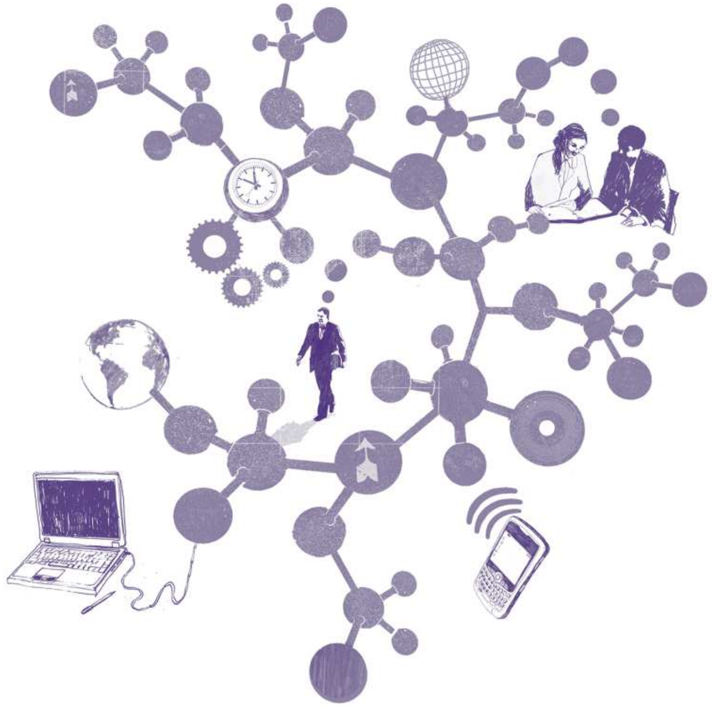
The Annual Audit Letter for Birmingham City Council

Year ended 31 March 2016

October 2016



Phil W Jones
Director
T021 232 5437
E phil.w.jones@uk.gt.com

Richard Percival
Associate Director
T 0121 232 5434
E richard.d.percival@uk.gt.com

Lorraine Noak
Manager
T 0121 232 5407
E lorraine.noak@uk.gt.com

Contents

Executive summary

Purpose of this letter

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at Birmingham City Council (the Council) for the year ended 31 March 2016.

This Letter is intended to provide a commentary on the results of our work to the Council and its external stakeholders, and to highlight issues that we wish to draw to the attention of the public. In preparing this letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice (the Code) and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'.

We reported the detailed findings from our audit work to the Council's Audit Committee, in our Audit Findings Report on 12 September 2016 with a final addendum on 29 September discussed with the Audit Committee chair under his delegated powers.

Our responsibilities

We have carried out our audit in accordance with the NAO's Code of Audit Practice, which reflects the requirements of the Local Audit and Accountability Act 2014 (the Act). Our responsibilities are to:

- consider whether we need to exercise any of our statutory powers under the Act (section one)
- assess the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources (the value for money conclusion) (section two).
- give an opinion on the Council's financial statements (section three)

In our audit of the Council's financial statements, we comply with International Standards on Auditing (UK and Ireland) (ISAs) and other guidance issued by the NAO.

Our work

Statutory recommendation

Our powers and duties under the Act include making written recommendations to the Council under section 24 of the Act. The Council is required by the Act to hold a public meeting to consider such recommendations and publicly respond to them.

We have concluded that it is appropriate for us to use our powers to make a recommendation under section 24 of the Act due to the Council's current and forecast financial position. Section one details our recommendation, the reasons why we are making the recommendation and what the Council needs to do to respond to the recommendation.

Value for money conclusion

We qualified our value for money conclusion on an 'except for' basis and issued it on 30 September 2016. This means we were satisfied that the Council had put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources during the year ended 31 March 2016 except for the following matters.

- Savings Challenge – due to the impact of non-recurrent savings in 2015/16 and the weaknesses in the Peoples Directorate's savings plan delivery
- Services for vulnerable children – due to the concerns reported by Ofsted following their monitoring visit and the continuing need for the Council to have external oversight of its arrangements by the Children's Commissioner
- Management of schools – due to Ofsted feedback indicating that there are significant governance issues in some schools and concerns reported by Ofsted on the pace of change
- Improvement Panel – due to continuation of the Panel's appointment.

We identified five key actions the Council needs to take from our value for money conclusion work. These are:

- Effective plans are put in place to respond to the under delivery of savings plans and emergent budget pressures, particularly in the People Directorate. These need to include a realistic assessment of the use of reserves to enable sufficient lead time for the savings plans to be implemented.
- Plans for services to vulnerable children, including the options for setting up a Children's Trust, need to deliver significant and measurable improvement promptly.
- The implementation of the Birmingham Education Delivery and Improvement Plan needs to demonstrate that the issues raised by Ofsted, including the children missing from education, are being addressed promptly and effectively.
- The pace of change and the impact of new political and corporate leadership arrangements need to demonstrate to the Improvement Panel that this intervention is no longer required.
- The Council and its health partners need to decide whether to reinstitute the joint commissioning board for the learning disabilities and mental health services pooled budget, or agree and implement alternative arrangements.

Section two summarises the significant risks we considered, and our findings and conclusions.

Financial statements opinion
We gave an unqualified opinion on the Council's financial statements on 30 September 2016.

It is pleasing to report that we have seen further improvement in both the timeliness and quality of the accounts production process. We noted in particular that the information provided by group entities was delivered more promptly, enabling group accounts to be completed in line with the Council's accounts.

