

Report on the arrangements for securing the Financial Sustainability of Birmingham City Council

Economy, Efficiency and effectiveness (management arrangements) report

January 2025

Final Report - Redacted due to Council application of legal privilege (Equal Pay)



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The contents of this report relate only to those matters which came to our attention during the conduct of our normal audit procedures which are designed for the purpose of completing our work under the NAO Code and related guidance. Our audit is not designed to test all arrangements in respect of value for money. However, where, as part of our testing, we identify significant weaknesses, we will report these to you. In consequence, our work cannot be relied upon to disclose all irregularities, or to include all possible improvements in arrangements that a more extensive special examination might identify. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

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1 Introduction

- 1.1.1 We reported in our Statutory Recommendations of 29 September 2023 that *“Birmingham City Council is currently facing a number of issues, each one of them significant enough to have caused any other council significant financial challenge. The fact that all of these issues are impacting upon the Council at the same time is of such significance that in our view it has de-stabilised the Council’s financial position.”*
- 1.1.2 As the largest Council in Europe, serving over one million people, the Council spends significant resources on the delivery of public services and on capital investment. The impact of its current challenges will therefore be felt widely and potentially over a significant period.
- 1.1.3 Grant Thornton has undertaken work to consider changes to the Council’s Financial Sustainability in response to the announcements about the significant additional costs of the Oracle implementation and the identification of significant additional financial liabilities relating to potential Equal Pay claims. We have undertaken detailed work on both of these issues.
- 1.1.4 This report sets out our findings in relation to the Council’s arrangements underpinning its revenue budget and planning assumptions and assurance for 2022/23 and 2023/24. This includes its capital investment and debt position, its approach to setting savings targets and performance in achieving savings, its approach to medium term financial planning and other matters which have an effect on the Council’s financial sustainability.
- 1.1.5 We note that the Council’s current Interim Director of Finance (Section 151 Officer) issued a Report under Section 114(3) of the Local Government Finance Act 1988 on 5 September 2023. On 21st September, a second Section 114 Notice was issued under Section 114(2) of the Local Government Finance Act 1988 which was a consequence of the failure of the Council’s Business Management Committee to take a decision regarding future Job Evaluation arrangements to address the Council’s rising Equal pay liabilities. This Section 114(2) Notice considered that the Council was incurring unlawful expenditure as a result of its lack of a decision on Job Evaluation and the Section 114(2) Notice was accompanied by a Report issued under Section 5 of the Local Government and Housing Act 1989.
- 1.1.6 Our Statutory Recommendations report, referred to above, set out 12 ‘statutory recommendations’ under the Local Audit and Accountability Act 2014, targeted at addressing concerns across a range of areas within the Council.
- 1.1.7 The Council met on 14 October 2023 and decided upon a way forward in response to these statutory notices and our statutory recommendations. We welcome the action that the Council and Commissioners are now taking to resolve these matters.
- 1.1.8 This report provides a retrospective view on the budget setting process to identify any matters that can be used to ensure the appropriate future governance of the Council. It forms part of a series of external audit reports to the Council and is written to fulfil our external audit responsibilities, under the NAO’s Code of Audit Practice
- 1.1.9 It focuses on the adequacy of the Council’s arrangements for financial sustainability in 2022/23 and 2023/24 but will also serve to finalise our reporting responsibilities for this area of the National Audit Office’s Code of Audit Practice (the Code) for 2020/21 and 2021/22. During the course of this work we have identified further key and improvement recommendations in line with the Code. These are set out at the end of this report.
- 1.1.10 We note that the Council has withdrawn the 2020/21 and 2021/22 financial statements for restatement and that we have not received 2022/23 and 2023/24 financial statements for audit (as at January 2025). All of the information in this report is based on the Council’s management reporting and has not been audited. Given the issues with the ERP system the figures reported by the Council may alter. If this were to occur this may change the findings in this report.
- 1.1.11 The conclusions we have reached on Equal Pay are based on consideration of more material than the report itself mentions. We note that the Council has, reasonably, applied legal advice privilege (LAP) and litigation privilege (LP) to aspects of our reporting. Due to this we have redacted some aspects of our report for reasons of legal privilege, without prejudice privilege, and confidentiality/commercial sensitivity, in order not to risk further damaging the Council’s legal and financial position on Equal Pay.

2 Revenue Budget

Revenue and outturn position

- 2.1.1 Birmingham City Council's Financial Plan covering 2022/23 was approved on 22 February 2022 and set a net revenue budget for 2022/23 of £759.2 million. The Plan incorporated a revised Medium-Term Financial Plan (MTFP) for 2022-2026 which summarised the immediate prospects as follows: *“The next twelve months looks to be one of the most challenging periods in public sector finance. The ongoing financial impact of COVID-19 after a decade of austerity, inflationary pressures and the increasing demand for our services pose a real threat to the financial sustainability of the city and Council.”*
- 2.1.2 The 2023/24 budget and MTFP update were set out in the Financial Plan 2023 which was approved by the Council on 28 February 2023. A net revenue budget of £925.1 million for 2023/24 was approved. This was a £165.9 million (21.9%) increase on the 2022/23 net revenue budget.
- 2.1.3 The Council reported its provisional outturn for 2022/23 in May 2024. This outturn has yet to be finalised and, understandably, the provisional outturn is highly caveated due to the issues the Council has faced in implementing its Enterprise Resource Planning system, Oracle.

2022/23 Budget planning assumptions

- 2.1.4 The Financial Plan for 2022/23 made a range of planning assumptions which included a rise in Council Tax by 1.99% together with a further 1% for the adult social care precept in 2022/23. It also made an assumption that its Business Rate Retention pilot would continue and that no inflation would be applied to business rates in 2022/23 (but real terms growth of 0.5% would resume from 2022/23 onwards).
- 2.1.5 Projections assumed a growth of 1.7% in the Council Tax base in 2022/23, reverting back to normal levels of 0.8% from 2023/24. The Council expected to receive £1.9 billion in grants (both ringfenced and non-ringfenced) in 2022/23, which was an increase of £96.3 million on the previous year. Income from fees and charges and other sources of income was estimated as £383.3 million.
- 2.1.6 The MTFP identified a number of demand pressures which impacted on the 2022/23 budget and on the plans for future financial years. They included growing demand from an increasing number of vulnerable people which created cost pressures in social care, children's services and homelessness services. Inflationary increases were factored into Adult Social care costs. These totalled £13.7 million, in part reflecting the increase of 6.6% in the national minimum wage which impacts on a significant proportion of care workers and resulted in an additional budget requirement of £4.2 million. The MTFP also identified the growing costs of temporary accommodation to deal with homelessness cases and incorporated an additional £2.6 million in the MTFP to deal with these pressures.
- 2.1.7 The total allowance for inflation costs across the four years to 2025/26 amounted to £159.6 million and included an uplift of non-pay budgets by 2% and income budgets by 1% annually. Pay budgets were uplifted by 2.5%. Inflation allowances were calculated for specific contracts where known commitments were in place and there was a specific estimated provision for energy inflation. The rate of inflation (CPI) was 4.9% in January 2022, and the Office for Budget Responsibility (OBR) November 2021 forecast was 4%. The general inflation assumptions for 2022/23 in the 2022 Financial Plan were therefore lower than actual and forecast figures at the time, although inclusion of known specific contractual inflation and energy costs improved the accuracy of estimates.
- 2.1.8 The MTFP included a provision of £153.8 million for liabilities in respect of claims issued under the Equal Pay Act 1970 on the basis of an estimate of total liabilities of £1.2 billion, of which £1.1 billion were settled as at 31 March 2021. The revenue implications of Equal Pay settlements including financing costs, loss of income and the repayment of temporary borrowing from reserves were estimated as £123.9 million in 2022/23 rising to £124.1 million in 2025/26.

2023/24 Budget planning assumptions

- 2.1.9 The Financial Plan for 2023/24 made a range of planning assumptions including a rise in Council Tax by the maximum permissible level of 2.99% together with a further 2% for the adult social care precept in 2023/24. It was assumed that the Business Rate Retention pilot would continue for 2023/24 and the report noted that DLUHC had confirmed that councils would be compensated for reductions relating to revaluation. The timing of a Business Rates reset was now considered to be in 2025/26 at the earliest.

- 2.1.10 Overall growth in the Council Tax base up to November 2022 resulted in a forecast of 263,262 Band D equivalent properties, a 1.9% increase. The Council expected to receive £2 billion in grants (both ringfenced and non-ringfenced) in 2023/24, which was an increase of £99.5 million on the previous year. Income from fees and charges and other sources of income (excluding the Housing Revenue Account) was estimated at £248.6 million.
- 2.1.11 The MTFP identified a number of demand pressures which impacted on the 2023/24 budget and on the plans for future financial years. They include growing demand from an increasing number of vulnerable people which created cost pressures in social care, children’s services and homelessness services. An additional £13.5 million was raised through additional Social Care Grant (£5.5 million) and the additional social care precept (£8 million) to offset some of the pressures in adult and children’s social care. Demand growth in social care switched towards younger adults with more complex needs and inflationary pressures in externally commissioned care packages (primarily provider wage costs) were factored in. A similar financial impact of demand pressures was anticipated for children’s social care.
- 2.1.12 The allowance of inflation costs for uplift of contract budgets in 2023/24 averaged 5% and a similar amount was added to pay budgets. Projections for subsequent years were reduced to reflect Treasury estimates returning to target inflation of 2% from 2025/26. The report noted that CPI of 11.1% in October 2022 was resulting in a cost-of-living crisis which was increasing demand for services and increasing unit costs. Officer for Budget Responsibility (OBR) forecasts of inflation published in November 2022 at the time the 2023/24 budget was being prepared indicated a forecast of 7.4% inflation for 2023 and anticipated a 9.1% inflation outturn for 2022. It would therefore have been prudent for the Council to factor in a higher level of general inflation in its budget than it did. The then Section 151 Officer has told us that inflation forecasts were based on a report published by KPMG and that inflation and other assumptions were triangulated with other core city local authorities. We have not been able to confirm the use of KPMG inflation projections in the Council’s planning (and note that the source was not referred to in the Council’s MTFP document) but we have considered the KPMG¹ projections published in December 2022 and have concluded that they do not differ significantly from the OBR projections. We were also told that assumptions and estimates were shared with other core city councils but consider that whilst this would have been useful for comparison purposes, it would not represent an authoritative source on which to base a forecast of inflation.
- 2.1.13 In September 2022 a number of additional equal pay claims had been made against the Council. We discuss this further in Section 7 but in summary we do not consider that a sufficiently reliable estimate was available to allow the Council to make a provision regarding its potential equal pay liabilities in the 2023/24 budget. However, we do consider that, as a newly emerging risk, they should have been referenced in the MTFP.
- 2.1.14 The assumptions set out in the Financial Plan were the subject of significant revisions only five months later in the MTFP update report to Cabinet on 25 July 2023. That report adjusted the MTFP general inflation assumption upwards to 6.2% noted that “the increase in forecast inflation is due to the increase compared to the 2023/24 Financial Plan, in which assumptions were made that directorates would not receive any inflationary uplift for premises, transport and supplies and service costs and would need to manage pressures within existing budgets.” We discuss this further in Section 6 of this report but in summary we consider that inadequate assumptions were made regarding inflation pressures in the budget. These inadequate inflation assumptions resulted in an under-estimation of the budget requirement for 2023/24.

Planning and Delivering savings for 2022/23

- 2.1.15 The Financial Plan approved by the Council in February 2022 identified a savings requirement of £40.8 million in 2022/23 which would contribute to a balanced budget. The position for the following three years was more challenging with planned savings of £107 million and an additional £32.6 million of ‘other solutions to be determined’ required to balance the budget.

2.1.16 *Table 1. Savings requirement from BCC financial plan 2022*

Savings Requirement	2022/23	2023/24	2024/25	2025/26
	£m	£m	£m	£m

¹ KPMG Economic Outlook, December 2022

Base Budget 2020/21	828.671	828.671	828.671	828.671
Changes in pay and price inflation	63.420	94.104	127.316	159.580
Budget pressures	110.009	40.248	53.165	62.253
Corporate adjustments:				
Other net change in use of/contribution to reserves	(144.094)	(10.239)	10.567	9.481
Corporately managed budgets	20.179	38.090	34.809	35.916
Changes in corporate government grants	(78.160)	(11.124)	(13.259)	(15.230)
Total Expenditure	800.025	979.750	1,041.269	1,080.671
Business Rates	(352.040)	(435.702)	(450.715)	(464.023)
Top up grant	(59.400)	(48.209)	(43.454)	(39.222)
Council Tax	(401.153)	(413.563)	(425.257)	(437.189)
Collection Fund (surplus)/deficit Business Rates	35.997	16.222	0.000	0.000
Collection Fund (surplus)/deficit Council Tax	17.365	1.532	0.000	0.000
Total Resources	(759.231)	(879.720)	(919.426)	(940.434)
Savings Requirement	40.794	100.030	121.843	140.237
Planned savings	(40.794)	(67.475)	(89.399)	(107.433)
Other solutions to be determined	0.000	32.555	32.444	32.794

Figures shown cumulatively

- 2.1.17 In view of this challenging financial landscape, the savings plans agreed in 2021/22 were reviewed for the 2022/23 Financial Plan resulting in the re-phasing and removal of some savings proposals. Transformative work under the Delivery Plan continued to identify savings under three pillars – People, Place and Fit-for-Purpose Council, with new savings proposals anticipated in the summer of 2022. In addition to permanent savings, some one-off savings which could only be achieved in 2022/23 were included in the plans. A total of £36.9 million of new savings was identified for 2022/23 and the resulting savings programme up to 2025/26 reached a total of £107.4 million.
- 2.1.18 Of the planned savings for 2022/23, 45% were existing plans and 55% were new plans, over 50% of which (£10.8 million) related to becoming a 'Fit-for-Purpose Council.' Existing savings included a £2 million annual saving which was anticipated from 2022/23 due to reduced application costs resulting from the change in the Council's financial ledger system from SAP to Oracle, which will not be delivered. New savings included £1 million savings in 2022/23 from improved debt management.
- 2.1.19 It was reported that savings delivered in 2021/22 amounted to £29.9 million (based on the Q3 position in 2021/22) which was 91% of the target set. This was presented as an improved performance over the previous four years. Therefore, the target for 2022/23 was judged by officers to be realistic.

Table 2. From BCC Financial Plan 2022

Year	Planned savings £m	Savings Delivered £m	Delivery %
2016/17	88.2	32.4	37%
2017/18	70.9	48.3	68%
2018/19	52.9	42.8	81%
2019/20	46.2	38.7	84%

2020/21	22.1	16.0	73%
2021/22*	33.1	29.9	91%

*Quarter 3 position

- 2.1.20 The savings performance figures reported in the MTFS show an improvement over the six years. However, the savings target for 2022/23 did not include any headroom to compensate for under-achievement of any of the proposed savings (which was likely given the Council's track-record on achieving savings). Furthermore, the year's 2023/24 to 2025/26 are balanced by a line in the Table 1 "*Other solutions to be determined*" which amounted to £32.6 million in projections for 2023/24.
- 2.1.21 The Council's process for monitoring and managing the delivery of savings involves the collation of data in the form of a Savings Tracker spreadsheet. This data indicates that £3.9 million of targeted savings were not delivered in 2021/22 and were therefore carried forward into 2022/23. Non-delivery of these savings would have amounted to a £16.2 million budget gap over the four years to 2025/26.
- 2.1.22 Savings plans were therefore a mixture of existing transformation projects, departmental savings, and 'Fit for Purpose' projects. The 'Fit for Purpose' savings included significant savings from City operations and Council Management which were identified in monitoring for June 2022 as '*high risk*' savings. A narrative is recorded in the savings tracker which sets out information about any deviation from the outline business case. For example, three '*high risk*' savings in customer services have the following narrative attached: "*Lack of service engagement and no detailed implementation plan developed/agreed yet.*" The then Strategic Director responsible for City Operations told us that there was a lack of engagement from his services because the savings proposals had been put forward from outside the service areas without the necessary detailed plans for achieving the savings. This is in contrast to comments made by the then Strategic Director of Council Management, who stated that the savings plans had been developed and signed off by the Directors responsible for the service areas as being "fully deliverable". Such a fundamental difference of opinion illustrates the degree of confusion that we observed regarding this savings process and the level of tension within CLT at the time. A significant proportion of the savings targets are '*Corporate Items*' which amount to £14.3 million in 2022/23. The narrative on these savings targets indicates that they appear to have been set without effective and credible plans or resources in place to ensure that they could be achieved. For example, a voluntary workforce savings target of £2 million in 2022/23 is RAG-rated (Red/Amber/Green-rated) as red with the following narrative: "*Need detailed plans and clarity on how this will be delivered.*" A £1.6 million saving in Traded Services has the following comments: "*Services selected for deep dive reviews and resources secured to support these services with the detailed review. Need CLT agreement before we can progress deep dive reviews.*" The then Section 151 Officer has told us that detailed plans were in place for each savings line and overseen by the Director of Transformation at the time. However, our review of documentation², including the above comments, and meetings with officers who were involved supports our view that the planning of some proposed savings was inadequate.
- 2.1.23 The Strategic Director of Council Management, who was also the Council's Section 151 Officer, was the named operational sponsor for corporate savings of £14.3 million and Council Management and City Operations savings of £10.6 million in 2022/23. This was 61% of the total savings requirement for the year. There is a conflict of interest in being an operational sponsor responsible for delivering a saving and being the Section 151 Officer whose responsibilities include holding operational sponsors to account. The then Section 151 Officer has told us that there was no conflict of interest because she was not the 'operational sponsor' and that the responsibility lay with service directors who were held to account for the delivery of savings. However, the documentation³ we have reviewed clearly identifies the Strategic Director of Council Management (Section 151 Officer) as operational sponsor.
- 2.1.24 On 24th October 2022 a Star Chamber⁴ meeting of the Cabinet considered a report which identified £8.7 million '*high risk*' savings in Corporate Items and £2.4 million '*high risk*' savings in Council Management. The meeting also received information about overspends and emerging costs in relation to the Oracle implementation of £2.6 million. This is consistent with the Financial Monitoring report to Cabinet on 11 October 2022 which reported that 27% of savings were classified as 'High Risk' at Month 5. Therefore, seven months into the financial year, the Cabinet and the Council's senior managers were aware that there was a serious risk that savings targets would be under-achieved by a considerable margin in 2022/23 and that there were emerging cost issues with the Oracle project.

