

**ANNUAL AUDIT LETTER YEAR ENDED 31 MARCH 2018 – STATUTORY  
RECOMMENDATIONS MADE UNDER SECTION 24 LOCAL AUDIT AND  
ACCOUNTABILITY ACT 2014**

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

### **1. Basis for Statutory Recommendation**

The Annual Audit Letter for the year ending 31 March 2018 issued by Grant Thornton, the External Auditor, includes the following statement:

“The key messages arising from our audit of the Council’s financial statements are as follows:

- We received a good quality set of financial statements on 31 May in line with the statutory deadline. The working papers supporting the accounts have been fit for purpose and we appreciate the support that the Finance Team have given us throughout the audit.
- Our audit has identified one adjusted error. Further details are provided in Appendix C. Our audit has not identified any unadjusted errors.
- We are planning to issue an unqualified opinion on the financial statements. Our enhanced audit report will include an Emphasis of Matter paragraph in relation to the disclosure of the uncertainties surrounding the volume and timing of any future equal pay claims.
- We are planning to issue a qualified ‘adverse’ Value for Money (VfM) conclusion. This is because the weaknesses in arrangements which we have identified, are both significant in terms of their impact and numerous in terms of the number of different aspects of proper arrangements affected, that we are unable to satisfy ourselves that the Council has proper arrangements to secure VfM:
  - Budget delivery and reserves management as well as savings proposals (including the principles of the Future Operating Model) and Equal Pay: due to the significant use of reserves in 2017/18, the planned use of £30.5m of Corporate Reserves in 2018/19, the failure to deliver all of the planned savings in 2017/18 and the £9.1m of savings identified as not deliverable in 2018/19 as reported by the Council at Month 3;
  - Improvement Panel (‘the Panel’): The Council is working collaboratively with the Panel, but needs to address the issues highlighted in its Improvement Stocktake Report;
  - Services for vulnerable children: although Ofsted has acknowledged improvement following its most recent monitoring visits, the Council is still rated as ‘inadequate’; and
  - Management of schools: Ofsted has identified some improvements in arrangements, but Internal Audit reports suggest weaknesses in financial and other controls at 52% of schools visited.

Whilst we have not qualified our VfM conclusion in relation to the Commonwealth Games, we do recognise that a significant level of funding has not yet been received by the Council

and there is a risk that hosting the games will impact upon the Council's future financial sustainability if it is not adequately managed."

As a result of these findings the Auditor saw fit to take the relatively unusual step of issuing a number of Statutory Recommendations under Section 24 of the Local Audit and Accountability Act 2014. This measure is a strong warning to the Council of the Auditor's concerns but stops short of a public interest report. A S24 notice requires Full Council to agree its response to the points included within the recommendations within 1 month of issue and to publish how it proposes to address the issues raised.

As permitted in the legislation, an extension was sought from the Auditor to 11 September to align with the Council meeting schedule and this was granted.

The seven recommendations made are set out below

"The Council needs to:

#### *Finance*

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

#### *Transparency and Governance*

4. Ensure that its financial monitoring and budget reports are clear, transparent, and timely particularly in relation to the use of reserves, whether in-year or at year-end.
5. Report governance failures and emerging issues promptly and clearly to Members and local citizens.

#### *Subsidiary Bodies*

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

#### *Place Directorate*

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

A section 24 report had previously been issued to Birmingham City Council in respect of the 2015/16 accounts. A copy of the Full Council report submitted at that time is attached at annex 1.

## 2. Section 151 Officer Commentary

The City faces challenging and uncertain times ahead if it is to deliver high quality services to its residents and businesses, at a cost that is within the annual resources available to it *and* without recourse to the use of one-off reserves intended to cover unforeseen events. The use of reserves to fund day-to-day services merely delays making the necessary difficult decisions on which services to remodel, reduce or cease.

As with the rest of the local government sector, funding cuts and significant local expenditure pressures have made the Council's job far more difficult and has required annual savings of £642m over the seven years to 2017/18. This is more than 40% of total annual expenditure and the Council anticipates having to make further annual cuts in the region of £125m by 2021/22 bringing total annual savings to over £3.4bn over the eleven-year period. The Council's workforce will have fallen by more than 60% over this period. Inevitably this has had, and will continue to have, severe impacts both on front line and back office services in Birmingham.

A recent National Audit Office report noting the 49.1 per cent real-terms cut in Government funding for local authorities in 2010–18, underlined how councils are affected by growing demand for key services and other cost pressures.<sup>1</sup>

The last three years have been especially problematic in Birmingham City Council. The level of savings delivered has fallen significantly below the planned level, and other spending pressures have also emerged, which has meant that additional uses of reserves have been required over and above original plans to balance and deliver the budget since 2015/16.