We worked closely with the Financial Accounts Team throughout the audit and we would like to express our gratitude and thanks for their hard work and support. From 2018 the statutory deadline for accounts production will be 31 May and the Financial Accounts Team is committed to delivering to this deadline in 2017. We will continue to work with the team to help embed the further process changes necessary to meet the earlier deadlines required in future.

The key issues we considered as part of our financial statements audit were as follows.

NEC and Grand Central - the disposal of the NEC in particular was a highly complex transaction requiring key judgements to be made about accounting treatment. We focused our attention on ensuring that the accounting treatment applied was consistent and reasonable. We agreed that a £67 million adjustment was needed to investments. This had no impact on the Council's usable reserves.

Going concern - we considered whether it was appropriate for the Council to prepare its accounts on a 'going concern' basis. We concluded that balances provide sufficient cover for the 12 months from our opinion date and there is no material uncertainty that the Council will continue as a going concern in this period.

Equal pay provision - during 2015/16 equal pay claims were settled and the value and volume of new claims reduced. The provision for equal pay claims decreased to £310 million at 31 March 2016. In previous years we have included an emphasis of matter paragraph in our opinion to draw attention to the risk of material misstatement of the equal pay provision due to uncertainty about the impact of court judgements, the potential for a high volume of claims and the outcomes of negotiating settlements. Although these are still risks, we do not now consider that these are significant enough to draw specific attention to them in our audit opinion.

Whole of government accounts
We completed our work on the Council consolidation return following guidance issued by the NAO and issued an unqualified report on 30 September 2016.

The completion of the whole of government accounts return is a significant task for the Finance Team due to the value and volume of transactions with other public bodies and the complexity of the Council's accounts. The pre-audit return was submitted by the deadline and appropriate amendments made following completion of the audit. We are grateful for the work carried out by the Finance Team on this.

Certificate
We certified that we had completed the audit of the accounts of Birmingham City Council in accordance with the requirements of the Code on 30 September 2016.

We were able to do this because:

- we had completed our audit of the financial statements and issued our audit opinion
- we had completed our value for money work and issued our value for money conclusion
- the whole of government accounts return had been submitted as we had completed our audit work on it
- there were no matters brought to our attention relating to objections to the accounts.

Certification of grants
We also carry out work to certify the Council's Housing Benefit subsidy claim on behalf of the Department for Work and Pensions. Our work on this claim is not yet complete and will be finalised by 30 November 2016. We will report the results of this work to the Audit Committee in our Annual Certification Letter.

Other work completed
We also completed audits of the 2015/16 accounts of the following Council subsidiaries.

- Acivico Limited
- NEC (Developments) PLC
- Innovation Birmingham Limited
- PETPS (Birmingham) Limited
- Finance Birmingham Limited
- Marketing Birmingham Limited

Working with the Council
We have met regularly with Strategic Directors to inform our value for money conclusion work. We have also been briefed by the Improvement Panel on their work with the Council.

We have continued to work with the Finance Team constructively throughout the year. This has included commenting on and supporting plans for earlier closedown and improvements to closedown processes. We have met regularly with the team to discuss emerging technical issues such as the impact of changes in financial reporting requirements.

We have provided a range of training and other events that officers have attended. These include technical accounting workshops as well as seminars on Better Care Fund and Joint Ventures. Three of the Council's Finance Team are currently participants in our Opportunity West Midlands programme which we are running for a number of local authorities.

We would like to record our appreciation for the assistance and co-operation provided to us during our audit by the Council's staff.

Grant Thornton UK LLP
November 2016

Statutory recommendation

Recommendation made under section 24 of the Local Audit and Accountability Act 2014

The Council needs 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 or non-delivery of savings plans in 2016/17; and
- ensuring that all savings plans are assessed for both lead time to implement and delivery risk

re-assess the impact of the combined savings and budget pressure risks on the planned use of reserves in 2016/17 and the impact of this on the reserves position from 2017/18 onwards.

Our responsibilities

As well as our responsibilities to give an opinion on the financial statements and assess the arrangements for securing economy, efficiency and effectiveness in the Council's use of resources, we have additional powers and duties under the Act. These include powers to issue a public interest report, make written recommendations, apply to the Court for a declaration that an item of account is contrary to law, and to give electors the opportunity to raise questions about the Council's accounts and to raise objections received in relation to the accounts.

We have concluded that it is appropriate for us to use our powers to make a recommendation under section 24 of the Act due to the Council's current and forecast financial position.

Reasons for making the recommendation

The scale of the Council's financial pressure and the savings delivery challenge is unprecedented. We are satisfied that there are sufficient balances to cover under delivery in the short term this capacity is limited, but are concerned that if the Council does not take effective action to bring its savings programme back in line there will be insufficient balances to manage its financial risks effectively from 2017/18 onwards.

It is essential that the Council takes prompt action to bring its savings delivery back in to line with its overall four year plan as rapidly as possible.

Statutory recommendation

Savings plan delivery in 2016/17
The Council identified in its Business Plan 2016+ an overall savings challenge of over £251 million to be delivered in the four years to 2019/20. We reviewed savings delivery as part of our value for money conclusion work and concluded that there were weaknesses in the Council's arrangements for planning finances effectively to support the sustainable delivery of strategic priorities (see section 2).

The Business Plan 2016+ savings for 2016/17 total £88.2 million. This has increased to £123.0 million due to £34.8 million of one-off savings brought forward that need to be replaced with recurrent savings in 2016/17.