² Savings Tracker 2022-23 as at 2-2-2023 RAG narrative

³ Savings Tracker 2022-23 as at 2-2-2023

⁴ Council Management Star Chamber October 2022

Planning and Delivering savings for 2023/24

2.1.25 The Financial Plan approved in February 2023 indicated a savings requirement of £48 million in 2023/24 which would contribute to a balanced budget. Over the following three years the savings requirement rises to £97 million.

Table 3. From BCC Financial Plan 2023

Savings Requirement	2023/24 £m	2024/25 £m	2025/26 £m	2026/27 £m
Base Budget 2023/24	759.231	759.231	759.231	759.231
Changes in pay and price inflation	85.045	106.211	117.135	148.649
Budget pressures	24.851	34.181	38.341	49.090
Corporate adjustments:				
Other net change in use of/contribution to reserves	145.954	204.942	231.751	200.776
Corporately managed budgets	18.322	8.984	6.397	10.350
Changes in corporate government grants	(59.468)	(18.242)	(20.204)	(21.095)
Total Expenditure	973.935	1,095.307	1,132.649	1,147.001
Business Rates	(410.863)	(487.852)	(495.937)	(501.120)
Top up grant	(69.303)	(71.421)	(67.856)	(63.856)
Council Tax	(429.159)	(459.040)	(471.819)	(484.958)
Collection Fund (surplus)/deficit Business Rates	(1.721)	0.000	0.000	0.000
Collection Fund (surplus)/deficit Council Tax	(14.032)	0.000	0.000	0.000
Total Resources	(759.231)	(879.720)	(919.426)	(940.434)
Savings Requirement	48.857	76.994	97.038	97.067
Planned savings	(48.857)	(76.994)	(97.038)	(97.067)
Other solutions to be determined	0.000	0.000	0.000	0.000

Figures shown cumulatively

2.1.26 In view of the challenging financial landscape, the savings plans agreed in 2022/23 were reviewed for the 2023/24 Financial Plan which noted that inflationary pressures and increasing demand were cancelling out some savings. Transformative work under the Delivery Plan continued to identify savings under three pillars – People, Place and Fit-for-Purpose Council.

2.1.27 In November 2022 it was reported internally that 50% of the £2.7 million target of procurement savings were at risk and that a key issue was a lack of timely engagement from services. Information obtained from our meetings with officers includes suggestions that reporting of overspends and under-achievement in savings targets was underplayed or omitted in some reporting to members. For example, the implementation costs for the Oracle implementation were showing a £3 million overspend in October 2022 but a finance officer has alleged that they were asked by a senior officer to change the figures to be reported to a Star Chamber meeting. We are also concerned that the under-performance in achieving savings and its impact on the Council's deteriorating financial position was not shared more widely within the Council, with the Council's Audit Committee and with ourselves as External Auditors. This appears to have reflected a culture where bad news was not encouraged or properly reported with significant consequences for the effective governance of the Council. There are more examples of this significant weakness in terms of the Council's culture referenced elsewhere in this report.

- 2.1.28 A total of £21 million of new savings was identified for 2023/24 making up 44% of the planned savings programme. External support was secured by the Section 151 Officer to identify new savings to close the budget gap. Of the new proposed savings, £13 million (62%) related to vacancy management i.e. delaying recruitment to fill staff vacancies. The then Section 151 Officer has told us that vacancy controls were already in place in 2022/23. We agree that this was the case but additional savings proposals were developed with external support which duplicated some of the vacancy savings plans which were already in place. Furthermore, finance officers supporting directorates were not initially engaged in putting together these plans or setting the targets and they later raised concerns about the double-counting of vacancy management savings and errors in the calculations. An account provided to us by one finance officer claims he reported concerns to the Section 151 Officer and was told it was too late because it could alter the proposed balanced budget over four years. The then Section 151 Officer has told us she refutes the allegation that she was alerted to errors in the budget and that she told the officer that it was too late to change. She has also commented that it was the responsibility of the interim Deputy Director of Finance to communicate savings to services, rather than her own responsibility. Nevertheless, on the balance of evidence available, we consider that there were significant deficiencies in savings planning and reporting.
- 2.1.29 It was reported in the MTFP that savings delivered in 2022/23 amounted to £36.8 million (based on the Q3 position in 2022/23 – see Table 4) which was 90% of the target set. This was presented as an improved performance averaging 85% per annum over the previous four years.

Table 4. From BCC Plan 2023 – Savings Delivery

Year	Planned savings £m	Savings Delivered £m	Delivery %
2016/17	88.2	32.4	37%
2017/18	70.9	48.3	68%
2018/19	52.9	42.8	81%
2019/20	46.2	38.7	84%
2020/21	22.1	16.0	73%
2021/22	33.1	29.9	91%
2022/23*	40.8	36.8	90%

*Q3 position

- 2.1.30 However, the Council's savings tracker indicates that £18.9 million of savings plans were at high or medium risk at the end of October 2022 which makes the estimate of savings delivered in the 2022/23 appear optimistic. The then Section 151 Officer has told us that there was full challenge and independent assurance of savings forecasts by her and the Interim Director of Transformation. The Council's savings tracker indicates that the level of high risk savings in October 2022 was over £5 million lower than the eventual shortfall of £9.454 million which suggests that assurance around savings delivery was insufficient. The tracker indicates that some medium risk savings had not had their RAG ratings reviewed since 29 July 2022. Given the lack of accurate financial information for 2022/23 (due to the issues with Oracle) we have been unable to confirm that these savings were made in 2022/23. We have established that the Council had a budget smoothing reserve which was used to backfill the gap when savings targets were not met. The then Section 151 Officer has told us that this reserve was only used when savings were still deliverable but there was a timing issue, rather than to "backfill gaps." Subsequent reporting of savings performance in July 2023 identified that £9.454 million of savings from 2022/23 were undelivered. The estimate of 90% achievement of savings reported in the 2023 Financial Plan therefore over-estimated the actual position by the third quarter of 2022/23 indicating that the challenge and assurance in progressing savings was ineffective.
- 2.1.31 The planned savings were a challenge for the Council to deliver given that it had only previously delivered a similar scale of savings plans in 2017/18 and 2018/19. Furthermore, whilst information was available about under-performance in achieving savings during the year, which was a high level of risk to the Council's financial plans, the action taken was insufficient to address shortfalls. The under-achievement of permanent savings was addressed to some extent through one-off measures and use of reserves and this approach reinforced optimism bias in respect of savings performance. The culture was not one of continuous improvement, collective responsibility or accountability and this resulted in under-performance being ignored or down-played.

Reporting and Outturn

- 2.1.32 As we have already set out, the net revenue budget for 2022/23 was £759.2 million.
- 2.1.33 In October 2022 a budget requirement of £80 million was estimated to cover in-year overspends. A Month 10 Financial Monitoring Report for 2022/23 was reported to Cabinet on 21 March 2023 indicating an estimated £68 million Directorate overspend in a forecast outturn report which indicated the use of an extra £80 million of reserves would be required to balance the budget.
- 2.1.34 In July 2023, the Cabinet considered a revised MTFs which identified additional significant demand-led budget pressures and overspends as well as a further gap of £9.5 million as a result of unachieved savings in 2022/23. These calls on the Council's financial reserves significantly weakened the Council's financial position.
- 2.1.35 The Council reported its provisional outturn for 2022/23 in May 2024. This outturn has yet to be finalised and, understandably, the provisional outturn is highly caveated due to the issues the Council has faced in implementing its Enterprise Resource Planning system, Oracle. The absence of a finalised outturn position for 2022/23 represents a risk to the Council given the extent of other financial challenges it faces.
- 2.1.36 The provisional outturn for 2022/23 reported the following:
- The provisional General Fund revenue outturn is an overspend of £66.2m before the corporate use of reserves.
 - The Collection Fund has a £29.9m deficit against budget. Approximately 50% of this is due to delayed debt collection with the remainder coming from appeals.
 - The Housing Revenue Account underspent by £5.6m.
 - The Dedicated Schools Grant (DSG) position has not yet been finalised
 - There has been significant slippage across the capital programme of £330.8m against a programme of £737.8m for the 2022/23 financial year.
 - Use of reserves is less than planned which is a creditable position given the lack of financial information available to the Council (due to the failed ERP implementation). For 2022/23 the Council utilised £269.3m against a budget of £283.2m. This has resulted in General Reserves and balances reducing from £230m to £149m and earmarked reserves reducing from £841.6m to £652.8m. Overall reserves reduced from £1071.7m to £801.4m.
- 2.1.37 We note that the combined reduction in reserves was £269.3m (although below that planned of £283.2m) and that there was a significant emerging pressure relating to Business rates (£29.9m). However, we also note that part of the reserves used relate to Section 31 grants (Covid related) which we would expect the Council to use. Also, given that the Council has needed to operate without a fully functioning ERP system its overall financial performance in not drawing further from reserves is a credible one for 2022/23. This said, we note that the Council's financial position for 2022/23 was not a balanced one and that it had an underlying deficit in excess of £100m.
- 2.1.38 The net revenue budget for 2023/24 was £925 million. The budget sets out opening reserves of £668m and a closing reserve of £682m. The Council has provided us with management reports that indicate that it has received a significant level of earmarked funds, such as the clean air zone reserve. As a result, it has revised the opening balances for reserves to c£806m and the closing reserves to (as per 14 January 2025 report to Cabinet) to £809.9m.
- 2.1.39 The Council has reported on the likely outturn three times. In July 2023, June 2024 and January 2025:
- on 25th July 2023, Cabinet was advised of a forecast General Fund overspend against budget of £87.4m for the 2023/24 financial year, for the Council's General Fund. Of this overspend, £35m was due to savings that were rated as Red Risk – i.e. highly unlikely to be delivered within the financial year.
 - on 25th June 2024, Cabinet was advised that the draft Quarter 3 forecast for the outturn position is £115.1m overspend and explains why closing reserves are likely to be lower than anticipated (given the greater opening balances). The overspend is built up of the following:

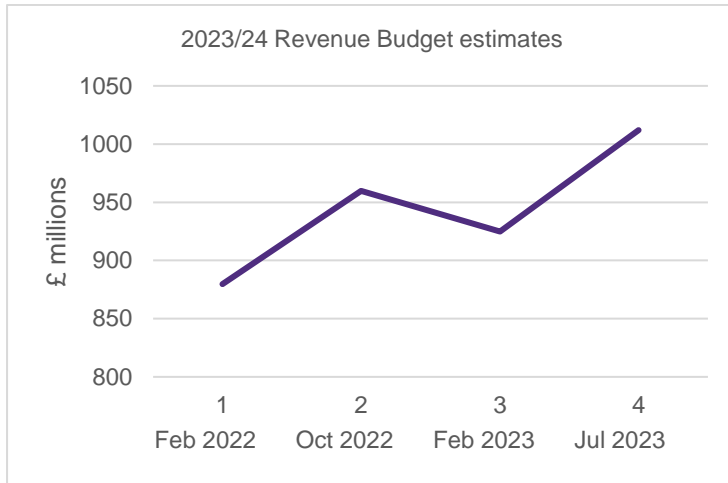
- Increased ERP (Oracle) costs, increased Temporary Accommodation Costs, Children's and Families pressures, and increased Adult Social Care demand pressures
- Greater inflation than was allowed in the budget
- Non-delivery of savings
- Business Rates and Council Tax impacts as a result of a collection fund deficit (see 2022/23 commentary).

- 2.1.40 As of January 2025 the finalised 2023/24 outturn report is still not available but a provisional outturn was published on 14 January 2025. The provisional outturn shows a £75m overspend in the general fund by services (offset by use of reserves), and significant under delivery of savings. Appropriate budget setting and management and delivery of savings remains a significant challenge for the Council. We note that the overspend is likely to have been worsened by the poor financial information available to the Council as a result of the failed ERP system implementation.
- 2.1.41 We have been told by the Council that reserves balances at 31 March 2024 were £809.9m of which available reserves are: General reserves and balances £156.2m, Other corporate reserves £35.7m, and earmarked reserves £132m. A total of £323.9m. We note that these outturn figures do not include the Council's alleged EP liability (which the Council has estimated to be in excess of £650m but which may be mitigated by the Council's proposed settlement and mitigation schemes).
- 2.1.42 Over 2022/23 and 2023/24 the Council's reserves have decreased by c£260m (from £1071m as at 31 March 2022 to £810m as at 31 March 2024). Some of this relates to Covid related grants that we would expect the Council to incur and additional spend on Oracle. However, even making allowance for this expenditure, at a high level this indicates a significant underlying deficit that, until 2024/25, had not been tackled by the Council. This underlying deficit has resulted in the significant financial pressures in 2024/25.
- 2.1.43 We note that the Council has now responded to these matters strongly in its 2024/25 budget and has instigated a series of savings plans to enable it to return to recurrent balance. If the Council had taken action earlier, particularly in 2022/23, had developed appropriate savings plans with effective challenge and assurance, and had made more reasonable assumptions in its 2023/24 budget a number of these financial pressures could have been managed earlier. We do, however, note that the Council and its officers have had limited financial control and information on which to address these matters and that the failed ERP system has played a significant role in the overspends and reduction in income collection in 2022/23 and 2023/24
- 2.1.44 We published Statutory Recommendations (**Statutory Recommendations 5, 6 and 7**) on 29th September 2023 setting out the actions that the Council should take. We have not repeated our recommendations. We are also aware that the Council has taken clear and decisive action to resolve these matters and to ensure that the 2024/25 budget was appropriately set. We have not therefore made further recommendations.

3 Medium -Term Financial Planning

3.1.1 The Council's Medium Term Financial Plan was updated in February 2022 and February 2023 at the time of setting the Budgets for 2022/23 and 2023/24. In October 2022 and July 2023 updates to the MTFP were reported. There are significant differences between the different iterations of the MTFP, particularly the February 2023 Plan. For example, the estimates of the revenue budget requirement for 2023/24 rose from £879 million in February 2022 to £959 million in October 2022. The actual budget requirement set in February 2023 was £35 million lower than the October 2022 estimate. The July 2023 MTFP then corrected the 2023/24 budget requirement to £1,012 million.

3.1.2 Table 5. MTFP revenue budget estimates for 2023/24



3.1.3 The refreshed MTFP reported to Cabinet on 25 July 2023 added-in a range of budget pressures and revised costs in the budget. The specific changes made in this report were:

- Corrections to pay costs relating to National Insurance changes in September 2022
- New estimates of spending pressures which included an additional £33 million in 2023/24 for the Oracle implementation; £8.6 million for temporary accommodation; £6.7 million for Children's and families (care and Children's Trust pension liabilities); £6.2 million for adult social care (care and Placement costs)
- A reduction in estimated borrowing costs of £3.9 million in 2023/24 resulting from delays in the capital programme.

