Key issues identified in Audit Findings 2017/18

Statutory Recommendations

1 Purpose and Attached Documents

1.1 Cllr O'Reilly, Cabinet Member for Finance and Resources, and Clive Heaphy, Corporate Director Finance and Governance, have been asked to attend your meeting to respond to the Statutory Recommendations from the auditors.

1.2 Attached to this paper are:

- The Audit Findings, including the statutory recommendations, for year ending 31 March 2018; issued 30 July 2018.
- Letter of 30 July from the City Council to Grant Thornton, provided in connection with the audit of the financial statements of Birmingham City Council and its subsidiary undertakings for the year ended 31 March 2018

1.3 The Annual Statement of Accounts is available from the Scrutiny Office on request.

1.4 This cover note sets out a short summary and some suggested questions. It does not set out a definitive set of questions to be asked but suggests a range of questions that could be asked, and to assist members to think through other possible questions that may arise from the key sections of the audit letter.

2 The Recommendations

2.1 On 11th September, the City Council is to vote on whether or not to accept the recommendations put forward by the auditors, and to agree on what action is to be taken in response.

Potential questions:

a. Will you be advising the Council to accept the recommendations?

b. Is there anything in the auditor's report that you would dispute?

Recommendation 1 – Mitigations

2.2 The recommendation of the auditor is to

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

2.3 A similar recommendation was made last year, but the report states that "little progress has been made". The period 3 financial report for 2018/19 notes that:

"For 2018/19, the Council has adopted a financial framework that emphasises Cabinet Member/Chief Officer accountable for the delivery of their services within the resources allocated with no recourse to reserves and Directorates are expected to identify further strategic mitigations to recover the budget position"

Potential questions:

c. The report states that "Delivery of savings has proved an enduring problem" – do you understand the reasons for this (e.g. is it about culture, process or something else?)?

d. Under-delivery of savings is continuing this financial year (as evidenced in Period 3) – what action is being taken to stop this? (the auditor's report refers to strengthening monitoring processes and embedding accountability for delivery of savings more strongly within Directorates – could you expand on this?)

e. The Period 3 monitoring report shows that mitigations still not in place – when do you expect this to be done?

Recommendation 2 – medium term financial planning

2.4 With regards to medium term financial planning, the recommendation is:

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

2.5 The Resources O&S Committee has agreed to undertake an inquiry into long term financial planning in the council, looking to learn from best practice.

Potential questions:

f. Which councils do this well and what can we learn from them?

g. What is your analysis of why medium term financial planning has not worked here in the past?

Recommendation 3 – adequate reserves

2.6 The recommendation of the auditor is to

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

2.7 This Committee previously agreed that the matter of reserves sits with the Audit Committee; however the report does raise some issues for scrutiny, particularly with regards to the risks relating to equal pay and Commonwealth Games.

Potential questions:

h. When will we have greater clarity on the risks to the Council relating to the CWG?

Recommendation 4 – Financial reporting

2.8 The auditor notes that the use of reserves in-year is not explicitly recorded in monitoring reports. The recommendation is to:

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

Potential questions:

i. What changes will be made to financial reporting in light of the auditor's recommendation and when?

Recommendations 5 – Governance Issues

2.9 The auditor recommended the need to:

"Report governance failures and emerging issues promptly and clearly to Members and local citizens"

2.10 As governance matters properly sit with the Co-ordinating O&S Committee, these have been referred to the Chair, Cllr John Cotton.

Recommendation 6 – Subsidiary Bodies

2.11 The recommendation of the auditor is to

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

2.12 The Resources O&S Committee has agreed to look at Acivico specifically at a later meeting.

Potential questions:

j. How will the activities of subsidiary bodies be made more transparent?

k. Are any governance changes required with regards to subsidiary bodies?

Recommendations 7 – Place Directorate

2.13 The auditor considered the particular case of the Place Directorate and recommended that the Council:

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

Potential Questions:

l. What checks and balances are in place to ensure that the financial challenges facing the Place Directorate are not repeated?

m. What action is in place to ensure that the failing in financial governance identified will not be repeated?

Contact officers:

Emma Williamson, Head of Scrutiny Services, 0121 464 6870

Jayne Power, Scrutiny Officer, 0121 303 4810

Grant Thornton

Audit Findings

Year ending 31 March 2018

Birmingham City Council

30 July 2018

Contents

Your key Grant Thornton team members are:

Phil Jones
Director
T: 0121 232 5232
E: phil.w.jones@uk.gt.com

Laura Hinsley
Senior Manager
T: 0121 232 5235
E: laura.e.hinsley@uk.gt.com

Tess Barker-Philips
Assistant Manager
T: 0121 232 5428
E: tess.s.barker-Philips@uk.gt.com

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 expressing our opinion on the financial statements. Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify control weaknesses, we will report these to you. In consequence, our work cannot be relied upon to disclose all defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. 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.

Headlines

This table summarises the key issues arising from the statutory audit of Birmingham City Council ('the Council') and the preparation of the group and Council's financial statements for the year ended 31 March 2018 for those charged with governance.

Financial Statements	Under the International Standards of Auditing (UK) (ISAs), we are required to report whether, in our opinion: • the group and Council's financial statements give a true and fair view of the group and Council's financial position and of the group and Council's expenditure and income for the year, and • have been properly prepared in accordance with the CIPFA/LASAAC code of practice on local authority accounting and prepared in accordance with the Local Audit and Accountability Act 2014. We are also required to report whether other information published together with the audited financial statements (including the Statement of Accounts, Annual Governance Statement (AGS) and Narrative Report), is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.	Our audit work was completed on site during June and July. Our findings are summarised on pages 4 to 24. We have identified four adjustments to the financial statements that have resulted in a £97m adjustment to Total Comprehensive Income. The audit adjustment is detailed in Appendix C. We have also raised recommendations for management as a result of our audit work in Appendix A. Our follow up of recommendations from the prior year's audit are detailed in Appendix B. Subject to receipt of the management representation letter, we anticipate issuing an unqualified audit opinion following the Audit Committee meeting on 30 July 2018, as detailed in Appendix E. We have concluded that the other information published with the financial statements, which includes the Statement of Accounts, AGS and Narrative Report, are consistent with our knowledge of your organisation and with the financial statements we have audited. Although we are not proposing to report any AGS issues in our audit report, we bring the following point to your attention: • Management of schools has not been included as a significant governance issue in this year's AGS due to it being removed from the Council's risk register in response to the enhanced governance arrangements. Although we are not challenging this assessment we are proposing to qualify our value for money conclusion due to ongoing governance issues identified by internal audit's reviews of schools.
Value for Money arrangements	Under the National Audit Office (NAO) Code of Audit Practice ('the Code'), we are required to report whether, in our opinion: • the Council has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources ('the value for money (VFM) conclusion')	We have completed our risk based review of the Council's value for money arrangements. We have concluded that Birmingham City Council does not have proper arrangements to secure economy, efficiency and effectiveness in its use of resources. We therefore anticipate issuing an adverse value for money conclusion, as detailed in Appendix E. Our findings are summarised on pages 26 to 33.
Statutory duties	The Local Audit and Accountability Act 2014 ('the Act') also requires us to: • report to you if we have applied any of the additional powers and duties ascribed to us under the Act; and • certify the closure of the audit	We have issued our Statutory Recommendation under section 24 of the Local Audit and Accountability Act 2014. Further details are included on pages 5 to 11 of this report. We do not expect to be able to certify the conclusion of the audit until: • we have completed our consideration of the one remaining objection brought to our attention in 2016/17 under Section 27 of the Local Audit and Accountability Act 2014; and • we have completed the necessary work to issue our Whole of Government Accounts (WGA) Component Assurance statement for the year ended 31 March 2018.

Acknowledgements

We would like to take this opportunity to record our appreciation for the assistance provided by the finance team and other staff during our audit.

Summary

Overview of the scope of our audit

This Audit Findings presents the observations arising from our audit that are significant to the responsibility of those charged with governance to oversee the financial reporting process, as required by International Standard on Auditing (UK) 260 and the Code. Its contents have been discussed with management. As auditor we are responsible for performing the audit, in accordance with International Standards on Auditing (UK), which is directed towards forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities for the preparation of the financial statements.

Audit approach

Our audit approach was based on a thorough understanding of the Council's business and is risk based, and in particular included:

- An evaluation of the components of the group based on a measure of materiality considering each as a percentage of total group assets and revenues to assess the significance of the component and to determine the planned audit response. From this evaluation we determined that a targeted audit response was required for Birmingham City Propco Ltd and PETPS (Birmingham) Pension Funding Scottish Limited Partnership as they were new companies set up in the 2017/18 year. An analytical approach was required for all other components.
- An evaluation of the group's internal controls environment including its IT systems and controls; and
- Substantive testing on significant transactions and material account balances, including the procedures outlined in this report in relation to the key audit risks.

Conclusion

We have substantially completed our audit of your financial statements and subject to outstanding queries being resolved, we anticipate issuing an unqualified audit opinion following the Audit Committee meeting on 30 July 2018, as detailed in Appendix E. These outstanding items include:

- receipt of management representation letter;
- reviewing the final version of the financial statements.

Key audit findings

The key messages arising from our audit of the Council's financial statements are as follows.

We received a good quality set of financial statements on 31 May in line with the statutory deadline. The working papers supporting the accounts have been fit for purpose and we appreciate the support that the Finance Team have given us throughout the audit.

Our audit has identified four adjusted errors. Further details are provided in Appendix C.

Our audit has not identified any unadjusted errors.

We are planning to issue an unqualified opinion on the financial statements. Our enhanced audit report will include an Emphasis of Matter paragraph in relation to the disclosure of the uncertainties surrounding the volume and timing of any future equal pay claims.

We are planning to issue a qualified 'adverse' Value for Money (VfM) conclusion. This is because the weaknesses in arrangements which we have identified, are both significant in terms of their impact and numerous in terms of the number of different aspects of proper arrangements affected, that we are unable to satisfy ourselves that the Council has proper arrangements to secure VfM:

- Budget Delivery and Reserves Management, as well as savings proposals (including the principles of the Future Operating Model) and Equal Pay: due to the significant use of reserves in 2017/18, the planned use of £30.5m of Corporate Reserves in 2018/19, the failure to deliver all of the planned savings in 2017/18 and the £9.1m of savings identified as not deliverable in 2018/19 as reported by the Council at Month 3;
- Improvement Panel ('the Panel'): the Council is working collaboratively with the Panel, but needs to address the issues highlighted in its Improvement Stocktake Report;
- Services for Vulnerable Children: although Ofsted has acknowledged improvement following its most recent monitoring visits, the Council is still rated as 'inadequate'; and
- Management of Schools: Ofsted has identified some improvements in arrangements but Internal Audit reports suggest weaknesses in financial and other controls at 52% of schools visited.

Whilst we have not qualified our VfM conclusion in relation to the Commonwealth Games, we do recognise that a significant level of funding has not yet been received by the Council and there is a risk that hosting the games will impact upon the Council's future financial sustainability if it is not adequately managed.

Statutory Recommendation

Recommendation made under Section 24 of the Local Audit and Accountability Act 2014 ('the Act')

The Council needs to:

Finance

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

Transparency and Governance

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

Subsidiary Bodies

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

Place Directorate

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

Our responsibilities

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

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

Statutory Recommendation (continued)

Reasons for making the recommendation

We included a statutory recommendation in October 2016 under Section 24 of the Local Audit and Accountability Act 2014 ('Section 24') in our 2015/16 Annual Audit Letter relating to the adequacy of budgetary arrangements. The recommendation stated that the Council needed to:

- ''ensure that there is Council-wide commitment to delivering alternative savings plans to mitigate the impact of the combined savings and budget pressure risks in 2016/17;
- demonstrate that it is implementing achievable actions to deliver its cumulative savings programme in the Business Plan 2017+ by:
  - revising savings programme from 2017/18 onwards to reflect the delayed on non-delivery of savings plans in 2016/17;
  - ensuring that all savings plans are assessed for both lead time to implement and delivery risk; and
- re-assess the impact of the combined savings and budget pressure risks on the planned use of reserves for 2016/17 and the impact of this on the reserves position from 2017/18 onwards.''

This recommendation and the Council's formal response were considered at the Council meeting on 10 January 2017.

We have now concluded that little progress has been made to 31 March 2018 in delivering against the recommendations. In addition, we have significant concerns about other areas of the Council's performance. Accordingly we now consider it appropriate to make further recommendations under the Act.

It is encouraging that the Council's Improvement Stocktake Report published on 29 June 2018 recognises many of the weaknesses which our recommendation seeks to address. The Birmingham Independent Improvement Panel ('the Panel') has also commented on 29 June that whilst the Council has 'not sufficiently gripped' the improvement challenge set by the Kerslake report, it is now committed to doing so. The key, from our perspective, now, is to start to convert the good intentions into the improvements required.

Finance

Savings Plan delivery

The Council has failed to deliver planned savings targets since 2016/17. It reported a budget overspend of £29.8m in 2016/17, but only after applying £42.1m of corporate reserves as well as making use of capital receipts flexibility. This resulted in spend of £71.9m more than the resources available. A key reason for the overspend was the failure to deliver large ambitious savings programmes such as the Adult Care savings plan. In the 2016/17 Annual Audit Letter, we commented:

'The Council needs to continue to take action to manage the emerging trend of underdelivery of savings against plan to date, specifically to mitigate current Directorate plans which are not achieving anticipated savings targets, but also to ensure that further non-delivery of savings does not occur in other planned areas currently shown as on track…

…The events surrounding the waste strike have affected capacity to focus on corporate budget and governance monitoring. The officer and political leadership need to work together to ensure that the Council's financial stability remains a top priority. If the waste strike resumes, the additional expense arising will add to cost pressures.'

In 2017/18, the Council reported a net overspend of £4.9m after use of £63.1m of reserves (£42.2m of which were planned) plus £11.7m to fund pension guarantees. It is of concern that the Council has applied £116.9m of reserves in 2016/17 and 2017/18 to deliver a cumulative deficit of £35m. The use of reserves has therefore masked the Council's true position. If the Council had not applied any reserves over the last two years, it would have had to deliver £150m more in aggregate savings to achieve balance. It has effectively been running an annual deficit of £75m.