When we carried out our value for money conclusion work information on financial performance up to May 2016 was available. Since we completed our work two further financial monitoring reports have been produced and reported to Cabinet, summarising the position and forecast at July and August 2016.

The latest revenue monitoring report (to August 2016) reports that of the £123.0 million required savings for the year:

- £37.9 million are not deliverable
- £26.0 million have actions in place but some risk to delivery
- £20.8 million have actions in place to achieve savings in year only.

The net forecast budget under delivery for 2016/17 is £37.6 million if no further actions are taken and the alternative savings proposals are fully delivered. The savings identified as 'actions in place but some risk to delivery' include £13.0 million of funding from Health partners predicated on delivery of their financial control totals. There is a continuing risk that the value of one-off savings will increase during 2016/17.

We have noted that the savings plan under delivery and budget pressures are most severe in the People Directorate, largely due to the non-delivery of adult social care service redesign savings and budget pressures relating to adult social care, deprivation of liberty safeguards and homelessness. We have also noted that there is a further £13 million of social care funding included in the forecast 2016/17 position which is at risk. It is clear that the People Directorate is not able to find sufficient alternative schemes to make good the shortfall in its original savings programme and absorb its budget pressures in 2016/17.

We have previously reported that budget monitoring arrangements have been strengthened and there is an intense focus from Corporate Leadership Team and Cabinet on actions to find alternative savings. This includes fortnightly 'challenge' meetings with People Directorate leads involving both the Cabinet member for Health and Social Care and the Deputy Leader. We recognise that this is a major management pressure for the Council and it is essential that there is commitment across the Council to deliver the maximum amount of alternative savings in 2016/17.

We have therefore recommended that the Council:
ensures 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.

Statutory recommendation

Savings plan delivery from 2017/18 onwards

The Business Plan 2016+ cumulative savings programme total of £251.2 million over the four year period 2016/17 to 2019/20 is equivalent to 30 per cent of the 2016/17 net revenue budget. The 2016+ savings programme has a high dependency on the People Directorate, with £120.6 million (48 per cent) of the total savings requirement coming from savings schemes within the People Directorate.

The People Directorate savings plan includes £60 million to be delivered in three years, by 2018/19. This savings programme is based on the joint re-design of adult social care services with Health partners. The first year savings of £28 million have not been delivered and there is a high level of uncertainty about how much of the cumulative savings will be delivered.

It is clear from latest 2016/17 revenue monitoring report that the People Directorate has a high value of savings not deliverable (£28.3 million) and actions in place but some risk to delivery (£26.0 million). However, other directorates also have significant savings delivery issues.

- The Place Directorate has identified £8.1 million of agreed savings as not deliverable (32 per cent of the Directorate total savings targets for 2016/17)
- The Economy Directorate has identified £4.4 million of agreed savings as actions in place to achieve savings in year only and a further £1.8 million as either some risk to delivery or not deliverable (in total 81 per cent of the Directorate's agreed savings programme)
- Corporate Resources has identified £15.3 million of savings as actions in place to achieve savings in year only (54 per cent of the agreed Corporate Resources savings programme).

We have concluded that the savings programme agreed as part of the Business 2016+ is not delivering the required level of cumulative recurrent savings, and this is a problem across the Council's Directorates. The savings programme requires re-profiling from 2017/18 onwards to identify how the overall £251 million requirement will be delivered by the end of 2019/20.

Savings plans included in the 2016+ Business plan have either taken longer to deliver than anticipated and/or have failed to deliver the anticipated level of savings. The revised 2017+ savings plan needs to include a reassessment of delivery lead times for current and revised savings plans and savings delivery profiled in line with this. In our view the risk of non-delivery of savings schemes needs to be clearly assessed as part of the overall savings programme development to enable a clearer view to be taken on the likelihood and nature of alternative actions that might need to be taken.

We have therefore recommended that the Council:

demonstrates 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 or non-delivery of savings plans in 2016/17 ;and***
- ***ensuring that all savings plans are assessed for both lead time to implement and delivery risk***

Statutory recommendation

Impact on reserves

As at the 31 March 2016 the Council had a General Fund balance of £110.9 million. This included an 'Organisational Transition Reserve' balance of £72.8 million. The Business Plan 2016+ identifies that £12.7 million of this balance is planned to be utilised against the 2017/18 budget, leaving £60.1 million available as a risk contingency against delays in transformational change.

It is now highly likely that some of this risk contingency will be needed in 2016/17 to balance the under delivery of savings programmes and unplanned budget pressures. We have also noted that:

- one off savings brought forward in to 2016/17 need to be converted to recurrent savings
- there is £13 million of social care funding included in the forecast 2016/17 position which is at risk
- the revised forecast deficit position for 2016/17 of £37.6 million assumes that all alternative savings plans will be fully delivered in year.

Under delivery of any of these will have an adverse impact on the amount of reserves utilised in 2016/17.

There is limited capacity for the Council to use balances in future years and every effort needs to be made to minimise the use of balances in 2016/17.

We have therefore recommended that the Council:

re-assess the impact of the combined savings and budget pressure risks on the planned use of reserves in 2016/17 and the impact of this on the reserves position from 2017/18 onwards.

What does the Council need to do next?

The Act requires the Council to:

- consider our recommendation at a meeting held within one month of the recommendation being sent to the Council; and
- at that meeting the Council must decide:
  (a) whether the recommendation is to be accepted, and
  (b) what, if any, action to take in response to the recommendation.

