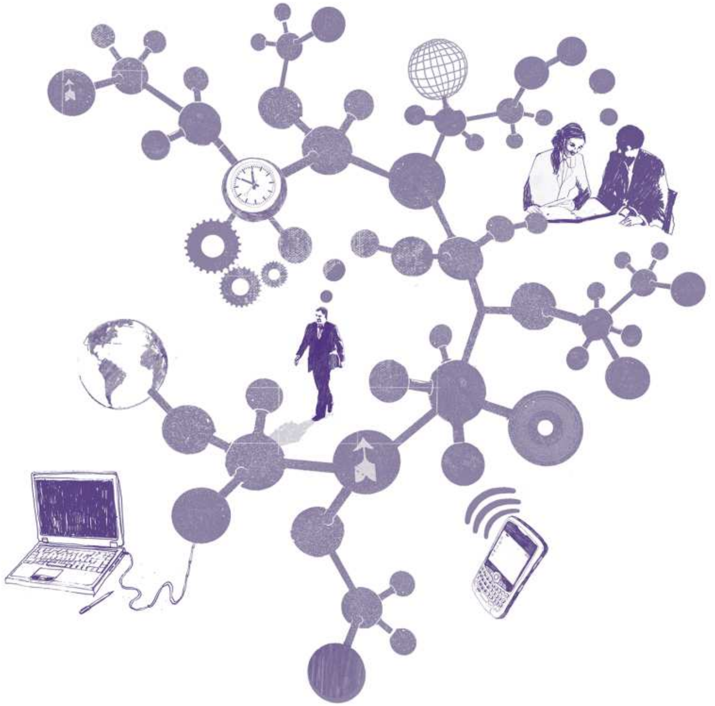
The Audit Findings for Birmingham City Council

Year ended 31 March 2015

September 2015



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Section 1: Executive summary

Executive summary

Purpose of this report

This report highlights the key matters arising from our audit of Birmingham City Council's (the Council) group and Council's financial statements for the year ended 31st March 2015. It is also used to report our audit findings to management and those charged with governance in accordance with the requirements of International Standard on Auditing 260 (ISA UK&I).

Under the Audit Commission's Code of Audit Practice we are required to report whether, in our opinion, the group and Council's financial statements present a true and fair view of the financial position and expenditure and income for the year and whether they have been properly prepared in accordance with the CIPFA Code of Practice on Local Authority Accounting. We are also required to reach a formal conclusion on whether the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources (the Value for Money conclusion).

Introduction

In the conduct of our audit we have not had to alter or change our planned audit approach, which we communicated to you in our Audit Plan and presented to Audit Committee on 30th June 2015.

Our audit is substantially complete although we are finalising our work in the following areas:

- final review of our audit work and follow up of any points arising;
- review of the final version of the financial statements;
- obtaining and reviewing the final management letter of representation;

Financial statement production

We received draft financial statements by the statutory deadline of 30th June 2015. It is pleasing to report that this is the second year that the accounts have been delivered on time and we are grateful to the Financial Accounts Team for their hard work and support throughout the audit. We will continue to work with the team to help embed the further process changes necessary to meet the earlier deadlines required in future.

Key issues arising from our audit

Financial statements opinion

We anticipate providing an unqualified opinion on the financial statements, but intend to include 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.

The key messages arising from our audit of the Council's financial statements, including the group accounts concern the:

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

We also note that during the year the Council changed its bankers requiring changes to payments and receipts systems to be implemented and communicated to everyone the Council transacts with. This complex and high profile project was well managed and the transfer was implemented with minimal disruption to the Council's receipts and payments systems.

Executive summary

Accounting treatment of NEC assets

The Council signed a contract for the sale of the NEC on 16th January 2015. Delivering this sale was a challenging and complex process for the Council and it is pleasing to report that it was well managed. It involved extensive engagement with stakeholders and other interested parties, and required a high level of internal and external support.

The sale agreement was subject to a three month period until the completion of the contract and transfer of assets to the purchaser on the 1st May 2015. The transaction was complex and broadly included the following:

- collapse of existing leases and granting of 125 year leases for assets on the NEC site and 25 year leases for the Barclaycard Arena and International Convention Centre;
- retention of the Council's ownership of NEC Developments, after leases relating to Halls 17 to 20 and loan stock of £192 million were transferred to NEC Limited;
- restructuring of NEC Limited debt, replacing the loan stock (debentures) with an equivalent value of equity, transferred to the purchaser;
- lease back to the Council of the two hotels on the NEC site;
- retention of the pension liability by the Council in the closed NEC defined benefit pension schemes; and
- a 'locked box' agreement relating to the NEC's trading income from 1st April 2014 to the 30th April 2015.

At 31st March 2015, although the contract to sell the NEC had been signed the transaction had not been completed. We agreed with the Council's view that assets and liabilities relating to the NEC should be included on the Council's balance sheet in accordance with accounting standards.

The disclosure requirements for this unique transaction in the 2014/15 accounts are complicated and dependent on interpreting financial reporting standards relating to assets held for sale and financial instruments. We reviewed the accounting disclosures in the draft accounts and challenged the following items.

- The inclusion of the £192 million of NEC loan stock (debentures) as assets held for sale in the Council's single entity balance sheet (note 27). Our conclusion was that as these are financial instruments they should not be disclosed as assets held for sale, but as short term investments.

- The inclusion of a £17 million adjustment to the value of assets held for sale in the group accounts to reconcile the value of assets disposed of to the NEC loan stock value. Our conclusion was that this was not appropriate.

We discussed these issues with the Director of Finance and agreed that both the single entity and group balance sheets should be amended.

Equal pay

The audited accounts include a provision for the Council's equal pay liability of £562 million (note 32), a decrease of £77 million compared to the 2013/14 accounts. This is the second year that the equal pay liability has decreased and reflects both the settlement of claims and the reduction in the volume of new claims. However, equal pay continues to be a major financial liability for the Council.

The accounting policy adopted by the Council is to recognise a provision for equal pay on receipt of a valid claim. Potential future claims are treated as a contingent liability. A significant number of variables impact the number and value of future claims. We have included an emphasis of matter paragraph in our proposed audit opinion. This draws the readers' attention to the point at which claims are recognised and the variables impacting on the valuation of the equal pay liability. It is not a qualification of the audit opinion.

Executive summary

Accounting treatment of voluntary aided and voluntary controlled schools
CIPFA's Local Authority Accounting Panel (LAAP) issued Bulletin 101 in December 2014 to clarify the appropriate accounting treatment of voluntary aided, voluntary controlled and foundation schools (VA/VC/FS) schools. As typically a local authority does not own either the land or buildings relating to these schools the key issue is whether these assets should be included on their balance sheet or not.

The on or off balance sheet decision is dependent on a range of factors which need to be considered on a case by case basis. Unlike many other local authorities, the Council reviewed its accounting treatment of VA/VC/FS schools when it implemented IFRS. The conclusion was that this was a relationship that contained a lease and that buildings should be included on balance sheet and land should not.

The publication of LAAP Bulletin 101 required the Council to re-visit this decision. The Council concluded that although the original decision to include buildings on balance sheet still held, the exclusion of land may not be appropriate. Due to the Council's high volume of VA/VC/FS schools the review of all schools was not complete when the draft accounts were produced. All VA/VC land and buildings were included on the balance sheet. The inclusion of this land increased property plant and equipment by £207 million.

