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# Audit and financial reporting under austerity localism—the case of the Birmingham City Council 'bankruptcy'

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**IMPACT**

This article explores the widely cited systemic issues in UK local government audit and financial reporting by examining the case of the Birmingham City Council 'bankruptcy'. By following the case, the article shows how unaudited and potentially incorrect management estimates can impact on public accountability, and how auditors can be caught between competing accounting regimes—auditing the wrong figures years too late at the moment of crisis. The author explains why the current system is vulnerable to vested interests, political tensions, and competing accountabilities that result in a lack of transparency as authorities fall into financial distress. The author goes on to outline why accountability to local residents and the wider public should be a crucial foundation stone for future accounting and audit reform—both in the UK and internationally.

**ABSTRACT**

Accountability and value-for-money arrangements in English local government were severely eroded during the coalition government (2010–2015) and subsequent austerity era, under 'austerity localism'. Meanwhile, the adoption of IFRS in 2011 seems to have done little to address the opacity of local government accounts. This article explores the shortcomings of the austerity localism model as an iteration of New Public Management (NPM) reforms in recent times via the 'extreme case' of the Birmingham City Council 'bankruptcy'. The case exposes the contradictions of the austerity localism model as the reforms undermine transparency and public accountability, creating a system that is perhaps less transparent than ever before. As such, the article contributes to our empirical understanding of NPM under austerity, and to our understanding of the role of accounting standards and audit practices in the NPM agenda.

**KEYWORDS**

Audit reform; austerity; Birmingham City Council; IFRS; local audit; local government; new public management

## Introduction

In recent times, the local government sector in England, and associated regimes of auditing and financial accounting, have come under exceptional pressure. In 2023, just five out of 467 financial audits were issued on time (PSAA, 2023), while growing pressures had led to a £4 billion sector-wide budget deficit (LGA, 2024) and 19 authorities seeking 'exceptional financial support' (DLUHC, 2024a). Meanwhile, prior literature on local government accounting has drawn out the importance of the UK sector for an international audience in several respects. The sector has long been seen as a forerunner of New Public Management (NPM) reforms (Ferry et al., 2015), and, more recently, studies have noted the radical nature of the post 2010 'austerity localism' model (Ferry & Murphy, 2018; Ferry et al., 2019). Under this model a relatively stable regime of hierarchal financial and performance accountability was replaced with a new regime of 'radical transparency', which included, among other things, the adoption in 2011 of full IFRS accounting; the Local Audit and Accountability Act of 2014, that was set to create 'an army of armchair auditors' who would hold authorities to account; and the abolition of the Audit Commission in 2016. All of this took place in a context of severe reductions in spending power (NAO, 2021) and a shift from performance accountability (for outputs and outcomes) to a financial accountability that was primarily focused on delivering input reductions (Ferry & Murphy, 2018; Brackley et al., 2021; Ferry et al., 2022; Brackley, 2024a).

In examining these dynamics, this article draws on the extreme case of Birmingham City Council (BCC) which, in 2023, issued their first ever section 114 (s114) notice under the local government Finance Act 1988 (widely reported in the media as an 'effective bankruptcy'). I choose this case as both a *politically important* and *extreme* case, following the guidance suggested by Lee and Saunders (2017) on case selection, on the basis that such a case provides an illustrative and sobering example of what can go wrong within the current system. The case is also suggestive of the direction many other authorities could be headed if we continue down the current reform pathway, noting the recent findings of a Special Interest Group of Municipal Authorities (SIGOMA) survey that suggested as many as one in 10 English local authorities are considering issuing s114 notices (SIGOMA, 2023).

The BCC case is extreme for several reasons. Birmingham is among the most deprived authorities in England by local population, with evidence suggesting that such authorities were disproportionately worse affected by austerity cuts since 2010 (Hastings et al., 2015). It is currently the largest city authority in Europe, with the capitalization direction required to cover the short fall in reserves of £1.255 billion being by a distance the largest of its kind in the sector

This article has been corrected with minor changes. These changes do not impact the academic content of the article.

(DLUHC, 2024a). Similarly, the 2024/25 budget cuts of £149 million were the largest single year cuts in the UK in recent times. While many of the background issues leading to the s114 played out in a manner that was specific to the council they were also indicative of sector-wide issues (Brackley & Leaver, 2024). The case therefore provides an important stress test of the current system of audit, reporting, accountability and intervention. Finally, the case is politically important, again because of its size, but also due to a major mayoral election that took place shortly after the s114 notice. These dynamics brought out the conflicts between the different forms of accountability and control, and placed further strain on the system of audit and reporting.

The case therefore helps us address the following research questions on financial accounting and audit within a newly established system of transparency and accountability, under what we refer to as the 'austerity localism' (Ferry & Murphy, 2018; Ferry et al., 2019) model of financial management in UK local government:

> *RQ 1: What does the Birmingham case tell us about accountability and transparency under austerity localism?*
>
> *RQ 2: What was the role of financial accounting and audit arrangements in the Birmingham case?*

To address these questions, the article draws on a range of documentary analysis and observation. Background analysis included a review of the prior year budget consultations, annual accounts, and financial plans issued between 2020 and 2023, together with a retrospective review of key cabinet and audit committee document packs. Following the s114 notice in September 2023, I systematically reviewed all document packs for the audit committee, cabinet, full council, together with public notices, statutory recommendations, statements from commissioners, and media coverage of the case between September 2023 and May 2024.