Following the meeting the Council needs to notify us, as the Council auditors, of its decisions and publish a notice containing a summary of its decisions which have been approved by us.

Value for Money conclusion

Background

We carried out our review in accordance with the NAO Code of Audit Practice (the Code), following the guidance issued by the NAO in November 2015 which specified the 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.

Overall VfM conclusion

We issued an 'except for' qualified value for money conclusion in our audit opinion on 30 September 2016.

We concluded that we were satisfied that, in all significant respects, except for the matters we identified below, the Council had proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2016.

The qualification issues we identified were:

- Savings Challenge – due to the impact of non-recurrent savings in 2015/16 and the weaknesses in the Peoples Directorate's savings plan delivery
- Services for vulnerable children – due to the concerns reported by Ofsted following their monitoring visit and the continuing need for the Council to have external oversight of its arrangements by the Children's Commissioner
- Management of schools – due to Ofsted feedback indicating that there are significant governance issues in some schools and concerns reported by Ofsted on the pace of change
- Improvement Panel – due to continuation of the Panel's appointment.

Key findings and recommendations

Our first step in carrying out our work was to perform a risk assessment and identify the key risks where we concentrated our work. The key risks we identified and the work we performed are set out in table 2 overleaf.

We made the following recommendations to address our findings.

The Council needs to ensure:

- Effective plans are put in place to respond to the under delivery of savings plans and emergent budget pressures, particularly in the People Directorate. These need to include a realistic assessment of the use of reserves to enable sufficient lead time for the savings plans to be implemented.
- Plans for services to vulnerable children, including the options for setting up a Children's Trust, need to deliver significant and measurable improvement promptly.
- The implementation of the Birmingham Education Delivery and Improvement Plan needs to demonstrate that the issues raised by Ofsted, including the children missing from education, are being addressed promptly and effectively.
- The pace of change and the impact of new political and corporate leadership arrangements need to demonstrate to the Improvement Panel that this intervention is no longer required.
- The Council and its health partners need to decide whether to reinstitute the joint commissioning board for the learning disabilities and mental health services pooled budget, or agree alternative arrangements.

Value for Money conclusion

Risk identified	Findings and conclusions
Savings challenge The Council has identified an overall savings challenge of over £251 million to be delivered in the four years to 2019/20. The five largest savings schemes proposed over the period account for just under half of the savings target. They are challenging and include health and social care service redesign, efficiency improvements and workforce changes. The key risk is that these schemes will not deliver the required recurrent savings, or will take longer to implement than planned.	**We concluded that there were weaknesses in the Council's arrangements that relate to the adequacy of the financial planning VfM criteria as part of sustainable resource deployment.** The Council reported a 2015/16 revenue budget underspend of £2.8 million on a net revenue budget of £874.5 million. This included the delivery of a £110.3 million savings programme. Delivery of the budget and a savings programme of this scale was a notable achievement. There was however a significant dependence on non-recurrent savings to do this. The Council's Business Plan 2016+ identifies continuing savings pressures, with a requirement of £251.2 million of savings to be delivered by the end of 2019/20; 2016/17 (£88.2 million) and 2017/18 (£75.1 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. We reviewed financial performance reported to Cabinet in July 2016. This identified more severe financial pressures than anticipated due to £51.6 million of savings actions not in place and the emergence of £11.6 million of budget pressures. The largest savings programme is £60 million relating to health and social care service redesign and Better Care Fund funding. Of this, £28 million was due to be delivered in 2016/17. This savings programme assumed that funding would be released by central government and health partners would direct this to the Council. This has not happened for 2016/17 and there is uncertainty about how much of this funding the Council will receive in the following two years. Savings of £14.8 million were also planned from the redesign of adult social care packages which are not being realised and budget pressures of £7.1 million identified for adult social care provision. We identified in our initial risk assessment that the key risk was that the major savings schemes will not deliver the required recurrent savings, or will take longer to implement than planned. The £34.8 million shortfall in recurrent savings brought forward from 2015/16 and the delivery difficulties with the largest savings scheme in 2016/17 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.

Value for Money conclusion

Risk identified	Findings and conclusions
Services for vulnerable children The Council's services for vulnerable children are assessed as inadequate by Ofsted and subject to an Improvement Notice. The Secretary of State has appointed a second Children's Commissioner. The key risk is that the service does not show demonstrable improvement and continues to be subject to external intervention.	**We concluded that there were weaknesses in the Council's arrangements for managing risks effectively and maintaining a sound system of internal control, demonstrating and applying the principles and values of good governance, and planning, organising and developing the workforce effectively to deliver strategic priorities** The Secretary of State appointed Andrew Christie as the Council's Children's Commissioner in December 2015. He is the second post holder and was appointed as the Council was not performing to an adequate standard and meeting all of its responsibilities under the Education Act 1996 and the Children's Act 2004. The Council was subject to an Ofsted monitoring visit in early June 2016 which focussed on safeguarding arrangements in schools, children missing from education, children being educated at home and the application of the Prevent agenda in schools. The inspector identified 13 areas where the Council was found to be underperforming. Ofsted's full inspection is likely to report by December. It is clearly important that the Council can demonstrate sufficient improvement to be assessed as adequate. The Council announced in May 2016 its intention to investigate a children's trust model as part of its improvement planning. A report was presented to Cabinet in July 2016 supported by a 'case for change' analysis. An appraisal process and timetable was agreed at that meeting. At its September 2016 meeting Cabinet agreed the draft scope of the proposed Trust and agreed that both the wholly owned company and employee owned mutual would proceed to the design phase. The Trust service scope and delivery option and its governance arrangements will be reported to Cabinet in January 2017. 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 and the continuation of external intervention by the Children's Commissioner means that this risk is not sufficiently mitigated.

