The Audit Findings for Birmingham City Council - Addendum

Year ended 31 March 2016

September 2016

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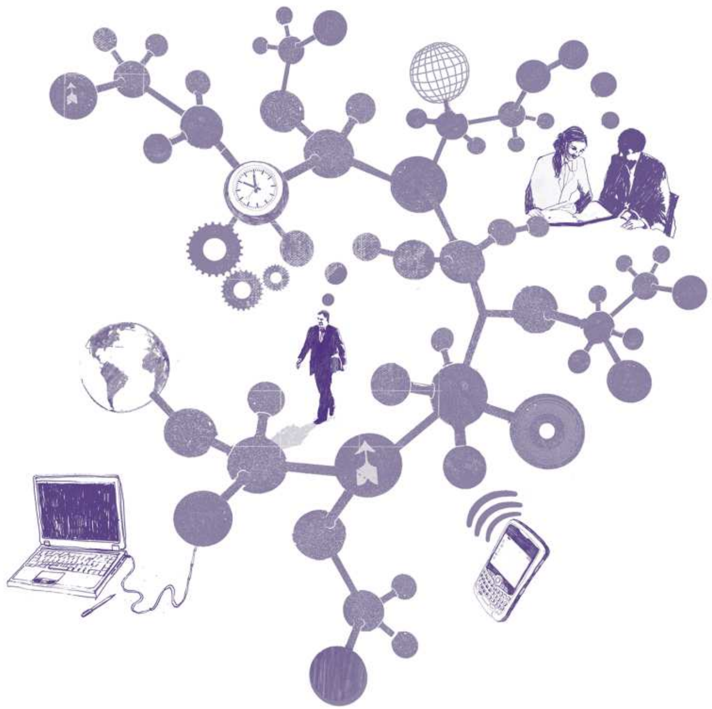

Purpose of this addendum

This addendum provides the Chairman and Members of the Audit Committee with a briefing of the accounting issue and adjustment to the Statement of Accounts that has arisen since we presented our Audit Findings Reports to the Audit Committee of 12 September 2016.

The issue

The Council established NEC Developments PLC (NECD) a wholly owned subsidiary in 1997 to raise finance to construct Halls 17 -20 at the NEC. The company raised capital through a bond issue of £73 million which was supported by a guarantee from the Council. The Council sold NEC Ltd (NECL) on 1 May 2015. As part of this transactions the assets of NECD were transferred to NECL prior to the sale.

In previous years the Council's guarantee of the loan stock had been disclosed in the financial statements as a contingent liability. As part of the reorganisation of NECD the Council agreed a direct obligation to pay principal and interest on the loan stock to the note holders. This meant that this obligation needed to be recognised as a liability in the Council's accounts.

Due to the complexity of the sale transaction the Council sought accounting advice which included accounting for the £73 million loan stock obligation. The accounting treatment adopted for this liability resulted in an investment asset of £67 million being recognised on the Council's balance sheet as well as the liability.

We sought clarification of two issues in relation to the £67 million asset:

- why the £67 million asset had not been impaired, as it appeared to have limited realisable value; and
- whether the Council was satisfied that the assertion that the asset was capital expenditure within the definitions of the Capital Finance Regulations was appropriate.

Impact on the Financial Statements

Following our discussion of this issue with the Strategic Director of Finance and Legal we agreed that:

- the financial statements should be restated to impair the £67 million asset; and
- the Council's view, having taken external financial and legal advice, that the asset was within the scope of the Capital Finance Regulations was sufficient to support the assertion that this accounting adjustment is not a charge to the General Fund.

It should be noted that these changes do not have any impact on the Council's General Fund reserves as at 31 March 2016, or on the Council's continuing obligation with respect to the £73 million loan debt.

The overall impact on the financial statements is summarised on the following pages.

Impact on the Audit Opinion

We reported to Audit Committee on 12 September 2016 our intention to provide an unqualified audit opinion in respect of the financial statements. We still intend to provide an unqualified financial statements opinion following the approval of the amended financial statements.

Communication with Those Charged with Governance

The Chairman of the Council's Audit Committee has delegated authority to act on behalf of the committee. We discussed the contents of this addendum with him on 29 September 2016

Adjusted misstatement

Impact of adjusted misstatements

The adjusted misstatement is set out in detail below along with the impact on the key statements and the reported net expenditure for the year.

Detail	Comprehensive Income and Expenditure Statement £m	Balance Sheet £m	Impact on total net expenditure £m
Long term investments		(66.3)	
Continuing operations – culture and related services	66.3		66.3
Unusable reserves – capital financing reserve		66.3	
Overall impact on single entity accounts	£66.3	Nil	£66.3
Impact on usable reserves	Nil	Nil	Nil

Disclosure changes

The table below provides details of the disclosure changes which have been made in the final set of financial statements.

	Adjustment Type	Issue
1.	Disclosure	Narrative report 5.3 Comprehensive Income and Expenditure Statement – restatement of increase 5.4 Balance Sheet – restatement of reduction in net liability 7.8 Reserves – restatement of unusable reserves
2	Disclosure	Note 3 Critical Judgements in Applying Accounting Policies Sale of the NEC – restated to include the judgement that the investment in NECD is within the scope of the Capital Finance Regulations.
3	Disclosure	Note 6 Adjustments Between Accounting Basis and Funding Basis Under Regualations Restatement of adjustments to General Fund to mitigate the impact of the impairment transaction
4	Disclosure	Note 9 Unusable Reserves Capital Adjustment Account – restatement to include the impairment transaction
5	Disclosure	Note 12 Material Items of Income and Expense and Acquired Operations Addition of a paragraph explaining that the NECD investment has been impaired and charged to the CIES.
6	Disclosure	Note 24 Long Term Investments Investments in subsidiary companies restated from £92.7 million to £26.4 million.
7	Disclosure	Note 39 Financial Instruments Categories of financial instruments – restatement of 'investments that are not financial instruments'
8	Disclosure	Group accounts narrative report 5.3 and 5.5 – restatement of entity deficit, assets and liabilites
9	Disclosure	Group accounts note G13 and G14 Restatement of Profit and Loss Reserve from £144.2 million to £77.9 million.