Statutory Recommendation (continued)

Delivery of savings has proved an enduring problem. The Council continued to under-deliver planned savings in 2017/18, again, in part due to the failure to deliver large savings plans such as the Future Operating Model (FOM), which under delivered by £15.4m in 2017/18, an underdelivery which was to rise to £34.2m in future years. As noted in the 2016/17 Annual Audit Letter, the waste strike also diverted corporate focus from budget monitoring, but contributed significantly to the overall overspend of £17m.

2018/19 and beyond looks extremely challenging. The Council's medium-term financial plan provides for £52.9m of savings in 2018/19 after applying £30.5m of reserves. The month 3 budget monitoring report is forecasting a £17.9m overspend, comprising a base budget overspend of £10.1m and £9.1m of savings not deliverable, offset by £1.3m of accelerated efficiency targets. £10.8m of the £17.9m overspend relates to the Place Directorate, of which £5.3m relates to waste.

The Council is seeking to strengthen its monitoring processes and embed accountability for delivery of savings more strongly within Directorates. There will be, for instance, much stronger control over the use of reserves. This requires stronger working relationships between Finance and Service Directorates. It is imperative that the Council stays on track to deliver its budget in 2018/19 in order to:

- develop momentum
- avoid storing up problems for the future
- avoid further calls on reserves

The need to re-establish a track-record of savings delivery is important, not least as the cumulative savings requirement over the next few years is very demanding, rising from £88m by 2019/20 to £108m by 2020/21 and £117m by 2021/22. In the last two years savings delivery on that scale has proved unachievable. But without delivery of these ambitious savings plans, reserves will rapidly erode, which would leave the Council with insufficient financial resources to call upon, in the event of any budget contingencies arising.

Accordingly, we have therefore recommended that the Council needs to:

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

Medium Term Financial Plan (MTFP)

There are signs, however, that the Council's new management team, with a newly appointed Chief Executive and Corporate Director, Finance & Governance, and a newly elected political administration in place for four years, is starting to develop a more robust MTFP which is less dependent on the use of reserves to support budget delivery. Whilst the 2018/19 plan is reliant on £30.5m of reserves, the Council argues that this is a recognition that it needs time and capacity to transform its services.

Developing a realistic MTFP which is deliverable, and delivers, is important because it provides a map of how a significant savings requirement can be delivered over a period of time, which builds in adequate lead-times for major transformational initiatives, which are well-designed and owned by Service Directorates. The MTFP also needs to build in headroom to accommodate financial pressures arising from increase in service demand, legislative requirements or one-off risks. The Commonwealth Games and Equal Pay are only two of the potential financial pinch-points.

We have therefore recommended that the Council needs to:

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

Statutory Recommendation (continued)

Adequacy of Reserves

The 2017/18 statement of accounts show that the Council holds the following reserves:

- un-earmarked reserves: £170.4m (including the £41.5m Organisational Transitional Reserve and £98.2m Financial Resilience Reserve);
- earmarked reserves: £302.9m;
- capital reserves: £427.4m; and
- ringfenced reserves: £69.2m.

The un-earmarked reserves are key to the Council's MTFP as they are available for general application rather than reserved for a specific purpose. The level of un-earmarked reserves has increased by £69.6m in 2017/18, largely due to:

- the Council's policy decision to change its Minimum Revenue Provision (MRP) policy, which generated an unplanned additional reserve of £98.2m; and
- the beneficial repayment of a provision no longer required in respect of NEC Pensions - £23.6m.

Without the MRP policy change, un-earmarked reserves would have totalled £72.2m We wrote to the Corporate Director, Finance & Governance on 24 January 2018, noting that whilst the change in policy has resulted in an increase in reserves to support budget strategy, and is not unlawful, it also has the effect of pushing additional costs into future years. The Council argues that the arrangements are 'reasonable and prudent', in accordance with Government guidance, which states that it is for Councils to assess what is prudent according to their particular circumstances.

Whilst the Council's reserves, earmarked and un-earmarked, are not insubstantial, they should be viewed in the context of the financial risks it faces. Equal Pay remains a significant risk, whilst the Commonwealth Games, which represents a significant opportunity for the City and the region, nonetheless also presents financial risks. As of December 2017, the Council had committed to providing £30m in capital funds for the project, leaving a gap of around £44m revenue and £40m capital. Whilst this gap could narrow, it could also grow wider.

There are other potential financial risks relating to the Council's subsidiary bodies, which are referred to later. Additionally, any failure to deliver on planned savings over the next three years, could also lead to rapid depletion of reserves. A recent NAO report in March 2018 argued that many local authorities are relying on using their savings to fund local services and are overspending on services, which is not financially sustainable. For that reason, we have recommended that the Council needs to:

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

Transparency and Governance

The Council has not been effective in the way that it reports:

- its financial position; and
- governance failures and emerging issues.

Statutory Recommendation (continued)

The Council has not been transparent, in particular, in the way that it reports its financial position. In particular, the practice of applying reserves in-year (of itself unusual), rather than at year-end, has not been stated clearly at the start of in-year reports but has been lost in the detail. The Council's in-year monitoring reports have accordingly appeared to present a better financial picture than was in fact the case. This has made it difficult for Members, in particular, to establish the Council's true financial position.

The reported year-end overspend of £4.9m in 2017/18 appears a modest deficit, but was delivered through the application of £75m of reserves (£42m planned), a significant proportion of which were applied in-year. Had the reserves not been applied in-year, the emerging deficit reported in-year would have appeared substantially larger. The Council's new Management Team has now implemented more transparent reporting arrangements which explain more clearly the use of reserves. This is to be commended.

The Council also has a track record of not reporting governance failures effectively; whether relating to Equal Pay or the waste dispute. For instance, the additional costs arising from the waste dispute have not been published nor has any report on the lapses in governance, which contributed to the prolongation of the dispute, been produced. Whilst an independent investigation into the background of the waste dispute, including the conduct of the former Leader, has been commissioned, this is yet to be published, almost 12 months after the dispute commenced.

As external auditors, we have not always been made privy to emerging issues. In September 2016, the (then) budget forecast of a £50m deficit had not been discussed with us prior to the issue of the report. Similarly in August 2017, key information relating to Equal Pay, which led to the inclusion of an emphasis of matter within our audit report, had to be requested from the Council as it had not been disclosed to us.

There are again some encouraging signs that the new Management Team is being far more open with Members, the public and the external auditor. To assist the team further we have therefore recommended that the Council needs to:

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

Subsidiary Bodies

In recent decades, the Council has created a number of companies with partners to deliver its services. The Council's Group Accounts disclose that it has seven subsidiaries, one associate company and one joint venture. Total net spend is of the order of £40m. The bodies are accordingly a key part of the Council's delivery mechanisms, but their activities have not always been transparent. In particular, their financial position and the Council's accountability for their liabilities has not been well understood or reported by the Council. The Council has therefore not always had sufficient accurate information upon which to make decisions relating to these entities in order to mitigate risk.

The new Corporate Director, Finance & Governance, has brought a greater rigour to the monitoring of the Council's subsidiaries and other entities. For instance, Acivico Ltd., has had a troubled financial and operational record in recent years, providing excellent services in some areas, and poorer services in other areas as measured by customer satisfaction surveys. The Council is currently considering ways to strengthen its governance and performance.

Statutory Recommendation (continued)

However, governance arrangements have not been adequate to enable the Company's activities to be adequately monitored. For instance, the Council has not always had the most appropriate nominees sitting on the Company's Board and the Company's records and financial reporting have proved inadequate. This has resulted in recognition of £9.5m of pre-2018/19 accumulated losses and long-standing disputes. This has added further to the Council's overall spending pressures.

Acivico Ltd. is a 100% owned Council company and any losses and liabilities may fall to the Council. The Council is determined to exercise more effective control over the Company in future; for instance the Corporate Director, Finance & Governance will be an observer to the Board, and a number of changes have been made to the management and governance of the Company.

Acivico Ltd illustrates a wider issue about inadequacies in the Council's reporting of the financial and service performance of its subsidiary companies and other entities. For instance, the joint venture, Paradise Circus General Partner Limited, would appear to have incurred cost overruns on the project, but it is unclear at this stage whether this is a genuine overspend or is a result of re-phasing of the spend. Governance arrangements for identifying and reporting the overspend appear to have been inadequate. We have therefore recommended that the Council needs to:

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

Place Directorate

The Place Directorate has experienced a turbulent year, best illustrated by the events associated with the waste dispute. The Directorate has also not managed its budget effectively and there have been significant failings in its governance arrangements.

In relation to the budget, the Month 3 budget report for 2018/19 shows that over half the Council's anticipated year-end overspend of £17.9m is accounted for by an expected overspend in the Place Directorate of £10.8m. The key pressure point for most metropolitan authorities is the social care budget, which is overwhelmingly demand-driven. It is relatively unusual for the key financial challenges to relate to place-based services. This is an indication that things have gone badly wrong at Birmingham in this regard.

The Month three budget report explains that the Place Directorate financial pressures include the following:

- £5.3m relating to Waste Services and £3.5m relating to other assorted service pressures across the Directorate;
- a forecast £0.7m overspend on Markets; and
- further projected overspends of £0.4m relating to Housing Options and £0.9m relating to pension strain and other Directorate wide pressures.

The Month three report notes that there are no firm plans identified to mitigate the base pressures and non-delivery of savings. It is clear that budget accountability has not been operating effectively within the Place Directorate, which indicates a lack of leadership.

Whilst overspends have been identified across the Directorate, the Waste Service has been a focal point of the financial problems that the Directorate has experienced, with its origins in the waste dispute.

Statutory Recommendation (continued)

We noted in the 2017/18 Annual Audit letter that the events leading to the strike being suspended on 16 August 2017, then re-instated on 1 September 2017 when 106 workers were handed their redundancy notices:

'did not serve to enhance confidence in the Council's systems of governance… ..Members will recall that a key strand of the Kerslake report related to the need to re-set member-officer relations. It is of concern that initial improvements in this area may not have been sustained.'

The action was suspended on 20 September 2017 when Unite won an injunction blocking the proposed redundancies. A full court hearing took place in November 2017. The Council's June 2018 Stocktake Report quotes the Judge's criticisms of the conduct of the waste dispute, in particular as they related to member-officer relations and local disagreements about role definitions. The Judge noted that, 'neither party (officers or members) comes out of this sorry saga with any credit at all.'

The Court ordered the re-instatement of the dismissed workers but also the immediate implementation of the proposed revised working arrangements, incorporating in particular, a move to five day working. Whilst the dismissed workers were reinstated in different roles in January 2018, the revised working arrangements have yet to be introduced, and September 2018 appears to be the earliest date for their implementation.

The waste strike and the failure to introduce revised working arrangements have given rise to significant budget pressures in both 2017/18 and 2018/19. In our Annual Audit Letter dated October 2017 we noted that additional costs in 2017/18 were running at £0.3m per week, but the true additional cost of the waste strike has not yet been reported.

We understand that in recent months, invoices totalling £1.6m have been submitted to the Council in respect of the costs of private contractors, who were hired to deliver waste rounds during the strike. This work does not appear to have been properly authorised and was accordingly not recognised in 2017/18 budget monitoring reports. This represents a significant failing in financial governance which the Council is seeking to get to the bottom of.

The Council is now seeking to get a grip on the managerial and operational delivery of the Directorate. This work needs considerable impetus and urgency of attention. Accordingly we have recommended that the Council now needs to:

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

What does the Council need to do next?

The Act requires the Council to:

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

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

Other considerations

Key audit findings (continued)

Paradise Circus Limited Partnership Joint Venture

We have considered whether the Council should disclose a contingent liability in relation to cost overruns in relation to its joint venture. The Council as Accountable Body has provided loan finance for the scheme which, it is intended, will be repaid by the uplift in Business Rates generated by the development. Given that Phase 1 of the project is complete and a number of the offices developed, have been let, the Council considers that its loan finance will be covered by the Business rates generated. The movement to Phase 2 is expected to be agreed by the Enterprise Zone Board in September 2018.

The Council does not consider that any liability arises in its role as Accountable Body, as its loan finance will be covered by the Business Rates uplift, and it does not therefore consider that a contingent liability is appropriate.

We have had access to documentation, which does not suggest at this stage that any liability exists which would not be covered by the uplift in Business Rates. Accordingly we are not minded to challenge the Council's view. However all projects are dynamic in nature and there is inherent risk in all business assumptions. We will therefore continue to monitor the progress of the project.

Materiality

Our approach to materiality

The concept of materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to the monetary misstatements but also to disclosure requirements and adherence to acceptable accounting practice and applicable law.

Materiality calculations remains the same as reported in our audit plan. We detail in the table below our assessment of materiality for Birmingham City Council.

	Group Amount (£)	Council Amount (£)	Qualitative factors considered
Materiality for the financial statements	£43,830,000	£43,575,000	We decided that gross total cost of services expenditure in year was the most appropriate benchmark. Given the increasing level of public interest in the Council's activities during a sustained period of cost-cutting and efficiency measures we consider that it is appropriate to set the percentage applied at 1.5%.
Performance materiality	£32,873,000	£32,681,000	We have not previously identified significant control deficiencies as a result of our audit work and there were no material misstatements in the 2016/17 draft accounts. We decided that performance materiality of 75% of materiality is an appropriate level.
Trivial matters	£2,191,000	£2,178,000	Our trivial threshold has been calculated as 5% of materiality. We will report any errors over this threshold to those charged within governance within this report.
Materiality for specific transactions, balances or disclosures	£100,000	£100,000	We have identified senior officers remuneration (including exit packages for senior officers) as a sensitive item and set a lower materiality of £100,000 for testing these items based on the fact that we consider the disclosures to be sensitive and of specific interest to the reader of the financial statements.

Going concern

Our responsibility

As auditors, we are required to "obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern" (ISA (UK) 570).

Going concern commentary

Management's assessment process	Auditor commentary
Management assess that the Council will continue as a going concern. Whilst facing significant financial pressures in common with the rest of the public sector the Council has used reserves to balance its budget in 2017/18 and will require a further £30.5m of reserves to balance the 2018/19 budget.	• Management has documented the basis of their judgement, presented this to the Audit Committee within our ''Informing the Risk Assessment' 'report and the Audit Committee has endorsed it. • Management's assessment of use of going concern basis of accounting is that it is appropriate because ''Local Authorities are required by the Code of Practice on Local Authority Accounting 2017/18 to prepare their accounts on the going concern basis, that is that the functions of the Council will continue in operational existence for the foreseeable future, as it can only be discontinued as a result of statutory prescription.''
Work performed	**Auditor commentary**
Detail audit work performed on managements assessment	We performed the following audit procedures: • Discussions with management about the Council's current and future financial plans; • Considered whether the results of our audit procedures indicate the existence of going concern events or conditions which may cast significant doubt on the entity's ability to continue as a going concern; • Review of managements assessment of the going concern assumption and supporting information; and • Review of the disclosures included within Note 2 of the financial statements (Critical Judgements in Applying Accounting Policies).
Concluding comments	**Auditor commentary**
	• Whilst we acknowledge that the Council faces significant financial pressures we have concluded that the going concern basis of accounting is appropriate for the Council and our audit report is unmodified in relation to going concern.