The article proceeds as follows—first I review the prior literature on the 'austerity localism' reforms in the UK, with a particular focus on accountability and transparency. With reference to the themes of this special issue, I introduce in this section the challenges to financial reporting and external audit. Next, I introduce the BCC case, exploring the financial reporting and audit issues and how these became entangled in a network of accountability that, I argue, failed to serve the interests of local residents or the wider public. Finally, I reflect on what we learn from this case and how the case adds to the prior literature.

## Accountability, 'austerity localism', and the interaction between the accounting basis and the funding basis under statute

Let us begin by introducing a number of key terms of reference. Starting with 'accountability' and 'transparency', these terms have generated significant traction in public and policy discourse (Mulgan, 2003; Bovens, 2007; Hood, 2010), with successive governments often trying to legitimize their reforms with reference to these terms. These two terms will then help us define what has been referred to as 'austerity localism' in the UK context (Ferry & Murphy, 2018; Ferry et al., 2019).

Accountability can be defined as the giving of an 'account' that is subject to scrutiny, with some potential for consequence or reprisal (Bandy, 2011, p. 191). The nature of the 'account' can be broad ranging, and may be written, spoken, or numerical. These in turn might be based on formal reports prepared under accounting standards or might be more informal, such as the giving of an oral account to a local committee (Bovens, 2007). Different forms of accountability can then be classified on the basis of who the account is given to or what is being accounted for. The definition therefore moves beyond simply being 'responsible' or in control and implies that the account giver is in some way 'answerable' (Mulgan, 2003).

In the case of local government, two important forms of 'accountability-for' are 'financial accountability', which in public sector contexts tends to refer to the proper management or stewardship of public resources (Jones & Pendlebury, 2010, p. 112), and, relatedly, accountability for achieving 'value for money' (often referred to in local government as 'best value'), which has traditionally been defined as achieving the best possible outcomes or performance measures for a given set of resource inputs (Jones & Pendlebury, 2010, p. 133). Building on these ideas, it is widely accepted that crucial to any financial accountability relationship is a meaningful audit process, so that the underlying accounting information can be relied upon (Ferry & Eckersley, 2015).

Two difficulties arise in the context of local government accounting and reporting, however. First is the difficulty of adopting private sector financial accounting practices, especially given the complex nature of local authority asset bases, pension arrangements, and how concepts such as 'fair value' translate into the local government context (Sheen, 2014). Second is the complexity of the organizational objectives and associated accountability mechanisms through which such accounts might be variously mobilized. These difficulties create associated challenges to the audit process:

- In relation to the subject matter, with local audits tending to be highly complex and time consuming, with auditors often spending a significant amount of resource auditing figures that are not crucial to the users of the accounts (Redmond, 2020).
- In relation to the extent to which the auditor audits the broader financial accountability arrangements, with reference to their 'best value' duty, in addition to their audit of the underlying financial accounts (Research for Action, 2023).

Turning to the concept of 'transparency', like accountability, it is a concept that has gained discursive traction in the public sphere in recent decades—typically referring to the process of 'making visible' from the outside in the interests of good public governance (Hood, 2010). While related, it is perhaps important to distinguish the *internal* transparency associated with an NPM agenda of performance management (Roberts, 2009), or transparency 'as surveillance' (Heald, 2006), from the broader *external* transparency of public bodies in the wider public interest (Birkinshaw, 2006). Similarly, we might also want to distinguish between the ideals of transparency, and the often disappointing, counterproductive, or unexpected empirical experiences of transparency reforms (Hood, 2010). With reference to the ideals of transparency, Birkinshaw (2006) and O'Neill (2006) provide convincing accounts of the importance of reforms that foster openness and trustworthiness, arguing that such transparency is both central to democracy and an important public right, comparable with freedom of speech and access to justice. In this sense, transparency refers to the keeping of observable records of official decisions, reasoned explanations for decisions that affect public life, and opening the governance process so that it is understandable and accessible to the general public (Birkinshaw, 2006). Examples in the UK include the Freedom of Information Act 2000, which provides an avenue for citizens to request information from public bodies; the public recording or webcasting of local government committees; or the publishing of datasets, for example of performance metrics or lists of individual transactions (Ferry & Murphy, 2018).

'Austerity localism', in this context, has been characterized as a set of reforms that have prioritized 'transactional transparency' and 'individualism' over hierarchal performance accountability in times of severe resource constraint (Ferry & Murphy, 2018; Ferry et al., 2019). Such reforms are typically seen as a continuation of NPM reforms, but with a renewed focus on shrinking the role of the state and devolving political accountability from central to local government (Ahrens & Ferry, 2015; Hyndman & Lapsley, 2016).

