Accountability Act 2014.
- 1.13 The Act requires the Council to
 - a) Consider the recommendation at a meeting held within one month of the recommendation being sent to the Council; and
 - b) at that meeting the Council must decide:

- whether the recommendation is to be accepted, and
- what, if any, action to take in response to the recommendation.

1.14 Further reports will be provided to the Audit Committee setting out the progress in implementing the proposed activity in response to the recommendations.

2. Section 151 Officer Comment

- 2.1 The City faces challenging and uncertain times ahead if it is to deliver high quality services to its residents and businesses, at a cost that is within the annual resources available to it *and* without recourse to the use of one-off reserves intended to cover unforeseen events. The use of reserves to fund day-to-day services merely delays making the necessary difficult decisions on which services to remodel, reduce or cease.
- 2.2 As with the rest of the local government sector, funding cuts and significant local expenditure pressures have made the Council's job far more difficult and has required annual savings of £690m over the eight years to 2018/19. The Council anticipates having to make further annual cuts in the region of £85m by 2022/23 bringing total annual savings to over £3¼bn over the twelve-year period. The Council's workforce will have fallen by more than 60% over this period. Inevitably this has had, and will continue have, severe impacts both on front line and back office services in Birmingham.
- 2.3 A recent National Audit Office report noting the 49.1 per cent real-terms cut in Government funding for local authorities in 2010–18, underlined how councils are affected by growing demand for key services and other cost pressures.
- 2.4 The three years to March 2018 were especially problematic in BCC. The level of savings delivered has fallen significantly below the planned level, and other spending pressures have also emerged, which has meant that additional uses of reserves have been required over and above original plans to balance and deliver the budget since 2015/16.
- 2.5 In 2016/17, Directorates overspent by £71.9m, due mainly to the non-delivery of savings in Adults, Social Care and Health and Place Directorates as well as some base budget pressures across the Council. Corporate mitigations, including use of capital receipts flexibility, were identified totalling £42.1m.
- 2.6 2017/18 showed a similar picture with Directorates overspent by £12.7m, again due to base budget pressures in Place Directorate and some savings non-delivery across most Directorates. Furthermore, Corporate overspends of £24.1m occurred in 2017/18 relating to accumulated losses and write-offs in one of its subsidiaries (£9.5m) and the non-delivery of the Council's Future Operating Model (£14.6m). Corporate underspends were identified of £15.9m. Overall, it was necessary to use £20.9m of additional reserves taking the total use of reserves to support day-to-day spending in 2017/18 to £63m.

- 2.7 A further planned structural use of reserves of around £30m was required in 2018/19 in order to balance the budget assuming that spending is maintained within budget. By month 2, it was clear that a forecast overspend of £28m was emerging as a result of base budget pressures and savings not being delivered. By month 4, this forecast overspend had reduced to £12m and pressure continues to be applied to eradicate any overspend. By month 11, thanks to prudent financial management, a relentless bearing down on costs, strong Member and officer oversight and improved budgetary control measures, the forecast is for a small but significant underspend after absorbing £5.8m of direct costs associated with industrial action in the Waste Service.
- 2.8 The 2019/20 – 2022/23 Medium term Financial Plan (MTFS) was approved by Council on 26th February 2019 and for the first time in many years, is a plan which has no reliance on the use of corporate reserves to support financial pressures or the non-delivery of savings. This does not mean that it is without its challenges – a significant savings target to be achieved and further transformation to be delivered as well as ensuring that our reserves remain adequate to protect the Council against the risks that it faces.
- 2.9 If the Council is to move towards top quartile service performance across the board and financial stability, then it must take tough decisions on service transformation and continue to ensure that it develops robust and deliverable spending and saving plans. If problems are identified in year, resolutions must continue to be identified from within existing budgets, with any use of reserves being the option of last resort.