Our view is that land relating to VA/VC/FS schools should only be included on the Council's balance sheet in specific circumstances. Examples are where the Council has authority over both land and buildings use, or there are restrictive covenants in place which require the land to be used for education purposes in perpetuity.

The Council is taking a thorough approach to this issue and documentation for over 80 schools has been examined. On completion of this review land totalling £58 million was removed from the balance sheet value of property, plant and equipment. Our testing confirmed that this was appropriate. The Financial Accounts Team is planning to continue with this review to reduce the number of schools with insufficient evidence to support their accounting treatment. They anticipate that this will result in more land being included on the balance sheet.

Consideration of the going concern assessment
Going concern is a fundamental principle in the preparation of financial statements. Under the going concern assumption, a local authority is viewed as continuing in operation for the foreseeable future with no necessity of liquidation or ceasing trading. Accordingly, its assets and liabilities are recorded on the basis that assets will be realised and liabilities discharged in the normal course of business. A key consideration of going concern is that the local authority has the cash resources to meet its obligations as they fall due in the foreseeable future. This is usually considered to be a year after the date of issue of the audit opinion.

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

If the Council does not generate the required savings or capital asset sales it will need to utilise both general fund and earmarked reserves to manage any revenue consequences. In terms of liquidity, the Council would need to increase its borrowing or reduce its short term lending to meet its cash requirements. It may also need to consider delaying equal pay settlements.

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

Executive summary

We consider that the Council's ability to meet its statutory financial duties and our assessment of the Council as a 'going concern' is dependent on both the delivery of its savings plans and the asset sales highlighted above. This is a 'significant judgement' under accounting standards and has been included within the relevant note to the financial statements.

We have requested representations from the Council with regard to 'going concern' on the following aspects:
- the Council considers that it remains a 'going concern'
- the Council has considered the need to generate capital receipts and is satisfied that it has appropriate plans in place to generate sufficient capital receipts in 2015/16 and 2016/17

Further details of audit opinion work is set out in section two of this report.

Value for Money conclusion
Our review of the Council's arrangements to secure economy, efficiency and effectiveness has highlighted the following issues which will give rise to a qualified 'except for' Value for Money conclusion.
- The Secretary of State's appointment of an Improvement Panel
- The need for further improvements in the Council's arrangements for ensuring the effectiveness of its arrangements for children in need of help and protection, children looked after and care leavers
- The need for further improvement in the Council's governance arrangements to oversee the management of schools within the City
- The impact of equal pay claim settlements and the savings requirement of £359 million over the next three years.

Further detail of our work on Value for Money is set out in section three of this report.

Whole of Government Accounts (WGA)
The Council submitted its WGA return by the required deadline. Our audit work is in progress and we anticipate completing our work in accordance with the national timetable.

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.

We reported in our audit plan that there is a potentially material control issue relating to unauthorised journals input by senior staff. A compensating journal control has been introduced which requires a review of a monthly sample of unauthorised journals entered by senior staff to ensure journals are valid and accurate.

Group accounts have been produced from unaudited accounts for all the group entities included in the consolidated balance sheet. At the time of drafting this report no audited accounts had been received by the Financial Accounts Team. We repeat our recommendation from our 2013/14 audit that the Audit Committee needs to ensure that unaudited accounts are delivered by the end of May and audited accounts before the completion of the Council's audit.

The financial statements include a prior period adjustment of £27 million relating to the previous misposting of schools capital expenditure to revenue. Our audit testing has identified further mispostings of capital items. We have concluded that improvements are required in the accuracy of capital postings.

Further details are provided within section two of this report.

The way forward
Matters arising from the financial statements audit and review of the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources have been discussed with the Director of Finance.

We have made a number of recommendations, which are set out in the action plan in Appendix A. Recommendations have been discussed and agreed with the Director of Finance.

Grant Thornton UK LLP
September 2015

Section 2: Audit findings

Audit findings

We set out on the following pages the work we have performed and the findings arising from our work in respect of the audit risks we identified in our audit plan, presented to the Audit Committee on 30th June 2015. We also set out the adjustments to the financial statements arising from our audit work and our findings in respect of internal controls.

Changes to Audit Plan

We have not made any changes to our Audit Plan as previously communicated to you on 30th June 2015.

Audit opinion

Our proposed audit opinion is set out in Appendix B.

Audit findings against significant risks

"Significant risks often relate to significant non-routine transactions and judgmental matters. Non-routine transactions are transactions that are unusual, either due to 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 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
1.	**Improper revenue recognition** Under ISA (UK&I) 240 there is a presumed risk that revenue may be misstated due to improper recognition	• Reviewed and tested revenue recognition policies • Tested of material revenue streams • Reviewed unusual significant transactions	Our audit work has not identified any issues in respect of revenue recognition.
2.	**Management override of controls** Under ISA (UK&I) 240 there is a presumed risk of management over-ride of controls	• Reviewed accounting estimates, judgements and decisions made by management • Tested journal entries • Reviewed unusual significant transactions	Our audit work has not identified any evidence of management override of controls. In particular the findings of our review of journal controls and testing of journal entries has not identified any significant issues. We set out later in this section of the report our work and findings on key accounting estimates and judgements.

Audit findings against significant risks (continued)

	Risks identified in our audit plan	Work completed	Assurance gained and issues arising
3.	**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 gives rise to a significant risk.	• Reviewed the key assumptions underpinning the provision • Reviewed the agreements reached with claimants representatives • Reviewed the provision made for PAYE and NI, and requested and received evidence to support the continued use of the composite tax rate • Reviewed the provision made for overtime • Sample tested the calculation of the provision • Reviewed the disclosures in the accounts. We note that the Council has not disclosed an amount for contingent liabilities or the timing of future cash flows as it is felt this would prejudice the Council's interest • Considered the impact of the future settlement cash flows on the current value of the provision • Considered and concluded that it is appropriate for the receipt of a claim to be used as the point at which equal pay liabilities are recognised as a provision	Our audit plan identified that there was potentially a high level of estimation uncertainty with respect to the £562 million provision in the accounts. We noted that estimated future cash flows relating to the provision have not been discounted and we are satisfied that the Council's assessment that this would not be material is reasonable. The impact of claims received since 31st March 2015 was also assessed. On the basis of our work, we concluded that the level of estimation uncertainty does not present material uncertainty in the accounts. The Council recognises equal pay claims and estimates the potential cost when they are received. It does not forecast future claims on the basis that a significant number of variables impact on the number and value of future claims. We have concluded that (given the information available) this recognition point is appropriate. However, we have included an 'emphasis of matter' in our draft opinion. This emphasises the potential for future Equal Pay costs to significantly vary (either upwards or downwards) from that estimated in the accounts due to the variability of the factors impacting on the value of the claim. This is not a modified opinion.

Audit findings against significant risks (continued)

	Risks identified in our audit plan	Work completed	Assurance gained and issues arising
4.	**Sale of the NEC** Risk that complex accounting entries required are not correctly performed.	• Obtained an understanding of the nature and timing of the sale transaction • Considered the accounting treatment of NEC assets and liabilities in the single entity and group accounts • Agreed the carrying value of land and buildings to supporting valuations	At the 31st March 2015, although the contract to sell the NEC had been signed the transaction had not been completed. We agreed with the Council's view that assets and liabilities relating to the NEC should be included on both the Council's single entity balance sheet and group balance sheet. We considered the inclusion of the £192 million of NEC loan stock (debentures) as assets held for sale in the Council's single entity balance sheet (note 27). Our conclusion was that as these are financial instruments they should not be disclosed as an asset held for sale, but as short term investments. However, due to the subsequent conversion of the debentures to equity sold to the purchaser, financial reporting standards require additional disclosures to be made. We considered the inclusion of a £17 million adjustment in the value of assets held for sale in the group account s (note G8). The draft accounts included all the assets and liabilities included in the NEC sale transaction as assets held for sale. To reconcile the carrying value in the group accounts to the single entity value including NEC loan stock a £17 million adjustment was included. Our conclusion was that this adjustment was not appropriate.