Significant audit risks

	Risks identified in our Audit Plan	Commentary
1	**Improper revenue recognition** Under ISA 240 (UK) there is a presumed risk that revenue may be misstated due to the improper recognition of revenue. This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.	**Auditor commentary** Having considered the risk factors set out in ISA240 and the nature of the revenue streams at the Council, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because: • there is little incentive to manipulate revenue recognition; • opportunities to manipulate revenue recognition are very limited; and • the culture and ethical frameworks of local authorities, including Birmingham City Council, mean that all forms of fraud are seen as unacceptable. Therefore we do not consider this to be a significant risk for Birmingham City Council.
2	**Management override of controls** Under ISA 240 (UK) there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities. The Council faces external scrutiny of its spending, and this could potentially place management under undue pressure in terms of how they report performance. Management over-ride of controls is a risk requiring special audit consideration.	**Auditor commentary** As part of our audit procedures we have: • updated our review of the control environment for the preparation and authorisation of journal entries and performed a walkthrough of the controls; • tested the completeness of the journal listing; • analysed the journals listing to identify any unusual changes in volume or value of journals; • identified and selected journals which we deemed to be high risk or unusual; • tested all high risk journals and obtained managements explanations and corroborating evidence; and • reviewed management estimates and critical judgements by challenging assumptions, verifying completeness and accuracy of source date and checking calculations. **Our audit work did not identify any issues that we wish to bring to your attention.**

Significant audit risks (continued)

Risks identified in our Audit Plan	Commentary
3 **Valuation of property, plant and equipment** The Council revalues its land and buildings on a rolling five year programme to ensure that carrying value is not materially different from fair value. This represents a significant estimate by management in the financial statements. We identified the valuation of land and buildings (specifically council dwellings, other land and buildings and surplus assets) revaluations and impairments as a risk requiring special audit consideration and a key audit matter for the audit.	**Auditor commentary** On receipt of the draft financial statements we identified that impairment was not material to the financial statements. We have considered the appropriateness of management's consideration of possible impairments but have derecognised this particular element as a significant risk requiring special audit consideration. As part of our audit procedures we have: • updated our understanding of the processes put in place by management to ensure that revaluation measurements are correct and evaluating the design of the associated controls; • evaluated management's processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work; • evaluated the competence, capabilities and objectivity of the valuation expert (the valuer); • discussed with the valuer the basis on which the valuation was carried out; • challenged the information and assumptions used by the valuer to ensure completeness and consistency with our understanding; • tested revaluations made during the year to ensure they were input correctly into the Council's asset register and correctly reflected in the financial statements; and • evaluated the assumptions made by management for those assets either revalued at the start of the financial year or not revalued during the year to determine how management has satisfied themselves that the current values (or fair values for surplus assets) at the year-end are not materially different to the carrying values per the financial statements. We have identified two adjustments from our work on the valuation of property, plant and equipment: Firstly, we identified a £50.3m credit to the HRA Income and Expenditure Statement relating to depreciation incorrectly reversed through the CIES on revaluation. This had no impact on net book value and has been corrected in the final version of the financial statements. We also identified an error relating to accounting for the revaluation of council dwellings due to a formula error in the HRA working papers. The effect of this was an understatement of the net book value of council dwellings by £97.1m. Further details of these audit adjustments are included within Appendix C. **Other than the points noted above which have no impact on our audit opinion, our audit work did not identify any issues that we wish to bring to your attention.**

Significant audit risks (continued)

	Risks identified in our Audit Plan	Commentary
4	**Valuation of pension fund net liability** The Council's pension fund asset and liability as reflected in its balance sheet represent a significant estimate in the financial statements. We identified the valuation of the pension fund net liability as a risk requiring special audit consideration and a key audit matter for the audit.	**Auditor commentary** As part of our audit procedures we have: • gained an understanding of the processes and controls put in place by management to ensure that the Council's pension fund net liability was not materially misstated and evaluating the design of the associated controls; • tested the appropriateness of data provided for the purposes of the IAS19 actuarial valuation; • evaluated the competence, capabilities and objectivity of the actuary who carried out the Council's pension fund valuation; • tested the consistency of the pension fund asset and liability and disclosures in the notes to the core financial statements with the actuarial report from the actuary; and • undertaken procedures to confirm the reasonableness of the actuarial assumptions made by reviewing the report of the consulting actuary (as auditor's expert) and performing any additional procedures suggested within the report. **Our audit work did not identify any issues that we wish to bring to your attention.**
5	**Valuation of equal pay provision** Under ISA 540 (Auditing Accounting Estimates, including Fair Value Accounting Estimates and Related Disclosures), the auditor is required to make a judgement as to whether any accounting estimate with a high degree of estimation uncertainty gives rise to a significant risk. We identified the valuation of the equal pay provision as a risk requiring special audit consideration.	**Auditor commentary** As part of our audit procedures we have: • updated our documentation of the process and undertaken a walkthrough of the controls in place to estimate the equal pay provision; • reviewed the assumptions on which the equal pay provision estimated was based; • considered the events or conditions that could have changed the basis of estimation; • reperformed the calculation to the estimate; • checked that the estimate has been determined and recognised in accordance with accounting standards; • determined how management assessed the estimation uncertainty; and • considered the impact of any subsequent transactions or events. The impact of claims received since 31 March 2018 was also assessed. New claims received between February and June totalled £8m. The Council has not amended for this finding. We concluded that there was not a risk of material misstatement of the provision by not including these clams in the estimation. From our testing we identified that the classification between 'additional provisions' and 'unused amount reversed' required amending. Detail of this disclosure amendment are included in Appendix A. **Other than the points noted above which have been amended, our audit work did not identify any issues that we wish to bring to your attention.**

Reasonably possible audit risks

	Risks identified in our Audit Plan	Commentary
1	**Employee remuneration** Payroll expenditure represents a significant percentage (approximately 30%) of the Council's operating expenses. As the payroll expenditure comes from a number of individual transactions there is a risk that payroll expenditure in the accounts could be understated. We therefore identified completeness of payroll expenses as a risk requiring particular audit attention	**Auditor commentary** We have undertaken the following work in relation to this risk: • evaluated the Council's accounting policy for recognition of payroll expenditure for appropriateness; • gained an understanding of the Council's system for accounting for payroll expenditure and evaluated the design of the associated controls; • obtained year-end payroll reconciliation, ensured the amount in the accounts could be reconciled to the ledger and through to payroll reports, and investigated significant adjusting items; • agreed payroll related accruals (e.g. unpaid leave accrual) to supporting documents and reviewed any estimates for reasonableness; and • completed substantive analytical procedures on 12 months of payroll data and investigated any variances outside of our 'acceptable range'. Our testing identified one member of staff who resigned in June 2017, but the resignation form was not signed until October 2017. Although we are satisfied the amount recognised within employee costs is correct we have identified a control weakness and more detail has been provided within Appendix A. **Other than the control weakness identified above which has no impact on our audit opinion, our audit work did not identify any issues that we wish to bring to your attention.**
2	**Operating expenses** Non-pay expenses on other goods and services also represents a significant percentage (approximately 50%) of the Council's operating expenses. Management uses judgement to estimate accruals of un-invoiced costs. We identified completeness of non-pay expenses as a risk requiring particular audit attention:	**Auditor commentary** We have undertaken the following work in relation to this risk: • evaluated the Council's accounting policy for recognition of non-pay expenditure for appropriateness; • gained an understanding of the Council's system for accounting for non-pay expenditure and evaluated the design of the associated controls; • documented the accrual process and the controls management has put in place. We challenged any key underlying assumptions, the appropriateness of the source of data used and the basis for calculations; and • obtained a listing of non-pay payments made in April, and tested a non-statistical sample of transactions to ensure that they have been charged to the appropriate year. **Our audit work did not identify any issues that impact upon our audit opinion.** However, we were made aware of a number of waste invoices relating to services provided 2017 which had not been recorded in the financial statement. Whilst the values involved are immaterial to our audit we have raised a control weakness and recommendation within Appendix A.

Reasonably possible audit risks (continued)

	Risks identified in our Audit Plan	Commentary
3	**Property, plant and equipment - additions** The forecast capital spend for 2017/18 at the end of Q2 was £474.2m which represents a significant level of expenditure for the Council. As additions spend relates to a high number of individual transactions, including some complex projects, there is a risk that additions could be capitalised incorrectly. We have therefore identified valuation of property, plant and equipment additions as a risk requiring particular audit attention.	**Auditor commentary** We have undertaken the following work in relation to this risk: • gained an understanding of the Council's system for accounting for additions to property, plant and equipment and evaluate the design of the associated controls; • obtained a breakdown of additions and review for individually significant or unusual items to be tested; and • as the residual population was above tolerable error, we selected a sample of remaining additions and agreed to invoices, certificates or equivalent in order to confirm that the cost had been accurately recorded, that the asset belonged to the Council and that is had been correctly classified. **Our audit work did not identify any issues that we wish to bring to your attention.**

Significant findings arising from the group audit

Findings	Group audit impact
• In our audit plan we reported that we intended to take an analytical approach to all components other than the parent Council. In the course of our audit we identified that an analytical approach would not be appropriate for Birmingham Propco Limited and PETPS (Birmingham) Pension Funding Scottish Limited Partnership due to the fact that these entities are both new for 2017/18. We therefore carried out targeted procedures on key balances and transactions for these entities.	• We carried out targeted procedures on key balances and transactions for new subsidiaries. This reflects a change to our audit plan. • No issues identified from our work.
• We identified one audit adjustment from our work on the group consolidation relating to intra-group eliminations between the Council and Innovation Birmingham.	• The accounts have been amended to correct this error. See page 43 for details.
• As in previous years, group accounts have been produced from unaudited accounts for all group entities included in the consolidated Balance Sheet. Audited accounts are received by the finance team throughout the audit process but to date these have only been received for InReach. Due to information delay management accounts have been used to consolidate 4 out of the 7 subsidiaries and 1 of the 2 associates.	• Due to the relative scale of the subsidiaries compared to the Group, we have not identified a material risk in the course of our work from the use of unaudited and management accounts. However the Audit Committee needs assurance that group entities provide sufficient information by the end of April to ensure materially accurate group accounts can be produced.
• The Council has taken the option in IAS 7 to present cash flows relating to investing and borrowing activities on a net basis for cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short.	• For the Council, the gross receipts and payments are shown in Notes 36 and 37 so we are satisfied this is disclosed appropriately elsewhere in the accounts. However we have not been able to verify that the definition within IAS 7 applies to all such receipts and payments for subsidiary companies.

Accounting policies

Accounting area	Summary of policy	Comments	Assessment
Revenue recognition	The Council has adopted the following revenue recognition policy: • Service activity is accounted for in the year it takes place, not simply when cash payments are made or received; • Revenue from the sale of goods is recognised when the Council transfers the significant risks and rewards of ownership to the purchaser and it is probable that economic benefits or service potential associated with the transaction will flow to the Council; • Revenue from the provision of services is recognised when the Council can reliably measure the percentage of completion of the transaction and it is probable that economic benefits or service potential associated with the transaction will flow to the Council; • Supplies are recorded as expenditure when they are consumed – where there is a gap between the date supplies are received and their consumption, they are carried as inventories on the Balance Sheet, for example, fuel and transport parts; • Interest receivable on investments is accounted for as income on the basis of the effective interest rate for the relevant financial instrument rather than the cash flows fixed or determined by the contract; • When income has been recognised but cash has not been received, a debtor for the relevant amount is recorded in the Balance Sheet. Where debts may not be settled, the balance of debtors is written down and a charge made to revenue for the income that might not be collected. The Council has based its general accruals on the difference between the forecast revenue outturn for the year and the actual income/expenditure recorded by 31 March. Specific accruals are included for material items and for items relating to: • Statutory accounts, for example, the Collection Fund, Precepts; • Grants received by the Council that are conditional on expenditure within the year. This is intended to improve the efficiency of the final accounts process in order that earlier closedown deadlines can be achieved.	We are satisfied that the Council's disclosure note on revenue recognition is adequate, appropriate and is consistent with the requirements of the CIPFA Code.	**Green**

Assessment
- Red - Marginal accounting policy which could potentially be open to challenge by regulators
- Amber - Accounting policy appropriate but scope for improved disclosure
- Green - Accounting policy appropriate and disclosures sufficient

Accounting policies (continued)

Accounting area	Summary of policy	Comments	Assessment
Judgements and estimates	Key estimates and judgements include: • Required level of provisions, specifically with respect to equal pay liabilities and business rates valuation appeals; • The valuation and remaining useful life of Property Plant and Equipment; • Assessment of PFI schemes and other arrangements as to whether they fall within the scope of IFRIC 12; • Valuation of long term liabilities for PFI and leasing; • Valuation of pension fund net liability; • Estimate of provision required for bad debts.	Our findings from our review of judgements and estimates are set out below: We have reviewed the Council's accounting policies with regard to judgements and estimates and are satisfied that they are appropriate and in accordance with the recommendations of the CIPFA Code. Note 32 Provisions includes: • A £152m provision for the payment of Equal Pay claims. The Council recognises equal pay claims and estimates the potential cost when they are received. The impact of claims received between February 2018 and June 2018 were also assessed and totalled £8m. The Council has not amended for this as it is immaterial to the financial statements. • We concluded that there was not a risk of material estimation uncertainty from not including these claims in the provision. We are satisfied that the Council's judgement and estimation in relation to Equal Pay is adequate and is consistent with the requirements of the CIPFA Code. • A £35m provision for business rates valuation appeals. The settlement of business rates valuation appeals is determined by the Valuation Office Agency (VOA). We reviewed the Council's approach to estimating its provision including its consideration of the impact of the settlement of appeals since the Balance Sheet date. We are satisfied that the estimate has been made on a reasonable basis. We note that the Council has made judgements regarding the sale of leases of two hotel sites from the Council to Propco (Birmingham) Ltd. on 125 year leases, which have been treated as finance leases for both the buildings and the land elements of the leases. We are satisfied that the fair value of the lease assigned to Propco (Birmingham) Ltd is not material, therefore, we have not challenged the recognition of a capital receipt.	Green

Assessment
- Red - Marginal accounting policy which could potentially be open to challenge by regulators
- Amber - Accounting policy appropriate but scope for improved disclosure
- Green - Accounting policy appropriate and disclosures sufficient

Accounting policies (continued)

Accounting area	Summary of policy	Comments	Assessment
Judgements and estimates (continued)		The Council's estimated net pension liability reduced by £283m compared to the 2016/17 balance sheet. This change is largely due to the increase in the fair value of assets in the pension scheme. As reported in previous years, although the Council does not accurately classify housing benefit debtors between short and long term we are satisfied that this would not lead to a material misstatement in the financial statements. However, we recommend that the estimation of debt to be received after the year end should accurately reflect the time collection period. We also note that the CIES prior year restatement was estimated on an apportionment basis using the 2017/18 proportions. We have undertaken audit procedures to satisfy ourselves that the estimate is not materially misstated.	Green
Other critical policies		We have reviewed the Council's policies against the requirements of the CIPFA Code of Practice. The Council's accounting policies are appropriate and consistent with previous years.	Green

Assessment
- Red - Marginal accounting policy which could potentially be open to challenge by regulators
- Amber - Accounting policy appropriate but scope for improved disclosure
- Green - Accounting policy appropriate and disclosures sufficient

Other communication requirements

We set out below details of other matters which we, as auditors, are required by auditing standards and the Code to communicate to those charged with governance.