3.1.4 The report also identified an increase in inflation forecasts in comparison with the Financial Plan approved in February in order to:

- Correct an assumption in the 2023/24 Financial Plan that Directorates would manage inflationary costs within existing budgets, and
- Make specific assumptions about inflation costs tied to contractual arrangements.

The then Section 151 Officer has told us that the containment of inflation within existing directorate budgets was agreed by Directors and reflected arrangements in previous years. We note that other members of CLT have commented that this was not the case.

3.1.5 The report forecast that £33.2 million of savings in 2023/24 were at 'high risk' with a further £21.1 million of savings unlikely to be delivered in 2024/25. It also assumed that £9.5 million of savings which were not delivered in 2022/23 would need to be reflected in the outturn report for 2022/23 when it could be presented.

3.1.6 The changes made to the July 2023 iteration of the MTFP identified specific in-year challenges for the Council:

- An in-year budget gap of £87 million which included a forecast that the Council would fall short of its savings target for 2023/24 by £35 million.
- An estimate of £9.5 million of savings which were not achieved in 2022/23 which would impact on the 2022/23 outturn and the Council's reserves position.

- A significant weakness in the way that the Council estimated demand and inflation costs in its 2023/24 budget. Also see paragraph 2.1.12
 - A significant weakness in the way that the Council managed the delivery of its savings plans in 2022/23 and 2023/24 and in its past reporting of savings delivery performance.
- 3.1.7 The report referred to additional financial costs to the Council of liabilities relating to new Equal Pay Claims which are estimated at between £650 million and £760 million. These additional costs were not included in the Medium-Term Financial Strategy at this stage, pending more detailed estimates. Previously these costs were reported as contingent liabilities.
- 3.1.8 The consistency in the way inflation and other pressures were treated in the February 2023 Financial Plan also diverged significantly from previous estimates for 2023/24 to 2025/26 which were set out in the October 2022 Medium-Term Financial Plan. Effectively both inflation and other pressures were understated in the February 2023 plan.
- 3.1.9 This position was corrected in the July 2023 update of the MTFP by adding back inflation and demand pressures which included Temporary Accommodation (£8.6 million), Children and Families pressures relating to unaccompanied asylum seekers, home to school transport and Birmingham Children's Trust pension liabilities (£6.7 million), and adult social care pressures relating to demand for care and placement costs (£6.2 million). The update report also highlighted the under-achievement of savings despite the performance achievements reported in the 2022 and 2023 Financial Plans.
- 3.1.10 We have also identified other concerns about the preparation of the Financial Plan 2023 regarding the timetable for internal consultations within the Council which we understand did not engage with the leading members in a timely way leaving little time for appropriate challenge or scrutiny. We are concerned that members were not engaged in considering future scenarios in as timely a manner that they would normally have been. The then Section 151 Officer has told us that the Leader and Cabinet Members were involved in the 2023/24 budget preparations and that the Leader discussed this with the Labour Group. We agree with this but reiterate our concerns about the timeliness of engagement with the budget preparation process for 2023/24.
- 3.1.11 We have also identified examples of departmental resistance to meeting the corporate priorities and savings targets set by the Council.

4 Capital and Borrowing

4.1.1 In the 2022/23 Financial Plan the Council identified the key drivers of its capital investment as:

its property strategy, including the schools estate
economic regeneration and transport, including the HS2 terminal
housing
the Commonwealth Games.

4.1.2 The Capital programme for 2022/23 to 2025/26 included:

HRA investment in council housing of £76 million
Perry Bar residential scheme of £82 million
Roads and transport infrastructure of £191 million
Enterprise Zone of £54 million
Commonwealth Games of £11 million
Waste Management of £49 million
Education and Skills of £62 million

4.1.3 Provision was also made for capital receipts to be used to meet the liabilities which had been identified at that time for Equal Pay Settlements. The Council's four-year capital programme therefore consisted of spending of £531 million in 2022/23 and a total spend of £1,200 million over the four-year period. This was to be resourced by a combination of capital receipts (£210 million), revenue resources (£333 million), Government grants and contributions (£288 million) and prudential borrowing (£368 million). Of the total planned prudential borrowing, the Council planned to borrow £217 million of the total £368 million in 2022/23.

4.1.4 The Council's Minimum Revenue Provision Policy was:

- To charge MRP on pre-2008/09 borrowing at 2% of the balance at 31 March 2008, fixed at the same cash value so that the whole debt is repaid after 50 years.
- To repay prudential borrowing since 1 April 2008 within the expected life of the asset being financed, in accordance with the 'asset life' method. The Council's previous practice was to use a maximum period of 40 years but the MTFS introduced a new maximum period of 50 years to "*better reflect the life of the assets employed and is consistent with other councils.*"
- To use an average asset life for each project based on the normal asset life used for depreciation accounting purposes, and using a standard schedule of asset lives with the provision that where a project exceeds £10 million, expert property advice may be taken into account. Asset life will be determined by the Section 151 Officer.
- To make a provision that other methods to provide for debt repayment may occasionally be used in individual cases where this is consistent with the statutory duty to be prudent. This is at the discretion of the Section 151 Officer.
- The Council's pre-2008 MRP policy differs from the Statutory Guidance issued by the Secretary of State under section 21 (1A) of the Local Government Act 2003, which provides (Option 2) that MRP is equal to 4% of the non-housing Capital Financing Requirement (CFR) at the end of the preceding financial year. The Council's policy is to charge 2% of the balance as at 31 March 2008 over a fifty year period. The Council's post 1 April 2008 policy uses an annuity method which is permitted by the statutory guidance and is a prudent method where assets produce a steady flow of benefits over their useful life. It requires an interest rate to be applied which fairly represents the circumstances as they are likely to apply over the life of a particular project. Over fifty years the policy resulted in a lower charge in the early years and a higher charge in later years but was not significantly different to a straight-line approach over fifty years.

4.1.5 We note that the Council changed its policy from using a maximum period of 40 years to a maximum of 50 years in the 2022/23 Financial Plan and that the statutory guidance provides that Councils should explain in their statement why the change would allow them to make prudent provision. The Council's Debt Repayment Policy asserts that "The amended policy should better reflect the life of the assets employed and is consistent with other Councils." However, this assertion does not explain why the change better allows the Council to make prudent

provision which is specifically required in the Guidance. We do not consider that the assertion made by the Council fulfils the requirement to have regard to the Statutory Guidance.

- 4.1.6 The Council set its Prudential Limit for Debt at £4,500 million for 2022/23 (rising to £4,700 million in 2025/26). This was calculated on the basis of a forecast closing gross loan debt of £3,910 million (including PFI liabilities) for 2022/23 which is a rise of 5.2 % on the £3,721.8 million for 2021/22. £2,781 million was the forecast closing liability for general fund debt a rise of 5.8% compared to the figure of £2,568 in 2021/22. In the 2022/23 Financial Plan general fund borrowing was identified as 29.4% of the net revenue budget which is an increase of 0.5% on the figure of 28.9% of the net revenue budget in the 2021/22 Outturn report; and an increase of 1.2% on the figure of 28.2% in the 21/22 Financial Plan.
- 4.1.7 Comparative data drawn from the CIPFA Financial Resilience Index shows that Birmingham's gross external debt in 2021/22 (£3,505 million) and its Interest Payable as a percentage of Net Revenue Expenditure (15.65%) were the highest among its nearest neighbour comparator group. Birmingham's long-term borrowing as a percentage of its long-term assets was 39% in 2021/22 ranking Birmingham as 8th highest among the 36 Metropolitan Authorities. The Council's debt levels were therefore high and increasing.

2023/24

- 4.1.8 The 2023/24 Financial Plan identified the focus for new capital projects as:
- The Council Plan and its key priorities
 - Statutory requirements and other legal commitments
 - Proposals which support revenue savings, income or service modernisation.
- 4.1.9 The proposed capital programme for 2023/24 involved expenditure of £634 million (of which £241 million was HRA capital spending) and £1,608 million over the four-year period to 2026/27.
- 4.1.10 The capital programme for 2023/24 to 2026/27 included:
- Housing investment of £864 million
 - Continuing investment of £16 million in the Perry Bar residential scheme
 - £182 million on Transport connectivity
 - £79 million on Highways infrastructure
 - £52 million in the Enterprise Zone
 - £2 million on the Alexander Stadium legacy scheme
 - £33 million on the Waste Management Strategy
 - £113 million in Education and Skills
 - £53 million in Adult Social Care
- 4.1.11 The four-year capital programme was to be resourced by a combination of capital receipts (£249 million), revenue resources (£319 million), Government grants and contributions (£436 million) and prudential borrowing of £602 million.
- 4.1.12 The Council set its Prudential Limit for Debt at £4,500 million for 2023/24 (rising to £5,000 million in 2026/27). This was calculated on the basis of a forecast closing gross loan debt of £3,850 million (including PFI liabilities) for 2023/24, of which £2,678 million was the forecast closing liability for general fund debt. The forecast for the Council's new and replacement long and short-term borrowing in 2023/24 was £573 million in 2023/24.
- 4.1.13 The Council's Minimum Revenue Provision Policy remained the same as its policy in 2022/23.
- 4.1.14 The Treasury Management Revenue Budget estimated the net interest costs and revenue charge for loan debt repayment would be £250 million in 2023/24, rising over a four-year period to £297 million in 2026/27. £194 million would be met by the General Fund and £56 million by the Housing Revenue Account. There would be an additional annual cost to the General Fund of £3.3 million for every 1% rise in variable interest rates and an additional £1.8 million for the HRA.
- 4.1.15 The Council's forecast new borrowing requirement in the Financial Plan 2023 was £573 million in 2023/24. This was an increase on the forecast borrowing for 2023/24 of £532 million, which was included in the Financial Plan 2022. The forecast new borrowing rises to £806 million in 2024/25 compared to a forecast of £573 million in the previous year. The significant rise in new borrowing represents a risk of further significant cost pressure on the revenue budget in terms of its interest and repayment provisions. The forecast new borrowing plans set out in the 2023/24 Financial Plan would therefore exacerbate the problem of the Council's increasing indebtedness.

- 4.1.16 The Council's maintenance of its roads is delivered via a PFI scheme. We note that the Government is considering whether to continue all of the grant funding to support the scheme. To the extent that Government funding is not available the Council will need to reduce its expenditure to ensure that there is not an additional revenue or capital impact on its expenditure. This will require re-prioritization of its highways maintenance expenditure.
- 4.1.17 In addition, during the year it became apparent that much of the Council's housing stock was in need of remedial action under the Decent Homes Standard, as the Regulator for Social Housing concluded in May 2023 that the Council had breached the Home Standard. Consequently, the Regulator recommended that the Council should take "*urgent action*" in response to the failings. Such action will place further strain on the Council's capital resources for the future.
- 4.1.18 The impact of the Council's capital plans resulted in its Capital Financing Requirement (CFR) rising by 2.5% between the 2022/23 Financial Plan and the 2023/24 Financial Plan (£4639 million to £4753 million). The 2023/24 Financial Plan includes a further rise of 5% in the CFR in 2024/25 and remains at that level for the following two years. This will impact further by increasing the Council's MRP. Given the level of the likely equal pay liabilities, the impact of the current capital programme on MRP and the Council's planned borrowing, it is clear that the future level of capital investment envisaged in the 2023 Financial Plan is unaffordable. We note that the Council has now addressed this matter and that the Council's 2024/25 Budget approved on 5 March 2024 sets out plans for the capital programme and strategy which reduce capital spending with the intention of bringing General Fund borrowing to nil by the end of 2026/27.

5 Reserves

- 5.1.1 The draft accounts for 2021/22 indicated that the Council had usable reserves of £1,512 million. Capital reserves (£400 million), ringfenced reserves (£117 million), and grants provided for specific purposes (£380 million) would not be available to the Council to support any shortfall in funding. Of the remaining balance of £613 million there was a total of £383 million of earmarked reserves and £230 million of unearmarked reserves.
- 5.1.2 The Council planned to use £283 million of its reserves in 2022/23. This consisted of use of a net £15.1 million of the Delivery Plan Reserve; a net £30.9 million of the Financial Resilience Reserve; a net £9.2 million of the Public Health Reserves; and a net £228 million of earmarked reserves. By the end of 2022/23, earmarked reserves were expected to be £443 million of which £207 million was earmarked for contractual commitments including the Highways PFI contract leaving a balance of £236 million. After taking account of planned contributions to reserves, the General Reserve was expected to be £163 million at the end of 2022/23. The end of year planned total of general and non-contractual earmarked reserves was therefore £399 million, £214 million less than the balance showed in the draft accounts for 2021/22.
- 5.1.3 In October 2022 a budget requirement of £80 million was estimated to cover in-year overspends. A Month 10 Financial Monitoring Report for 2022/23 was reported to Cabinet on 21 March 2023 indicating an estimated £68 million Directorate overspend in a forecast outturn report which indicated the use of an extra £80 million of reserves would be required to balance the budget.
- 5.1.4 In July 2023, the Cabinet considered a revised MTFs which identified a further gap of £9.5 million in unachieved savings in 2022/23. These calls on the Council's financial reserves significantly weakened the Council's financial position.
- 5.1.5 The provisional outturn for 2022/23 reported the following:
- The provisional General Fund revenue outturn is an overspend of £66.2m before the corporate use of reserves.
 - The Collection Fund has a £29.9m deficit against budget. Approximately 50% of this is due to delayed debt collection with the remainder coming from appeals.
 - The Housing Revenue Account underspent by £5.6m.
 - The Dedicated Schools Grant (DSG) position has not yet been finalised
 - There has been significant slippage across the capital programme of £330.8m against a programme of £737.8m for the 2022/23 financial year.
 - Use of reserves is less than planned which is a creditable position given the lack of financial information available to the Council (due to the failed ERP implementation). For 2022/23 the Council utilised £269.3m against a budget of £283.2m. This has resulted in General Reserves and balances reducing from £230m to £149m and earmarked reserves reducing from £841.6m to £652.8m. Overall reserves reduced from £1071.7m to £801.4m.
- 5.1.6 As reported in Section 2, we note that the combined reduction in reserves of £269.3m (although below that planned £283.2m) and the emerging pressure re Business rates (£29.9m) is significant. However, we also note that part of the reserves used relate to Section 31 grants (Covid related) which we would expect the Council to use. Also, given that the Council has needed to operate without a fully functioning ERP system its overall financial performance in not drawing further from reserves is a credible one for 2022/23. This said, we note that the Council's financial position for 2022/23 was not a balanced one and that it had an underlying deficit in excess of £100m.
- 5.1.7 The net revenue budget for 2023/24 was £925 million. The budget sets out opening reserves of £668m and a closing reserve of £682m. The Council has provided us with management reports that indicate that it has received a significant level of earmarked funds, such as the clean air zone reserve. As a result it has revised the opening balances for reserves to c£806m and the closing reserves to (as per 14 January 2025 report to Cabinet) to £809.9m.
- 5.1.8 On 25th June 2024, Cabinet was advised that the draft Quarter 3 forecast for the outturn position is £115.1m overspend and explains why closing reserves are likely to be lower than anticipated (given the greater opening

balances). We note that the overspend is likely to have been worsened by the poor financial information available to the Council as a result of the failed ERP system implementation.

- 5.1.9 Over 2022/23 and 2023/24 the Council's reserves have decreased by c£261m (from £1071m as at 31 March 2022 to £809.9m as at 31 March 2024). Some of this relates to Covid related grants that we would expect the Council to incur and additional spend on Oracle. However, even making allowance for this expenditure, at a high level this indicates significant financial pressures that, until 2024/25, had not been tackled by the Council. This underlying deficit has resulted in the significant financial pressures in 2024/25. The then Section 151 Officer has told us that reserves were in the main used to address economic shock in 2022/23, rather than underlying budget deficits. Due to the lack of documentation we have not been able to verify this comment.
- 5.1.10 In our opinion, in 2022/23 and 2023/24 the Council relied on reserves to balance its budget to an extent which is unsustainable, even before its equal pay liabilities are taken into account. The then Section 151 Officer told us that she created a Financial Resilience Reserve of £146 million to give the Council greater resilience and that this was above the levels of reserves put aside by other Councils for financial resilience. However, our opinion is based on the sustainability of the approach rather than the principle of the planned use of reserves. We note that the Council has addressed this matter and that the Council's 2024/25 Budget approved on 5 March 2024 sets out new and improved reserves and balances policies.
- 5.1.11 The Council estimated in July 2023 that it had a potential Equal Pay liability of between £650 million and £760 million. We note that the Council is negotiating with claimants and their representatives to reduce any payments. As at January 2025 [remaining text redacted under legal advice privilege and litigation privilege at request of Council]. Equal Pay is dealt with later in this Report.
- 5.1.12 We published a Statutory Recommendation (**Statutory Recommendation 10**) on 29th September 2023 setting out the action the Council should take. While noting the significant financial challenges ahead, we are satisfied that the Council has responded positively to this recommendation.