Value for Money conclusion

Risk identified	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. This appointment is continuing and the Birmingham Education Partnership (BEP) has responsibility for implementing the improvement plan. The key risk is that plan implementation will be slower than envisaged and underlying issues will not be effectively addressed.	**We concluded that there were weaknesses in the Council's arrangements to manage risks effectively and maintain 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.** The Birmingham Education and Schools' Strategy and Improvement Plan (2015-16) was subject to an LGA peer challenge which reported to the Council in December 2015. The peer challenge considered five work streams. Its findings included the following. • The Council has made good progress across the five work streams • There is confidence amongst members, officers and partners that the basics for strong effective city wide system of school improvement • Stronger professional leadership is making a significant impact and governance is now high on the agenda • The Birmingham Education Partnership (BEP) is widely regarded as the right vehicle for school improvement and has good buy-in from schools. These findings are not wholly consistent with the Ofsted monitoring visit findings, which indicated that there are continuing and serious weaknesses in the management of schools. In particular, arrangements for ensuring children with special educational needs receive full time education, weak links with independent schools and ensuring appropriate suitability checks are carried out for potential governors of schools not maintained by the Council. 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 so far have shown that there are a range of governance issues to address across the schools visited (approximately a third of all Birmingham schools). 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 establishment of the BEP and the implementation of the improvement plan there is still work to do. The pace of school improvement is the key issue affecting our judgement.

Value for Money conclusion

Risk identified	Findings and conclusions
Improvement Panel The Improvement 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 Council, 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 concluded that the Panel's continuing engagement is evidence of significant failings in governance arrangements as part of Informed Decision Making.** The Panel wrote to the Secretary of State in November 2015, January 2016 and March 2016. The Panel's March 2016 letter referred to the positive improvement that the change in political leadership was having, the strengthening of corporate leadership and the Council's gap analysis of what it needs to do in the next six months. The Panel noted that: "…., much has been done, progress continues to be made, the pace of change is picking up, but the required impact is not yet sufficient. The Panel is hopeful about the prospects for further improvement, but the robustness, resilience and sustainability of the Council's progress is yet to be evidenced." The Panel's letter also refers to the development of the long term financial strategy and raises concerns about the scale and nature of the 2017/18 savings plans in particular. The letter concludes: "….., the Panel believes it would now be appropriate for the political and managerial leadership to be given the chance to work together and demonstrate the Council's ability to deliver the actions outlined in the Council's recent gap analysis, without the current level of intervention. The Panel therefore considers it should stand back for a period, undertaking a review of further progress in the autumn, drawing again on feedback from residents, partners, elected members and staff." The Secretary of State agreed to this course of action in his response. 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 whether the stepping back of the Panel is sufficient for us not to qualify our VfM conclusion. In our view it is not. The Panel was fully engaged with the Council during 2015/16 and it is yet to conclude that sufficient progress has been made in implementing the changes needed.

Value for Money conclusion

Risk identified	Findings and conclusions
Health and Social Care funding The Council has a good track record of controlling health and social care spend and has extensive partnership arrangements with Health bodies. Delivery of service outcomes is dependent on effective partnership working with Clinical Commissioning Groups. The key risk is that partnership arrangements do not fully deliver service outcomes and improvements.	**We concluded that the risk was sufficiently mitigated and the Council has adequate arrangements to deliver service outcomes and improvements.** We considered the governance arrangements for the Better Care Fund and other pooling agreements. In particular, the clarity of lines of accountability to the Council. We also considered the risk sharing arrangements in place and the partnership arrangements. The Birmingham Better Care Fund totals £100 million for 2015/16 with contributions from the Council and its Health partners. The main decision making forum for the Better Care Fund is the 'Commissioning Executive'. Whilst our work has shown that the governance of the fund is operating effectively and appropriately it is clear that the partnership has not achieved the forecast efficiencies. This is indicative of the weaknesses nationally in the fund implementation. The Council also works with its Health partners through the Learning Disabilities and Mental Health pooled budget. The Council contributed £93.0 million of the total pooled spending of £259.3 million in 2015/16. We found that the joint commissioning board ceased operating in April 2015. This means that there has been inadequate reporting of performance or financial information to all pooled budget members collectively. We are not aware of any plans to address this. 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 noted that the Better Care Fund has not fully delivered due to weaknesses in national implementation. We have also considered the impact of the failure maintain the joint commissioning board for the pooled budget. The lack of oversight has resulted in ineffective working with third parties and needs to be rectified. However, we have seen no evidence that service outcomes and improvements have not been delivered