	Issue	Commentary
1	**Matters in relation to fraud**	• We have previously discussed the risk of fraud with the Audit Committee. We have not been made aware of any incidents in the period and no issues have been identified during the course of our audit procedures.
2	**Matters in relation to related parties**	• We are not aware of any related parties or related party transactions which have not been disclosed.
3	**Matters in relation to laws and regulations**	• You have not made us aware of any significant incidences of non-compliance with relevant laws and regulations and we have not identified any incidences from our audit work.
4	**Written representations**	A letter of representation has been requested from the Council which is included in the Audit Committee papers. • Specific representations have been requested from management in respect of the significant assumptions used in making accounting estimates for: – Property, plant and equipment; – Equal pay measurement; – Equal pay recognition; – Academy schools; and – Group boundaries.
5	**Confirmation requests from third parties**	• We requested from management permission to send confirmation requests for bank and all material and a sample of non material borrowings / investment balances. This permission was granted, the requests were sent and all responses were obtained.
6	**Disclosures**	• We have summarised the disclosure amendments included in the final version of the accounts in Appendix C.
7	**Audit evidence and explanations**	• All information and explanations requested from management were provided.

Other responsibilities under the Code

We set out below details of other matters which we, as auditors, are required by the Code to communicate to those charged with governance.

	Issue	Commentary
1	**Other information**	We are required to give an opinion on whether the other information published together with the audited financial statements (including the Statement of Accounts, Annual Governance Statement (AGS) and Narrative Report), is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. Inconsistencies have been identified but have been adequately rectified by management. Details are provided in Appendix A. We plan to issue an unqualified opinion in this respect – refer to Appendix E.
2	**Matters on which we report by exception**	We are required to report on a number of matters by exception in a numbers of areas: • If the Annual Governance Statement does not meet the disclosure requirements set out in the CIPFA/SOLACE guidance or is misleading or inconsistent with the other information of which we are aware from our audit • If we have applied any of our statutory powers or duties We have nothing to report on the AGS. However, we have included our Statutory Recommendation made under section 24 of the Act on pages 5 to 11 of this report.
3	**Specified procedures for Whole of Government Accounts**	We are required to carry out specified procedures (on behalf of the NAO) on the Whole of Government Accounts (WGA) consolidation pack under WGA group audit instructions. As the Council exceeds the specified group reporting threshold of £500 million, we examine and report on the consistency of the WGA consolidation pack with the Council's audited financial statements. Note that work is not yet completed and will be undertaken in August 2018.
4	**Certification of the closure of the audit**	We do not expect to be able to certify the completion of the 2017/18 audit of Birmingham City Council in our auditor's report, as detailed in Appendix E, until we have completed our consideration of an objection raised on the 2016/17 financial statements brought to our attention by a local authority elector under Section 27 of the Act. In addition, we can also not certify the completion of the 2017/18 audit until we have completed the work necessary to issue our Whole of Government Accounts Component Assurance statement for the year ended 31 March 2018. This work is due to be undertaken in August 2018.

Value for Money

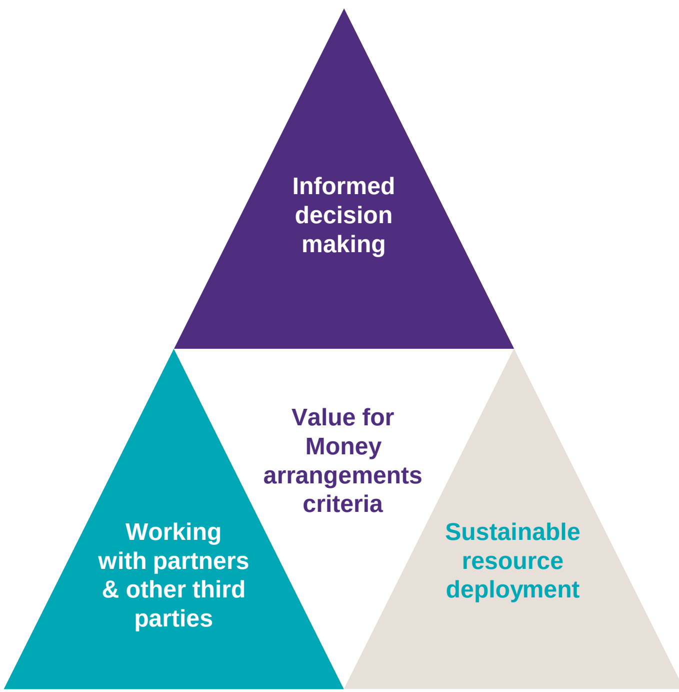
Background to our VFM approach

The NAO issued its guidance for auditors on Value for Money work for 2017/18 in November 2017. The guidance states that for local government bodies, auditors are required to give a conclusion on whether the Council has proper arrangements in place.

The guidance identifies one single criterion for auditors to evaluate:

"In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people."

This is supported by three sub-criteria, as set out below:



Risk assessment

We carried out an initial risk assessment in January 2018 and identified a number of significant risks in respect of specific areas of proper arrangements using the guidance contained in AGN 03. We communicated these risks to you in our Audit Plan dated March 2018.

We have continued our review of relevant documents up to the date of giving our report, and have not identified any further significant risks where we need to perform further work.

Value for Money (continued)

Our work

AGN 03 requires us to disclose our views on significant qualitative aspects of the Council's arrangements for delivering economy, efficiency and effectiveness.

We have focused our work on the significant risks that we identified in the Council's arrangements. In arriving at our conclusion, our main considerations were:

- Budget Delivery and Reserves Management, as well as savings proposals (including the principles of the FOM) and Equal Pay: due to the significant use of reserves in 2017/18, the planned use of £30.5m of Corporate Reserves in 2018/19, the failure to deliver all of the planned savings in 2017/18 and the £9.1m of savings identified as not deliverable in 2018/19 as reported by the Council at Month 3;
- The Panel: the Council is working collaboratively with the Panel, but needs to address the issues highlighted in its Improvement Stocktake Report;
- Services for Vulnerable Children: although Ofsted has acknowledged improvement following its most recent monitoring visits, the Council is still rated as ‘inadequate’; and
- Management of Schools: Ofsted has identified some improvements in arrangements but Internal Audit reports suggest weaknesses in financial and other controls at 52% of schools visited.

We have set out more detail on the risks we identified, the results of the work we performed and the conclusions we drew from this work on pages 27 to 32.

Overall conclusion

Based on the work we performed to address the significant risks, we concluded that:

- because of the pervasive significance of the matters we identified in respect of Budget Delivery and Reserves Management, as well as savings proposals (including the principles of the FOM) and Equal Pay; Improvement Panel; Services for Vulnerable Children and Management of Schools, we are not satisfied that the Council has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. We therefore propose to give a qualified ‘adverse' conclusion.

The text of our proposed report can be found at Appendix E.

Recommendations for improvement

We discussed findings arising from our work with management and have agreed recommendations for improvement as follows. The Council needs to:

- deliver the elements of the statutory recommendation that relate to finance and transparency and governance (see page 5) to address the Budget Delivery and Reserves Management, as well as savings proposals (including the principles of the FOM) and Equal Pay issues;
- implement the actions identified in its Improvement Stocktake Report and demonstrate measurable outcomes to the Panel;
- continue to demonstrate measurable improvements in services for vulnerable children through the Children’s Trust; and
- increase the pace of improvement in schools governance arrangements to ensure that it can demonstrate to Ofsted that it has addressed the issues that it raised.

Our recommendations and management's response to these can be found in the Action Plan at Appendix A.

Significant difficulties in undertaking our work

We did not identify any significant difficulties in undertaking our work on your arrangements which we wish to draw to your attention.

Significant matters discussed with management

There were no matters where no other evidence was available or matters of such significance to our conclusion or that we required written representation from management or those charged with governance.

Key findings

We set out below our key findings against the significant risks we identified through our initial risk assessment and further risks identified through our ongoing review of documents and discussions with management.

	Significant risk	Findings	Conclusion
1	**Budget Delivery and Reserves Management, as well as saving proposals (including the principles of the Future Operating Model) and Equal Pay** The key risk is that the proposed savings schemes (including the implementation of savings proposals) will not deliver the required recurrent savings, or will take longer to implement than planned. We reviewed the Council's latest financial reports including savings plans trackers, to establish how the Council is identifying, managing and monitoring this risk. This involved considering the adequacy of reserves and their prudent use. We also considered the transparency of financial reporting.	The Council reported a 2017/18 revenue budget overspend of £4.9m after the use of £63.1m of reserves (£42.2m of which was planned) plus £11.7m to fund pension guarantees. The outturn overspend is in the context of demanding savings targets of £85.3m including finding 2017/18 solutions for £14.4m largely for savings achieved on a non-recurrent basis in 2016/17. The Council's Business Plan 2018+ identifies continuing savings pressures, with a requirement of £117.0m of savings to be delivered by the end of 2021/22; 2018/19 (£52.9m) and 2019/20 (£35.6m) are the two years with the greatest savings demand. The Business Plan includes a detailed analysis of savings schemes across the four year period. We focused our work on the delivery risks for the major savings schemes. The Council is planning to use £30.5m of Corporate Reserves in 2018/19. The Month 3 Corporate Revenue Budget Monitoring report position up to the end of June 2018 identifies the following: • at the end of June 2018 a gross revenue overspend of £17.9m in 2018/19 is being forecast. This consists of an overspend of £10.1m in the base budget delivery and £9.1m of savings not deliverable in 2018/19, offset by partially accelerated achievement of £1.3m of the efficiency target of £5.7m; • the total forecast overspend of £17.9m is primarily related to Place Directorate (£10.8m) and Children and Young People (CYP) £2.7m); • in the case of the Place Directorate, the overspend of £10.8m relates primarily to Waste Management services (£5.3m), Markets (£0.7m), Housing Options (£0.4) pay and pension strain related pressures (£0.5m) and other Directorate wide pressures (£0.4m). In addition, there are some savings delivery challenges totalling £3.5m; and • CYP relates largely to savings delivery challenges on Travel Assist.	**Auditor view** We identified in our initial risk assessment that the key risk was that the major savings schemes would not deliver the required recurrent savings, or would take longer to implement than planned. The Council's failure to deliver its 2017/18 savings plans and the delivery difficulties associated with the largest savings schemes in 2018/19 mean that this risk is not sufficiently mitigated. In our view savings planning arrangements did not sufficiently take into account the impact of the level of non-recurrent savings or adequately assess the vulnerability of the largest proposed savings scheme. We have concluded that these weaknesses in the Council's arrangements relate to the adequacy of financial planning as well as planning, organising and developing the workforce to deliver strategic priorities, as part of sustainable resource deployment.

Key findings (continued)

	Significant risk	Findings	Conclusion
1	**Budget Delivery and Reserves Management, as well as saving proposals (including the principles of the Future Operating Model) and Equal Pay (continued)**	The Council has now reviewed its expectations for when settlement of equal pay claims will be achieved. It is now anticipated that settlement will be concluded in 2018/19. The provision raised in the 2017/18 financial statements has taken into account the negotiated settlements made with major solicitors and the agreed payments going forward. Submissions for pre 2008 claims (1^{st} generation) and post 2008 claims (2^{nd} generation) expired in August 2014 and October 2017 respectively. This gives a certain level of assurance to ongoing provision required by the Council. However, there are still uncertainties around the volume and timing of further 3^{rd} generation claims that may be received, although this has been mitigated by some negotiated agreements with solicitors.	

Key findings (continued)

Significant risk	Findings	Conclusion
2 **The Panel**		**Auditor view**
The key risk is that the Panel will conclude that the Council is not making sufficient progress in implementing the changes needed. We considered the Panel's reports and discuss the progress made and key issues with the Panel's Vice Chair, to establish how the Council is identifying, managing and monitoring this risk.	We have met with the Vice Chair of the Panel on a frequent basis throughout the year and been briefed on the Panel's view of the progress being made. The Council has been working more closely with the Panel since the autumn of 2017 and the Panel, in conjunction with the Council, has written to the Secretary of State several times since 1 April 2017, most recently in June 2018. The joint letter from the Panel and the Council in March 2018 outlined the more collaborative approach. The letter stated that: "… with support and advice from the Panel, the Council intends to publish a suite of improvement plans. Progress on delivering all of the plans and the impact of the changes they bring about will be rigorously tracked and evaluated." The letter also refers to the financial challenges facing the Council: "The Council also recognises that it has not yet brought its day to day expenditure into line with its revenue. Balancing its revenue budget has therefore required, and continues to require, substantial draw down of the Council's reserves. This position is not sustainable and high quality strategic financial management and difficult decisions will be required to achieve financial sustainability." The joint letter from the Panel and the Council in June 2018 included a copy of the Council's Improvement Stocktake Report, which represents the Council's self-assessment against the Local Government Association's criteria for an effective organisation underpinned by a suite of detailed corporate governance and service improvement plans. The Panel and the Council will monitor early indications of improvement in social outcomes, through adherence to the 2018/19 budget and stronger grip on issues such as homelessness, skills, community cohesion, waste and equal pay.	We identified in our initial risk assessment that the key risk is that the Panel will conclude that the Council is not making sufficient progress in implementing the changes needed. We have considered the latest findings of the Panel, in collaboration with the Council, and concluded that these weaknesses in the Council's arrangements do not support informed decision making.