6 Section 25 Reports

- 6.1.1 Chapter Seven of the 2022 Financial Plan included a Section 25 Report. This set out the then Section 151 Officer's opinion that the budget estimates were robust and the level of reserves adequate. It covered the approach to setting and managing the level of reserves, the management of savings plans, the approach to applying inflation estimates to the budget, the approach to estimating income, capital investment and borrowing plans and the approach to managing strategic risks and governance relating to the management of the Council's finances. The report advised that: *"The medium-term plan shows a balanced position for 2022/23. At this stage it assumes possible use of the budget smoothing reserve over the period 2023/24 to 2025/26 to allow savings options to be developed and implemented in a managed way over the three years. This use of the Budget Smoothing Reserve is considered the best approach to manage the level of savings required over this period."*
- 6.1.2 The Financial Plan approved by the Council on 25th February 2023 included a Section 25 Report which noted that the background to the 2023/24 budget and medium-term financial proposals was one of considerable uncertainty and volatility. The report confirmed the then Section 151 Officer's view that robust mechanisms were in place to ensure accountability for the delivery of planned savings. And it stated that *"The proposals included in this report establish a balanced budget for a four-year period 2023/24 to 2026/27 having taken a considered view of all relevant factors. This is the first time that the Council has achieved the setting of a four-year balanced budget."* The report referred to well-established procedures to identify and anticipate risks. It noted that a full review of strategic risks took place in 2022/23 with regular monthly reports presented to CLT assurance meetings and Audit Committee. The main risks identified within the S.25 report do not make specific reference to the potential additional Equal Pay liability or Oracle implementation risks.
- 6.1.3 We have identified sufficient evidence to form a view that the Section 25 statement in the February 2023 Financial Plan provided by the s151 Officer could not have been relied upon to provide adequate assurance or guidance to the Council in setting its budget. Our concerns are based on the following facts:
- Savings targets were insufficient to ensure that the Council's finances were sustainable because they were based on an under-estimated budget gap. The 2022 Financial Plan included a Savings Target of £40.8 million on the basis of its calculated budget requirement whereas the estimated use of additional reserves needed to balance the budget in 2022/23 is in excess of £80 million.
 - Performance in achieving savings was assessed and reported inadequately and inaccurately and where under-performance was identified, insufficient action was taken to correct the financial position. For example, the Council reported in its Financial Plan 2023/24 that its savings at Quarter 3 of 2022/23 were £4 million short of the target. In July 2023/24 it reported a shortfall of £9.5 million on its 2022/23 savings target.
 - Pressures on spending, including demand and inflation pressures, were forecast inaccurately and built into the 2023/24 Budget on the basis of Directorates absorbing inflation which did not happen. Together with the removal of a general inflation allowance from the budget without broad agreement or accompanying savings plans in the Financial Plan 2023, this is a significant weakness in the Council's financial planning. We note that the Council subsequently had to revise its budget to reflect more accurate inflation and demand figures in July 2023.
 - Significant liabilities in respect of the additional costs of implementing the Oracle project were not recognised or taken into account. For example, additional costs relating to Oracle were reported internally in September/October 2022 but were not included in the 2023/24 budget set out in the Financial Plan. The former Section 151 Officer has told us that no estimates of any nature on costs relating to Oracle were available to her up to March 2023. However, we have seen evidence from a draft presentation to the Council's management 'Star Chamber' of October 2022 that confirms that the risk of additional costs relating to Oracle was known. We consider that it would have been prudent to recognise this in reporting on the robustness of budget estimates with the Section 25 statement.
- 6.1.4 The then Section 151 Officer has told us that budget estimates were based upon demand, costs and income estimates signed off by Directors and their management teams and that the absorption of inflation by directorates was an explicit decision taken by CLT. We note that other members of CLT have disagreed with this comment.

6.1.5 We have considered all of these matters and concluded that the weaknesses we have identified around savings planning, assurance and performance, the treatment of inflation, the forecasting of demand, the availability of good quality financial data and the existence of new equal pay claim risks all served to undermine the quality of the report made under Section 25 of the Local Government Act 2003.

7 Equal Pay liabilities

Introduction and context

- 7.1.1 We are undertaking a separate review of the governance arrangements that the Council has deployed when dealing with its Equal Pay issues, and so this review of financial sustainability has not addressed these issues in detail. Nevertheless, the Council's own estimates of the potential liability it faces are a significant factor in its future financial sustainability. We have therefore set out the position as currently reported by the Council.
- 7.1.2 The conclusions we have reached on Equal Pay are based on consideration of more material than the report itself mentions. We note that the Council has, reasonably, applied legal advice privilege (LAP) and litigation privilege (LP) to aspects of our reporting. Due to this we have redacted some aspects of our report for reasons of legal privilege, without prejudice privilege, and confidentiality/commercial sensitivity, in order not to risk further damaging the Council's legal and financial position on Equal Pay.
- 7.1.3 On 25 July 2023 Cabinet approved the introduction of mandatory spending controls and a robust budget savings and recovery plan in response to revised MTFP forecasts which identified inflationary and demand pressures and under-performance in relation to previous savings targets. The revised MTFP estimates did not include the Equal Pay liabilities, although these were noted in the report: "*A provision for Equal Pay liability will also need to be made within all accounts that are not currently signed off by auditors – this includes the 2020/21, 2021/22 and 2022/23 financial years – to demonstrate the scale of the issue at that point in time.*" It also states that "*initial estimates of the potential additional Equal Pay liability are between £650m and £760m.*" A report to Cabinet about Equal Pay on 25 July 2023 identified an accrual rate for Equal Pay liabilities of [redacted under legal advice privilege and litigation privilege at request of Council]. Officers have stated that the estimate was prepared in accordance with International Accounting Standard (IAS) 37. It is supported by legal advice. We note that the figure and compliance with IAS37 is subject to audit and that the Council has announced an agreed settlement with the trade unions for [remaining text redacted under legal advice privilege and litigation privilege at request of Council].
- 7.1.4 On 5 September, the Section 114 report issued by the Council's Section 151 Officer identified that the negative General Fund position arose due to the cost of providing for Equal Pay claims and forecast service overspends of £87.4m. On 21st September a second Section 114 Notice and a Section 5 Notice were issued in response to the Council's delays in making a decision on the implementation of a Job Evaluation scheme.
- 7.1.5 On 12 October 2023 the Council determined that it would implement a revised JE Option (Option 3a). We published Statutory Recommendations (**Statutory Recommendations 1,2,3 and 12**) on 29th September 2023 setting out the actions the Council should take at that time.
- 7.1.6 Since October 2023 officers have continued to work on building the models to more accurately estimate the liabilities the Council is likely to face in future. Detailed models were provided to us to audit in November 2023 and in April 2024 the Council articulated a proposed change to its previous accounting methodology for recognising these liabilities which was required to reflect the Council's changing circumstances and its greater understanding of its liabilities. We note that the value in the models provided for audit were not subsequently altered from September 2023 to December 2024 and that throughout this period the Council confirmed that the £650m to £760m remained the most reliable estimate available to it. As at January 2025 we have not yet received a revised estimate although we are aware that the Council has
- 7.1.7 In May 2024, the Lead Commissioner was reported as stating that the potential to reach a negotiated settlement could considerably reduce officers' estimated liabilities for Equal Pay. We discussed this with Commissioners. They confirmed at that time that they were satisfied that the Council's estimate remained the most appropriate estimate. We note that in December 2024 the Council announced a settlement with the Trade Unions in relation to the claims that have been brought by their members. This settlement is subject to agreeing the terms of a framework agreement, which is currently being negotiated. We were provided with the Council's mitigation strategy for the potential equal pay liability not covered by the settlement with the Trade Unions on 10 January 2025. We have not yet been provided with a revised estimate for this potential liability.
- 7.1.8 Our commentary in this report is in the main based on the Council's July 2023 estimate. The following sections provide further explanation to the complex accounting and budgetary matters related to the Council's most recent

experience in this area. The historical background to the governance and decision-making that have created these significant issues will be subject to a further report from ourselves.

Background

- 7.1.9 Our work on the causes of the Council's potential EP liability is on-going. To support members in their understanding of the causes of the potential liability we have provided a brief summary below of the key matters and our provisional findings, as we understand them today. This commentary is subject to consultation with others including the possibility that consultees send in additional information. Our findings may as a result change. Nothing we say in this report should be considered as pre-judging our final findings and members should note that the commentary may fundamentally alter.
- 7.1.10 Since late 2006, the Council has been involved in Equal Pay litigation with group actions brought by employees and former employees alleging inequality in pay and employment terms. A provision and a contingent liability have been included in the financial statements in relation to these claims for a number of years.
- 7.1.11 The Council's current potential Equal Pay liability has arisen due to inadequate governance [remaining text redacted under legal advice privilege and litigation privilege at request of Council] and due to poor management control of [remaining text redacted under legal advice privilege and litigation privilege at request of Council]. The potential Equal Pay Liability, as estimated by the Council, was mainly avoidable and has created a significant and unnecessary cost for the people of Birmingham.

Technical note

- 7.1.12 IAS 37 deals with provisions and contingent liabilities. The term provision means, an estimated amount (of uncertain timing or amount) set aside when it is probable that a liability has been incurred. The contingent liability relates to other potential claims that could be made against the Council by individuals. Contingent liabilities are defined in accounting standards as:
- a possible obligation depending on whether some uncertain future event occurs, or
 - a present obligation for which payment is not probable or the amount cannot be measured reliably.
- 7.1.13 The Council has been aware of its Equal Pay liability for a significant period of time. Provisions have been reported in its financial statements but a contingent liability has also been maintained due to known risks regarding [remaining text redacted under legal advice privilege and litigation privilege at request of Council].
- 7.1.14 The weight of evidence needed to move from a contingent liability to provision is significant. This is due to the relative certainty needed with regard to whether there is a liability and whether a reliable estimate can be calculated. This is particularly so as a provision directly impacts on the Council's general fund reserves and therefore its financial stability. As such, we have been told by officers that, the Council's previous budgetary approach has been to directly budget for provisions but not for contingent liabilities.

Developments in 2023

- 7.1.15 The Equal Pay liabilities at the Council have arisen for a number of reasons. The primary reasons are: [remaining text redacted under legal advice privilege and litigation privilege at request of Council].
- Title re cause of equal pay liability redacted under legal advice privilege and litigation privilege at request of Council].**
- 7.1.16 [remaining text redacted under legal advice privilege and litigation privilege at request of Council]. The Council is responding to claims over [remaining text redacted under legal advice privilege and litigation privilege at request of Council].
- 7.1.17 We understand from [remaining text redacted under legal advice privilege and litigation privilege at request of Council]. To mitigate certain EP risks, a Memorandum of Understanding (MOU) was agreed between the Council and its Trade Unions for a settlement scheme for trade union members in May 2021. Council provisions up to September 2023 have been based on the successful implementation of the MOU.
- 7.1.18 The MOU did not include non trade union members and tribunal claims have been received. In November 2021 Cabinet authorised acceptance of counter proposals from the legal representatives of a group of claimants who were pursuing a class action for equal pay against the Council at that time (known as 'Jennings'). [remaining text redacted under legal advice privilege and litigation privilege at request of Council]. Following Cabinet's decision,

certain trade unions withdrew their support for the MOU (and advised members not to accept the offer). In April 2022 (as per documentation provided by the Council) a trade union alleged [remaining text redacted under legal advice privilege and litigation privilege at request of Council].

7.1.19 The following timeline of events sets out the matters that resulted in the re-evaluation of the JE methodology:

- 2017 to 2020 – [Remaining text redacted under legal advice privilege and litigation privilege at request of Council].
- May 2021 – a Memorandum of Understanding (MOU) was agreed between the Council and its three recognised Trade Unions (GMB, UNISON and Unite) for a settlement scheme for trade union members who had not brought a third generation equal pay claim but could potentially do so.
- November 2021 - Cabinet authorised acceptance of counter proposals from the ‘*Jennings*’ claimants. [remaining text redacted under legal advice privilege and litigation privilege at request of Council]. Following Cabinet’s decision, GMB and UNISON withdrew their support from the MOU.
- April 2022 - GMB allege [remaining text redacted under legal advice privilege and litigation privilege at request of Council].
- May 2022 - GMB issued the first ‘*Baker*’ claims in the Employment Tribunal alleging [remaining text redacted under legal advice privilege and litigation privilege at request of Council].
- February 2023 - The Council’s MOU steering group tasked itself to ascertain the Council’s ongoing potential equal pay liability in light of the *Baker* claims. [Remaining text redacted under legal advice privilege and litigation privilege at request of Council].
- June 2023 – The Council received revised legal advice [remaining text redacted under legal advice privilege and litigation privilege at request of Council].

7.1.20 In summary, the Council’s EP liability with regard to [remaining text redacted under legal advice privilege and litigation privilege at request of Council] arose due to the inappropriate governance and oversight of [remaining text redacted under legal advice privilege and litigation privilege at request of Council] and has recently increased due to the trade unions ceasing to support the MOU settlement (May 2021) and [remaining text redacted under legal advice privilege and litigation privilege at request of Council].

Title re cause of equal pay liability redacted under legal advice privilege and litigation privilege at request of Council.

7.1.21 [Paragraph redacted under legal advice privilege and litigation privilege at request of Council].

7.1.22 [Paragraph redacted under legal advice privilege and litigation privilege at request of Council].

7.1.23 [Paragraph redacted under legal advice privilege and litigation privilege at request of Council].

7.1.24 [Paragraph redacted under legal advice privilege and litigation privilege at request of Council].

7.1.25 [Paragraph redacted under legal advice privilege and litigation privilege at request of Council].

Estimated Equal Pay liability

7.1.26 In June 2023 the Council revised its estimate of its EP liability from £153m (2020/21 draft financial statements) and £121m (2021/22 draft financial statements) to a range estimate of £650m to £760m. The Council has confirmed to us that the estimate was prepared in accordance with IAS 37 based on the information available up to June 2023 (which was significantly different to the information available to officers at the time they calculated the provisions for the draft 2020/21 and 2021/22 financial statements). This figure remains subject to audit but we note that it is likely to be superseded by the recent mitigation strategy.

7.1.27 [Text redacted under legal advice privilege and litigation privilege at request of Council]. The increase arose due to new information being identified by the Council of the risks presented by previous [paragraph redacted under legal advice privilege and litigation privilege at request of Council] decisions and an emerging understanding of risks in relation to [paragraph redacted under legal advice privilege and litigation privilege at request of Council]. [Remaining text redacted under legal advice privilege and litigation privilege at request of Council].

7.1.28 The EP liability is an estimate and by its nature is judgemental. We have discussed this with officers and commissioners and they confirmed (up to December 2024) that the September 2023 estimate remained the most appropriate estimate of the Council’s EP liability until a mitigation strategy was put in place in December 2024.

We note that the Council remains at risk of Equal Pay claims until [paragraph redacted under legal advice privilege and litigation privilege at request of Council] is in place and [remaining text redacted under legal advice privilege and litigation privilege at request of Council]. The agreement with the Trade Unions to settle Equal Pay claims (in December 2024) is positive. We note that this settlement is subject to the terms of a framework agreement being agreed, that this settlement does not cover and resolve all of the Council's potential Equal Pay liability, and that the estimate of the potential Equal Pay liability not covered by the settlement may change further. We were provided with the Council's mitigation strategy for the potential Equal Pay liability not covered by the settlement with the Trade Unions on 10 January 2025. We have not yet been provided with a revised estimate for this liability.

7.1.29 We note that:

- The June 2023 methodology for calculating the EP liability was substantially different to that presented in the previously published draft 2020/21 and 2021/22 financial statements. It allowed for greater payments than those within the MOU and applied across all Council employees and bodies associated with the Council such as its companies, the children's trust, and schools.
- No provision was made in the draft 2020/21 and 2021/22 financial statements for [paragraph redacted under legal advice privilege and litigation privilege at request of Council] EP liabilities. [remaining text redacted under legal advice privilege and litigation privilege at request of Council].

Change in estimate

7.1.30 The change in estimate for the JE liability and the new estimate for the [paragraph redacted under legal advice privilege and litigation privilege at request of Council] liability were based on external legal advice from King's Counsel. This was provided between June to September 2023. During June to September 2023 the Council considered that a reliable evidence base was available to re-estimate the Council's JE EP liability and, for the first time, to estimate reliably its [paragraph redacted under legal advice privilege and litigation privilege at request of Council] Equal Pay liability.