Value for Money conclusion

Risk identified	Findings and conclusions
Future Council The programme is ambitious and extensive. It has five work streams and it is essential that delivery is effectively managed. The key risk is that deliverables are not clearly identified, project and risk management arrangements are not effective, and as a result changes are not implemented as intended.	**We concluded that the risk that deliverables are not clearly identified, and that project and risk management arrangements are not effective was sufficiently mitigated by the arrangements in place during phase one of the programme.** The Future Council programme has now moved to its second phase. A Programme Transition Report was presented to Corporate Leadership Team in June 2016. This identified the key outcomes of the first phase and the objectives and approach for the second phase. The report highlights the outcomes achieved, but also notes that there is outstanding activity to be carried forward to phase two. It also notes that the programme governance was thoroughly thought through and generally worked well. Performance against 134 key actions derived from the Kerslake report were tracked and the report identifies that 109 of these were delivered by June 2016. There is also a clear focus on risk management. A briefing document was sent to all staff on the 26 July 2016, providing an outline of the progress made with the Future Council Programme and how it is being developed. This includes five key outcomes from phase one and eight areas where improvements are still needed. Four supporting programmes for phase two; creating an improvement hub, developing the people strategy, implementing the IT and digital strategy and designing services from a citizen perspective through the citizen access strategy. A clear project management structure is outlined, with the establishment of a programme management office. This will have a key role in ensuring that the Council's leadership is clearly sighted on progress and risk management.
Equal Pay The Council has a settlement plan for Equal Pay claims that is dependent on utilising capital receipts. The key risk is that there will be insufficient resources available to meet these commitments.	**We concluded that the receipt of funds from asset sales and the continuing fall in the Council's equal pay liability contribute to sufficient resources being available to meet the Councils equal pay commitments**. We reviewed the settlement plan and are satisfied that the capital receipts generated are sufficient to meet the Council's anticipated equal pay commitments. During 2015/16 over £200 million of claims have been settled resulting in a reduced provision in the 2015/16 financial statements of £310 million. In previous years there has been greater uncertainty about the extent of the Councils liabilities for the claims as this is dependent on complex law against the particular circumstances at each authority. As more local cases have been settled and information about claims has become clearer, the extent of the Councils liability can be determined with greater certainty.

Audit of the accounts

Audit opinion

We gave an unqualified opinion on the Council's accounts on 30 September 2016.

There were further improvements in the production of the accounts. We received draft financial statements on 13 June 2016 more than two weeks in advance of the statutory deadline. The draft accounts were well presented. The delivery of working papers was also 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.

From 2018 the statutory deadline for accounts production will be 31 May and the Financial Accounts Team is committed to delivering to this deadline in 2017. We will continue to work with the team to help embed the further process changes necessary to meet the earlier deadlines required in future.

Issues arising from the audit of the accounts

We reported the key issues from our audit of the accounts of the Council to the Council's Audit Committee on 12 September 2016 and provided an updated addendum to the Audit Findings Report to the chair of the audit committee under delegated powers on the 29 September 2016. The addendum concerned the accounting treatment of the Council's investment in NEC (Developments) PLC, and is summarised below.

The key comments arising from our audit of the Council's financial statements concern:

- the accounting and disclosures relating to the disposal of the NEC and Grand Central
- our consideration of the going concern assessment
- the equal pay provision

NEC and Grand Central - the disclosures relating to these disposal transactions have been challenging for the Council due to the sensitive nature of these commercial transactions. Our initial review of the draft accounts concluded that there were insufficient disclosures of these two highly material transactions to meet the requirements of the Local Authority Accounting Code and IFRS (International Financial Reporting Standards). We discussed our concerns about the disclosures and amendments were made to both the narrative report, notes to the accounts and the group accounts. Our review of the amended accounts identified an issue with the accounting treatment of the Council's £67 million investment in NEC (Developments) PLC. We concluded that this should be impaired and the accounts were adjusted to reflect this. These changes did not have any impact on the Council's General Fund reserves as at 31 March 2016, or on the Council's continuing obligation with respect to the £73 million loan debt.

Going concern - we considered whether it was appropriate for the Council to prepare its accounts on a 'going concern' basis. In forming this view we consider the Council's forecast financial position for 12 months from the date of our audit opinion. We concluded that:

- the capital receipts generated by asset sales, including the NEC and Grand Central are sufficient to meet current equal pay obligations
- balances provide sufficient cover for any shortfall in savings delivery in the 12 month period but we emphasise that we are not expressing an opinion that balances should be used for this purpose and stress the importance of the actions currently being taken by the Council to respond to the savings challenge.

Audit of the accounts

Equal pay provision – the provision for equal pay claims decreased to £310 million at 31 March 2016 due to the settlement of existing claims and a reduction in the value and volume of new claims reduced. In previous years we have included an emphasis of matter paragraph in our opinion with regard to the Council's equal pay liability, due to the difficulties in accurately estimating equal pay liabilities. We did not include this in this year's audit opinion. Although these are still risks with regard to equal pay claims and settlement, we do not consider that these are significant enough to draw specific attention to them in our audit opinion.

Annual Governance Statement and Narrative Report
We are also required to review the Council's Annual Governance Statement and Narrative Report.

Both documents were prepared in line with the relevant guidance and were consistent with the supporting evidence provided by the Council and with our knowledge of the Council. We noted in our Audit Findings Report that:

- the management of schools had not been included as a significant governance issue in this year's Annual Governance Statement; and
- group governance arrangements were not referred to in the Annual Governance Statement.

Both the Annual Governance Statement and the Narrative Report were published on the Council's website with the draft accounts in line with the national deadlines.

Whole of Government Accounts
We completed our work on the Council consolidation return following guidance issued by the NAO and issued an unqualified report on 30 September 2016.

The completion of the whole of government accounts return is a significant task for the Finance Team due to the value and volume of transactions with other public bodies and the complexity of the Council's accounts. The pre-audit return was submitted by the deadline and appropriate amendments made following completion of the audit. We are grateful for the work carried out by the Finance Team on this.