Audit findings against significant risks (continued)

	Risks identified in our audit plan	Work completed	Assurance gained and issues arising
5.	**Cash – transfer of bank accounts** The Council transferred its bank accounts during the financial year. This was a complex process which raised a significant risk that all accounts had not been identified or correctly transferred.	• Reviewed the project and actions to date in relation to bank account transfers • Substantively tested accounts within the cash cycle. • Considered events or conditions that have occurred that could have affected the transfer process.	This complex and high profile project was well managed and the transfer was implemented with minimal disruption to the Council's receipts and payments systems. Our testing did not indicate that there was a high level of residual risk to the cash balances included in the accounts.

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 are attached at Appendix A.

Transaction cycle	Description of risk	Work completed	Assurance gained & issues arising
Employee remuneration	Employee remuneration accrual understated	We have undertaken the following work in relation to this risk: • updated our documentation of the payroll system • undertaken a walkthrough of the controls in place to ensure payroll expenses are not understated and are recorded in the correct period. • undertaken a monthly trend analysis for the financial year. • reconciled the annual payroll to the ledger and to the segmental analysis accounts note. • undertaken substantive testing of payroll payments in April and May to ensure payroll expenditure is recorded in the correct year. • reviewed payroll accrual processes and determined whether substantive testing required. • undertaken substantive testing of the completeness of year end payroll creditors • undertaken substantive testing of the completeness of IAS19 pension liabilities. • agreed employee remuneration disclosures in the financial statements to supporting evidence.	Our audit work has not identified any significant issues in relation to the risk identified, and we are satisfied that in all material respects employee remuneration has been appropriately accounted for.

Audit findings against other risks (continued)

Transaction cycle	Description of risk	Work completed	Assurance gained & issues arising
Operating expenses	Creditors understated or not recorded in the correct period	We have undertaken the following work in relation to this risk: • updated our documentation of the operating expenditure system • undertaken a walkthrough of the controls in place to ensure operating expenses are not understated and are recorded in the correct period. • carried out substantive testing of operating expenditure • reviewed the application of the year end closedown process for capturing creditor accruals • undertaken substantive testing of year end creditors including after date payments • tested Goods Received Not Invoiced listings and Purchase Orders raised after the year end to confirm appropriate accruals • reviewed control account reconciliations covering the agreement of creditor payments to the ledger and bank accounts	Our audit work has not identified any significant issues in relation to the risk identified, and we are satisfied that in all material respects operating expenditure has been appropriately accounted for.

Audit findings against other risks (continued)

Transaction cycle	Description of risk	Work completed	Assurance gained & issues arising
Welfare expenditure	Welfare benefit expenditure improperly computed	We have undertaken the following work in relation to this risk: • a predictive analytical review based on DWP statistics • initial testing of benefit expenditure by following the Audit Commission HBCOUNT methodology. • reviewed the reconciliation between Benefits system and general ledger	Our audit work has not identified any significant issues in relation to the risk identified, and we are satisfied that in all material respects welfare expenditure has been appropriately accounted for.
Property plant and equipment	Risk that property plant and equipment is improperly expensed	We have undertaken the following work in relation to this risk: • updated our documentation and undertaken a walkthrough of the controls in place to ensure that PPE activity is valid. • tested a sample of repairs and maintenance items to ensure they are properly expensed to the revenue account.	Our audit work has not identified any significant issues in relation to the risk identified, and we are satisfied that in all material respects property plant and equipment has been appropriately expensed in the accounts.

Audit findings against other risks (continued)

Transaction cycle	Description of risk	Work completed	Assurance gained & issues arising
Property plant and equipment	Risk that property plant and equipment activity is not valid.	We have undertaken the following work in relation to this risk: • updated our documentation and undertaken a walkthrough of the controls in place to ensure that PPE activity is valid. • tested the agreement of the fixed asset register to the accounts and supporting notes • sample tested PPE additions and disposals including compliance with capitalisation requirements	Our audit work has not identified any significant issues in relation to the risk identified. Our testing of assets disposed of in the year found two assets that were identified as being disposed of on long leases. Supporting documentation showed that the leases had been granted in prior years and the items were incorrectly included on RAM. We also identified one building that was demolished in 2013/14, but not eliminated from RAM until 2014/15. Schools Devolved Formula Capital (DFC) funding is recognised as capital additions when schools inform the finance team that it has been been spent. It is automatically recognised as 'buildings' but we found examples of it being spent on other items such as equipment. The total value of DFC applied in year was £3 million so we are satisfied there is no material risk to the accounts. [Recommendation1]

Audit findings against other risks (continued)

Transaction cycle	Description of risk	Work completed	Assurance gained & issues arising
Property plant and equipment	Risk that property plant and equipment activity is not valid (continued)	We have undertaken the following work in relation to this risk: • updated our documentation and undertaken a walkthrough of the controls in place to ensure that PPE activity is valid • tested the agreement of the fixed asset register to the accounts and supporting notes • sample tested PPE additions and disposals including compliance with capitalisation requirements	Our additions testing included two items being paid for on an instalment basis. An item was found to be incorrectly treated and should be treated as a payment in advance (£3.3 million). Further investigation by the Financial Accounts team has not identified any further errors of this nature. We also found instances where expenditure had been incorrectly classified. We are satisfied that this does not present a material risk to the accounts. [Recommendation 2]
Property plant and equipment	Risk that revaluation measurement is not correct	We have undertaken the following work in relation to this risk: • updated our documentation and undertaken a walkthrough of the controls in place to ensure that PPE activity is valid • tested the revaluation cycle, including instructions to valuer and valuer's report. • evaluated compliance with revised requirements of the Code for valuation particularly in relation to schools • Test of revaluation when assets brought in to use	Our audit work has not identified any significant issues in relation to the risk identified. The valuers report for both HRA and General Fund land and buildings is dated 1st April 2014, but has been accounted for as if the valuation was at 31st March 2015. The valuer reviewed the potential movement in values during the year. We are satisfied that there is no material impact on the carrying value of assets. See also our review of issues raised in prior year in the accounting policies, estimates and judgements section.