7.1.31 We note that even at September 2023 there remained a number of assumptions with regard to the EP estimate and that debate continued between the Council and its various external legal advisors as to the EP risk applicable to the various claims and staff roles. [remaining text redacted under legal advice privilege and litigation privilege at request of Council].

7.1.32 The current EP estimate has been subject to change as legal arguments have developed and as negotiations with claimants and their representatives progressed. While the current estimates provided above were based on the best knowledge to the Council as at September 2023, officers were aware that they could be subject to change (through the development of legal arguments and negotiation). [Remaining text redacted under legal advice privilege and litigation privilege at request of Council]. The split of the estimated liability between provisions and contingent liabilities remained uncertain and continues to remain uncertain.

7.1.33 At the time of producing our statutory recommendations (September 2023) we reported that we had not been provided with sufficient information to audit the estimated EP liability. Our prime focus in our recommendations was to ensure that the Council introduced a revised JE system and stopped "task and finish". In addition, due to the uncertainty of the above estimates, we recommended that:

- *Statutory recommendation 2: It is important that the Council reviews its previous equal pay estimates and regularly updates its estimate of the potential future liability (at least on a quarterly basis). This updated position should be reported to members on a quarterly basis.*
- *Statutory recommendation 3: The Council should separately report the financial impact of potentially enriched roles to members as a matter of urgency and should prioritise their assessment as part of the job evaluation process. This should include a consideration of the Council's Best Value duty. Similarly, officers should provide monthly updates to members on the Council's identification of roles where task and finish has been in operation and the financial impact of this practice and confirm at the earliest opportunity that these practices are no longer operated. The Council should undertake a review of all working practices within the Council and ensure that all employees comply with their terms and conditions, including working their full contractual hours.*

7.1.34 We have regularly discussed this with officers and they have confirmed on each occasion that the June 2023 estimate remained the most appropriate estimate of the Council's EP liability and that it remains compliant with

IAS 37. We note that following the negotiated settlement with the Trade Unions that the estimated liability is likely to change. [remaining text redacted under legal advice privilege and litigation privilege at request of Council].

- 7.1.35 As we had not been provided with evidence to support a revised estimate we commenced our audit of the June 2023 estimate and the accounting models provided by the Council to support this estimate. We received these accounting models on 29 November for the years ending 31 March 2020, 31 March 2021, and 31 March 2022. Evidence to support the models and an appropriate accounting paper was provided in April 2024. Our audit was substantially complete as at December 2024 but at this point the Council withdrew its financial statements as it had reached a negotiated settlement with the Trade Unions. [remaining text redacted under legal advice privilege and litigation privilege at request of Council].

Setting the budget for 2024/25

- 7.1.36 The Council has now set its budget for 2024/25. It has set the budget taking account of its June 2023 estimate of the EP liability but notes “*wider and significant financial pressures and a fundamental structural collapse of the 2023/24 General Fund budget*”.
- 7.1.37 It highlights budget gaps of £164m across 2023/24 and 2024/25, increased future forecast demands on services, particularly in Adults and Children’s Social Care and Housing, and the failure of the savings programme in 2023/24. It also notes the impact of the failed Oracle implementation on financial management (see below) and income collection, and the loss of Private Finance Initiative (PFI) funding. As a result of these reductions it has also highlighted the need to make redundancies.
- 7.1.38 The Council has estimated that this has resulted in a cumulative shortfall of c.£225m in its budget for 2024/25 and applied to the Secretary of State for Exceptional Financial Support (EFS) of £288m and for permission to set a Council Tax of 10%. An additional EFS request has been made for funds to cover redundancy payments. This shortfall in the General Fund has driven the service cuts that have impacted on the people of Birmingham and resulted in difficult decisions having to be made by members. We note that these service cuts are not as a result of the EP liability.
- 7.1.39 The EP liability is part of the EFS application but does not have a direct impact on the General Fund in 2024/25, or the savings having to be made by the Council. It will also be funded via EFS in future years and will not impact on the General Fund (other than through interest costs if the Council chooses to fund the EP liability via borrowing). The EFS approved by the Secretary of State will allow the Council to capitalise its EP liabilities and they will now be funded from either asset sales or borrowing.
- 7.1.40 As such, the EP liability has not impacted the revenue budget set for 2024/25. Nor has it, or is it likely to, impact the Council’s general fund reserves. Rather it will be funded by asset sales or borrowing. If the Council is able to mitigate its EP liabilities this will significantly alter the need for asset sales and for EFS approval for capitalisation of the liabilities. It is unlikely to significantly impact on the revenue savings or council tax increases put in place by the Council.

Setting the 2023/24 budget

- 7.1.41 On 28 February 2023 the Council set its budget for 2023/24. There has been significant commentary on the information available to those setting the budget and whether the budget was unlawful. We consider that the budget for 2023/24 is unlikely to have been unlawful as there was limited evidence, at the time, of the factors which have led to the revision of the provision since then (as they only became clear and evidence supporting them became more reliable from March to June 2023). It is only in June 2023 where a reliable estimate was agreed. We also note that sufficient reserves were available to meet other shortfalls caused by inadequate savings plan and inflation assumptions (as described earlier).
- 7.1.42 Even at the point of writing this report (December 2024) there remain a number of significant assumptions within the June 2023 estimate and the December 2024 settlement strategy.

Members

- 7.1.43 The Council operated its standard budget process during 2022/23 and by early February 2023 it had developed its budget papers for full Council. On 6 February 2023 a meeting was held between the then S151 officer with

Cabinet members to propose a new [paragraph redacted under legal advice privilege and litigation privilege at request of Council]. At this point budget papers had been finalised and printed. The then Chief Executive, then Monitoring Officers and City Solicitor, and the then Interim Director of HR were present. The high-level briefing was focussed on officers explaining the need for a change in the Council's proposed [paragraph redacted under legal advice privilege and litigation privilege at request of Council], as its current approach was taking too long to progress in their opinion. The briefing also set out a range of potential future equal pay liabilities but did not indicate that there was a current liability that needed to be recognised in the budget, nor that the MTFS should be altered.

- 7.1.44 We have discussed the estimated range of potential liabilities with the officers that produced the February 2023 estimate. They have indicated that the estimate was not sufficiently reliable for budgetary purposes and was only produced for the purpose of broadly informing the ongoing equal pay negotiations rather than for budgetary purposes. This is consistent with the additional work undertaken by officers between February to June 2023 to arrive at the June 2023 estimate. We also note, as set out earlier, that even the June 2023 estimate includes a number of assumptions that were subject to change through legal argument and negotiation. We are therefore satisfied that Members were not provided with a reliable estimate on which they could have made a different budgetary decision.
- 7.1.45 We have also considered the nature of the briefing and are satisfied that Members were not provided with a recommendation that additional provisions would need to be made in the budget. We also note that by presenting the paper on 6 February, even if officers were suggesting that current liabilities were understated, it was (in our view) too late for Members to amend the budget without causing significant damage to the Council and its operations.
- 7.1.46 Due to officers' emphasis on the [paragraph redacted under legal advice privilege and litigation privilege at request of Council] at the briefing rather than the existence of any current additional liabilities, the unreliability of the estimate and the relatively late briefing, we consider that it would have been reckless for members to have paused or amended the budget. This is even more so given the continuing legal hearings and the recent comment by the Lead Commissioner that the final EP liability may be significantly lower than the current estimate.
- 7.1.47 We have considered [paragraph redacted under legal advice privilege and litigation privilege at request of Council] separately [remaining text redacted under legal advice privilege and litigation privilege at request of Council]. Given that [paragraph redacted under legal advice privilege and litigation privilege at request of Council] was confirmed relatively late in February 2023, we do not consider that there was sufficient time available to Members to respond to the emerging [paragraph redacted under legal advice privilege and litigation privilege at request of Council] issues and to require an amendment to the budget. We note that the then S151 officer disputes this matter [remaining text redacted under legal advice privilege and litigation privilege at request of Council].
- 7.1.48 We note that officers have commented that in equal pay meeting towards the end of 2022 the nature of the EP claims being received by GMB were shared with senior members. We do not consider that this undermines members assertion that they were not aware of a liability at the time the budget was set. There does, however, appear to have been sufficient awareness of the issues with the MOU and the emergence of [paragraph redacted under legal advice privilege and litigation privilege at request of Council] for Members to challenge whether the MTFS should reflect an increased risk. We note, however, that primary responsibility for making this change to the MTFS rested with the statutory officers and note that no indication was given to Members that this change to the MTFS was needed.
- 7.1.49 In summary, we are satisfied that Members could not have responded to the information they were provided with in February 2023 and that they acted appropriately in allowing the budget to proceed (due to the insufficiently reliable nature of the evidence supporting the new estimate and the late notification of arising equal pay issues).
- 7.1.50 In addition, while we note the concern about the setting of the budget for 2023/24, we also note that by the time the budget was set in February 2023 that the practices in [paragraph redacted under legal advice privilege and litigation privilege at request of Council] had already resulted in a significant increase in the estimated EP liability. Action would have had to have been taken in 2020 or before for the Council to have avoided the liability. It would not therefore be reasonable to hold the current senior member team culpable for the Equal Pay liability up to this time.

Officers

7.1.51 Officers were aware of the emerging risks regarding the [paragraph redacted under legal advice privilege and litigation privilege at request of Council] from early in 2022. However, conflicting information was provided to senior officers up to January 2023 as to whether [paragraph redacted under legal advice privilege and litigation privilege at request of Council] was taking place. Greater clarity was only achieved in late February 2023 and further work was needed to confirm the extent of the practice and the Council's liability.

[Title redacted under legal advice privilege and litigation privilege at request of Council]

7.1.52 We note the following timeline:

- [Text redacted under legal advice privilege and litigation privilege at request of Council]
- [Text redacted under legal advice privilege and litigation privilege at request of Council].
- In August 2022 the [paragraph redacted under legal advice privilege and litigation privilege at request of Council] produced a report on the New Ways of Working, which was an initiative designed to promote flexible working in the [paragraph redacted under legal advice privilege and litigation privilege at request of Council] post-COVID, without creating Equal Pay liabilities. In the report the [paragraph redacted under legal advice privilege and litigation privilege at request of Council] is not occurring, that staff are being monitored, and that overtime is not being given other than as a last resort.
- Despite this reassurance [remaining text redacted under legal advice privilege and litigation privilege at request of Council]. In September 2022 the Chief Executive Officer, working with the then Director of Transformation, brought in a secondee (the Director – Neighbourhoods) from the West Midlands Fire and Rescue Service to review the practices in [paragraph redacted under legal advice privilege and litigation privilege at request of Council] and the services performance.
- [remaining text redacted under legal advice privilege and litigation privilege at request of Council].
- From October to December 2022 we understand that further investigations were made [although we have not been able to obtain these reports]. In December 2022 the Council instigated shadowing of [paragraph redacted under legal advice privilege and litigation privilege at request of Council] by the Director – Neighbourhoods.
- In December 2022 the [paragraph redacted under legal advice privilege and litigation privilege at request of Council] left the Council.
- In January 2023 the Interim Director of People Services commissioned a consultant to [remaining text redacted under legal advice privilege and litigation privilege at request of Council].
- [remaining text redacted under legal advice privilege and litigation privilege at request of Council].
- In late February 2023 [paragraph redacted under legal advice privilege and litigation privilege at request of Council].

7.1.53 [remaining text redacted under legal advice privilege and litigation privilege at request of Council]. While the CEO and other senior leaders continued to investigate these matters they were unable to confirm that [paragraph redacted under legal advice privilege and litigation privilege at request of Council] was occurring until late February 2023. Effectively, they were prevented from taking earlier action by the commentary provided by the [paragraph redacted under legal advice privilege and litigation privilege at request of Council], who had believed that New Ways of Working would be effective in preventing [remaining text redacted under legal advice privilege and litigation privilege at request of Council].

7.1.54 Further to this, the then [paragraph redacted under legal advice privilege and litigation privilege at request of Council] has commented that a restructure of the service was put forward in 2019 as it had been identified that the management structure was not sufficient to manage the service. This was not supported and in the then Directors view the management capacity was not sufficient to manage the service.

[Title redacted under legal advice privilege and litigation privilege at request of Council]

7.1.55 Officers had a reasonable knowledge of the [paragraph redacted under legal advice privilege and litigation privilege at request of Council] risks presented by the *Baker* claims from May 2022. It is apparent that, despite the increased risk following the settlement of the *Jennings* case (which resulted in the TUs advising their members not to accept a settlement under the MOU) and the receipt of the *Baker* claims from GMB in May 2022, [remaining text redacted under legal advice privilege and litigation privilege at request of Council].

- 7.1.56 Approximately 2100 new claims were brought by Trade Union members from May 2022 to April 2023. The bulk of the claims were served by the Employment Tribunal in November 2022. [Remaining text redacted under legal advice privilege and litigation privilege at request of Council]. Given that GMB had withdrawn supporting for the MOU, that some claims had been received, and that there was an awareness that this could result in additional liabilities, this could have been a trigger point for revising the [paragraph redacted under legal advice privilege and litigation privilege at request of Council provision]. This was not recognised by officers as an appropriate trigger and officers continued to provide supporting evidence and defend the level of provision in the draft 2020/21 and 2021/22 financial statements until June 2023.
- 7.1.57 Officers assessed that the impact of the *Baker* claims was minimal and that no change was required in the provision. In particular, officers concluded that the provision should not be changed due to the lack of information on potential claimants. Officers maintained this view until June 2023.
- 7.1.58 In June 2023 the estimated provision was re-estimated to reflect the receipt of the Baker claims and Trade Unions with drawing support from the MOU. The Council's understanding of the claims developed to June 2023 [remaining text redacted under legal advice privilege and litigation privilege at request of Council] and a Weighted Litigation Liability (WLL) methodology was introduced to estimate the Council's EP liability.
- 7.1.59 [Remaining text redacted under legal advice privilege and litigation privilege at request of Council]. There is no evidence that officers did not act in good faith by not recognising additional provisions. Rather, officers were of the view that the claims were defensible and that there was insufficient information to alter the provision. [Remaining text redacted under legal advice privilege and litigation privilege at request of Council], a WLL was produced which resulted in the revised estimate. However, as discussed earlier, even at this point the revised liability remains subject to a number of assumptions and may change following legal argument and negotiation.
- 7.1.60 We note that failure to updated the [paragraph redacted under legal advice privilege and litigation privilege at request of Council] is not the primary cause of the increase in the Council's EP liability and would not by itself have created a negative General Fund position in the unaudited accounts.

Revising the estimate

- 7.1.61 As with Members, we note that the paper presented on 6 February 2023 was based on data that was not produced or sufficiently reliable to support the budget or to impact on the budget setting process. The paper was prepared for the then Interim Director of Human Resources for the purposes of negotiating with the TUs and to demonstrate the potential future impact if a [paragraph redacted under legal advice privilege and litigation privilege at request of Council] was not put in place. [Remaining text redacted under legal advice privilege and litigation privilege at request of Council].
- 7.1.62 [Remaining text redacted under legal advice privilege and litigation privilege at request of Council].
- 7.1.63 The 6 February paper demonstrates a high degree of uncertainty in the estimate, with wide range of possible outcomes. As set out earlier, on occasion, this paper has been used to question the lawfulness of the 2023/24 budget. On the basis of the comments made by the officers who prepared the paper and the changes in legal advice up to September 2023, we do not consider that the paper presents a reliable estimate on which the lawfulness of the budget can be questioned.
- 7.1.64 In summary, given the unreliability of data in the 6 February 2023 paper we consider that officers acted reasonably in not including a provision in the 2023/24 budget. Clarity on the data and legal advice needed to calculate a reliable provision was only achieved between June to September 2023.
- 7.1.65 This said, we do note, that whilst the paper was prepared with good intentions, the timing and nature of the paper was unfortunate in that it has unnecessarily brought into question the lawfulness of the 2023/24 budget setting process.

Medium Term Financial Strategy (MTFS)

- 7.1.66 While we do not consider that there was sufficient surety to include a provision in the budget for the potential additional pay liabilities, we do consider that that officers were sufficiently aware of emerging [paragraph redacted under legal advice privilege and litigation privilege at request of Council] risks in January 2023 to include a commentary in the MTFS. We note that in doing so that this would have increased the profile of potential additional EP liabilities (and therefore the likelihood of claims being made against the Council). While this may have occurred, we consider, on balance, that the MTFS should have included reference to the increasing EP risks.