In 2016/17, Directorates overspent by £71.9m, due mainly to the non-delivery of savings in Adults, Social Care and Health and Place Directorates as well as some base budget pressures across the Council. Corporate mitigations, including use of capital receipts flexibility, were identified totalling £42.1m.

2017/18 showed a similar picture with Directorates overspent by £12.7m, again due to base budget pressures in Place Directorate and some savings non-delivery across most Directorates. Furthermore, corporate overspends of £24.1m occurred in 2017/18 relating to accumulated losses and write-offs in one of its subsidiaries (£9.5m) and the non-delivery of the Council's Future Operating Model (£14.6m). Corporate underspends were identified of £15.9m. Overall, it was necessary to use £20.9m of additional reserves taking the total use of reserves to support day-to-day spending in 2017/18 to £63m.

A further planned structural use of reserves of around £30m is required in 2018/19 in order to balance the budget – this assumes that spending is maintained within budget. By month 2, it was clear that a forecast overspend of £28m was emerging as a result of base budget pressures and savings not being delivered. By month 4, this forecast overspend had reduced to £12m and pressure continues to be applied to eradicate any overspend

If the Council is to move towards financial stability, then it must ensure that it develops robust and deliverable spending and saving plans. If problems are identified in year,

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<sup>1</sup> Comptroller and Auditor General, 'Ministry of Housing, Communities & Local Government: Financial sustainability of local authorities 2018', London: National Audit Office, 2018.

resolutions must be identified from within existing budgets, with any use of reserves being the option of last resort.

Birmingham City Council must address these issues, however difficult the decisions it needs to take to address them. This may involve re-designing some services, working in partnership with other bodies to deliver other services, reducing service levels and stopping some services altogether. Without these actions, the Council will continue to eat into its reserves and find itself in a financially unsustainable position.

### **3. Birmingham City Council Response to the Audit Statutory Recommendations**

The City Council recognises its responsibility in responding to the Statutory Recommendation under section 24 of the Local Audit and Accountability Act 2014.

The Act requires the Council to:

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

The external auditor has some flexibility to vary the timescales in the Act and is satisfied that this Council meeting is compliant. Prior to the issue of the recommendation the Council had already acknowledged that it needed to plan for and manage the impacts of budget pressures and non-deliverable savings in the current and future years. Actions to address specific recommendations are set out below and it is proposed that the Audit Committee be asked to monitor progress on the achievement of the proposed actions.

### **4. Actions to address specific statutory recommendations:**

***Recommendation 1:*** *Deliver its savings plans in 2018/19, in particular by identifying alternatives where existing plans are not deliverable, to mitigate the impact of the combined savings and budget pressure risks.*

The quality and timing of monthly budget monitoring has been improved to allow for early reporting and discussions with budget holders much earlier in the cycle. This in turn allows for corrective action to be taken considerably quicker.

Early reporting (month 2 2018/19) was forecasting an overspend of some £28m arising both from base budget pressures and the non-delivery of savings. As a result, a monthly star chamber process has been instigated whereby the Chief Finance Officer and the Cabinet Member for Finance and Resources meet with relevant Services Directors and their Cabinet Member to understand the reasons for the continuing forecasting overspend and to agree the mitigations which will lead to bringing forecast back within budget.

There is strong evidence that this approach is delivering results and by month 4, the forecast overspend had reduced to £12m. This continued focus at both member and officer level is now programmed for the rest of the year in order to maintain a 'grip' on spending.

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

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

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

More formal Scrutiny arrangements have been introduced for the Council's finances and there is an expectation that areas of financial concern will be examined in detail.

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

Finally, the Finance Team has been restructured to allow dedicated Business Partners to work more collaboratively with budget holders in assessing the financial implications of policy proposals along with robust implementation plans to reduce the likelihood of overspends.

The Chief Finance Office is content with the robustness of this approach and will continue, along with the Cabinet Member for Finance and Resources, to take all necessary steps to deliver expenditure in line with the approved budget.

***Recommendation 2: Develop a realistic medium term financial plan for 2019/20 to 2021/22 which incorporates realistic and detailed savings plans and takes account of key budget and service risks.***

For future years the Council is adopting a priority-based budgeting approach that will align the use of financial resources with its policy priorities, and involve considerable use of performance, unit cost and trend information. The budget setting process will also focus on exploring opportunities for service re-design and partnership working and promote links to the development of capital and asset strategies. In this way, the Council can streamline the resources it uses to achieve best fit with the priorities of the Council and reduce or eliminate spend on lower priority areas.

Target savings for the 4-year period will be of the order of £120m. The challenges of achieving this, on top of £642m of savings already delivered, are considerable but not insurmountable. By 2022, the Council will have cut more than 50% from its annual budgets and service impacts are inevitable.

The process for the 2019/20-2022/23 four-year cycle commenced in May 2018 – considerably earlier than in previous years. This involved a two day member workshop in June aimed at ensuring that every penny spent by the Council aligns with the priorities of the ruling administration. Further workshops are planned in September and October 2018 prior to the draft budget being issued for consultation.