Audit findings against other risks (continued)

Transaction cycle	Description of risk	Work completed	Assurance gained & issues arising
Property plant and equipment	Risk that revaluation measurement is not correct (continued)	We have undertaken the following work in relation to this risk: • updated our documentation and undertaken a walkthrough of the controls in place to ensure that PPE activity is valid • tested the revaluation cycle, including instructions to valuer and valuer's report. • evaluated compliance with revised requirements of the Code for valuation particularly in relation to schools • Test of revaluation when assets brought in to use	CIPFA's Local Authority Accounting Panel (LAAP) issued Bulletin 101 in December 2014 to clarify the appropriate accounting treatment of voluntary aided and voluntary controlled (VA/VC/FS) schools. The publication of LAAP Bulletin 101 required the Council to re-visit this decision. It was concluded that although the original decision to include buildings on balance sheet still held, the exclusion of land may not be appropriate. Due to the Council's high volume of VA/VC/FS schools the review of all schools was not complete when the draft accounts were produced. All VA/VC schools' land and buildings were included on the balance sheet. This increased property plant and equipment by £207 million. Our view is that land relating to VA/VC/FS schools should only be included on the Council's balance sheet in exceptional circumstances. Examples are where the Council has authority over both land and buildings use, or there are restrictive covenants in place which require the land to be used for education purposes in perpetuity. The Council is taking a thorough approach to this issue and documentation for over 80 schools has been examined. We found that land valued at £12 million had evidence of restrictive covenants, but the details were not available. The Council has assumed that these covenants will be similar to other schools in the population. We have not challenged this. On completion of the review the Council adjusted the accounts to remove £58 million of land from the balance sheet value of property, plant and equipment.

Audit findings against other risks (continued)

Transaction cycle	Description of risk	Work completed	Assurance gained & issues arising
Property plant and equipment	Risk that property plant and equipment allowance for depreciation is not adequate.	We have undertaken the following work in relation to this risk: • updated our documentation and undertaken a walkthrough of the controls in place to ensure that PPE activity is valid • tested depreciation and impairments, including evidence of review of Useful Economic Lives and mathematical accuracy • tested the surplus or deficit on disposal	Our audit work has not identified any significant issues in relation to the risk identified.

Group audit scope and risk assessment

ISA 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	Significant and other risks identified	Work completed	Assurance gained & issues raised
NEC Group Ltd	Yes	Targeted	Valuation of assets	Specific (targeted) scope procedures performed by non GT member firm (Price Waterhouse Coopers)	Our audit work has not identified any material issues, but audited accounts were not available.
NEC (Developments) PLC	No	Analytical	Valuation of assets	Desktop review performed by Grant Thornton	Our audit work has not identified any material issues, but audited accounts were not available.
Acivico Limited	Yes	Targeted	None	Specific (targeted) scope procedures performed by non GT member firm (KPMG)	Our audit work has not identified any material issues, but audited accounts were not available.
Birmingham Technology Ltd	No	Analytical	None	Desktop review performed by Grant Thornton	Our audit work has not identified any material issues, but audited accounts were not available.
Performances (Birmingham) Ltd	No	Analytical	None	Desktop review performed by Grant Thornton	Our audit work has not identified any material issues, but audited accounts were not available.
Birmingham Museum and Art Gallery Trust	No	Analytical	None	Desktop review performed by Grant Thornton	Our audit work has not identified any material issues, but audited accounts were not available.
Service Birmingham Ltd	No	Analytical	None	Desktop review performed by Grant Thornton	Our audit work has not identified any material issues, but audited accounts were not available.

Group audit scope and risk assessment (continued)

We also draw the Audit Committee's attention to the following group audit issues.

Delivery of accounts

Further improvements are needed in the timely delivery of component bodies draft and audited accounts. We raised this issue in our report last year and although delivery improved for some entities, there were still late submissions. Earlier submission of draft and audited accounts will need to be agreed for the Council to meet earlier reporting deadlines. [Recommendation 3]

At the time of drafting this report audited accounts had not been provided for NEC Limited or Acivico. Auditors' reports has recently been provided for both companies and we will update the Audit Committee if there are any issues arising.

Presentation and disclosure of accounts

There was an unexpectedly high volume of presentational and disclosure errors in the group accounts presented for audit. This is in part a consequence of the delays experienced in obtaining appropriate draft accounts from component bodies. Group accounts need to be adequately reviewed before being presented for audit. [Recommendation 4]

Supporting working papers

We agreed that the supporting working papers would not be provided on 30th June as we recognised that delays in draft accounts had delayed completion of the group financial statements. However, working papers supporting the group accounts will need to be provided more promptly in future. [Recommendation 4]

Other issues

Foreword to the Accounts (paragraph 2.1). The narrative refers to the deminimis for inclusion of subsidiary and associate companies in the group accounts. In our view it would be good practice to disclose the value of the deminimis.

Group Cash Flow Statement. The draft accounts did not include notes detailing the following entries on the face of the Group CF Statement:

- adjustments to net surplus / deficit on the provision of services for non-cash movements
- adjustments for items included in the net surplus / deficit on the provision of services that are investing and financing activities

Although not required by the Code in our view it would be good practice to include these.

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Accounting policies, estimates & 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 • The revenue accounts are maintained on an accruals basis (subject to a de-minimis of £5,000 with some exceptions). Expenditure is charged to the revenue accounts in the period in which goods and services are received and, similarly, income is credited in the period in which it falls due, regardless of the timing of cash payments or receipts. • Interest due to or from third parties in relation to loans and investments, is accrued in full at the year end on the basis of the effective rate of interest. • Provision is made for the impairment of debts in the General Fund and Housing Revenue Accounts. • Where income and expenditure have been recognised but cash has not been received or paid a debtor or creditor for the relevant amount is recognised on the Balance Sheet. Where debts may not be settled and it is likely that collection of such debt is doubtful, the balance of the debt is written down and a charge is made to revenue for the income that may not be collectable.	We are satisfied that the Council's disclosure note on revenue recognition is adequate and is consistent with the requirements of the CIPFA Code of Practice on Local Authority Accounting	● 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

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Accounting policies, estimates & judgements (continued)

Accounting area	Summary of policy	Comments	Assessment
Estimates and judgements	Key estimates and judgements include • The 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	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 of Practice on Local Authority Accounting. Our consideration of the equal pay provision is summarised under "audit findings significant risks" on page 12 Note 30 Provisions includes a £22 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 "review of issues raised in prior year" on page 28. [Recommendation 5]	● Amber

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

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Accounting policies, estimates & judgements (continued)

Accounting area	Summary of policy	Comments	Assessment
Estimates and judgements	Key estimates and judgements include • The assessment of PFI schemes and other arrangements as to whether they fall within the scope of IFRIC 12. • The valuation of long term liabilities for PFI and leasing • The present value of pension obligations • The estimate of provision required for bad debts	Our findings from our review of judgements and estimates are set out below: The Council has a number of PFI schemes. The finance liability is disclosed in the balance sheet at £459 million. Revenue and interests payments are also disclosed in Note 43. We are satisfied that the PFI liabilities are consistent with the Council'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 £489 million compared to the 2013/14 balance sheet. This change is largely due to the actuaries reassessment of the Council's future pension liability. We reported in our 2013/14 Audit Findings report that there was a risk that the Council Tax bad debt provision was understated. We are satisfied that the 2014/15 provision is calculated on a consistent basis, but repeat our view that there is an under statement risk.	● Amber

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 & judgements (continued)

Accounting area	Summary of policy	Comments	Assessment
Estimates and judgements – going concern	Going concern is a fundamental principle in the preparation of financial statements. Under the going concern assumption, a council is viewed as continuing in operation for the foreseeable future with no necessity of liquidation or ceasing trading. Accordingly, the council's assets and liabilities are recorded on the basis that assets will be realised and liabilities discharged in the normal course of business. A key consideration of going concern is that the council has the cash resources to meet its obligations as they fall due in the foreseeable future. This is usually considered to be a year after the date of issue of the audit opinion.	We have considered whether it is appropriate for the Council to prepare its accounts on a 'going concern' basis. In making our assessment we considered the Council's financial forecast for 2016/17 and the need for the Council to fund the claims made against it with regard to equal pay in 2015/16 and 2016/17. We have also considered the risk of the Council's level of borrowing and its pension liability. If the Council does not generate the required savings or capital asset sales it will need to utilise both general fund and earmarked reserves to manage any revenue consequences. In terms of liquidity, the Council would need to increase its borrowing or reduce its short term lending to meet its cash requirements. It may also need to consider delaying equal pay settlements. On the basis of our review we are satisfied that the Council remains a 'going concern'.	● Amber