7.1.67 We have also considered whether there has been detriment to the Council by the increasing EP liabilities not being included in the MTFs. We note that the period from when the budget set (28 February 2023) to the announcement of the revised EP liability (June 2023) is relatively short. In that period officers continued to work with members to agree a [paragraph redacted under legal advice privilege and litigation privilege at request of Council] and officers continued to take action to prevent [paragraph redacted under legal advice privilege and litigation privilege at request of Council]. As such we do not consider that there is significant detriment.

External audit

7.1.68 The audit of the 2020/21 and 2021/22 financial statements took place between May 2022 to March 2023. Work on equal pay in the financial statements continued throughout 2022 on both sets of financial statements audits. Between January to March 2023, the audit team drew their audit work to a conclusion, subject to the outstanding EP discussions. Provisions within those accounts were stated as £150m and £121m respectively.

[Heading redacted under legal advice privilege and litigation privilege at request of Council]

7.1.69 During this period (May 2022 to March 2023), officers considered that there was no requirement to alter provisions following the receipt of the *Baker* claims and the withdrawal of trade union support for the MOU. Officers were challenged on whether this should be treated as an adjusting event after the reporting period but maintained that the provision was materially correct. Analysis and evidence was provided to support their assurances.

7.1.70 Officers initially committed in March 2023 to provide an accounting paper to support their assurances that no change in the provision was needed but this was not provided. Officers did agree to reinstate the contingent liability note. This was intended to address all of the EP matters that had failed to meet the threshold for recognition as a provision (due to the uncertainty involved).

[Heading redacted under legal advice privilege and litigation privilege at request of Council]

7.1.71 Limited information was provided to the audit team on [paragraph redacted under legal advice privilege and litigation privilege at request of Council]. We note that none of the matters set out in paragraph 7.1.52 were shared with the audit team. For example, officers did not share the [remaining text redacted under legal advice privilege and litigation privilege at request of Council], the report or [paragraph redacted under legal advice privilege and litigation privilege at request of Council], the legal advice they had sought on [paragraph redacted under legal advice privilege and litigation privilege at request of Council], nor did they communicate the Council's on-going enquiries into [paragraph redacted under legal advice privilege and litigation privilege at request of Council], [remaining text redacted under legal advice privilege and litigation privilege at request of Council], or that a 'cease and desist' notice had been issued to staff re [paragraph redacted under legal advice privilege and litigation privilege at request of Council]. The audit team was only fully briefed on [paragraph redacted under legal advice privilege and litigation privilege at request of Council] in May 2023.

7.1.72 The Key Audit Partner (2020/21 & 2021/22) on 8 February was briefed on a change in the [paragraph redacted under legal advice privilege and litigation privilege at request of Council] and confirmation was received that no new liabilities had arisen at this point. He subsequently briefed the Key Audit Partner (2022/23 audit).

7.1.73 During March 2023, we met with officers on 1 March and 28 March. Finance officers continued to brief in the same manner and maintained that there was no additional current liability. We note, however, that on 1 March 2023, the interim Director of Human Resources confirmed that additional EP liabilities were currently accruing. Finance officers disagreed with this assessment and maintained that any additional liability was contingent, as they could not produce a reliable estimate.

7.1.74 We therefore agreed that an emphasis of matter (key observation) should be placed on the audit opinion and that officers would:

- enhance the contingent liability note in the financial statements
- add a disclosure on event after reporting period
- enhance disclosures within the Council's Annual Governance Statements
- provide additional management representations that provisions were appropriate
- provide an accounting paper to set out why no EP liability had accrued.

7.1.75 The Audit team met with Finance Officers immediately before the 28 March Audit Committee. Officers reconfirmed the EP provisions were appropriate and that any further liabilities were contingent. Following this

confirmation we reported to the Audit Committee that our audit was reaching completion but was subject to satisfactory completion of outstanding matters, including finalisation of our equal pay audit.

- 7.1.76 At the Audit Committee, officers provided a detailed Letter of Representation confirming that all matters had been disclosed to audit and that the provisions recognised in the financial statements were appropriate.
- 7.1.77 We have discussed these matter with finance officers and they have confirmed that at that point in time they did not consider that there was sufficient certainty over the EP estimate to include a provision in the 2020/21 and 2021/22 accounts. It is only on receipt of the revised legal advice post March 2023 when their view altered.
- 7.1.78 Post the Audit Committee, the Audit team continued to liaise with Finance Officers. On 25 April a further meeting was held and Finance Officers confirmed that there was no change to liabilities. A further meeting was held with the then CEO, the Section 151 officer and the Monitoring Officer and City Solicitor on 28 April. We subsequently wrote to the CEO on the 9 May with regard to the prudence of the Council's EP provision.
- 7.1.79 On 3 May 2023 we met with Government officials from the Department of Levelling Up Housing (DLUHC) and Communities to discuss our increasing concerns regarding EP and Oracle.
- 7.1.80 On 10 May 2023 a workshop was held with key officers and legal representatives from both the Council and ourselves. For the first time, officers fully explained the principles of [paragraph redacted under legal advice privilege and litigation privilege at request of Council]. A revised expectation was provided that the liabilities the Council had provided for in its draft accounts for 2020/21 and 2021/22 were likely to be significantly understated but officers were unable at that time to estimate by how much. Officers outlined that they were building a new model to accurately estimate this impact across various milestones in the past, present and future.
- 7.1.81 On 24 May 2023 we formally raised our concerns with DLUHC regarding the potential understatement of the Council's EP liability.
- 7.1.82 In June 2023, a revised estimate of the EP liability was provided. Officers at this point considered that they had obtained sufficiently reliably 'people' data and legal advice to provide a reliable range estimate This provided a range of £630m to £760m for the Council's EP liability.

Summary

- 7.1.83 In summary, the Council's understanding of its Equal Pay liability developed during 2022 but the commentary by the [paragraph redacted under legal advice privilege and litigation privilege at request of Council] (who had believed in error that New Ways of Working would be effective in [paragraph redacted under legal advice privilege and litigation privilege at request of Council] delayed a full understanding of [paragraph redacted under legal advice privilege and litigation privilege at request of Council] and prevented the Council taking action. The Council had a developing understanding of its EP (including [paragraph redacted under legal advice privilege and litigation privilege at request of Council] liability from January to September 2023.
- 7.1.84 In setting the 2023/24 budget, officers and members acted in good faith as they did not have a reliable basis to estimate the Council's EP liability. It is only by June 2023 that the Council had sufficient understanding to produce what it considered to be a reliable estimate. We are not aware of any information that indicates that officers have not acted in good faith in communicating these matters to us. Rather we consider that officers were struggling to understand the implications of the emerging issues with [paragraph redacted under legal advice privilege and litigation privilege at request of Council].
- 7.1.85 Due to the uncertainty regarding the estimate EP liability the Council would have been reckless in setting a budget including an increased EP liability. It would have had insufficient surety over the estimate and insufficient time to apply for EFS to avoid the impact on the general fund (as it has done in 2024/25). The Council's caution in not introducing an unreliable estimate into its 2023/24 budget setting process was appropriate.
- 7.1.86 We note that the approval of the 2023/24 budget has not been challenged in the courts or quashed by a court. As such, it remains valid and lawful. In public law, decisions taken by public bodies remain valid until ruled otherwise by a court. However, even if an application had been made to set the budget side, we consider that this would have been unlikely due to unreliability of the EP estimate and the availability of reserves to meet other shortfalls (see next section).
- 7.1.87 While we do not consider that the 2023/24 budget was unlawful, we do consider that additional disclosure should have been made in the MTFs of the EP liability.
- 7.1.88 Finally, while we note the concern about the setting of the budget for 2023/24, we also note that by the time the budget was set in February 2023 that the practices in [paragraph redacted under legal advice privilege and

litigation privilege at request of Council] had already resulted in an increased EP liability for the Council. Action would have had to have been taken in 2020 or before for the Council to have avoided the liability. It would not therefore be reasonable to hold the current senior member or officer team culpable for the Equal Pay liability up to this time.

8 Further legal considerations

- 8.1.1 In this section we give further consideration as to whether that budget could have been unlawful for other factors set out earlier in this report.
- 8.1.2 As set out in the previous section we do not consider that the 2023/24 budget was unlawful on the basis of the impact on the Equal Pay provision, due principally to the uncertainties surrounding the estimate when the budget was set in February 2023. We have not repeated this commentary in this section.

Relevant law

- 8.1.3 In local government it is the chief finance (section 151) officer's duty to report on the robustness of estimates and adequacy of reserves, under section 25 of the Local Government Act 2003 (the Act) when an authority is considering its budget requirement:

- *"25 Budget calculations: report on robustness of estimates etc*

(1) Where an authority to which section 31A, 32, 42A or 43 of the Local Government Finance Act 1992 (billing or major precepting authority) or section 85 of the Greater London Authority Act 1999 (Greater London Authority) applies is making calculations in accordance with that section, the chief finance officer of the authority must report to it on the following matters –

(a) the robustness of the estimates made for the purposes of the calculations, and

(b) the adequacy of the proposed financial reserves.

(2) An authority to which a report under this section is made shall have regard to the report when making decisions about the calculations in connection with which it is made."

- 8.1.4 The so-called "balanced budget requirement" arises from the legal duty to set council tax to meet any estimated shortfall in income and reserves required to meet expenditure and to maintain reserves, as determined by the calculations set out in section 31A of the Act.
- 8.1.5 A billing authority is then required to determine whether its relevant basic amount of council tax for any financial year is excessive (section 52ZB(1) of the Act). This determination must be made by reference to the set of principles published and laid before Parliament by the Secretary of State, which identify the relevant increase on the previous year's council tax which shall be considered excessive.
- 8.1.6 The Secretary of State's principles set for 2023/24, as relevant to Birmingham City Council in February 2023, stated that the basic amount of council tax was excessive if it was 5%, or more than 5%, greater than the relevant basic amount of council tax for the previous financial year, (comprising 2% for expenditure on adult social care, and 3% for other expenditure).
- 8.1.7 The Secretary of State's principles may give different definitions of excessive for different local authorities. For example, in the most recent principles applicable to the Council's 2024/25 budget, the definition for Birmingham City Council was set at an overall increase of 10% or more.
- 8.1.8 Where the council tax requirement is determined by the authority to be above the excessive threshold for that financial year, the authority must make arrangements to hold a local referendum to obtain approval to use the excessive council tax rate (section 52ZB(2)). It must also make a separate substitute calculation which produces a council tax requirement which is not excessive (section 52ZF). If the original council tax rate is approved by a majority in the referendum, it will take effect. If it is not approved by a majority in the referendum, then the substitute calculation takes effect.
- 8.1.9 Under section 52ZR of the Act, the Secretary of State may give a direction that the referendum requirement does not apply to an excessive council tax rate where it appears to them that for the relevant financial year, the authority will be unable to discharge its functions in an effective manner, or the authority will be unable to meet its financial obligations. Such a direction will state what the council tax requirement for that financial year shall be, and the authority then must use that figure.
- 8.1.10 As such, had the Council determined in February 2023 that its additional expected expenditure could not prudently have been met by using its reserves, then it could have sought to set a higher council tax requirement to meet this need by either:

- seeking additional provision in the Secretary of State's 2023/24 principles for excessive council tax rates;
- setting an excessive council tax rate and seeking approval via a local referendum; or
- seeking a direction from the Secretary of State under section 52ZR of the Act to enable it to set an excessive council tax rate without the requirement to obtain approval via a referendum.

8.1.11 Under Regulation 4 of the Accounts and Audit Regulations 2015, the chief financial officer (section 151 officer) must determine financial control systems, which must include measures to ensure that the risk of the Council going into a negative reserve position is appropriately managed.

8.1.12 These provisions are supported by the duty on the section 151 officer to report to all the authority's councillors under section 114 of the Act if there is or is likely to be unlawful expenditure (subsection (2)) or if the expenditure for the financial year is likely to exceed the resources available to meet that expenditure (subsection (3)).

Whether the Council's 2023/24 budget can be said to be unlawful

8.1.13 The Council set what it considered to be a balanced budget for 2023/24. The early sections of this report highlight our concerns that the figures underpinning the budget were materially flawed on two bases:

- Savings estimations were not realistic given the lack of implementation plans and buy in from Departments;
- Inflation figures were lower than they should have been.

8.1.14 The issues are whether the savings and inflation figures, had they been realistically assessed would, on the basis of the council tax set, have led to an unbalanced budget. If this had been the case, the Council could, instead of raising Council tax, have placed greater reliance on usable reserves, which were around £668m in February 2023, consisting of £432m of earmarked reserves and £236m unearmarked reserves

8.1.15 Section 31A(2)(c) of the Act provides for an amount of reserves to be deducted from net expenditure in order to assess the council tax requirement, but this amount is, by law, to be set at a level that the Council considers appropriate. The Council's reserve policy stated "*Reserves can only be used on a one-off basis which means that their application does not offer a permanent solution to the requirement to deliver significant reductions in the future level of Council expenditure. Reserves are not to be used to avoid the necessity to make or the failure to deliver ongoing savings*".

8.1.16 Section 31A(2)(c) of the Act provides for an amount of reserves to be deducted from net expenditure in order to assess the council tax requirement, but this amount is, by law, to be set at a level that the Council considers appropriate. The Council's reserve policy stated "*Reserves can only be used on a one-off basis which means that their application does not offer a permanent solution to the requirement to deliver significant reductions in the future level of Council expenditure. Reserves are not to be used to avoid the necessity to make or the failure to deliver ongoing savings*".

8.1.17 The Council set what it considered to be the appropriate level for reserves for 2023/24 at 4.1% of its net spending, which has risen to 5% for the 2024/25 budget and which compares to the generally accepted benchmark of 3-5% within councils.

8.1.18 If the Council had realistically and correctly estimated for savings and inflation in February 2023 it could, have placed greater reliance on usable reserves. The incoming interim s151 reported to July 2023 Cabinet that there was a forecast overspend for the 2023/24 budget year of £87.4m, attributable to demand led pressures and incorrect savings and inflation assumptions, which was within the £668m level of reserves it had at its disposal and, as such provides us with assurance over the lawfulness of the 2023/24 budget. In short, the Council had sufficient reserves to meet the inadequate inflation and savings assumptions.

8.1.19 Alternatively, it could in theory have raised Council tax to the necessary level which would have been above the cap of 5%, by attempting to secure a positive referendum to enable this, or in seeking the consent of Government.

8.1.20 Notwithstanding its likely lawfulness, had the Council accurately assessed its savings and inflation estimates at the time, it would have needed to report an increased risk to its financial sustainability and put in place remedial measures. Whilst these were not done at the time, when the flaws to the Council's savings and inflation plans were identified by the incoming interim s151 officer in her July 2023 report to Cabinet, such remedial measures were instigated. These measures were increased following the s114 report of September 2023 and the

appointment of Commissioners in September 2023. We note that the then Section 151 officer disputes these findings on savings and inflation.

- 8.1.21 Furthermore, in reality, what actually happened is that a balanced budget was set for 2023/24, when viewed solely in terms of the figures as presented to Council. As a decision taken by the Council that has not been challenged in the courts and quashed, it remains valid and lawful. In public law, decisions taken by public bodies remain valid until ruled otherwise by a court. By now it is highly unlikely that such a challenge could be successfully made to the 2023/24 budget due to the time limit that applies to judicial review claims. Such claims must be issued promptly and, in any event within three months, of the relevant decision, which is in place to allow public bodies the administrative certainty to move forward implementing their decisions with confidence. In summary, the decision to set the 2023/24 budget could have been challenged but was not, and therefore remains lawful.
- 8.1.22 Related to the above, we have also considered the impact on the lawfulness of the transactions entered into by the Council pursuant to the budget. We have been advised that, the general principle of administrative certainty referred to above means the public must be able to rely on the decisions of public authorities. As such, the transactions entered into would usually remain valid and enforceable even if there had been a successful legal challenge with a declaration that the budget authorising them had been adopted unlawfully. Furthermore, as the budget remains valid, having not been quashed by the court, there can be no reasonable doubt in our opinion that the decisions and actions made subsequent to the budget should be considered to be lawful and valid.
- 8.1.23 Finally, with regard to Equal Pay (and setting aside the unreliability of the estimate in February 2023), we note that the Council in 2024/24 successfully applied for Extraordinary Financial Support in 2024/25 against its estimated liability. It is reasonable to conclude that similar support would have been made available, if applied for in 2023/24. As such, it is unlikely that the budget set would have changed in any material respect from that set in February 2023.
- 8.1.24 In summary, we do not consider that the budget set by the Council in 2023/24 can be considered to be unlawful.