Key findings (continued)

Significant risk	Findings	Conclusion
3 **Services for Vulnerable Children**		**Auditor view**
The key risk is that the service does not show demonstrable improvement and continues to be subject to external intervention. Until such time as Ofsted has confirmed that adequate arrangements are in place this remains a significant risk to the Council's arrangements. We reviewed the latest findings from Ofsted, to establish how the Council is identifying, managing and monitoring this risk.	The Council was subject to its latest Ofsted monitoring visits in March 2018 and May 2018 and the inspector wrote to the Council summarising his findings on 29 March 2018 and 8 June 2018. The area covered by the March 2018 visit was children looked after by the Council. The inspector's letter stated that "positive progress identified at the point of the last inspection has been maintained, with further improvement evident in specific service areas. Senior managers continue to be aware that further work needs to be done to ensure that services for children are of a standard at which their outcomes are consistently good." The area covered by the May 2018 visit was services to young people leaving care at 18 years. The inspector's letter stated that "the local authority has demonstrated that it has made some further improvements to the quality of social work practice since the last inspection. However, where children in care have long-term plans, there is a risk that a lack of focus on ensuring long-term security will result in instability in the future and poorer outcomes as a result. Further work remains to be done to ensure that practice is consistently good and that the best outcomes for all children are achieved on a timely and consistent basis." Birmingham Children's Trust Ltd (BCT) contract commenced on 1 April 2018 and it has published its Strategic Business Plan 2018. The plan outlines how BCT will deliver services for children, young people and families in Birmingham from 1 April 2018. It sets out the vision and priorities and how BCT will deliver its commitments as contained in the Service Delivery Contract agreed with the Council for the delivery of children's social care and family support services for the next five years. BCT announced the appointment of a Director of Practice in June 2018, which further enhances its ability to deliver the further improvements required for services for vulnerable children in the near future.	We identified in our initial risk assessment that the key risk was that services for vulnerable children do not show demonstrable improvement and continue to be subject to external intervention. The findings of the Ofsted monitoring reports means that this risk is not sufficiently mitigated. We concluded that these weaknesses in the Council's arrangements relate to managing risks effectively and maintaining a sound system of internal control, demonstrating and applying the principles and values of good governance, as part of informed decision making and planning, organising and developing the workforce effectively to deliver strategic priorities as part of strategic resource deployment.

Key findings (continued)

Significant risk	Findings	Conclusion
4 **Management of Schools**		**Auditor view**
The key risk is that the governance issues identified at schools will not be addressed effectively. We reviewed the progress made by Internal Audit within their coverage of schools governance, to establish how the Council is identifying, managing and monitoring this risk.	Birmingham Education Partnership (BEP) is responsible for driving improvement in schools' performance. This includes the delivery of the Education Improvement Services contract between the Council and BEP which was amended in April 2017 to reflect a reduction in the value of the contract. The variations represent an evolution of the service specification and key performance indicators; all other terms of the contract remain in force. The BEP is also responsible for the allocation of the Strategic School Improvement Fund (SSIF). The SSIF is a £140m grant to support first, infant, primary, secondary, middle, all-through, maintained nursery schools, alternative provision, special academies, maintained schools, post-16 academies, and pupil referral units. It is intended to further build a school-led system, and aims to target resources at the schools most in need to improve school performance and pupil attainment; to help them use their resources most effectively, and to deliver more good school places. However, as part of the assessment of schools governance improvement Birmingham Audit (internal audit) has been commissioned to carry out a programme of audits over a two year period. Their findings have continued to show that there are a range of governance issues to address across the schools visited, 32 of the 87 schools audits (37%) undertaken by internal audit in 2017/18 were assessed as 'level 3' assurance (specific control weaknesses of a significant nature noted, and/or the number of minor weaknesses noted was considerable) and two schools (2%) were assessed as 'level 4' assurance (controls evaluated are not adequate, appropriate or effective. Risks are not being managed and it is unlikely that objectives will be met). These results are worse than the prior year when only 17 of the 97 schools visited were assessed as 'level 3' assurance (18%) and none were assessed as 'level 4' assurance.	We identified in our initial risk assessment that the key risk was that plan implementation will be slower than envisaged and underlying issues will not be effectively addressed. Although it is clear that progress has been made with the implementation of the improvement plan there is still work to do. The pace of school improvement remains the key issue which is affecting our judgement. We concluded that these weaknesses in the Council's arrangements relate to managing risks effectively and maintaining a sound system of internal control, demonstrating and applying the principles and values of good governance, as part of informed decision making and planning, organising and developing the workforce effectively to deliver strategic priorities as part of strategic resource deployment.

Key findings (continued)

Significant risk	Findings	Conclusion
5 **Commonwealth Games**		**Auditor view**
The key risk is that the cost of hosting the Commonwealth Games will impact on the Council's future financial sustainability. We reviewed the Council's latest plans for the delivery of the Commonwealth Games in 2022, to establish how the Council is identifying, managing and monitoring this risk.	The Council has developed comprehensive internal governance proposals for the management and delivery of the Commonwealth Games. The overall structure includes a Steering Group, a Project Board, a Project Group and 11 workstreams. The Steering Group is chaired by the Leader of the Council and its purpose is to provide strategic direction, guidance and oversight of the Council's responsibilities and commitments for Games-wide planning and delivery of contractual obligations, Games vision and legacy. The Project Board is chaired by the Corporate Director for Place and its purpose is to act as the Design Authority for the project and ensure the overall integrity of the Council's Commonwealth Games Project Plan, ensuring that workstream plans are consistent and coherent with the overall project plan and critical interfaces, both internal and external. The Project Group is chaired by the Project Director and its purpose is to coordinate the operational delivery of products and activities as commissioned by the Steering Group and Project Board by the project's workstreams. The workstreams will adopt a 'whole council' approach which is essential to successful delivery. The finance workstream will oversee and manage the Council's internal Games budget, liaise with partners regarding overall Games budgets and ensure all appropriate mechanisms are in place for robust financial management. The funding for the Games is due to be agreed in the Autumn Budget Statement and the Council's delivery plan is for the majority of its share of the costs of the Games to be capital expenditure. Other workstreams include a number of cross partner working groups such as transport and security (Home Office).	We identified in our initial risk assessment that the key risk is the cost of hosting the Commonwealth Games will impact on the Council's future financial sustainability. We have considered the Council's proposed governance arrangements for the management and delivery of the Commonwealth Games and are satisfied that they are appropriate. On that basis, we have concluded that the risk is sufficiently mitigated and that the Council has appropriate arrangements in place to act in the public interest, through demonstrating and applying the principles and values of sound governance. However, on the basis that the funding for the Games is not due to be agreed until the Autumn Budget Statement, we will revisit this risk as part of our 2018/19 VfM review.

Independence and ethics

Independence and ethics

- We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required, or wish, to draw to your attention. The firm, its partners, senior managers, managers and network firms have complied with the Financial Reporting Council's Ethical Standards and confirm that we are independent and are able to express an objective opinion on the financial statements.

We confirm that we have implemented policies and procedures to meet the requirements of the Financial Reporting Council's Ethical Standard and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements.

Further, we have complied with the requirements of the National Audit Office's Auditor Guidance Note 01 issued in December 2017 which sets out supplementary guidance on ethical requirements for auditors of local public bodies.

Details of fees charged are detailed in Appendix D.

Independence and ethics (continued)

Non-audit services

For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Council. The following non-audit services were identified.

Service	£	Threats	Safeguards
Audit related			
Certification of grant claims (outside PSAA requirements)	92,100 (23,250 paid by BCC)	Self-Interest (because this is a recurring fee)	The level of this recurring fee taken on its own is not considered a significant threat to independence as the fee for this work is £92,100 in comparison to the total fee for the audit of £314,168 and in particular relative to Grant Thornton UK LLP's turnover overall. Further, it is a fixed fee and there is no contingent element to it. These factors all mitigate the perceived self-interest threat to an acceptable level. The fee for grant certification is higher than in previous years due to the complex and numerous Regional Growth Fund grant certifications. We undertook work to certify six grants over a period of four years. The fee for this work was £68,850. The Council acts as agent in this arrangement and the fee was paid from funding received by the Council from the Department for Business, Energy and Industrial Strategy.
Non-audit related			
Chief Finance Officer Insights (CFOi) for 2017/18	10,000	Self-Interest (because this is a recurring fee)	The level of this recurring fee (subscription based for 3 years) taken on its own is not considered a significant threat to independence as the fee for this work is £10,000 in comparison to the total fee for the audit of £314,168 and in particular relative to Grant Thornton UK LLP's turnover overall. Further, it is a fixed fee and there is no contingent element to it. These factors all mitigate the perceived self-interest threat to an acceptable level.
Client Money and Assets (CASS) reporting – Finance Birmingham	7,000 (not paid by BCC)	Self-Interest (because this is a recurring fee)	The level of this recurring fee taken on its own is not considered a significant threat to independence as the fee for this work is £7,000 in comparison to the total fee for the audit of £314,168 and in particular relative to Grant Thornton UK LLP's turnover overall. Further, it is a fixed fee and there is no contingent element to it. These factors all mitigate the perceived self-interest threat to an acceptable level. It is usual practise for CASS reporting services to be provided by the external auditors of an FCA regulated entity.

The amounts detailed are fees agreed to-date for audit related and non-audit services to be undertaken by Grant Thornton UK LLP in the current financial year. These services are consistent with the Council's policy on the allotment of non-audit work to your auditors. All services have been approved by the Audit Committee. Any changes and full details of all fees charged for audit related and non-audit related services by Grant Thornton UK LLP and by Grant Thornton International Limited network member Firms will be included in our Audit Findings report at the conclusion of the audit.

None of the services provided are subject to contingent fees.

Action plan

We have identified 7 recommendations for the Council as a result of issues identified during the course of our audit. We have agreed our recommendations with management and we will report on progress on these recommendations during the course of the 2018/19 audit. The matters reported here are limited to those deficiencies that we have identified during the course of our audit and that we have concluded are of sufficient importance to merit being reported to you in accordance with auditing standards.

	Assessment	Issue and risk	Recommendations
1	Amber	**Control weakness – payroll leavers** As part of our payroll testing we identified one individual who resigned from the Council in June 2017. However, their resignation form was not authorised until October 2017. Salary overpayments were identified in February 2018 and payments to the individual were suspended. This has been recognised as a debtor. Although we are satisfied that this error was identified by the Council, there is a risk that salary overpayments could occur if resignation documents are not authorised and actioned on a timely basis.	We recommend that management consider the adequacy of controls in place to ensure authorisation of leaver documents does not lead to payments being made to individuals once they have ceased employment. **Management response** • […]
2	Amber	**Control issue – heritage asset valuations** From our work performed on heritage assets and through further discussions with management we consider that the value of heritage assets recognised on the balance sheet, whilst the accounting treatment is compliant with the Code based on insurance valuations, may not be a true reflection of the value of such assets.	We recommend that management consider the appropriateness of these insurance valuations. **Management response** • […]
3	Amber	**SAP – User access** We identified a higher than expected number of system accounts and service accounts with SAP_ALL access. SAP_ALL access provides access to all IT functions within the ledger system. We also noted one member of staff who was given this access in error. We can confirm no manual journals have been processed by this user in 2017/18.	We recommend that management considers which users need SAP_ALL access and removes access to this function where it is not required. **Management response** • […]
4	Amber	**Multiple accounts assigned to a single user** We identified a high number of users with multiple accounts within SAP. Whilst some of these are required for FireFighter ID purposes, it appears that some are unnecessary.	We recommend that management considers which users need multiple accounts within SAP and removes access to those where this function where is it not required. **Management response** • […]

Controls
- Red High - Significant effect on control system
- Amber Medium - Effect on control system
- Green Low - Best practice

Action plan (continued)

	Assessment	Issue and risk	Recommendations
5	Amber	**Under-accrual of waste invoices** Management made us aware of a number of waste invoices relating to services provided 2017 which had not been correctly recorded in the financial statement. Whilst the values involved are immaterial to our audit we have identified two weaknesses in the control environment. Firstly, one purchase order (PO) created in the system became 'stuck' and could not be authorised. This meant that invoices received could not be matched to the PO. Secondly, a number of payments were processed in relation to invoices which had not yet been recorded in the system.	We recommend that the Council considers its controls in place to ensure other invoices are not paid before they are recognised within the ledger system. **Management response** • […]
6	Amber	**Control weakness - HRA revaluation** From completing our testing on HRA revaluation, we noted a £97.1m error within council dwellings which resulted an understatement of net book value. This occurred due to a formula error and has now been corrected.	We recommend that a reconciliation control is put in place to ensure the prevention of similar errors in the future. **Management response** • […]
7	Amber	**Control weakness – Business Rates Appeals** Classification of additional provisions made in year and amounts used in year are incorrect. However, we are satisfied that the year end provision value is correct.	We recommended that the Council accurately calculates the amount of 'business rates appeals used in year' which will result in an accurate figure for 'additional provisions to be made in year'. **Management response** • […]

Controls
- Red High - Significant effect on control system
- Amber Medium - Effect on control system
- Green Low - Best practice

Action plan - VfM

	Assessment	Issue and risk	Recommendations
1	Red	**Budget Delivery and Reserves Management, as well as savings proposals** The key risk is that the proposed savings schemes (including the implementation of savings proposals) will not deliver the required recurrent savings, or will take longer to implement than planned.	We recommend that the Council deliver the elements of the statutory recommendation that relate to finance and transparency and governance (see page 5). **Management response** • […]
2	Amber	**The Panel** The key risk is that the Panel will conclude that the Council is not making sufficient progress in implementing the changes needed.	We recommend that the Council implement the actions identified in its Improvement Stocktake Report and demonstrate measurable outcomes to the Panel. **Management response** • […]
3	Amber	**Services for Vulnerable Children** The key risk is that the service does not show demonstrable improvement and continues to be subject to external intervention. Until such time as Ofsted has confirmed that adequate arrangements are in place this remains a significant risk to the Council's arrangements.	We recommend that the Council continue to demonstrate measurable improvements in services for vulnerable children through the Children's Trust. **Management response** • […]
4	Amber	**Management of Schools** The key risk is that the governance issues identified at schools will not be effectively addressed.	We recommend that the Council increase the pace of improvement in schools governance arrangements to ensure that it can demonstrate to Ofsted that it has addressed the issues that it raised. **Management response** • […]

Controls
- Red High - Significant effect on control system
- Amber Medium - Effect on control system
- Green Low - Best practice

Follow up of prior year recommendations

We identified the following issues in the audit of Birmingham City Council's 2016/17 financial statements, which resulted in six recommendations being reported in our 2016/17 Audit Findings report. We are satisfied that management have implemented five out of six prior year recommendations.