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 & Judgements– review of issues raised in prior year

	Assessment	Issue and risk previously communicated	Update on actions taken to address the issue
1.	✓	**Estimates and judgements - Property, Plant & Equipment** In previous years the Council carried out a rolling programme of revaluations, with the date of the valuations varying up to five years. This approach was similar to many other authorities and you had satisfied yourselves that the carrying amount of Property, Plant and Equipment (based on these valuations) did not differ materially from the fair value at 31 March 2014. However, in our view this rolling programme did not meet the Code's requirement to value items within a class of property , plant and equipment simultaneously, as this Code requirement, which is based on IAS 16 Property, Plant and Equipment, only permits a class of assets to be revalued on a rolling basis provided that: • the revaluation of the class of assets is completed within a 'short period' • the revaluations are kept up to date. We would normally expect this 'short period' to be within a single financial year. This is because the purpose of simultaneous valuations is to 'avoid reporting a mixture of costs and values as at different dates'. This purpose is not met where a revaluation programme for a class of assets straddles more than one financial year.	Page 87 of the accounts sets out the Council's rolling programme of revaluations. This explains that Council carries out valuations of its property assets over a five year cycle and reviews those assets that are not in the valuation cycle for the year to ensure that carrying values remain materially correct at the Balance Sheet date. The supporting table shows that £1,657 million of the land and building assets included on the balance sheet have valuation of more than a year old and £605 million are supported by valuations that are five years old. We reported last year that that the Council's approach to the revaluation of its property plant and equipment is not fully in line with the Code. The Code requires the revaluation of each class of assets to be completed within a 'short period' (which in our view, is a single financial year). The Council's view is that this is not practical due to the size of its asset base. CIPFA LAAP Bulletin 103 was published after the Code and clarifies that a 'short period' is five years. We have reviewed the analysis supporting the valuers consideration of the potential valuation changes since the last valuation date. We are satisfied that this demonstrates that there is a low risk of material misstatement.

Assessment
✓ Action completed
X Not yet addressed

Other communication requirements

We set out below details of other matters which we are required by auditing standards 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.
2.	**Matters in relation to laws and regulations**	• We are not aware of any significant incidences of non-compliance with relevant laws and regulations.
3.	**Written representations**	A letter of representation has been requested from the Council that includes specific representations on: • Confirmation of the Council's view that the receipt of the claim is the appropriate point to recognise a liability for equal pay • Confirmation of the Council's view that it is not possible to accurately estimate the volume, type or value of future equal pay claims • Confirmation that the equal pay liability does not impact on the assertion that the Council remains a going concern • Fair values of Property, Plant and Equipment, and the Equal Pay provision • Consideration of onerous contracts for Academy Schools with a PFI agreement in place at the transfer • Confirmation that the Council holds no investment properties other than those disclosed on the balance sheet • Confirmation that there are no further issues requiring section five of the Annual Governance Statement to be amended • Confirmation that the Council does not consider that it needs to make additional provision for uncollected Council Tax debt • The Council considers that it remains a 'going concern' • The Council has considered the need to generate capital receipts and is satisfied that it has appropriate plans in place to generate sufficient capital receipts in 2015/16 and 2016/17 • As contractual arrangements are not in place the Council confirms that it has adequate plans in place to generate the forecast capital receipts • If the Council is unable to generate sufficient capital receipts to meet its equal pay liabilities it could either defer the payments or utilise reserves • 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

We set out below details of other matters which we are required by auditing standards to communicate to those charged with governance.

	Issue	Commentary
4.	**Disclosures**	• Our review found no non-trivial omissions in the financial statements. We have summarised the disclosure omissions on pages 35 to 37.
5.	**Matters in relation to related parties**	• We are not aware of any related party transactions which have not been disclosed.
6.	**Confirmation requests from third parties**	• We sought direct confirmations for all material and a sample of non-material loans. At the time of drafting this report we had not received confirmations from State St Nominees Limited. • We also requested from management permission to send confirmation requests for bank and all material and a sample of non-material investment balances. This permission was granted and the requests were sent. All of these requests were returned with positive confirmation.

Internal controls

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

Our audit included consideration of internal controls 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. We considered and walked through the internal controls for Employee Remuneration and Operating Expenses, Welfare Expenditure and Property, Plant and Equipment.

The matters that we identified during the course of our audit are set out in the table below. These and other recommendations, together with management responses, are included in the action plan attached at Appendix A.

	Assessment	Issue and risk	Actions and Recommendations
1.	●	We reported in our audit plan that there is a potentially material control issue relating to unauthorised journals input by senior staff with authoriser permissions.	A compensating journal control has been introduced requires review of a monthly sample of unauthorised journals entered by senior staff to ensure journals are valid and accurate.
2.	●	We made five recommendations following review of general IT controls. One of these, relating to access controls was a potential significant deficiency and repeated our 2013/14 recommendation.	Management responded with a proposal to conduct a review of the relevant controls.
3.	●	Group accounts have been produced from unaudited accounts for all the group entities included in the consolidated balance sheet. At the time of drafting this report no audited accounts had been received by the Financial Accounts Team.	The Audit Committee needs to ensure that unaudited accounts are delivered by the end of May and audited accounts before the completion of the Council's audit. [Recommendation 3]

Assessment

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

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.

Internal controls (continued)

	Assessment	Issue and risk	Actions and Recommendations
4.	●	The financial statements include a prior period adjustment of £27 million relating to the previous misposting of schools capital expenditure to revenue. Our audit testing has identified further mispostings of capital items	Management need to review controls over posting of capital expenditure to ensure accuracy. [Recommendations 1 and 2]

Assessment

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

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.

Adjusted misstatements

A number of adjustments to the draft financial statements 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 financial statements 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 below along with the impact on the primary statements and the reported financial position.

	Detail	Comprehensive Income and Expenditure Account £m	Balance Sheet £m	Impact on total net expenditure £m
1	Reanalysis of NEC debentures - Assets Held for Sale - Short term Investments	Nil	(192) 192	Nil
2	Removal of VA/VC schools from balance sheet due to insufficient evidence to support the accounting treatment - Property Plant and Equipment - Unusable reserves (Capital Adjustment Account reserve)	Nil	(58) 58	Nil
3	Restatement of instalment payments - Property Plant and Equipment - Debtors (payments in advance)	Nil	(3) 3	Nil
4	Restatement of NEC shares to historic cost - Assets Held for Sale - Unusable reserves (available for sale financial instruments reserve)	Nil	(5) 5	Nil
	Overall impact on single entity accounts	**Nil**	**£258**	**Nil**

Adjusted misstatements (continued)

	Detail	Comprehensive Income and Expenditure Account £m	Balance Sheet £m	Impact on total net expenditure £m
5	Property Plant and Equipment - Assets Held for Sale - Revaluation reserve	Nil	(17) 17	Nil
	Overall impact on group accounts	**Nil**	**£17**	**Nil**

Misclassifications & disclosure changes

The table below provides details of misclassification and disclosure changes identified during the audit and whether they have been made in the final set of financial statements.