Our audit approach

Materiality
In our audit of the Council's accounts, we use the concept of materiality to determine the nature, timing and extent of our work, and in evaluating the results of our work. We define materiality as the size of the misstatement in the financial statements that would lead a reasonably knowledgeable person to change or influence their economic decisions.

We determined materiality for our audit of the Council's accounts to be £45,126,000, which is 1.5 per cent of the Councils gross revenue expenditure. We used this benchmark, as in our view, users of the Council's accounts are most interested in how it has spent the income it has raised from taxation and grants during the year.

Audit of the accounts

We also:

- set a lower level of specific materiality for certain areas such as cash and senior officer remuneration-and exit packages and auditor remuneration; and
- set a threshold of £2,256,000, above which we reported errors to the Audit Committee in our Audit Findings Report.

The scope of our audit

Our audit involves obtaining enough evidence about the amounts and disclosures in the financial statements to give reasonable assurance that they are free from material misstatement, whether caused by fraud or error.

This includes assessing whether:

- the Council's accounting policies are appropriate, have been consistently applied and adequately disclosed;
- significant accounting estimates made by management are reasonable; and
- the overall presentation of the financial statements gives a true and fair view.

We also read the Narrative Report and Annual Governance Statement to check they are consistent with our understanding of the Council and with the accounts on which we give our opinion.

We carry out our audit in line with ISAs (UK and Ireland) and the NAO Code of Audit Practice. We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our audit approach was based on a thorough understanding of the Council's business and is risk based. We identified key risks and set out overleaf the work we performed in response to these risks and the results of this work.

Audit of the accounts

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk
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 determined that the risk of fraud arising from revenue recognition could 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 **We did not identify any issues to report**
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.	We: • reviewed entity level controls • tested journal entries • reviewed accounting estimates, judgements and decisions made by management • reviewed unusual significant transactions **We did not identify any evidence of management over-ride of controls and our review of journal controls and testing of journal entries did not identify any significant issues**
Sale of the NEC and Grand Central Risk that complex accounting entries are not correctly posted in the accounts	We: • gained an understanding of the transactions including a review of supporting documentation • tested transactions in the financial statements to ensure they were consistent with our understanding including the elimination of lease/investment arrangements and sale proceeds • reviewed accounting entries including the treatment of sale proceeds to ensure they complied with the requirements of the CIPFA Code of Practice **We concluded that the Council's investment in NEC (Developments) PLC should be impaired and a £63 million adjustment from long term investments to unusable reserves was made. We also concluded that further disclosures relating to the sale of both the NEC and Grand Central were needed and these were included in the final version of the accounts. We considered the Grand Central profit share payment of £72.9 million, disclosed as an exceptional item and concluded that the payment was in accordance with the agreement with Network Rail.**

Audit of the accounts

Risks identified in our audit plan	How we responded to the risk
Actuarial Valuation of LGPS pension liability Under ISA 540 (Accounting Estimates and Related Disclosures), the auditor is required to make a judgement as to whether any accounting estimates with a high degree of estimation uncertainty give rise to a significant risk.	We: • documented the key controls put in place by management to ensure that the pension fund liability was not materially misstated • walked through these key controls to assess whether they were implemented as expected and mitigated the risk of material misstatement in the financial statements • reviewed the professional competence, expertise and objectivity of the actuary who carried out the Council's pension fund valuation • gained an understanding of the basis on which the IAS 19 valuation was carried out, and carried out procedures to confirm the reasonableness of the actuarial assumptions made • reviewed the consistency of the pension fund asset and liability and disclosures in notes to the financial statements with the actuarial report from your actuary **We did not identify any issues that we need to bring to your attention.**
Equal Pay Provision Under ISA 540 (Auditing Accounting Estimates, including Fair Value Accounting Estimates and Related Disclosures), the auditor is required to make a judgement as to whether any accounting estimates with a high degree of estimation uncertainty give rise to a significant risk.	We: • reviewed of the assumptions on which the equal pay provision estimate was based • considered events or conditions that could change the basis of estimation • checked the calculation of the estimate • confirmed that the estimate was determined and recognised in accordance with accounting standards • considered how management assessed estimation uncertainty and the potential impact of subsequent transactions **On the basis of our work, we concluded that the level of estimation uncertainty does not present material estimation uncertainty to the provision included in the accounts.**
Valuation of property, plant and equipment The Council revalues its assets on a rolling basis over a five year period. The 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.	We: • reviewed management's processes and assumptions for the calculation of the valuation estimate, including the instructions issued to valuation experts and the scope of their work • discussed with the valuer the basis on which the valuation was carried out • tested revaluations made during the year to ensure they were input correctly into the Council's asset register • evaluated the assumptions made by management for those assets not revalued during the year **The valuer's report for both HRA and General Fund land and buildings was as at 1 April 2015. To ensure that the valuation was not materially misstated as at 31 March 2016 the valuer reviewed the potential movement in values during the year. This resulted in an increase of £38.5 million for assets revalued in 2015/16, and £164.3 million for assets not revalued during 2015/16.**

Audit of the accounts

Risks identified in our audit plan	How we responded to the risk
Better Care Fund Risk that transactions are not accounted for correctly	We: • obtained an understanding of the nature of any Better Care Fund agreements in place, and documented the control environment. • reviewed the accounting treatment of significant agreements • agreed the accounting entries and disclosures in the financial statements **Our audit work did not identify any issues regarding accounting treatment that we wished to bring to your attention.**

Working with the Council

Our work with you in 2015/16

We are really pleased to have worked with you over the past year. We have an established a positive and constructive relationship with key officers and the Audit Committee. Some of the ways we have worked together are summarised below.