	Assessment	Issue and risk previously communicated	Update on actions taken to address the issue
1	✓	**Cut-off of operating expenditure in Schools** We tested a sample of payments made in April and May 2017 to identify whether there were items relating to goods/services received in 2016/17 which had not been appropriately accrued for (whether via system/manual accruals or the forecast accrual process). Two out of the seven schools invoice payments selected within our sample related to services received prior to 31/3/17, but processed for payment after year-end. We are satisfied there cannot be a material risk of under accrual of schools invoices. However, we recommend that the Council review their processes for ensuring schools expenditure includes appropriate accruals.	**Management response:** The Council provides guidance to schools on the appropriate accounting treatment for expenditure relating to specific financial years. The guidance will be reviewed to ensure that the information provided to schools is clear. Information will also be provided in relevant schools forums to ensure that as many people as possible are contacted. **Update:** The Council has reviewed its year-end processes. For the 2017/18 closedown process, detailed guidance letters were sent out tailored to the type of school:- • Chequebook schools • EPA schools using SIMS FMS • EPA schools using CMIS FMS • Nursery, Primary and Special non-chequebook schools using SIMS FMS • Nursery, Primary and Special non-chequebook schools using CMIS FMS
2	✓	**HRA Assets under construction** We identified that all spend on HRA additions is fully settled in year, with nothing being retained in AUC at year-end. While for spend relating to renewals to existing properties any AUC element is unlikely to be material at year-end, in recent years the Council has undertaken significant construction of new properties, and where construction spans year-end the spend should properly be included in AUC until brought into use. We are satisfied that the estimated potential impact would be trivial due to the need to impair the spend to reflect the social housing factors, and any impact on depreciation would also be trivial. We recommend that this is reviewed in future years if the Council continues to expand its house building programme, to ensure there is no material misstatement.	**Management response:** Agreed. The extent to which new homes are partially constructed at the financial year-end will be evaluated and if material accounted for as Assets Under Construction. **Update:** A large piece of work was undertaken at year-end to identify all new build homes that were still in the course of construction. At 31 March 2018 there was £23.7m relating to new homes within the Assets Under Construction overall total.

Assessment
✓ Action completed
X Not yet addressed

Follow up of prior year recommendations (continued)

	Assessment	Issue and risk previously communicated	Update on actions taken to address the issue
3	✓	**Housing Benefits** There have been two instances in the year where potential control weaknesses regarding the housing benefit system have been identified. The first related to a duplicate payment run which the Authority manually prevented from being paid. However, it still continued to be recorded as duplicated within the RBIS and therefore subsidy. The second related to two high value payments made in error, where on both occasions, an incorrect weekly rent figure had been manually entered in to the rent field of RBIS. These payments were manually stopped by the Council as they were identified as unusually large from the >£3k checks which are performed by the Housing Benefits Team. However, we recommend that the Council continues to strengthen its internal controls with regards to Housing Benefit payments in order to reduce the risk of incorrect payments being made and not being identified manually prior to payment.	**Management response:** In relation to both of these issues the controls in place within the Housing Benefit and payments system worked as intended to prevent incorrect high value and duplicate payments from being dispatched to citizens and landlords. Thereby, preventing both overpaid benefit and loss of housing benefit subsidy due to 'Local Authority error'. Both instances did create substantial additional work for officers within the Council as manual adjustments to the Housing Benefit subsidy claim had to be made and reconciliation between the Housing Benefit system and payment system had to be manually adjusted. In order to further strengthen the controls the following measures have been put in place: • Within the Housing Benefit system the payment field has now been restricted from an unlimited size to a maximum of 6 digits including 2 decimal points; • The duplicate payment issue was generated through an inappropriate batch parameter error and Service Birmingham have strengthened their controls around batch processing in order to reduce the instance of this occurring in the future. **Update:** This matter was brought to the attention of the Service Director, Customer Services who commissioned an internal audit investigation into how the above errors happened and to provide assurance that such risks are mitigated to a low level. The findings are outlined in the Final Audit Report 1700/029 with agreed actions from Senior Managers dated June and August 2017. These recommendations have been implemented.

Follow up of prior year recommendations (continued)

	Assessment	Issue and risk previously communicated	Update on actions taken to address the issue
4	✓	**Capitalisation of expenditure in Schools** We identified a number of issues relating to capital spend recorded by schools: - 1 item selected in our sample which had been capitalised related to IT support for April 2016 – March 2017 which had been funded by DFC. This was capitalised as spend on buildings which is incorrect as this appears to be a revenue cost. - All DFC is capitalised as buildings spend, but 1 item selected related to playground equipment which would be better classified as equipment. This is a misclassification issue only with no impact on the total value of PPE. Although we are satisfied there is no risk to material misstatement for the above noted issues, we recommend that the Council continues to review the procedures for ensuring capital expenditure by schools is recorded completely and accurately in the accounts.	**Management response:** Guidance on the appropriate accounting arrangements for capital expenditure will be reviewed to ensure that it is clear on the correct treatment. Guidance will also be provided in appropriate school forums to ensure that relevant staff have access to the information. The Capital Team within the Council's Finance & Governance Directorate will continue, where possible, to review detailed expenditure within school accounting records to ensure the correct accounting treatment for capital expenditure. **Update:** Revised guidance has been issued following consultation between the Capital Finance Team, Schools Finance Team and Schools Financial Services in relation to EPA and chequebook schools. EPA and chequebook schools now provide a capital analysis and copies of invoices relating to capital expenditure. This return relates to all capital spend including that funded by the devolved capital grant. For non EPA schools the invoices are held within BCC systems. The Capital Team continue to review all capital spend to ensure eligibility under Accounting Standards.

Assessment
✓ Action completed
X Not yet addressed

Follow up of prior year recommendations (continued)

	Assessment	Issue and risk previously communicated	Update on actions taken to address the issue
5	✓	**Group Accounts** Group Accounts are drafted using unaudited financial information provided by group entities. In future the Audit Committee need assurance that group entities provide sufficient information by the end of April to ensure materially accurate Group Accounts can be produced and that audited accounts are received before the completion of the Council's audit.	**Management response:** Discussions are held with Group entities before the year end so that contacts are aware of the Council's timetable for completion of the financial statements. The timetable includes the dates for provision of draft and audited financial statements. Information is also sought from companies in December, prior to the end of the financial year, so that any potential issues can be identified. Companies have a longer statutory timeframe for the completion and audit of their financial statements than the Council. The Council can influence companies to accelerate the completion and audit of their financial statements and companies will be encouraged to see the benefits of early completion. This is more difficult where the Council has only a minority shareholding in a company as external influences will have more power. **Update:** There has continued to be regular liaison with the Councils' group entities to ensure that they were aware of the Council's reporting deadlines and the information that would be required to complete the draft Group Financial Statements by 31 May 2018. Whilst information was provided by the majority of companies by the due date, some information was provided late. Audited statements have been provided by some of the companies but some will not have been completed by the time the Council's accounts are signed off. However, any changes to the data used in producing the Group Financial Statements will not be material.
6	X	**Exit Packages** We recommend that the Council reflects on the advice given by the Department of Communities and Local Government in relation to member consideration of exit packages. This advice suggests that authorities should report all exit payments over £100k to Full Council. Whilst Birmingham City Council is not alone in not following the advice, it may wish to consider whether this could be a useful enhancement to strengthen the transparency of its arrangements	**Management response:** The Council has previously considered the advice provided by the Department of Communities and Local Government in relation to member consideration of exit packages, which is provided as guidance only. As part of our considerations on this matter, the Council set up its own governance in 2016 for exit payments, which for chief officers' exits includes sign off from a cross party elected member JNC panel. The Council does plan to further review the guidance from Department of Communities and Local Government during the next 6 months, as part of the elected member JNC panel. **Update:** No update provided.

Assessment
✓ Action completed
X Not yet addressed

Audit adjustments

We are required to report all non trivial misstatements to those charged with governance, whether or not the accounts have been adjusted by management.

Impact of adjusted misstatements

All adjusted misstatements are set out in detail below along with the impact on the key statements and the reported net expenditure for the year.

	Detail	Comprehensive Income and Expenditure Statement £'000	Balance Sheet £'000
1	**Housing Revenue Account (HRA) depreciation** Within the draft accounts we identified a £50.3m credit to the HRA Income and Expenditure Statement relating to depreciation reversed through the CIES on revaluation. The correct accounting treatment is to calculate the revaluation movement based on the net movement with the resulting net gain/loss being taken to the CIES or revaluation reserve as appropriate.	Dr Total cost of services: £50,300 Cr Surplus/deficit on revaluation of PPE (other comprehensive income) £50,300	
2	**HRA revaluation** We identified an error in the accounting for the revaluation of council dwellings. The effect of this was an understatement of the net book value of council dwellings by £97.1m.	Cr Surplus/deficit on revaluation of PPE (other comprehensive income) £97,100	Dr Property, plant and equipment £97,100 Cr Unusable (revaluation) reserve £97,100
3	**Short term investments** We have identified £15.9m of Short term investments which are instant access accounts and should therefore be classified as cash.		Dr Cash £15,900 Cr Short term investments £15,900
4	**Group Balance Sheet intra-group eliminations.** We identified one audit adjustment from our work on the group consolidation relating to intra-group eliminations between the Council and Innovation Birmingham.		Dr Long Term Debtors £7,635 Dr Short Term Debtors £8,562 Cr Short Term Creditors £693 Cr Long Term Borrowing £15,504
	Overall impact	**£97,100**	**£0**

Audit adjustments (continued)

Misclassification and disclosure changes

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

Misclassification and disclosure changes	Detail	Adjusted?
Disclosure – Narrative Report	Section 6.5.1 of the Narrative Report incorrectly disclosed the future liability of service concession arrangements. This has been corrected to £421.8m which agrees to Note 43.	✓
Disclosure – Narrative Report	A number of trivial changes have been made to the Narrative Report to ensure transparency and consistency with the financial statements.	✓
Disclosure – Note 2 Critical Judgements in Applying Accounting Policies	Additional disclosures have been required within Note 2 to include added narrative regarding the early payment of pension contributions.	✓
Disclosure – Note 4 Assumptions made about the future and other areas of estimation uncertainty	One error was identified in 'assumptions made about the future and other major sources of estimation uncertainty relating to property, plant and equipment.	✓
Disclosure – Expenditure Funding Analysis	The 2016/17 restated adjustments to arrive at the amount chargeable to the General Fund and HRA balances have been amended to ensure they are consistent with Notes 6 and 7.	✓
Disclosure – Note 7: Note to the Expenditure and Funding Analysis	We identified that depreciation reported for the centrally managed directorate had been incorrectly stated. This has now been corrected as well as the total depreciation reported at a directorate level.	✓
Disclosure – Note 14 Grant Income	The Grant Income note has been amended to include additional disclosures of grants which were originally included under the heading 'grants and contributions of less than £3m' but have subsequently been identified as over this threshold	✓
Disclosure – Note 19 Unusable Reserves and note 21 Defined Benefit Pension Schemes	We identified errors relating to the disclosure of pension adjustments within the pensions reserve and general fund.	✓
Disclosure – Note 22 Property, Plant and Equipment	The fair value disclosure for surplus assets has been corrected to agree to the NBV as at 31/03/2018 of £112.2m.	✓

Audit adjustments (continued)

Misclassification and disclosure changes	Detail	Adjusted?
Misclassification – Note 25 Long Term Investments	The disclosure of long term investments 'Available for Sale Financial Assets' includes £9.5m investment in Birmingham City Propco Ltd. This has been reclassified as 'Investment in Subsidiary and Associated Companies'.	✓
Misclassification – Note 32 Provisions	From our testing on provisions we noted that the unused provision amount reserve of £7.7m had been incorrectly netted off against the additional provision required. We have therefore increased the additional provision made in 2017/18 by £7.7m and similarly included an unused amount reversed in 2017/18 of £7.7m This has no impact on the provision balance as at 31 March 2018	✓
Note 33 – Contingent liabilities	Additional disclosures have been included in the contingent liabilities note to ensure the note is complete and correctly reflects potential future liabilities which may fall to the Council.	✓
Disclosure – Note 39 Financial Instruments	The fair value of PFI schemes have been disclosed incorrectly and have been amended. The fair value disclosure has increased by £67.5m In addition, other long term liabilities have decreased by £5.8m due to the correction of the £9.5m investment in Birmingham City Propco Ltd. being removed from note 25.	✓
Misclassification – Note 39 Financial Instruments	The Council has opted to remove the long term and short term classifications within the Fair Value of Financial Instruments table.	✓
Disclosure – Note 48 Related Parties	A number of disclosures have been amended within the related parties transactions note in relation to the Group disclosures of related parties.	✓
Disclosure – Note 48 Related Parties	The related parties note disclosure detailing BCF schemes has been updated to reflect that the 'Equipment Contracts' is a 'lead commissioning arrangement' by the Council. This was incorrectly disclosed as being joint control.	✓
Misclassification – Note H5 Capital Expenditure on HRA assets	We identified a lack of consistency between Note H5 and the Useable Reserves and Capital Expenditure and Capital Financing notes. This has now been amended.	✓
Disclosure – Note G2 Critical judgements in applying accounting policies	Updated disclosures within note G2 and note G3 to ensure accurately and consistently disclosed judgements for why Performances Birmingham Limited and Birmingham Museums Trust Limited have been excluded from the Group on the grounds of lack of control.	✓
Various	In addition to the items identified above, a number of other minor changes have been made to the presentation of, and disclosures, within the accounts. This is to ensure consistency, enhance transparency and ensure compliance with the Code. None of these are deemed significant enough to bring to your attention individually	✓

Audit Adjustments (continued)

Impact of unadjusted misstatements

No unadjusted misstatements have been identified.