	Item	Issue	Amended
1	Foreword to the Accounts (paragraph 7.4.)	Accounting for Schools Non Current Assets Further clarification should be included in the narration to include the fact that schools have been reviewed on a case by case basis.	Yes
2	Note 3 Critical Judgements in Applying Accounting Policies	Schools Narrative on LAAP Bulletin 101 should include reference to the Code and state that there has been a case by case review.	Yes
3	Note 3 Critical Judgements in Applying Accounting Policies Note 45 Officers' Remuneration	Schools In our view inclusion of employees of voluntary aided and foundation trust schools in Note 45 does not comply with accounting standards. Remuneration disclosures are stipulated by legislation. Where the authority is not the employer (and the person is not the employee of the authority), their contract of employment takes precedence in the disclosures even though these costs will be included in the single entity Comprehensive Income and Expenditure Statement.	No
4	Note 6 Events After the Reporting Period	NEC Group The narrative should include a clear summary of what has been sold and the value of the receipt generated.	Yes
5	Note 6 Events After the Reporting Period	The note should be updated to include relevant issues that have emerged since the accounts were presented for audit. These include: - the potential impact of the 1 per cent reduction in social housing rents announced by the Chancellor on 8th July - an update on progress with the West Midlands Combined Authority bid	Yes

Misclassifications & disclosure changes

	Item	Issue	Amended
6	Note 20 Amounts Reported for Resource Allocation Decisions (Segmental Analysis)	Reconciliation to Subjective Analysis Incorrectly included £11.5 million of equal pay costs in the depreciation, amortisation and impairment line which should be disclosed in the employee expenses line	Yes
7	Note 21 Property Plant and Equipment	Revaluations Details should be included for the valuers of Tyseley Waste as this is not included by Birmingham Property Services valuation.	Yes
8	Note 33 Contingent Liabilities and Contingent Assets	Item 4 – Equal Pay The Council has not disclosed an amount for this contingent liability or the timing of future cash flows. We are aware of the sensitivities and the difficulties in estimating the volume and type of future claims. The disclosure made is consistent with previous years.	No
9	Note 33 Contingent Liabilities and Contingent Assets	Item 6 – Network Rail The Council has not disclosed an amount for this contingent liability or the timing of future cash flows. Management's view is that of any disclosure would impair its negotiating position with Network Rail should overruns occur.	No
10	Note 33 Contingent Liabilities and Contingent Assets	Item 7 – Claims from Former Employees and Others The Council has not disclosed an amount for this contingent liability or the timing of future cash flows. Management's view is that of any disclosure would prejudice the Council's interests.	No
11	Note 39 Financial Instruments	Income, Expenses, Gains and Losses In the table 'Total income in (Surplus)/Deficit on the Provision of Services' should be shown as £(22.5) million.	Yes
12	Note 40 Nature and Extent of Risks Arising from Financial Instruments	Market Risk Narrative includes reference to the NEC debenture loan stock, which was disposed of as part of the NEC sale transaction.	Yes

Misclassifications & disclosure changes

	Item	Issue	Amended
13	Group Accounts – Foreword to the Accounts (paragraph 4.3)	The Main Financial Statements The narrative explains that the reduction of £417 million in the net cost of services is in part due to £276 million reduction in the Council's net cost of services. It also needs to also provide an explanation for the remaining £141 million movement.	No
14	Group Accounts – Note G24 Associate and Joint Venture Companies	Birmingham Airport Holdings Ltd (BAH) Disclosures in the final paragraph should be as follows:- *Share of investments in Associates and JV of £38.9m (2013/14 : £51.7m) shown in the Group BS in respect of this entity is £37.2m (2013/14 £49.4m).* 2012/13 and 2013/14 figures have been incorrectly used.	Yes

Section 3: Value for Money

Value for Money

Value for money conclusion

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

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

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

These criteria are:

The Council has proper arrangements in place for securing financial resilience - the Council has robust systems and processes to manage effectively financial risks and opportunities, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.

The Council has proper arrangements for challenging how it secures economy, efficiency and effectiveness - the Council is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

Key findings

Securing financial resilience

We have undertaken a review which considered the Council's arrangements against the three expected characteristics of proper arrangements as defined by the Audit Commission:

- Financial governance;
- Financial planning; and
- Financial control.

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

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

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

The level of overall borrowing (£3.3 billion) continues to be very high. General reserves have increased by £52 million but still only provide the Council with limited capacity to deal with overspends and delays in delivering savings.

Value for Money

Challenging economy, efficiency and effectiveness
We have considered the Council's arrangements to challenge economy, efficiency and effectiveness against the following themes:

- Prioritising resources
- Improving efficiency & productivity

We continue to be concerned with regard to some aspects of the Council's arrangements to challenge economy, efficiency and effectiveness and intend to issue a qualified value for money conclusion with respect to the following.

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

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

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

Arrangements for children in need of help and protection, children looked after and care leavers
In May 2014 OFSTED reported that the most vulnerable children in Birmingham continue to be failed by the local authority and that there is an insufficient focus on children who need help and protection and who need to be cared for. A Children's Commissioner was appointed as part of the Secretary of State's response to this service failure with the primary purpose of overseeing the implementation of a single integrated plan. Lord Warner issued his final report in March 2015 and the improvement plan is now being implemented.
Services for vulnerable children continue to face significant challenges, not least of which is the recruitment and retention of social workers. Delivery of the improvement plan is closely monitored and managed by senior management and members.

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

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

Value for Money

Overall VfM conclusion

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

- The appointment of the Improvement Panel and the concerns they have expressed.
- Although progress is being made in the implementation of improvements services for vulnerable children continue to be rated as inadequate by OFSTED.
- The Single Integrated Plan in response to the need to improve the management of school governance has been developed but has not yet been fully implemented.
- The settlement of equal pay claims and the scale of savings the Council needs to make in the next three years is having a significant impact on the Authority's financial resilience.

On the basis of our work, and having regard to the guidance on the specified criteria published by the Audit Commission, we are satisfied that in all significant respects the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2015.

We set out below our detailed findings against six risk areas which have been used to assess the Council's performance against the Audit Commission's criteria. We summarise our assessment of each risk area using a red, amber or green (RAG) rating, based on the following definitions:

Green	Adequate arrangements
Amber	Adequate arrangements, with areas for development
Red	**Inadequate arrangements**

The table below and overleaf summarises our overall rating for each of the themes reviewed:

Theme	Summary findings	RAG rating
Key indicators of financial performance	The Council has a good record in delivering its savings plans, but needs to generate an additional £359 million of savings over the next three financial years. This is a significant challenge and the Council recognises that it requires major changes in how services are delivered. The Future Council programme is focusing on the response to this financial challenge. The Council continues to have very high levels of borrowing (£3.3 billion). General fund reserves have increased by £52 million but only provide the Council with limited capacity to deal with overspends and delays in delivering savings. This increase in reserves largely reflects the impact of changes to the Council's minimum revenue provision that were implemented in 2013/14. In terms of liquidity the Council can continue to borrow short term funds or reduce its short term investments. However, any significant additional borrowing would increase its already high level of borrowing and increase revenue pressures. The Council has generated significant capital receipts to settle its equal pay liability, but still needs to generate more. It continues to be heavily reliant on the sale of major assets to meet these payments and to manage its cash and revenue position. Delays in selling assets could present risk for the timely settlement of equal pay claims, however the Council has sufficient contingency to manage this in the short term. The Council pension fund deficit has increased to £2.3 billion, due to changes in the actuaries assumptions estimating its future liabilities. The Council's contributions to correct this deficit continue to place a significant financial burden on its resources. However, it has built these costs into its medium term financial plan. Due to the significant savings plan, high borrowing levels, continued equal pay payments and future pension costs we have rated this as 'red'.	**Red**