3. Birmingham City Council Response to the Auditors Statutory Recommendations

- 3.1 The auditor has made two recommendations. They do not relate to any specific year of account and they are not based on specific audit work of indeed any conversations with Cabinet Members or officers other than high level verbal updates with the Assistant Chief Executive and the Chief Finance Officer.
- 3.2 Whilst the first recommendation can be viewed as an update to recommendation 7 of the previous Section 24 notice in the light of industrial action taken since the 11th September 2018 Council meeting, the rationale for issuing recommendations relating to the Council's finances is less clear since the Council is likely to deliver an underspend in the current financial year, use less reserves, and for the first time in a number of years, deliver service and financial proposals over the next four years which do not require the use of reserves outside of the reserves policy.
- 3.3 The second recommendation in particular would have carried more weight had it been supported by fact-based audit fieldwork and detailed discussions on the underlying assumptions and factual basis for the agreed plan and also an in-

depth discussion on the levels of reserves held in relation to the risks faced by the Council.

- 3.4 Nonetheless, the auditor has issued these recommendations and the proposed response is as follows: -

Auditor's Recommendation 1

Governance and the Waste Service

- ensure that the terms of reference for the planned review of future options for the delivery of the refuse collection service, provide for the review to be carried out in a timely fashion, and include an examination of all options for delivering the refuse collection service going forward, in order that the service can demonstrate value for money in the delivery of its financial and service objectives; including, for instance:
 - looking to best practice models across the sector
 - examining different staffing and working arrangements
 - combining collection and disposal functions
 - other potential options, such as outsourcing
- build industrial relations capability within the Council to ensure that it is able to maintain consistent and effective relations with its trade union partners.
- commission a review of the new working practices in place within the refuse service to ensure that they are embedded and monitored robustly to minimise the potential for further Equal Pay claims

Recommendation 1 – Proposed response

On 26th March 2019, Cabinet approved the commissioning of an independent review on refuse collection and disposal which officers are now actioning. The review will report to Cabinet and will consult with the Waste Services Joint Services Improvement Board (JSIB) on the Terms of Reference and throughout the review.

This review contains a clear and repeated commitment to publish the findings of this review report at the end of the initial phase which is anticipated to be September 2019.

The Council intends to draw heavily on benchmarking and peer mentoring to support this review and will have the option to deploy additional external capacity as a result of the commissioned arrangements to support any change management required as a 'phase 2' from October 2019 onwards.

This review will also consider a risk assessment of management practice and equal pay liability in line with the auditor's statutory recommendation.

Furthermore, the Council has indicated that it will establish a dedicated unit to manage industrial relations within the authority committed to developing and maintaining consistent and effective relations with its trade union partners and thereby mitigating its risks and creating the right environment for service transformation and change. This team will be headed by Human Resources but will be a cross functional team of HR, Legal, Finance and Communications professionals who will develop an effective strategy across the Council and lead its delivery.

Auditor's Recommendation 2

Finance

- continue to reduce the likelihood of the non-delivery of savings plans for 2019/20 and beyond through the delivery of clear plans and robust programme management arrangements
- broaden transformational work across the Council's financial plan for 2019/20 to 2022/23, to help deliver savings at scale to address the impact of the combined savings and budget pressure risks
- keep under close review the potential impact of one-off budget risks, such as the Commonwealth Games, Equal Pay and Amey, by: -
 - continuing to strengthen its level of reserves; and
 - completing the development of contingency plans to minimise the effects of these risks should they crystallise.

Recommendation 2 – Proposed Response

The Council continues to move towards a priority-based budgeting approach that aligns its policy priorities with the use of its financial resources. The budget setting process for the 2019/20 – 2022/23 MTFP focussed on deliverability and exploring opportunities for service re-design and partnership working and promoting links to capital and asset strategies. In this way, the Council aims to streamline the resources it uses to achieve best fit with the priorities of the Council and reduce or eliminate spend on lower priority areas.

Target savings for the 4-year period will be of the order of £85m. The challenges of achieving this, on top of £690m of savings already delivered, are considerable but not insurmountable through sound management.