Fees

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

Audit Fees

Audit Fees	Proposed fee	Final fee
Council Audit	314,168	TBC
Objections from 2016/17		TBC
Grant Certification – Housing Benefits	17,594	TBC
Total audit fees (excluding VAT)	**£331,762**	**£TBC**

The proposed fees for the year were in line with the scale fee set by Public Sector Audit Appointments Ltd (PSAA). Our fees for grant certification covers only Housing Benefit subsidy certification, which falls under the remit of PSAA. Fees in respect of other grant work, such as reasonable assurance reports, are shown under 'Fees for other services'.

Note 47 of the financial statements shows £0.3m for 'fees payable with regards to external audit services'. This agrees to our disclosed audit fees table above.
Note 47 also shows £0.1m for 'fees payable for the certification of grant claims and returns'. This is comparable to our non audit fees paid by BCC below. The Council have rounded this up so as not to show as NIL in the financial statements.

Non Audit Fees paid by BCC

Fees for other services	Fees £
Audit related services:	
• Certification of grant claims excluding Housing Benefits (BCC element only)	23,250
Non-audit services	
• CFOi insights 2017/18	10,000
Total	**33,250**

Group audit fees

These fees have not been disclosed separately in the notes to the group accounts.

Fees for other subsidiaries	Fees £
Acivico Limited	38,000
Innovation Birmingham Limited	22,800
West Midlands Growth Company Limited	13,900
Finance Birmingham Limited	7,000
NEC (Developments) PLC	35,000
PETPS (Birmingham) Limited	7,500
PETPS subsidiaries	20,000
Total	**144,200**

Audit opinion

We anticipate we will provide the Council with a modified audit report.

Independent auditor's report to the members of Birmingham City Council

Report on the Audit of the Financial Statements

Opinion

Our opinion on the financial statements is unmodified

We have audited the financial statements of Birmingham City Council (the 'Council') and its subsidiaries, associates and joint ventures (the 'group') for the year ended 31 March 2018 which comprise the Comprehensive Income and Expenditure Statement, Movement in Reserves Statement, the Balance Sheet, the Cash Flow Statement, the Housing Revenue Account - Income and Expenditure Statement, the Movement on the Housing Revenue Account Statement, the Collection Fund Income and Expenditure Account, the Group Comprehensive Income and Expenditure Statement, Group Movement in Reserves Statement, the Group Balance Sheet, the Group Cash Flow Statement and all notes to the financial statements, including the Accounting Policies to the Core Financial Statements and the Group Accounts. The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC code of practice on local authority accounting in the United Kingdom 2017/18.

In our opinion, the financial statements:

- give a true and fair view of the financial position of the group and of the Council as at 31 March 2018 and of the group's expenditure and income and the Council's expenditure and income for the year then ended;
- have been prepared properly in accordance with the CIPFA/LASAAC code of practice on local authority accounting in the United Kingdom 2017/18; and
- have been prepared in accordance with the requirements of the Local Audit and Accountability Act 2014.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report. We are independent of the group and the Council in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of matter – completeness of equal pay contingent liability

We draw attention to the disclosures made in note 33 to the core financial statements (contingent liabilities and contingent assets) concerning the uncertain outcome of claims that may be received by the Council under the Equality Act. As stated in section 2 of the contingent liabilities disclosures in note 33, the Council has set aside a provision of £151.8m for claims received under the Equality Act, which incorporates all claims received and negotiations agreed to 28 February 2018. Whilst the provision reflects the forecast impact of claims made to date, there remain a number of uncertainties regarding any additional liabilities that the Council may face. There are uncertainties surrounding the volume and timing of any future claims and the determination of any settlements. Our opinion is not modified in respect of this matter.

Who we are reporting to

This report is made solely to the members of the Council, as a body, in accordance with Part 5 of the Local Audit and Accountability Act 2014 and as set out in paragraph 43 of the Statement of Responsibilities of Auditors and Audited bodies published by Public Sector Audit Appointments Limited. Our audit work has been undertaken so that we might state to the Council's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Council and the Council's members as a body, for our audit work, for this report, or for the opinions we have formed.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the Corporate Director, Finance & Governance's use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the Corporate Director, Finance & Governance has not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the group's or the Council's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Overview of our audit approach

- Overall materiality: £43.8 million, which represents 1.5% of the group's gross total cost of services expenditure;
- Key audit matters were identified as:
  - Valuation of land and buildings (other land and buildings, council dwellings and surplus assets); and
  - Valuation of the pension fund net liability.
- We performed a full scope audit of the Council, targeted procedures on Birmingham City Propco Limited and analytical procedures on all the other non-significant components within the Group.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current year and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those that had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Key Audit Matter – Group and Council	How the matter was addressed in the audit – Group and Council
Risk 1 – Valuation of land and buildings (other land and buildings, council dwellings and surplus assets) The Council revalues its land and buildings on a rolling five year programme to ensure that the carrying value is not materially different from the current value or the fair value (for surplus assets). This represents a significant estimate by management in the core financial statements and group accounts. Valuation of land and buildings is considered a significant estimate due to the size of the numbers involved (£4.7 billion) and the sensitivity of this estimate to changes in key assumptions. We therefore identified the valuation of land and buildings (other land and buildings, council dwellings and surplus assets) as a significant risk, which was one of the most significant assessed risks of material misstatement.	Our audit work included, but was not restricted to: • Updating our understanding of the processes put in place by management to ensure that revaluation measurements are correct and evaluating the design of the associated controls; • Evaluating management's processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work; • Evaluating the competence, capabilities and objectivity of the valuation expert (the valuer); • Discussing with the valuer the basis on which the valuation was carried out; • Challenging the information and assumptions used by the valuer to ensure completeness and consistency with our understanding; • Testing revaluations made during the year to ensure they were input correctly into the Council's asset register and correctly reflected in the financial statements; and • Evaluating the assumptions made by management for those assets either revalued at the start of the financial year or not revalued during the year to determine how management has satisfied themselves that the current values (or fair values for surplus assets) at the year-end are not materially different to the carrying values per the financial statements. The Council's accounting policy on valuation of land and buildings (other land and buildings, council dwellings and surplus assets) is shown in note 1.xi to the core financial statements and related disclosures are included in note 22 to the core financial statements and note G7 to the group accounts.

Key Audit Matter – Group and Council	How the matter was addressed in the audit – Group and Council
	Key observations We obtained sufficient audit assurance to conclude that: • the basis of the valuation was appropriate and the assumptions and processes used by management in determining the estimate were reasonable; and • the valuation of land and buildings disclosed in the financial statements is reasonable. We identified that £50 million of in-year depreciation for council dwellings was incorrectly written out to the CIES on revaluation when this should have been accounted for as part of the overall revaluation increase recognised in the revaluation reserve. We also identified an error of £97 million in the accounting for the revaluation of council dwellings. The impact on the comprehensive income and expenditure statement has been to increase net cost of services expenditure by £50 million and to increase the surplus on revaluation of property, plant and equipment assets by £147 million. These adjustments are subsequently reflected in the capital adjustment account and revaluation reserve. The impact on the balance sheet has been to increase the net book value of property, plant and equipment by £97 million and to increase unusable reserves by £97 million.
Risk 2 - Valuation of the pension fund net liability The Council's pension fund net liability, as reflected in its balance sheet as the net liability on defined pension scheme, represents a significant estimate in the core financial statements and group accounts. The pension fund net liability is considered a significant estimate due to the size of the numbers involved (£2.6 billion in the Council's balance sheet) and the sensitivity	Our audit work included, but was not restricted to: • Gaining an understanding of the processes and controls put in place by management to ensure that the Council's pension fund net liability was not materially misstated and evaluating the design of the associated controls; • Evaluated the appropriateness of data provided for the purposes of the IAS19 actuarial valuation; • Evaluating the competence, capabilities and objectivity of the

Key Audit Matter – Group and Council	How the matter was addressed in the audit – Group and Council
of the estimate to changes in key assumptions. We therefore identified valuation of the Council's pension fund net liability as a significant risk, which was one of the most significant assessed risks of material misstatement.	actuary who carried out the Council's pension fund valuation; • Testing the consistency of the pension fund asset and liability and disclosures in the notes to the core financial statements with the actuarial report from the actuary; and • Undertaking procedures to confirm the reasonableness of the actuarial assumptions made by reviewing the report of the consulting actuary (as auditor's expert) and performing any additional procedures suggested within the report. The Council's accounting policy on valuation of the pension fund net liability is shown in note 1.vi to the core financial statements and related disclosures are included in note 21 to the core financial statements. **Key observations** We obtained sufficient audit assurance to conclude that: • the basis of the valuation was appropriate and the assumptions and processes used by the actuary in determining the estimate were reasonable; and • the valuation of the Council's pension fund net liability disclosed in the financial statements is reasonable.

Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality in determining the nature, timing and extent of our work and in evaluating the results of that work.

Materiality was determined as follows:

Materiality Measure	Group	Council
Financial statements as a whole	£43.8 million, which is 1.5% of the Group's gross total cost of services expenditure. This benchmark is considered the most appropriate because we consider users of the financial statements to be most interested in how it has expended its revenue and other funding. Materiality for the current year is at the same percentage level of gross total cost of services expenditure as we determined for the year ended 31 March 2017, as we did not identify any significant changes in the Group or the environment in which it operates.	£43.6 million, which is 1.5% of the Council's gross total cost of services expenditure. This benchmark is considered the most appropriate because we consider users of the financial statements to be most interested in how it has expended its revenue and other funding. Materiality for the current year is at the same percentage level of gross total cost of services expenditure as we determined for the year ended 31 March 2017, as we did not identify any significant changes in the Council or the environment in which it operates.
Performance materiality used to drive the extent of our testing	75% of financial statement materiality	75% of financial statement materiality
Specific materiality	None	£100,000 for senior officer's remuneration (including exit packages for senior officers) based on the fact that we consider the disclosures to be sensitive and of specific interest to the reader of the financial statements.
Communication of misstatements to the Audit Committee	£2.2 million and misstatements below that threshold that, in our view, warrant reporting on qualitative grounds.	£2.2 million and misstatements below that threshold that, in our view, warrant reporting on qualitative grounds.

The graph below illustrates how performance materiality interacts with our overall materiality and the tolerance for potential uncorrected misstatements.

An overview of the scope of our audit

Our audit approach was a risk-based approach founded on a thorough understanding of the group's business, its environment and risk profile and in particular included:

- Gaining an understanding of significant changes to the Group structure;
- Evaluation of identified components to assess the significance of each component and to determine the planned audit response based on measures of the materiality and significance of the component as a percentage of the group's current assets, total assets, current liabilities, total liabilities, equity and revenues. A full scope, targeted or analytical approach was taken for each component based on their relative materiality to the group and our assessment of audit risk;
- Full scope audit procedures on the Council, which represents 99.7% of the group's income and 99.5% of its group's total expenditure;
- Performing analytical procedures or targeted procedures on all non-significant components included in the group financial statements which make up the remainder of the group's income and total expenditure;
- Gaining an understanding of and evaluating the Council's internal control environment, including its financial and IT systems and controls; and
- Substantive testing of the income, expenditure and net assets for the Council. Testing undertaken covered 99.1% of group income and 99.3% of group expenditure.

Other information

The Corporate Director, Finance & Governance is responsible for the other information. The other information comprises the information included in the Statement of Accounts set out on pages 1 to 221 other than the group and Council financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge of the group and Council obtained in the course of our work including that gained through work in relation to the Council's arrangements for securing value for money through economy, efficiency and effectiveness in the use of its resources or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

Other information we are required to report on by exception under the Code of Audit Practice

Under the Code of Audit Practice published by the National Audit Office on behalf of the Comptroller and Auditor General (the Code of Audit Practice) we are required to consider whether the Annual Governance Statement does not comply with the 'Delivering Good Governance in Local Government: Framework (2016)' published by CIPFA and SOLACE or is misleading or inconsistent with the information of which we are aware from our audit. We are not required to consider whether the Annual Governance Statement addresses all risks and controls or that risks are satisfactorily addressed by internal controls.

We have nothing to report in this regard.

Our opinion on other matter required by the Code of Audit Practice is unmodified

In our opinion, based on the work undertaken in the course of the audit of the financial statements and our knowledge of the Council gained through our work in relation to the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources, the other information published together with the financial statements in the Statement of Accounts for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

Under the Code of Audit Practice we are required to report to you if:

- we have reported a matter in the public interest under section 24 of the Local Audit and Accountability Act 2014 in the course of, or at the conclusion of the audit; or
- we have made a written recommendation to the Council under section 24 of the Local Audit and Accountability Act 2014 in the course of, or at the conclusion of the audit; or
- we have exercised any other special powers of the auditor under the Local Audit and Accountability Act 2014.

We have nothing to report in respect of the above matters except on 30 July 2018 we made written recommendations to the Council in our Audit Findings Report under section 24 of the Local Audit and Accountability Act 2014 in relation to the Council's financial plans and reserve levels from 2018/19, its governance arrangements over financial monitoring and the Council's Place Directorate and its oversight of subsidiary bodies.

Responsibilities of the Council, the Corporate Director Finance and Governance and Those Charged with Governance for the financial statements

As explained more fully in the Statement of Responsibilities for the Statement of Accounts set out on page 17, the Council is required to make arrangements for the proper administration of its financial affairs and to secure that one of its officers has the responsibility for the administration of those affairs. In this Council, that officer is the Corporate Director, Finance & Governance. The Corporate Director, Finance & Governance is responsible for the preparation of the Statement of Accounts, which includes the financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC code of practice on local authority accounting in the United Kingdom 2017/18, which give a true and fair view, and for such internal control as the Corporate Director, Finance & Governance determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Corporate Director, Finance & Governance is responsible for assessing the group's and the Council's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the group or the Council lacks funding for its continued existence or when policy decisions have been made that affect the services provided by group or the Council.

The Audit Committee is Those Charged with Governance.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

We are responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. Owing to the inherent limitations of an audit, there is an unavoidable risk that material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the ISAs (UK). Our audit approach is a risk-based approach and is explained more fully in the 'An overview of the scope of our audit' section of our audit report.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Other matters which we are required to address

We were appointed by the Audit Commission on 26 July 2012. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 6 years.