Theme	Summary findings	RAG rating
Strategic financial planning	The Council's Medium Term Financial Strategy is documented in the Council Business Plan and Budget 2015+. The plan focuses on the Council's priorities, and is linked to the detailed savings plans. The plan includes key assumptions such as grant funding, workforce levels, fees and charges, and detailed savings plans. The Council is developing its Future Council programme, which includes a fundamental review of the steps needed to re-shape the Council, including its financial strategy as part of its new operating model. Significant emphasis is being put on the effective communication of the financial challenge across the organisation and the need to respond to it. Two hundred and thirty 'cases for change' were submitted to the Future Council team from across the Council and are currently being appraised. It is intended that these will form a key part of future savings plans. The Improvement Panel reported in July 2015 that although that the approach being taken to the long term financial strategy was "thorough and professional" it was concerned about the slow progress being made to develop the financial strategy to deliver a balanced financial position in the period up to 2017/18. However, the Panel also recognised that the Council had recently got back on track with the challenging delivery timetable. We have considered the development of savings plans. For 2015/16 the Council has a savings requirement of £105 million and detailed implementation plans are not yet in place in all instances. The annual savings requirement increases to £167 million for 2016/17 and plans have not yet been developed for the majority of this. Equal Pay continues to have an impact on the Council's financial position. As we have noted, although significant capital receipts have been generated, there is a continuing need to generate further capital receipts to meet agreed settlements. Due to the financial challenge facing the Council, including the development of savings programmes, the concerns expressed about progress in developing the financial strategy and the continuing impact of settling equal pay clams we have assessed Strategic Financial Planning as an 'amber' risk.	**Amber**

Theme	Summary findings	RAG rating
Financial governance	**Council services** The Council continues to have effective financial governance arrangements in place. Its financial environment and its financial performance is understood at all levels of the organisation. Revenue budget monitoring is reported to the Cabinet and Star Chamber throughout the year and provides a further level of challenge, alongside reviewing any impact on service performance. This is supported by a detailed monthly review of savings plans by the Deputy Leader. The Council has a good track record of delivering performance in line with budgets in recent years. **Non-core services** We have previously reported the need to strengthen the overarching governance arrangements for the Council's wider interests. This remains a risk and we have made recommendations that will ensure that appropriate governance arrangements are in place to address the overall financial risk presented by its group companies, partnerships and accountable body arrangements. Due to the need for the Council to demonstrate that it is strengthening its broader financial governance arrangements with its group companies, partnerships and accountable body arrangements we have assessed financial governance as an 'amber' risk.	**Amber**

Theme	Summary findings	RAG rating
Financial control	Budget setting, reporting and monitoring continue to be effective. The Council continues to have a good track record of achieving its overall savings targets and meeting its budget. The Council delivered savings of £98 million in 2014/15 and has a savings requirement of £105 million in 2015/16. The Council has a comprehensive monitoring process using detailed trackers to oversee the delivery of its savings plans. The month 4 trackers for 2015/16 show that the Council has actions in place to fully achieve £78 million of savings. A further £9 million are identified as in year (non-recurrent) savings, £9 million are identified as at risk and the remaining £14 million of savings plans do not have actions in place and solutions have yet to be identified. There remains a risk to the delivery of the 2015/16 savings targets. The Council continues to have sound financial systems to deliver effective financial reporting to its demanding standards and timetable. It also continues to have an effective internal audit function. The 2014/15 accounts were presented for audit by 30th June 2015. The accounts were supported by comprehensive working papers and were subject to quality assurance. Some working papers, particularly those relating to group accounts were presented late in the audit process. Further improvements to the timeliness of the accounts production process are planned from 2015/16 onwards, in anticipation of revised statutory reporting requirements. Due to the continuing need for the Council to demonstrate delivery of its planned savings programme we have assessed financial control as 'amber'.	**Amber**

Theme	Summary findings	RAG rating
Prioritising resources	The Council is reviewing its arrangements for prioritising resources through the Future Council Programme. Six key streams have been identified and are being worked on; the Council's future vision and values, developing the operating model, changing workforce management, the role of elected members, inclusive approaches to partnership working and improving the efficiency of support services. The Council has made a significant resource commitment to the Future Council Programme with staff seconded on a full time basis to it and the appointment of an Interim Director for Service Delivery. Additional revenue funding has been secured from the government to support the Programme. The Improvement Panel has commented that the design and implementation of the Future Council programme in particular is seen to demonstrate a positive and committed approach to the changes that are needed. The Panel has, however, noted that there are key risks and challenges. It has expressed concern relating to slow progress in developing a City Partnership and an agreed vision for the City, and securing the senior management capability required for the size of the Council and the scale of the task it faces. The Council is responding to these issues and the Panel is due to issue its second progress report to the Secretary of State in October. Due to the scale of change needed in the way the Council prioritises its resources and the need for it demonstrate that it is responding effectively to the Improvement Panel's concerns we have assessed prioritising resources as 'amber'.	**Amber**

Theme	Summary findings	RAG rating
Improving efficiency & productivity	We have considered the effectiveness of key services during the last year and noted the following two discrete areas, services for vulnerable children and the management of the governance of schools. In May 2014 OFSTED reported that the most vulnerable children in Birmingham continue to be failed by the local authority and that there is an insufficient focus on children who need help and protection and who need to be cared for. The issues relating to the poor performance of this service are longstanding and there has been specific external intervention with the appointment of Lord Warner as Children's Commissioner. Progress is being made on responding to the issues raised and a three year improvement plan has been agreed and is being implemented. Lord Warner completed his appointment in March 2015. Notwithstanding the priority given to improvement, services for vulnerable children continue to be rated as inadequate. Progress has been made following the external and internal reviews in 2014 that found serious failings in the Council's governance of schools. A Single Integrated Plan has been developed and is being implemented. Sir Mike Tomlinson, the Education Commissioner appointed by the Secretary of State for Education, continues to meet regularly with senior members and management to review progress with the implementation of the Single Integrated Plan.	**Red**

Section 4: Fees, non-audit services and independence

Fees, non-audit services and independence

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

Fees

	£
Council audit	417,420
Grant certification	26,600
Total fees (excluding VAT)	**444,020**

Our fee assumptions include:

- Supporting schedules to all figures in the accounts are supplied by the agreed dates and in accordance with the agreed upon information request list
- The scope of the audit, and the Council and its activities, have not changed significantly
- The Council will make available management and accounting staff to help us locate information and to provide explanations

Grant certification

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

Fees for other services

Service	Fees £
Group Governance Review	33,000
Finance Birmingham (tax advice, due diligence support and secondment)	97,100
Innovation Birmingham (tax advice)	8,000
Certification of grant claims (outside Audit Commission/PSAA requirements)	11,250
Total	149,350

Fees for other services

Fees for other services reflect those agreed at the time of issuing our Audit Plan and include other services carried out since 1 April 2014. We obtained Audit Commission approval for all work once the other services fee was in excess of the 20 per cent (£83,484) threshold. Any changes will be reported in our Audit Findings Report and Annual Audit Letter.