Central to ensuring delivery is the creation of a central Project Management Office (PMO) and robust business cases/implementation plans to enable delivery to be tracked and monitored with the same rigour as being applied in the current year. Only with such a focus can the Council improve its financial performance whilst at the same time delivering its service priorities.

***Recommendation 3: Ensure that it maintains an adequate level of reserves to mitigate the impact of budget risks, in particular one-off risks such as the Commonwealth Games and Equal Pay.***

Reserves are intended to be held to mitigate the financial impact of unforeseeable and infrequent events. They are not intended to support ongoing financial pressures or the non-delivery of savings and such use represents a false economy, serving only to defer rather than resolve pressures that require difficult decisions to be made.

At March 2018, the Council held total reserves of £301m including £170m not earmarked for specific purposes. This includes £98m created in 2017/18 from an agreed permitted change in the accounting treatment of debt repayment. The approved 2018/19 budget includes a further approved use of reserves of £30m.

In addition, the Council's existing financial plans include building up a contingency reserve of £40m over the next 4 years in respect of the Commonwealth Games, using future business rates growth.

The revised strategy restricting the use of reserves is set out in response to recommendation 1 above and is consistent with aiming to use reserves carefully and not to support ongoing pressures.

It is important that the Council's reserves are neither too high or too low. The Council is working on a risk-based approach to identify an appropriate minimum level of reserves which it needs to hold to mitigate its risk profile and plans to manage those risks.

The Council will keep risks under regular review to ensure that adequate resources are set aside where necessary as its risk profile changes.

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

Considerable work has been undertaken over the last six months to improve financial reporting to make it more transparent and clearer. Improvements in reporting will continue to be developed and the council remains committed to open and full reporting. This includes working with the Resources Overview & Scrutiny Committee to improve accountability.

The Council Plan and Budget 2018+ report considered at the City Council meeting on 27 February 2018 set out a summary of the expected level of reserves over a five-year period, and new internal rules have been introduced to prevent the use of reserves to support budget pressures and the non-delivery of savings.

Budget monitoring reports now include explicit reference to the budgeted and planned use of reserves, with the latter being considered in accordance with the approach set out in response to recommendation 1 above.

Financial reporting will continue to evolve to ensure that members, the public and stakeholders have a clear picture of the Council's finances and the opportunity to challenge and shape spending as budgets continue to fall.

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

It is acknowledged that the Council has not always recognised quickly issues of governance and that as a result, these have not been reported promptly. A full review of governance, including the governance of associated bodies and companies, is taking place.

The Group Governance Committee Terms of Reference are being revised to ensure that it is able to provide effective oversight of the many stakeholder interests, including associated companies and bodies, where some of the greatest risks apply.

For matters within the Council, more transparent performance, financial and risk reporting will identify issues earlier to allow actions plans to be developed. The Council is working to improve the efficacy of its role as client in a number of key relationships (such as The Children's Trust) and ensuring that its role as stakeholder is clearly separated from its role as service deliverer where a conflict exists.

The Council is also working with the Greater Birmingham and Solihull Local Enterprise Partnership (GBSLEP) both in relation to the role of the City Council as the Accountable Body and in establishing GBSLEP as an independent and self-controlling company in line with the findings of the Government's LEP review and the Ney Review.

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

The Council has various relationships with its subsidiary companies including shareholder, customer, landlord and service provider.

The shareholder role is discharged through the Cabinet Committee – Group Company Governance (CC-GCG), with attendance by subsidiaries either on a cyclical timeframe or where there are concerns with a Council-owned company, on a more regular basis.

The Intelligent Client Function is more robustly developed for some subsidiary bodies than others and the role of contact officers requires formal definition. This will form part of the work programme for CC-GCG in 2018, along with further development of the training package for officers and members who take up directorships.

Risks within subsidiary bodies are formally reported to Audit Committee annually as part of an assurance statement. The Council will extend this mechanism to capture emerging in-year risks.

It is important that the Council recognises both the opportunities and risks associated with subsidiary bodies and puts in place appropriate and robust management and reporting arrangements to ensure that they meet their various objectives.

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

The Place Directorate continues to be under the greatest financial pressures, especially in the area of waste management. A new Memorandum of Understanding (MoU) is due for implementation in September 2018 and arrangements are being put in place to monitor performance and financial arrangements that will lead to improvements in services to the public and most particularly to recycling rates.

### **MOTION**

The Council accepts the statutory recommendation of Grant Thornton made under section 24 of the Audit and Accountability Act 2014 and the responses and actions set out in section 4 of this report.

Annex 1: Annual Audit Letter, year ended 31/03/2016

Annex 2: Annual Audit Report, year ended 31/03/2017