9 ERP system implementation

9.1.1 In April 2022 the Council introduced a new Enterprise Resource Planning (ERP) System – Oracle Cloud. However, elements of the system did not function adequately. In June 2023 the Cabinet approved a report for expenditure of £46.53 million to fix the urgent issues. This was in addition to the budget of £39.97 million approved in March 2021. It was estimated that £30 million of the additional expenditure would be required in 2023/24. This additional expenditure in 2023-24 was included in the revised financial estimates in the MTFP report of 25 July 2023.

In addition to the risks that the revised costs of the Oracle implementation created for the Council's financial sustainability, we have already referred to the significant risk which the absence of a fully functioning ERP system represents in terms of the Council exercising full control of its financial management, reporting and planning processes. We are also concerned that the capacity within the Council's finance function may not be sufficient to maintain adequate financial management processes during a period of change.

9.1.2 We are aware that internal considerations within the Council identified that the budget for the implementation of Oracle was insufficient as early as July 2020 and that there were estimates that at least double the budgeted amount would be required. We also understand that the Oracle project was RAG-rated as red for a considerable period before it the system went live and that allegedly staff were pressurised to disguise information on overspending on the Oracle project. We have set out further information about the culture of suppressing 'bad news' in Section 7 of this report.

9.1.3 We have reported separately on these matters and will be reporting in 2025 in relation to the Oracle implementation as part of our Value for Money audit. We published Statutory Recommendations (Statutory Recommendations 5 and 7) on 29th September 2023 setting out the actions the Council should take.

10 Conclusions and recommendations

Inflation

- 10.1.1 The Council developed appropriate planning assumptions about funding, income and demand pressures for its 2022/23 and 2023/24 budgets. However, whilst the approach to estimating inflationary pressures in 2022/23 and 2023/24 took into account pay inflation costs, energy cost inflation and specific contractual provisions, the 2022/23 budget assumed an uplift in general inflation of only 2.5% at a time of rising inflation when forecasts were generally higher.
- 10.1.2 For example, the October Office for Budget Responsibility (OBR) forecast for CPI inflation was 4.4% for 2022. General inflation uplifts for the 2023/24 budget were initially included at 8% in the budget preparations but were reduced to 5% prior to its approval. The November 2022 OBR forecast for CPI inflation was 7.4% for 2023, reducing from its forecast peak of 11.1% at the end of 2022/23. The BoE (Bank of England) Monetary Policy Committee projected that the average mid-point CPI inflation projection from Q2 2023 to Q1 2024 was 6.9%.
- 10.1.3 It was therefore reasonable for the Council to review its 8% inflation estimate in the light of these projections. However, in our judgement, the estimates used for general inflation for the 2022/23 and for revising the general inflation allowance in 2023/24 were over-optimistic and this contributed to a significant weakness in determining the budget requirement for both years.
- 10.1.4 The assumptions set out in the Financial Plan were the subject of significant revisions only five months later in the MTFP update report to Cabinet on 25 July 2023. This report added-in a range of budget pressures and revised costs to the 2023/24 budget. One specific change made in this report corrected an assumption in the 2023/24 Financial Plan that Directorates would manage inflationary costs within existing budgets. It also revised the general inflationary component in the 2023/24 budget to 6.2% based on BoE CPI forecasts made in May 2023. It therefore appears that, whilst the narrative in the 2023/24 budget made reference to a general inflationary increase, this increase was excluded from the budget on the basis that directorates would absorb these costs.
- 10.1.5 We have raised this issue with a number of current and former Birmingham City Council officers and reviewed available documentation. This has led us to conclude that there were differences in the way that some senior officers in finance and the rest of the organisation understood that general inflation would be treated. The then Section 151 Officer at the time of the 2023/24 budget preparations considers that the absorption of general inflation within directorate budgets was agreed at CLT (Corporate Leadership Team). Other senior officers at the time consider that it was made clear at the time that such an approach would not have worked and was not agreed.
- 10.1.6 In summary, due to the inadequate assumptions made regarding inflation pressures in the budget and the omission of a general inflation factor, we consider that the approved 2023/24 budget was based on a significant under-estimation of the budget requirement. In reaching this conclusion, we note that the Cabinet report of July 25th 2023 identified and corrected the estimated impact of inflation on the 2023/24 budget.

Key Recommendation 1: *The Council should ensure that the inflation cost estimates used to prepare its annual budget are robust and based on credible sources of analysis and information, including appropriate sensitivity analysis, and are prepared in accordance with professional guidance. The Council should ensure that any proposal for absorbing inflationary pressures in individual service areas is accompanied by credible plans to achieve equivalent savings and that the approach being taken is fully documented and capable of being scrutinized. The Council should require specific assurance on this issue as part of a S25 report accompanying the budget and should take a prudent approach to incorporating inflation risk in its plans.*

Budget planning

- 10.1.7 Engagement during much of the budget planning process appeared to be thorough with regular reports to CLT, external support to help identify savings, briefings for the Council Leader and Cabinet members and a budget working group within the Finance Team. However, engagement with senior members appears to have started later than would normally be the case in that the scale of the deficit facing the Council was not discussed in detail until September 2022 when it became clear that significant savings would be required. We note that the then S151 Officer disputes whether budget preparations were delayed.

- 10.1.8 The budget preparations were led by the then S151 Officer, initially supported by the Deputy S151 Officer (Director of Finance). However, in October 2022 the Director of Finance (Deputy S151 Officer) was asked by the S151 Officer to lead work on the Oracle programme and the Director - Group and Capital Finance (also a Deputy S151 Officer) took over the budget preparation work. This change inevitably interrupted the continuity of budget preparations.
- 10.1.9 Written records show that a Corporate Leadership Team meeting on 3rd May 2022 discussed a presentation of the budget approach for 2023/24, led by the S151 Officer, during which the proposals to contain pressures within directorate budgets were put forward. The note of that meeting records that, in the ensuing discussion it was noted that “CLT require visibility of any increases/unforeseen pressures and planned growth in order to address and agree these collaboratively” and that the wording in the presentation was to be reviewed and reflect the need to manage any residual budget gap across CLT. There is insufficient clarity in the decision-making records of the CLT to confirm whether the budget approach was being approved or amended. Instead, the outcome is ambiguous and the result appears to have been that CLT members generally believed they had not agreed to absorb inflationary pressures whilst the S151 Officer and Deputy S151 Officer believed they could continue with their proposed strategy to rely on directorates to absorb these costs.
- 10.1.10 The consequence was that inflation was modelled and revised during the budget process but it appears that an element of inflation was removed at a late stage in the process, prior to the budget approval, on the basis that it would be absorbed by directorates. However, this decision is not documented. We have not identified specific savings plans for directorates that would have enabled them to meet this commitment.
- 10.1.11 We have therefore concluded that the preparation of the 2023/24 budget was a significant weakness because the following factors:
- The implication of removing an estimate of general inflation from the budget and for this to be treated as an additional saving to be achieved by directorates was not widely understood or agreed in the organisation.
 - The Corporate Leadership Team did not have sufficiently clear governance and decision-recording processes to ensure that the budget was developed within agreed corporate principles.
 - Budget preparations engaged senior members later than normal, impacting on the time available to fully explore ways to close the budget gap. The then Section 151 Officer has told us the significant amount of work needed to prepare proposals by CLT were a cause of this delay and that CLT members were threatened with a s114 notice if proposals were not brought forward.
 - Delays and problems in implementing the ERP project had a knock-on impact on the continuity of budget preparations.

Key Recommendation 2: *The Council should produce and adhere to a budget planning timetable and guidelines which set out core principles agreed by the Corporate Leadership Team, provide for effective engagement across the organisation, and allow Members to exercise their executive and scrutiny roles effectively in shaping, scrutinising and challenging the budget before its formal consideration by the Council.*

Savings

- 10.1.12 Through our work we have identified a significant weakness in terms of the cultural barriers which have impacted on the Council's ability to deliver savings targets. They include examples of corporately approved savings targets which did not appear to have buy-in at service level (paragraph 2.1.28); under-achievement of savings targets and mis-reporting of the achievement of savings in the MTFP (paragraph 2.1.30); savings plans which were not sufficiently robust (paragraph 2.1.22); and insufficient action taken where savings were not on track (paragraph 2.1.24 and 2.1.27).
- 10.1.13 The programme management processes applied to monitor the savings programme was robust and required detailed reports which used RAG (Red-Amber-Green) ratings to monitor progress and delivery. Progress was reported to CLT and CDOG (Corporate Oversight Delivery Group). However, the follow-through in terms of action to correct under-achievement of savings was weak (paragraph 2.1.30). Where savings were not being achieved, service areas were initially asked to provide alternative savings to mitigate the situation. Where the savings were delayed, a contribution from the budget smoothing reserve was applied to the saving and in the case of issues relating to the rising cost of living, a contribution from the Finance Resilience Reserve was applied (paragraph 2.1.30). The then Section 151 Officer has told us that this reserve was only used when savings were still deliverable but there was a timing issue, rather than to “backfill gaps.” Subsequent reporting of savings

performance in July 2023 identified that £9.454 million of savings from 2022/23 were undelivered. The estimate of 90% achievement of savings reported in the 2023 Financial Plan therefore over-estimated the actual position by the third quarter of 2022/23 indicating that the challenge and assurance in progressing savings was ineffective.

- 10.1.14 Additional savings proposals for the 2023/24 budget were developed with the help of external consultants between September and December 2022. These proposals were not shared with finance officers working to support directorates until late December 2022, which was very late in the budget process. Those finance officers had specific and detailed insights about and responsibilities in relation to each directorate's budget and were immediately able to identify inaccuracies, double-counting and flaws in some of the proposals. For example, the application of a vacancy savings across the board was one such issue because it included posts from which vacancy savings could not be extracted (such as traded services and grant-funded posts). It is alleged that when these issues were reported to a senior officer, the concerns were dismissed because a balanced budget had already been achieved and the original reports with errors within them remained as part of the budget savings which were eventually approved. (paragraph 2.1.28) Many of these unachievable savings had to be reduced or removed as part of the MTFP update to Cabinet in July 2023.
- 10.1.15 In a further example (paragraph 2.1.27), it is alleged that officers were pressurized into making changes by a senior officer to soften a report which set out issues and anticipated overspends in relation to the Oracle implementation. The report was due to be considered by Cabinet members. We have commented further in Section 9.8 of this report about the prevailing culture in the Council.
- 10.1.16 Due to the issues with the Council's Oracle implementation it is not possible to conclude how many of the savings plans were individually or cumulatively delivered. However, given the additional estimated £80 million use of reserves referred to in section 5.1.3 of this report and the estimate of £9.2 million of undelivered savings in 2022/23 in the 25 July 2023 report on the MTFP, which came on top of significant demand pressures, it is clear that the approach across many parts of the organisation to planning and delivering savings was inadequate and was not sufficiently robust, credible or deliverable in the timescales envisaged. There is evidence of insufficient involvement and buy-in to savings plans across the organization. A lack of clarity and consistency in reporting savings achievement (paragraphs 2.1.27 & 2.1.29) meant that the Council's plans were not always transparent, capable of being scrutinised and publicly accountable. In paragraph 2.1.23 of this report we referred to the situation in the 2022/23 savings programme where over 60% of the planned savings were the responsibility of the then Section 151 Officer. This resulted in a conflict of interest and a significant flaw in the governance arrangements. In our opinion, because of these factors, the governance arrangement for the development and delivery of the savings plans for 2022/23 and preparation of savings plans for 2023/24 were a significant weakness in the Council's arrangements.

Key Recommendation 3: *The Council should change its approach to planning and delivering savings to i) ensure that oversight and accountability within the management structure and in reporting to Members is transparent and effective in holding responsible officers to account; ii) ensure that reporting of savings achieved is accurate and does not include the use of reserves to disguise unachieved savings; iii) address cultural challenges including securing buy-in and challenging resistance to savings requirements. The Council should take urgent action to ascertain the current status of savings which were not delivered in 2022/23 and in 2023/24 and to ensure that timely delivery of savings plans is achieved.*

Reporting

- 10.1.17 We have noted in the report that the delays in implementing the ERP financial system have contributed to increased uncertainty in that the Council has not been able to report an outturn position for 2022/23 or 2023/24. We published Statutory Recommendations (**Statutory Recommendations 5, 6 and 7**) on 29th September 2023 setting out the actions that the Council should take. We further reported to the Audit Committee in January 2024 on the actions needed with regard to the ERP implementation.

Capital programme and borrowing

- 10.1.18 The Council planned for continued high levels of debt when setting its budget and approved borrowing plans which would increase its indebtedness. We have noted that the Council changed its policy from using a maximum period of 40 years to a maximum of 50 years in the 2023/24 Financial Plan but did not provide a justification for this change. We also note that its approach to MRP did not fully follow the statutory guidance, particularly in respect of the treatment of capitalised loans.

- 10.1.19 The impact of increasing borrowing will impact on the revenue budget through MRP and the Council's extensive capital plans will not be affordable given the financial sustainability challenges it faces. We note that the Council's 2024/25 Budget approved on 5 March 2024 sets out plans for the capital programme and strategy which reduce capital spending with the intention of bringing General Fund borrowing to nil by the end of 2026/27.

Reserves

- 10.1.20 The Council does not have the reserves required to meet its medium to long term liabilities and continue to operate in the way it has been doing. This is due to a mixture of factors including poor budget management and savings delivery, the failure of its ERP system, equal pay, and demand led pressures. We published a Statutory Recommendation (**Statutory Recommendation 10**) on 29th September 2023 setting out the action the Council should take.
- 10.1.21 As reported by the S151 in the 2023/24 budget, the Council will not be able to continue to provide the range of services, engage in the range of activities or own and operate the range of assets it currently does until the shortfall in reserves is resolved. We note that the Council's 2024/25 Budget approved on 5 March 2024 set out new and improved reserves and balances policies and forecast a closing balance of £674 million of reserves at the end of 2023/24 before the impact of provisions for potential equal pay liabilities. We note that the latest Council report (14 January 2025) indicates a reserves position of £809.9m due to the increase in earmarked reserves.
- 10.1.22 Of the forecast reserves balance (£809.9m) at 14 January 2025 the available reserves are: General reserves £156.2m, Other corporate reserves £35.7m, and earmarked reserves £132m. A total of £323.9m. We note that these outturn figures do not include the Council's alleged EP liability (which the Council has estimated to be in excess of £650m but which may be mitigated by the Council's proposed settlement and mitigation schemes).

Section 25 reports

- 10.1.23 Section 25 of the Local Government Act 2003 requires the Council's chief financial officer (Section 151 Officer) to report on the robustness of the estimates made for the purposes of its budget calculations and the adequacy of proposed financial reserves. The Council must have regard to this report when agreeing its annual budget and precept. The Financial Plans for 2022 and 2023 both included a Section 25 report in which the Section 151 Officer provided assurance that the assumptions under-pinning the budget were robust and the level of reserves proposed was adequate.
- 10.1.24 On both occasions we consider that the absence of appropriate inflationary assumptions and savings plans resulted in Section 25 report assurances about the robustness of estimates and the level of reserves which could not be relied on and was a significant weakness in the Council's budget. We also note that whilst the uncertainty over potential equal pay liabilities and the additional costs relating to the Oracle implementation were live issues at the time the 2023/24 budget was approved, no reference to these matters or the financial risks they represented was included in the Section 25 report.
- 10.1.25 Whilst there is no prescribed format for a Section 25 report, best practice would suggest that it would include clear evidence/reasoning of the basis on which its assurances are given and make explicit reference to the way in which any known significant financial issues have been taken into account in the judgements made and assurances given. This would include references to known issues which are understood to have significant financial implications but for which a final estimate of cost or liability has not yet been finalised. We acknowledge that the Council's consideration of its 2024/25 Budget included a full report under Section 25 of the Local Government Act 2003.

Equal pay

- 10.1.26 The conclusions we have reached on Equal Pay are based on consideration of more material than the report itself mentions. We note that the Council has, reasonably, applied legal advice privilege (LAP) and litigation privilege (LP) to aspects of our reporting. Due to this we have redacted some aspects of our report for reasons of legal privilege, without prejudice privilege, and confidentiality/commercial sensitivity, in order not to risk further damaging the Council's legal and financial position on Equal Pay.
- 10.1.27 The Council's Equal Pay liability has arisen due to inadequate governance [remaining text redacted under legal advice privilege and litigation privilege at request of Council] and due to poor management control of [paragraph

redacted under legal advice privilege and litigation privilege at request of Council]. The Equal Pay Liability, as estimated by the Council, was mainly avoidable and has created a significant and unnecessary cost for the people of Birmingham.