The non-audit services prohibited by the FRC's Ethical Standard were not provided to the group or the Council and we remain independent of the group and the Council in conducting our audit.

The following services, in addition to the audit, were provided by the firm to the Council after 1 April 2017 that have not been disclosed separately in the Statement of Accounts:

- Chief Finance Officer Insights (CFOi) subscription for 2017/18
- Skills Funding Agency return certification for 2016/17
- Illegal Money Lending Team return certification for 2016/17 and 2017/18
- Regional Growth Fund return certifications for the years of 2012/13 to 2016/17
- Pooling of Housing Capital Receipts return certification for 2016/17
- Teachers' Pensions return certification for 2016/17

Our audit opinion is consistent with the additional report to the Audit Committee.

Report on other legal and regulatory requirements - Conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources

Adverse conclusion

On the basis of our work, having regard to the guidance issued by the Comptroller and Auditor General in November 2017, because of the significance of the matters described in the basis for adverse conclusion section of our report, we are not satisfied that, in all significant respects, the Council put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2018.

Basis for adverse conclusion

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

Budget Delivery and Reserves Management, as well as saving proposals (including the principles of the Future Operating Model) and Equal Pay

The Council had demanding savings targets of £85.3 million in 2017/18 which included finding solutions for £14.4 million based mostly on savings achieved on a non-recurrent basis in 2016/17. The Council continued to under-deliver planned savings in 2017/18, again, in part due to the failure to deliver large savings plans such as the Future Operating Model (FOM), which under-delivered by £15.4 million in 2017/18, an under-delivery which was due to rise to £34.2 million in future years. As a result, the Council reported a 2017/18 revenue budget overspend of £4.9 million after the use of £63.1 million of reserves (£42.2 million of which was planned).

The Council's Business Plan 2018+ identifies continuing savings pressures, with a requirement of £117.0 million of savings to be delivered by the end of 2021/22, with 2018/19 (£52.9 million) and 2019/20 (£35.6 million) being the two years with the greatest savings demand.

The uncertainties surrounding the volume and timing of future equal pay claims and the determination of any settlements may also have an impact on the level of the Council's reserves.

These matters are evidence of weaknesses in proper arrangements for sustainable resource deployment in:

- planning finances effectively to support the sustainable delivery of strategic priorities and maintain statutory functions; and
- planning, organising and developing the workforce effectively to deliver strategic priorities.

Birmingham Independent Improvement Panel ('the Panel')

The Secretary of State for Communities and Local Government appointed the Panel in January 2015 to oversee improvements in the Council's governance arrangements.

The Council has been working more closely with the Panel since the autumn of 2017 and the Panel, in conjunction with the Council, has written to the Secretary of State several times since 1 April 2017, most recently in June 2018.

The joint letter from the Panel and the Council in March 2018 recognised that the Council has experienced a number of changes in key leadership positions during the last year and still needs to address a number of significant financial challenges to achieve financial sustainability.

The joint letter from the Panel and the Council in June 2018 included a copy of the Council's Improvement Stocktake Report, which represents the Council's self-assessment against the Local Government Association's criteria for an effective organisation, underpinned by a suite of detailed corporate governance and service improvement plans. This demonstrates that the Council has not yet addressed the issues identified to drive improvement in its corporate governance and achieve financial sustainability in the context of significant changes within the Council's leadership team.

This matter is evidence of weaknesses in proper arrangements for informed decision making in acting in the public interest, through demonstrating and applying the principles and values of sound governance.

Services for Vulnerable Children

In May 2014 and November 2016 the Office for Standards in Education (Ofsted) issued reports which assessed the services as inadequate and identified a number of serious weaknesses in the Council's arrangements for looking after vulnerable children and young people.

The Ofsted monitoring visit undertaken in March 2018 highlighted that the Council has demonstrated that it has maintained and made some further improvements to the quality of social work practice since the last inspection. Further work remains to be done to ensure that practice is consistently good and that the best outcomes for all children are achieved on a timely and consistent basis.

This matter is evidence of weaknesses in proper arrangements for informed decision making and sustainable resource deployment in:

- acting in the public interest, through demonstrating and applying the principles and values of sound governance;
- managing risks effectively and maintaining a sound system of internal control; and
- planning, organising and developing the workforce effectively to deliver strategic priorities.

Management of Schools

Significant failings in the Council's management of schools were identified in a review by Peter Clarke in July 2014. Since this review the Council has taken and continues to take action to improve its management of schools through the implementation of its improvement plan.

As part of the assessment of schools governance improvement Birmingham Audit (internal audit) have been commissioned to carry out a programme of audits over a two year period. Their findings have continued to show that there are a range of governance issues to address across the schools visited. Specifically, 32 of the 87 schools audits (37%) undertaken by internal audit in 2017/18 were assessed as 'level 3' assurance (specific control weaknesses of a significant nature noted, and/or the number of minor weaknesses noted was considerable) and two schools (2%) were assessed as 'level 4' assurance (controls evaluated are not adequate, appropriate or effective, and/or risks are not being managed and it is unlikely that objectives will be met).

This matter is evidence of weaknesses in proper arrangements for informed decision making and sustainable resource deployment in:

- acting in the public interest, through demonstrating and applying the principles and values of sound governance;
- managing risks effectively and maintaining a sound system of internal control; and
- planning, organising and developing the workforce effectively to deliver strategic priorities.

Responsibilities of the Council

The Council is responsible for putting in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to review regularly the adequacy and effectiveness of these arrangements.

Auditor's responsibilities for the review of the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources

We are required under Section 20(1)(c) of the Local Audit and Accountability Act 2014 to be satisfied that the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. We are not required to consider, nor have we considered, whether all aspects of the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

We have undertaken our review in accordance with the Code of Audit Practice having regard to the guidance on the specified criterion issued by the Comptroller and Auditor General in November 2017, as to whether in all significant respects the Council had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. The Comptroller and Auditor General determined this criterion as that necessary for us to consider under the Code of Audit Practice in satisfying ourselves whether the Council put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2018.

We planned our work in accordance with the Code of Audit Practice. Based on our risk assessment, we undertook such work as we considered necessary to be satisfied that the Council has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

Report on other legal and regulatory requirements - Delay in certification of completion of the audit

We cannot formally conclude the audit and issue an audit certificate in accordance with the requirements of the Local Audit and Accountability Act 2014 and the Code of Audit Practice until we have completed the work necessary to issue our Whole of Government Accounts (WGA) Component Assurance statement for the Council for the year ended 31 March 2018. We are satisfied that this work does not have a material effect on the financial statements or on our conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2018.

In addition, we cannot formally conclude the audit and issue an audit certificate for the Council for the year ended 31 March 2018 in accordance with the requirements of the Local Audit and Accountability Act 2014 and the Code of Audit Practice until we have completed our consideration of an objection brought to our attention by a local authority elector under Section 27 of the Local Audit and Accountability Act 2014. We are satisfied that this matter does not have a material effect on the financial statements or on our conclusion on the

Council's arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2018.

Signature to be added

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

The Colmore Building
20 Colmore Circus
Birmingham
B4 6AT

31 July 2018

Our Ref.: BCC/MS/

Date: 30 July 2018

Grant Thornton UK LLP
The Colmore Building
20 Colmore Circus
Birmingham
West Midlands
B4 6AT

Dear Sirs

Birmingham City Council
Financial Statements for the year ended 31 March 2018

This representation letter is provided in connection with the audit of the financial statements of Birmingham City Council and its subsidiary undertakings (as listed in note 48 of the Council's financial statements) for the year ended 31 March 2018 for the purpose of expressing an opinion as to whether the group and parent Council financial statements are presented fairly, in all material respects in accordance with International Financial Reporting Standards and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18 and applicable law.

We confirm that to the best of our knowledge and belief having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves:

Group Financial Statements

i) We have fulfilled our responsibilities for the preparation of the group and parent Council's financial statements in accordance with International Financial Reporting Standards and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18 ("the Code"); in particular the group and parent Council financial statements are fairly presented in accordance therewith.

ii) We have complied with the requirements of all statutory directions affecting the group and parent Council and these matters have been appropriately reflected and disclosed in the group and parent Council financial statements.

Finance & Governance
P.O. Box 16306
10 Woodcock Street
Aston
Birmingham. B2 2XR

Contact: Clive Heaphy
Tel.: 0121-303-2950
Fax: 0121-303-1356
E-Mail: clive.heaphy@birmingham.gov.uk
www.birmingham.gov.uk

iii) The Council has complied with all aspects of contractual agreements that could have a material effect on the group and parent Council financial statements in the event of non-compliance. There has been no non-compliance with requirements of any regulatory authorities that could have a material effect on the group and parent Council financial statements in the event of non-compliance.

iv) We acknowledge our responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud.

v) Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable.

vi) Except as disclosed in the group and parent Council financial statements:
   a there are no unrecorded liabilities, actual or contingent
   b none of the assets of the group and parent Council has been assigned, pledged or mortgaged
   c there are no material prior year charges or credits, nor exceptional or non-recurring items requiring separate disclosure.

vii) We confirm that we are satisfied that the actuarial assumptions underlying the valuation of pension scheme assets and liabilities for IAS19 Employee Benefits disclosures are consistent with our knowledge. We confirm that all settlements and curtailments have been identified and properly accounted for. We also confirm that all significant post-employment benefits have been identified and properly accounted for.

viii) Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of International Financial Reporting Standards and the Code.

ix) All events subsequent to the date of the group and parent Council financial statements and for which International Financial Reporting Standards and the Code require adjustment or disclosure have been adjusted or disclosed.

x) We have considered the adjusted misstatements, and misclassification and disclosures changes schedules included in your Audit Findings Report. The group and parent Council financial statements have been amended for these misstatements, misclassifications and disclosure changes and are free of material misstatements, including omissions.

xi) Actual or possible litigation and claims have been accounted for and disclosed in accordance with the requirements of International Financial Reporting Standards.

xii) We have no plans or intentions that may materially alter the carrying value or classification of assets and liabilities reflected in the group and parent Council financial statements.

Finance & Governance
P.O. Box 16306
10 Woodcock Street
Aston
Birmingham. B2 2XR

Contact: Clive Heaphy
Tel.: 0121-303-2950
Fax: 0121-303-1356
E-Mail: clive.heaphy@birmingham.gov.uk
www.birmingham.gov.uk

xiii) We believe that the group and parent Council’s financial statements should be prepared on a going concern basis on the grounds that current and future sources of funding or support will be more than adequate for the group and parent Council’s needs. We believe that no further disclosures relating to the group and parent Council's ability to continue as a going concern need to be made in the financial statements.

xiv) We have considered the impact of the Council’s Equal Pay liability and we are satisfied that the Council can manage its cash flow through the receipts from the sale of assets to meet all of its current Equal Pay liabilities.

Information Provided

xv) We have provided you with:
a. access to all information of which we are aware that is relevant to the preparation of the group and parent Council financial statements such as records, documentation and other matters;
b. additional information that you have requested from us for the purpose of your audit; and
c. unrestricted access to persons within the Council from whom you determined it necessary to obtain audit evidence.

xvi) We have communicated to you all deficiencies in internal control of which management is aware.

xvii) All transactions have been recorded in the accounting records and are reflected in the group and parent Council financial statements.

xviii) We have disclosed to you the results of our assessment of the risk that the group and parent Council financial statements may be materially misstated as a result of fraud.

xix) We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the group and parent Council and involves:
a. management;
b. employees who have significant roles in internal control; or
c. others where the fraud could have a material effect on the group and parent Council financial statements.

xx) We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the group and parent Council's financial statements communicated by employees, former employees, analysts, regulators or others.

xxi) We have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements.

xxii) We have disclosed to you the identity of the group and parent Council's related parties and all the related party relationships and transactions of which we are aware.

Finance & Governance
P.O. Box 16306
10 Woodcock Street
Aston
Birmingham. B2 2XR

Contact: Clive Heaphy
Tel.: 0121-303-2950
Fax: 0121-303-1356
E-Mail: clive.heaphy@birmingham.gov.uk
www.birmingham.gov.uk

xxiii) We have disclosed to you all known actual or possible litigation and claims whose effects should be considered when preparing the group and parent Council financial statements.

xxiv) We confirm the reasonableness of the significant assumptions used in making accounting estimates, including those measured at fair value. We also confirm the following:

a) Property, Plant and Equipment. We confirm that the controls operated over the recognition, valuation, presentation and disclosure of Property, Plant and Equipment are appropriate and materially accurate estimates of the Council's non-current assets. We also confirm that the reporting of Property, Plant and Equipment complies with the relevant frameworks.

b) Equal Pay – measurement. We confirm that the measurement methods including related assumptions and models is appropriate and have been consistently applied. We also confirm that we have provided you with all information available to us that could impact on the estimated value of the Council's liability.

c) Equal Pay – recognition. We confirm that the receipt of an Equal Pay claim is the appropriate point at which to recognise the Council's liability and these recognition criteria have been consistently applied. We also confirm that it is not possible to accurately estimate the volume, type or value of future Equal Pay claims. We have reached this conclusion due to the number of variables impacting on the claims including future court judgement, the number of claims the Council receives, the settlement amount for claims, and any costs in respect to taxation.

d) Academy Schools subject to PFI. We confirm that no onerous contracts as defined by IAS 37 exist.

e) Group boundaries. We confirm that we do not have control as defined by IFRS 10 of Performances Birmingham Limited and Birmingham Museums Trust Limited and are therefore not consolidated.

Annual Governance Statement

xxv) We are satisfied that the Annual Governance Statement (AGS) fairly reflects the Council's risk assurance and governance framework and we confirm that we are not aware of any significant risks that are not disclosed within the AGS.

Narrative Report

i) The disclosures within the Narrative Report fairly reflect our understanding of the group and parent Council's financial and operating performance over the period covered by the group and parent Council financial statements.

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Approval

The approval of this letter of representation was minuted by the Council's Audit Committee at its meeting on 30 July 2018.

Yours faithfully

Name:……………………………

Position: Corporate Director, Finance & Governance

Date: 30 July 2018

Name……………………………

Position: Chair of Audit Committee

Date: 30 July 2018

Signed on behalf of the Governing Body

Yours Sincerely

Clive Heaphy
Corporate Director, Finance & Governance

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