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. We have complied with the Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

Full details of all fees charged for audit and non-audit services will be included in our Audit Findings report at the conclusion of the audit.

We confirm that we have implemented policies and procedures to meet the requirement of the Auditing Practices Board's Ethical Standards.

Section 5: Communication of audit matters

Communication of audit matters to those charged with governance

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

The Audit Plan outlined our audit strategy and plan to deliver the audit, while this Audit Findings report presents the key issues and other matters arising from the audit, 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 the Audit Commission (www.audit-commission.gov.uk).

We have been appointed as the Council's independent external auditors by the Audit Commission, the body responsible for appointing external auditors to local public bodies in England. 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 Audit Commission and includes nationally prescribed and locally determined work. Our work considers the Council's key risks when reaching our conclusions under the Code.

It is the responsibility of the Council 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 Council 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		✓
Compliance with laws and regulations		✓
Expected auditor's report		✓
Uncorrected misstatements		✓
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 & responsibility
1	The posting of capital expenditure funded by Schools Devolved Funding needs to be reviewed to ensure it is accurate.	Medium		
2	Finance staff need to ensure that posting of non-schools capital expenditure is appropriate and meets the Code recognition criteria for capital expenditure.	Medium		
3	The Audit Committee needs to ensure that unaudited accounts of group entities are delivered by the end of May and audited accounts before the completion of the Council's audit.	High		
4	Ensure that group accounts and the supporting working papers are adequately reviewed before audit submission and that working papers are submitted promptly.	High		
5	Ensure that the valuer provides an analysis to support the assertion that there is no material risk arising from not valuing the whole class of assets each year.	High		

Priority
High, Medium or Low

Appendix B: Audit opinion

We anticipate we will provide the Council with an unqualified audit report

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

We have audited the financial statements of Birmingham City Council for the year ended 31 March 2015 under the Audit Commission Act 1998. The financial statements comprise the Movement in Reserves Statement, the Group Movement in Reserves Statement, the Comprehensive Income and Expenditure Statement, the Group Comprehensive Income and Expenditure 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 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 2014/15.

This report is made solely to the members of Birmingham City Council, as a body, in accordance with Part II of the Audit Commission Act 1998 and as set out in paragraph 48 of the Statement of Responsibilities of Auditors and Audited Bodies published by the Audit Commission in March 2010. Our audit work has been undertaken so that we might state to the 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 Authority and the Authority's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of the Director of Finance and auditor
As explained more fully in the Statement of the Director of Finance's Responsibilities, the Director of Finance 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 2014/15, and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards also 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 Authority's and Group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Director of Finance; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Foreword to the Accounts and Group Foreword to the Accounts 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:

- give a true and fair view of the financial position of Birmingham City Council as at 31 March 2015 and of its expenditure and income for the year then ended;
- give a true and fair view of the financial position of the Group as at 31 March 2015 and of its expenditure and income for the year then ended; and
- have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2014/15 and applicable law.

Emphasis of Matter – equal pay claims
In forming our opinion on the financial statements, which is not modified, we have considered the adequacy of the disclosures made in the Comprehensive Income and Expenditure Statement, notes 1, 3, 4, 6, 7, 10, 13, 32, 33 and 41, the Housing Revenue Account Income and Expenditure Statement and note H9 to the financial statements concerning the uncertain outcome of claims made against the Authority under equal pay legislation. The final amount payable and timing of the payments is uncertain and influenced by court judgements; the number of claims the Authority receives; the outcomes of negotiations in respect of the claims and associated oncosts. The ultimate liability can fluctuate significantly and, therefore, may materially increase or decrease the provision included in the financial statements for these claims. Accordingly, the impact of this uncertainty on the provision currently included in the financial statements cannot be quantified.

Opinion on other matters
In our opinion, the information given in the Foreword to the Accounts and Group Foreword to the Accounts for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we report by exception
We are required to report to you if:

- in our opinion the annual governance statement does not reflect compliance with 'Delivering Good Governance in Local Government: a Framework' published by CIPFA/SOLACE in June 2007; or
- we issue a report in the public interest under section 8 of the Audit Commission Act 1998; or
- we designate under section 11 of the Audit Commission Act 1998 a recommendation as one that requires the Authority to consider it at a public meeting and to decide what action to take in response; or

- we exercise any other special powers of the auditor under the Audit Commission Act 1998.

We have nothing to report in these respects.

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

Respective responsibilities of the Authority and the auditor

The Authority is responsible for putting in place proper arrangements to secure 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 5 of the Audit Commission Act 1998 to satisfy ourselves that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the Audit Commission requires us to report to you our conclusion relating to proper arrangements, having regard to relevant criteria specified by the Audit Commission in October 2014.

We report if significant matters have come to our attention which prevent us from concluding that the Authority has put in place 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 Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

Scope of the review of arrangements for securing economy, efficiency and effectiveness in the 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, published by the Audit Commission in October 2014, as to whether the Authority has proper arrangements for:

- securing financial resilience; and
- challenging how it secures economy, efficiency and effectiveness.

The Audit Commission has determined these two criteria as those necessary for us to consider under the Code of Audit Practice in satisfying ourselves whether the Authority put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2015.

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 Authority had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Basis for qualified conclusion

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

- The Secretary of State for Communities and Local Government appointed an Improvement Panel in January 2015 in response to recommendations made in Sir Bob Kerslake's review of the Authority in his report dated December 2014. The Panel has recognised that the Authority is making some progress in addressing the recommendations made. It has however expressed concerns relating to slow progress in the development of a City Partnership and an agreed vision for the City and the securing of sufficient senior management capability.
- In May 2014 OFSTED reported that the most vulnerable children in Birmingham continue to be failed by the local authority and that there was an insufficient focus on children who needed help and protection and who need to be cared for. Following this inspection a three year improvement plan has been agreed by the Authority and this plan is being implemented. However, at this time services for vulnerable children continue to be rated as inadequate by OFSTED.
- Significant failings in the Authority's management of schools were identified by Peter Clarke in July 2014 and the Secretary of State for Education appointed an Education Commissioner in September 2014 to oversee the implementation of improvements in the management of schools at the Authority. A Single Integrated Plan has been developed by the Authority, but this plan has not yet been fully implemented.

These matters are evidence of weaknesses in arrangements for prioritising resources and improving efficiency and productivity.

In considering the Authority's arrangements for securing financial resilience we have identified the following matter:

- The settlement of equal pay claims is continuing to have a significant impact on the Authority's financial resilience and the Authority needs to generate £359 million of savings by the end of 2017/18. The Improvement Panel has expressed concern relating to the slow progress made by the Authority in the development of its financial strategy. However, the Panel also recognised that the Authority had got back on track with the challenging delivery timetable. Detailed savings implementation plans are being developed but are not yet in place in all instances for 2015/16 and plans have not been developed for the majority of savings required in 2016/17.

This matter is evidence of weaknesses in arrangements for strategic financial planning.

Qualified conclusion

On the basis of our work, having regard to the guidance on the specified criteria published by the Audit Commission in October 2014, with the exception of the matters reported in the basis for qualified conclusion paragraph above, we are satisfied that in all significant respects, Birmingham City Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2015.

Certificate

We certify that we have completed the audit of the financial statements of Birmingham City Council in accordance with the requirements of the Audit Commission Act 1998 and the Code of Audit Practice issued by the Audit Commission.

Phil Jones
Director

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

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