Audit efficiency – we worked closely with the Finance Team throughout the year and this enabled us to carry out more work at the interim stage of our audit before the accounts are produced. We had regular briefing meetings with the team throughout the audit, making sure that they were fully aware of any audit issues. We recognise that we still have work to do to further improve our audit efficiency and two key actions are to bring more audit work forward to our interim visits and ensure the prompter clearance of technical issues.

Understanding your operational health – through the value for money conclusion work we provided you with a clear statement on your operational effectiveness and highlighted the key actions you need to take on:

- savings plan delivery
- improving services for vulnerable children
- responding effectively to issues raised by Ofsted
- demonstrating to the Improvement Panel that they can fully disengage
- re-establishing effective governance arrangements for joint commissioning through pooled budgets.

In forming our view we have consulted widely with the Chief Executive, Strategic Directors, other key officers, and the Leader and Deputy Leader. We have also had regular discussions with the current and former Audit Committee Chairs. It is also important that we take into account the views of other external agencies. We have had meetings with the Council's Children's Commissioner and regular briefings with the Vice Chair of the Council's Improvement Panel.

Sharing our insight – we provided regular audit committee updates covering best practice. Areas we covered included Innovation in public financial management, Knowing the Ropes – Audit Committee effectiveness review, Making devolution work, Reforging local government. We have shared our publication on Building a successful joint venture and officers attended the supporting workshops which provided insights from a range of practitioners. We will continue to support you as you consider greater use of alternative delivery models for your services.

Providing training and supporting development – we provided your teams with training on financial accounts and annual reporting. We also hosted a Better Care Fund workshop which enabled your Finance Team to work with colleagues in partner organisations and implement a consistent approach.

Providing information – we provided you with a demonstration of CFO insights, our online analysis tool. This gives you insight on the financial performance, socio-economy context and service outcomes of councils across the country.

Working with the Council

Working with you in 2016/17

Operational issues - responding to our statutory recommendation
The Council is in a challenging position and we have made clear in our statutory recommendation the actions needed. We will review your progress with delivering these and report on progress to the Audit Committee.

We will continue to meet frequently with senior management, members and the Improvement Panel to ensure that we understand the key issues you are tackling and the progress you are making.

Accounts and audit delivery - change in the statutory deadline
The statutory deadlines for accounts and audit delivery change in 2018 to the end of May for accounts and the end of July for the audit. We will continue to work with the Financial Accounts team to help embed the further process changes necessary to meet the earlier deadlines required in future.

Accounting issues - Highways Network Asset
The Code of Practice on Local Authority Accounting requires authorities to account for Highways Network Asset (HNA) at depreciated replacement cost (DRC) from 1 April 2016. This is a major change from the current approach of accounting on a depreciated historic cost basis.

The Code sets out the key principles but also requires compliance with the requirements of the recently published Code of Practice on the Highways Network Asset, which defines the assets or components that will comprise the HNA. This includes roads, footways, structures such as bridges, street lighting, street furniture and associated land. These assets have always been recognised within Infrastructure Assets.

The Code includes transitional arrangements for the change in asset classification and the basis of measurement from depreciated historic cost to DRC. This is expected to have a significant impact on the Council's 2016/17 accounts, both in values and levels of disclosure, and may require considerable work to establish the opening inventory and condition of the HNA as at 1 April 2016.

The nature of these changes means that finance officers need to work closely with colleagues in the highways section and potentially also to engage other specialists to support this work. Some of the calculations are likely to be complex and will involve the use of external models, a combination of national and locally generated rates and a number of significant estimates and assumptions.

We have been working with the Council on the accounting, financial reporting and audit assurance implications arising from these changes. We have issued two Client Briefings which we have shared with you. We will issue further briefings during the coming year to update the Council on key developments and emerging issues.

Appendix A: Reports issued and fees

We confirm below our final fees charged for the audit and provision of non-audit services.

Fees

	Planned £	Actual fees £	2014/15 fees £
Statutory audit of Council	314,168	314,168	418,890
Audit of subsidiaries			
Acivico Limited	37,500	37,500	Nil
Innovation Birmingham Limited	22,500	22,500	19,000
NEC (Developments) PLC	10,000	10,000	Nil
PETPS (Birmingham) Limited	7,500	7,500	Nil
Finance Birmingham Limited	6,800	6,800	6,600
Marketing Birmingham Limited	13,750	13,750	10,550
Subsidiaries total	98,050	98,050	36,150
Housing Benefit Grant Certification	17,594	TBC	29,600
Total fees (excluding VAT)	**429,812**	**TBC**	**484,640**

Fee variations are subject to approval by Public Sector Audit Appointments Ltd.

Fees for other services

Service	Fees £
Audit related services:	
Certification of grant claims (outside PSAA requirements)	16,700
Non audit related services:	
Finance Birmingham – operational support	22,215
Innovation Birmingham – tax advice	6,400
Marketing Birmingham – tax advice	1,315

Reports issued

Report	Date issued
Audit Plan	March 2016
Audit Findings Report	September 2016
Annual Audit Letter	October 2016

Grant Thornton

grant-thornton.co.uk