The process for the 2019/20 – 2022/23 four-year cycle commenced after the election in June 2018 – considerably earlier than in previous years. This involved a 2 day member workshop in July aimed at ensuring that every penny spent by the Council

aligns with the priorities of the administration. Further workshops were undertaken in September and October 2018 prior to the draft budget being issued for consultation.

Central to ensuring delivery is the creation of a central Project Management Office (PMO) and more robust business cases/implementation plans to enable delivery to be tracked and monitored with additional rigour compared with the current year. An officer Budget Programme Board is also being set up. Only with such a focus can the Council improve its financial performance whilst at the same time delivering its service priorities. In order not to repeat past mistakes, spend reduction and transformation proposals are only accepted into the plan once there is a clear implementation plan and a high level of confidence that delivery will happen on time and on budget. The Council has also been able to identify a savings delivery contingency budget in case difficulties are encountered.

Beginning in 2018/19, access to reserves as mitigation for base budget pressures and savings non-delivery was severely restricted and Directorates now hold only limited grant reserves and ring-fenced account reserves for specific items of expenditure. All other reserves are held corporately with access to them requiring Cabinet approval.

The updated revenue (and capital) monitoring process is more risk-focussed and concentrates on identifying solutions to issues and delivering these solutions. Where a service identifies that its spending forecast is likely to exceed the available budget, a clear process has been introduced as set out below:

- The service will be expected to identify recovery plans and/or new savings proposals to bring its spending back in line with budget;*
- If this cannot be achieved, CMT and Cabinet will consider re-allocating budgets across the Council to re-balance spending;*
- Consideration will then be given to utilising the savings delivery contingency*
- Only with these routes exhausted will consideration be given to using reserves to fund any overspend, and then, only as a year end measure.*

More formal Scrutiny arrangements have been introduced for the Council's finances and it is clear that the Resources Scrutiny Committee plays an important role in holding the Executive to account for spending, income and savings proposals thus contributing to BCCs improved financial health.

In additional, a new Capital Board, chaired by the Leader, has been established to ensure that capital controls and monitoring are in place and that capital spend proposals are in line with the Council's objectives. These controls are an essential part of ensuring that schemes are delivered on time and on budget.

Finally, the Finance Team has been restructured to allow Business Partners to work more collaboratively with budget holders in assessing the financial implications of

policy proposals along with robust implementation plans being produced to reduce the likelihood of overspends.

The Chief Finance Office is content with the robustness of this approach and will continue, along with the Cabinet Member for Finance and Resources, to take the necessary steps to deliver expenditure in line with the approved budget. This work, which is already being undertake, satisfies the first two elements of the auditor's recommendations.

Reserves are intended to be held to mitigate the financial impact of unforeseeable and infrequent events or to fund specific items of expenditure where resources are received in advance of the need to spend. They are not intended to support ongoing financial pressures or the non-delivery of savings and to use them in such a manner would be a false economy, serving only to defer rather than resolve pressures that require difficult choices to be made.

Other than those ringfenced for specific purposes, the Council anticipates holding total reserves approaching £500m at the end of 2018/19, including £153m not ringfenced for specific purposes.

In addition, the Council's existing financial plans include budget for the anticipated costs of the Commonwealth Games (based on bid assumptions) as well as building up a contingency reserve to help smooth any unforeseen annual variations. These resources come from future business rates growth and the Council continues to seek other forms of funding to minimise pressures on revenue resources.

The revised strategy, approved by Cabinet and included within the Financial Plan, restricts the use of reserves and is consistent with aiming to use reserves prudently and not to support ongoing pressures.

It is important that the Council's reserves are neither too high nor too low. The Council published in the 2019+ MTFS a risk-based analysis to identify an appropriate minimum level of reserves which it needs to hold to mitigate its risk profile.

The Council keeps under regular review its level of reserves in relation to its risks to ensure that adequate resources are set aside where necessary as its risk profile changes.

Again, existing controls are already in place to meet the auditor's recommendations

4. Motion

The Council accepts the statutory recommendations of Grant Thornton made under section 24 of the Audit and Accountability Act 2014 and the responses and actions set out in section 3 of this report.