- 10.1.28 With regard to [remaining text redacted under legal advice privilege and litigation privilege at request of Council], These risks were known to the Council during the [paragraph redacted under legal advice privilege and litigation privilege at request of Council]. To mitigate these risks, a Memorandum of Understanding (MOU) was agreed between the Council and its Trade Unions for a settlement scheme for trade union members. Council provisions up to June 2023 were based on the successful implementation of the MOU.
- 10.1.29 The MOU did not include non trade union members and claims have been received from other claimants and their representatives. In November 2021 Cabinet authorised acceptance of counter proposals from the legal representatives of a group of claimants who were pursuing a class action for equal pay against the Council at that time ([remaining text redacted under legal advice privilege and litigation privilege at request of Council]). Following Cabinet's decision, certain Trade Unions withdrew their support from the MOU and in [remaining text redacted under legal advice privilege and litigation privilege at request of Council]
- 10.1.30 In summary, the Council's EP liability with regard to [paragraph redacted under legal advice privilege and litigation privilege at request of Council] arose due to the inappropriate governance and oversight of [remaining text redacted under legal advice privilege and litigation privilege at request of Council] and has recently increased due to the trade unions advising their members not to settle under the MOU (May 2022) [remaining text redacted under legal advice privilege and litigation privilege at request of Council]. We will return to explain this conclusion more fully in our planned Equal Pay Governance report.
- 10.1.31 With regard to [paragraph redacted under legal advice privilege and litigation privilege at request of Council]. This creates an equal pay liability if it was not offered to other workers in different service areas.
- 10.1.32 The Council initially allowed [Paragraph redacted under legal advice privilege and litigation privilege at request of Council] during COVID 19. This is not unreasonable. More recently, allegations have been made that the services impacted were [paragraph redacted under legal advice privilege and litigation privilege at request of Council] post COVID 19. [remaining text redacted under legal advice privilege and litigation privilege at request of Council].
- 10.1.33 [remaining text redacted under legal advice privilege and litigation privilege at request of Council].
- 10.1.34 Again, we will provide further commentary of the Council's actions, that have led to this conclusion, in our forthcoming Equal Pay Governance report.

Estimated Equal Pay liability

- 10.1.35 In June 2023 the Council revised its estimate of its EP liability from £153m (2020/21 draft financial statements) and £121m (2021/22 draft financial statements) to a range estimate of £650m to £760m. The Council considers that the estimate was prepared in accordance with IAS 37.
- 10.1.36 [remaining text redacted under legal advice privilege and litigation privilege at request of Council].
- 10.1.37 The EP is a key estimate for the Council and by its nature is judgemental. We have regularly discussed this with officers and between September 2023 to December 2024 they have reconfirmed that this remained the most appropriate estimate of the Council's EP liability. We note that in December 2024 the Council announced a settlement with the Trade Unions. This settlement is subject to agreeing the terms of a framework agreement, which is currently being negotiated. We were provided with the Council's mitigation strategy for the potential equal pay liability not covered by the settlement with the Trade Unions on 10 January 2025.. We have not yet been provided with a revised estimate for this liability.

Setting the 2023/24 budget

- 10.1.38 On 28 February 2023 the Council set its budget for 2023/24. There has been significant commentary on the information available to those setting the budget and whether the budget was lawful. We consider that the budget for 2023/24 was lawful as a sufficient and reliable EP estimate of the liability was not available to officers and members until June 2023 to change the estimate and sufficient reserves were available to meet other shortfalls caused by inadequate savings plans and inflation assumptions.
- 10.1.39 The Council operated its standard budget process during 2022/23 and by early February 2023 it had developed its budget papers for full Council. At this point officers were aware of the emerging risks regarding the [paragraph redacted under legal advice privilege and litigation privilege at request of Council] from Autumn 2022. However,

as at February 2023, officers considered that the EP estimate was based on unreliable data and have confirmed that the estimate was not produced to support or impact on the budget setting process [remaining text redacted under legal advice privilege and litigation privilege at request of Council]. Due to the unreliability of the estimate we consider that officers' decision not to include a revised EP provision in the budget to be appropriate.

- 10.1.40 While we do not consider that there was sufficient surety to include a provision in the budget for the potential additional pay liabilities, we do consider that that officers were sufficiently aware of emerging [paragraph redacted under legal advice privilege and litigation privilege at request of Council] risks in January 2023 to include a commentary in the MTFS.
- 10.1.41 On 6 February 2023 a meeting was held between the then Section 151 officer with Cabinet members to confirm the budget. At this point budget papers had been finalised and printed. A high-level briefing was provided to members on the need to introduce a revised [paragraph redacted under legal advice privilege and litigation privilege at request of Council] to avoid future EP liabilities. The briefing set out a range of potential future equal pay liabilities but did not indicate that there was a current liability that needed to be recognised in the budget, nor that the MTFS should be altered. We are satisfied that Members were not provided with information that would have led them to alter the 2023/24 budget and that they acted reasonably in letting the budget proceed. We note that the then S151 officer disputes this matter and considers that members were aware of an Equal Pay liability should [paragraph redacted under legal advice privilege and litigation privilege at request of Council] be confirmed.
- 10.1.42 By January 2023, the audit of the 2020/21 and 2021/22 accounts was substantially complete. At this point, officers had confirmed that there was no requirement to alter provisions (following the receipt of the *Baker* claims and the withdrawal of the TUs from the MOU). Officers had agreed to reinstate the contingent liability note. It is also worth noting that officers had not communicated to external audit [remaining text redacted under legal advice privilege and litigation privilege at request of Council]. The Key Audit Partner on 8 February was briefed on a change in the [paragraph redacted under legal advice privilege and litigation privilege at request of Council] and confirmation was received that no new liabilities had arisen at this point.
- 10.1.43 EP briefings to external audit continued in this manner (confirming no change to EP provisions) from March 2023 until May 2023. On 10 May 2023 a workshop was held with key officers and legal representatives. Officers outlined that they were building a new model to accurately estimate the Council's EP liability. In June 2023, a revised estimate of the EP provision was provided. This was confirmed as accurate by the Council in September 2023.
- 10.1.44 In summary, the Council had a developing understanding of its EP liability throughout 2022 and from January to June 2023. We consider that [remaining text redacted under legal advice privilege and litigation privilege at request of Council].
- 10.1.45 In setting the 2023/24 budget, officers and members acted in good faith as they did not have a reliable basis to estimate the Council's EP liability. It is only by June 2023 that the Council considered it had sufficient understanding to produce a reliable estimate.
- 10.1.46 Due to the uncertainty regarding the estimated EP liability, the Council would have been reckless in setting a budget including an increased EP liability. It would have had insufficient surety over the estimate and insufficient time to apply for EFS to avoid the impact on the general fund (as it has done in 2024/25). The Council's caution in not introducing an unreliable estimate into its 2023/24 budget setting process was appropriate.
- 10.1.47 We note that the approval of the 2023/24 budget has not been challenged in the courts and quashed. As such, it remains valid and lawful. In public law, decisions taken by public bodies remain valid until ruled otherwise by a court. However, even if an application had been made to set the budget aside, we consider that this would have been unlikely due to unreliability of the EP estimate and the availability of reserves to meet other shortfalls (see next section).
- 10.1.48 While we do not consider that the 2023/24 budget was unlawful, we do consider that additional disclosure should have been made in the MTFS of the EP liability.
- 10.1.49 We have therefore made two further key recommendations about the approach the Council should take to address significant weaknesses in reporting of significant estimates and matters which are uncertain.

Key Recommendation 4: *The Council should ensure that emerging risks are reported clearly to members and that there is a culture of openness and transparency in the reporting of matters that could impact the Council's*

financial sustainability. Matters that do not impact on the current budget should be clearly captured and reported in the MTFs.

Key recommendation 5: *The information provided to members in February 2023 has resulted in queries being raised with regard to the legality of the 2023/24 budget. In providing information to members, officers should be clear as to: the purpose of the information, the reliability of the information, and the actions that are needed. This is especially the case where information could impact on budget preparations.*

Setting the budget for 2024/25

- 10.1.50 The Council has now set its budget for 2024/25. It has set the budget taking account of its September 2023 estimate of the EP liability but notes “wider and significant financial pressures and a fundamental structural collapse of the 2023/24 General Fund budget”. It highlights budget gaps of £164m across 2023/24 and 2024/25, increased future forecast demands on services, particularly in Adults and Children’s Social Care and Housing, and the failure of the savings programme in 2023/24. It also notes the impact of the failed Oracle implementation on financial management (see below) and income collection, and the loss of Private Finance Initiative (PFI) funding. As a result of these reductions it has also highlighted the need to make redundancies.
- 10.1.51 The Council has estimated that this has resulted in a cumulative shortfall of c.£225m in its budget for 2024/25 and applied to the Secretary of State for Exceptional Financial Support (EFS) of £288m and for permission to set a Council Tax of 10%. An additional EFS request has been made for funds to cover redundancy payments. This shortfall in the General Fund has driven the service cuts that have impacted on the people of Birmingham and resulted in difficult decisions having to be made by members. We note that these service cuts are not as a result of the EP liability.
- 10.1.52 The EP liability is part of the EFS application but does not have a direct impact on the General Fund in 2024/25, or the savings having to be made by the Council. It will also be funded via EFS in future years and will not impact on the General Fund (other than through interest costs if the Council chooses to fund the EP liability via borrowing). The EFS approved by the Secretary of State will allow the Council to capitalise its EP liabilities and they will now be funded from either asset sales or borrowing.

Other legal considerations

- 10.1.53 The Council set what it considered to be a balanced budget for 2023/24. The early sections of this report highlight our concerns that the figures underpinning the budget were materially flawed on two bases:
- Savings estimations were not realistic given the lack of implementation plans and buy in from Departments;
 - Inflation figures were lower than they should have been.
- 10.1.54 The issues are whether the savings and inflation figures, had they been realistically assessed would, on the basis of the council tax set, have led to an unbalanced budget. We have considered these matters and concluded that, if the Council had realistically and correctly estimated for savings and inflation in February 2023, it could have placed greater reliance on usable reserves.
- 10.1.55 We note that the incoming interim s151 reported to July 2023 Cabinet that there was a forecast overspend for the 2023/24 budget year of £87.4m, attributable to savings and inflation assumptions, which is within the £668m level of reserves it had at its disposal and, as such provides us with assurance over the lawfulness of the 2023/24 budget. In short, at the time, the Council had sufficient reserves to meet the inadequate inflation and savings assumptions but has since taken prudent action in its 2024/25 budget to rebuild these reserves to reasonable levels.
- 10.1.56 In summary, taking account of EP, savings plans, inflation assumptions and the projected outturn for 2023/24, we do not consider that the budget set by the Council in 2023/24 can be considered to be unlawful.

Culture and Governance

- 10.1.57 In this report we have identified significant weaknesses in the Council’s approach to setting the 2022/23 and 2023/24 budget which include the approach to planning and delivering savings, the assumptions underpinning the budget, the level of reserves and borrowing and the quality of Section 25 reports. We have noted the specific financial challenges in terms of the Council’s equal pay liabilities and Oracle implementation challenges which

were emerging during 2022/23 and which undoubtedly took attention and focus away from the budget preparations for 2023/24. Our Statutory Recommendations 1,2,3,5,7 and 12 made on 29 September 2023 addressed these issues.

- 10.1.58 In addition to the recommendations we have already made, our work has gained insights into some of the cultural and governance challenges the Council faces. When preparing this report we reviewed a wide range of documents and sought information from some officers and members through meetings and written questions in order to gain insights into the developments which have impacted on the Council's financial sustainability. As a result, we have identified concerns about alleged behaviours within the Council and aspects of the Council's culture which in themselves are a significant weakness and have impacted on the Council's financial sustainability. These concerns are set out below.
- 10.1.59 Some issues of concern were identified in our conclusions on savings and they include instances of errors in the calculation of savings being deliberately ignored (paragraph 2.1.28), bad news about performance being softened or suppressed (paragraphs 2.1.27 and 2.1.30), and governance arrangements which failed to recognize a potential conflict of interest (paragraph 2.1.23). We have also identified concerns about resistance to change and lack of support for corporate priorities in some parts of the organisation which are sometimes manifested in the form of weak compliance and accountability (paragraph 2.1.22).
- 10.1.60 We were also informed by more than one source that much of the decision-making around the final budget report was shaped in meetings which only involved the then Leader and the then Section 151 Officer. According to one CLT (Corporate Leadership Team) member: "There was a very clear budget strategy that was agreed between the then Section 151 Officer and the then Leader. It was very clear the then Leader had a particular view about how the budget would be managed and presented. It wasn't done in a strategic way. And we knew there were budget savings to be made but there was very little direction or thought about how the Corporate Leadership Team should be both challenged but also enabled and supported to try and identify those savings." It has also been suggested by other sources that engagement with members started later in the year than normal, reducing the time available to challenge and shape the budget. The then Leader has told us that he refutes the allegations about having a particular view about how the budget would be managed and presented and about decision-making being shaped in meetings between him and the then Section 151 Officer. He also told us that there were meetings between Cabinet and Strategic Directors about the budget and presentations to the Labour Group. We have no reason to doubt that political consultation meetings were held in the budget preparation, although no formal records of these meetings have been provided to us. We do, nevertheless, conclude, on balance, that there was not sufficiently effective and collaborative political and managerial engagement and influence in the approach taken to planning the budget and that there was, at the very least, a perception created that then then Leader and then Section 151 Officer were excluding other senior officers and members from deliberations regarding the budget.
- 10.1.61 In our consideration of the assumptions under-pinning the budget we have already drawn attention to absence of clarity between the CLT and the Section 151 Officer in respect of the treatment of general inflation pressures. Whilst the then Section 151 Officer considers that there was clarity over the arrangements being followed, we were informed about the sense of shock among some members of the CLT when the budget report was published and approved and the implications of the treatment of inflation were fully understood. One CLT member commented: "I don't recall any conversation that was untoward or different from what we normally do. I don't remember anybody saying to me 'By the way, you're going to have to sort out your own inflation next year.' That's not something I was familiar with so, when this came out it was like 'What? How did we miss that?'."
- 10.1.62 The Council's officer leadership in relation to the effective planning and use of resources lacked the coherence and collegiate qualities to ensure the wider organization understood and responded to significant financial challenges. In paragraph 10.1.3 we conclude that the proposed treatment of inflation in the budget process was ambiguous and not broadly understood, agreed or owned at the top of the organisation. The Section 151 Officer's efforts were focused on highlighting positive progress and good news at the expense of real and significant risks to the Council's financial sustainability. There was too much emphasis on the achievement of a balanced four-year MTFP and the Council's three-star CIPFA rating and too little emphasis on the known risks to the Council's financial sustainability. This was characterised by one senior officer as follows: "The kind of fail-safe every step of the way was 'Oh it's ok, it's not a problem. The process has been validated by CIPFA because we've got a three-star rating.'"
- 10.1.63 These cultural and governance weaknesses contributed significantly to the difficulties the Council now faces. They will continue to undermine the Council's ability to recover from its current position if they are not addressed. The scope of this review has precluded examination of the level of compliance with corporate rules and

procedures throughout the Council but given our findings, we recommend that further work is undertaken to provide assurance that processes comply with statutory, constitutional and professional requirements.

10.1.64 We have therefore made two further key recommendations about the approach the Council should take to address significant weaknesses in its culture and governance.

Key Recommendation 6: *The Council should recognise the specific cultural challenges it faces in terms of:*

- *The suppression of 'bad news' and the reluctance to deal with difficult challenges*
- *Silo behaviours in some parts of the organisation which undermine corporate coherence and strategy*
- *The need to reinforce values which strike an appropriate balance between openness, trust, mutual respect, accountability and constructive challenge.*

Key Recommendation 7: *The Council should commit to a long-term programme of organisational development and change which re-sets cultural norms and expectations, reinforces ethical values and behaviours, strengthens accountability, encourages people to raise concerns and values them for doing so, recognises and respects key statutory and professional roles in the organisation which enable the council to function effectively and lawfully. This programme should apply to and engage paid staff and all elected members.*

Progress in recent months

10.1.65 The Council approved its 2024/25 Budget on 5 March 2024. The process is significantly improved and more transparent than in the previous 2 years. We have acknowledged a number of aspects of the revised approach it has agreed in this report because of their direct relevance to significant weaknesses we identified in the Council's approach in 2022/23 and 2023/24.

10.1.66 The Council has applied for and received Exceptional Financial Support from the Department of Levelling Up, Housing and Communities of £1.255 billion to enable it to set a balanced budget, cover its Equal Pay liabilities and meet redundancy costs. We note the progress the Council is making in terms of its re-basing of the General Fund revenue budget and the development of a new approach to savings. We also note the changes to the Council's capital programme, the improved reserves and balances policies and forecasting and the improved Section 25 reporting in the 2024/25 budget.

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