### *Transparency and accountability since 2010*

Despite leaning heavily on the language of transparency and accountability, the extent to which 'austerity localism' in the UK context delivers on these ideals has been questioned from the outset. The reforms began with a radical shake up of the accountability arrangements, with the abolition of value-for-money inspections (Ferry et al., 2015), an increased discursive emphasis on 'deregulation' (Ferry & Murphy, 2018), and the privatization of external audit provision (Ellwood, 2014). All of which has shifted the accountability arrangements away from an assessment of the outcomes being delivered, and towards 'financial conformance' (Ferry et al., 2015). Much of this agenda was set into law by the Localism Act 2011 and the Local Audit and Accountability Act 2014, with the establishment of an elected mayoral system, local referendums on council tax increases, allowances for local committees to be publicly filmed, and the publication of large datasets of public contracts and transactions. All of which were aimed at increasing local democracy, accountability and transparency. Changes to funding arrangements, meanwhile, saw the removal of the 'ringfencing' of a number of local grants, freeing up what this money could be spent on, together with a shift in the funding mix, from central government block grant to funding via local taxation in the form of council tax and business rates (Atkins, 2023).

However, while ostensibly being put forward in the name of transparency, local democracy and accountability to citizens, the reforms did relatively little to achieve these aims in practice. Ferry et al. (2015), for example, note that the reforms tended to benefit private sector providers, who would be more likely to have the resources to analyse large datasets, as they sought to win public contracts, than citizens. More recently, evidence has shown that the increased protections for private firms have made it more difficult for citizens to access information where this may be deemed 'commercially sensitive' via freedom of information requests (FOIs) (Research for Action, 2023), while research has shown that the refusal rate on FOIs has increased significantly since 2010 (Cheung, 2018). All of which seems to support Ferry et al.'s (2015) conclusions that 'transparency' and 'accountability' have become an 'awkward couple' under these reforms, with the new accountability arrangements placing emphasis on 'transactional' and commercial accountability rather than public accountability or wider scrutiny.

Meanwhile, the 'austerity' element of 'austerity localism' has tended to shift the definition of 'best value' away from broader assessments of outputs and outcomes, towards a narrower focus on achieving cost reductions (Bracci et al., 2015; Brackley et al., 2021; Ferry et al., 2022; Brackley, 2024a). The external auditor's best value duty, for example, has been reduced to ensuring that the authority has 'appropriate processes' in place for balancing the budget and reducing costs during the annual budgetary cycle (Ellwood, 2014; Research for Action, 2023). As an assessment regime, it is now far removed from the wide-ranging best value inspections of the Audit Commission.

### *IFRS accounting in local government and the relation between the accounting basis and the funding basis under statute*

Linked to both financial accountability and transparency is the adoption of full IFRS accounting in UK local government in 2011, which took place against the broader historical movement from cash to accrual accounting in public sector contexts internationally (Mellett, 1997; Connolly & Hyndman, 2006). A core concept of modern accrual accounting and auditing is that of 'true and fair' measurement, with a recent Financial Reporting Council (FRC) review into the true and fair concept (FRC, 2014) concluding that accounting information should 'reflect economic reality' in any published financial reports in both UK GAAP and IFRS, and that this represents the 'whole essence' of recognition, measurement and disclosure.

More recently, it has become apparent that the complexity of IFRS as adopted in the UK local government sector has played a significant part in the current crisis of external audit and reporting (Sheen, 2014; DLUHC, 2024b). This has manifested on two fronts. First, there are significant challenges in applying IFRS measurement regimes to the complex asset bases of local authorities, particularly with respect to the application of fair value accounting. Applying such a framework to such a broad asset base requires significant work by valuers and auditors, particularly in relation to infrastructure assets, heritage assets, and social housing (Redmond, 2020). This is partly because of their size on the balance sheet, but also because they often have no obvious comparable market, and the benefit of such assets, that might traditionally have been considered public goods, is not obviously measurable via an economic return to the authority. Second, under both 'austerity localism' and prior iterations of NPM, authorities have been freed up to both borrow and to trade in financial instruments, which, again, creates various measurement difficulties and risks under IFRS. Other difficulties relate to the measurement of provisions, and how the expectations under IFRS intersect with the statutory rules around the management of reserves

—with this case exploring one particularly contested and politicized example in which the re-measurement of an equal pay provision triggered a damaging statutory intervention.

In addition to these already significant difficulties is the mismatch between the IFRS accounting basis and the funding basis under statute (Redmond, 2020, p. 59). In the UK local government sector, core elements of the financial accountability and reporting arrangements are set out by law, with strict rules setting out what costs can be accounted for in the setting of the revenue budget. These rules come primarily from successive local government and local government and finance acts dating back to the 1970s. Unlike the Companies Act 2006, these acts largely pre-date full accrual accounting and have led to heavy amendments to IFRS accounting and reporting under the CIPFA code. This means that there are large movements posted to reserves to account for the reconciliation between the 'accounting basis' under IFRS and the 'funding basis' that drives the budget, the setting of council tax rates, and, where authorities are unable to set a balanced budget, statutory interventions (CIPFA, 2023, p. 85).

Therefore considerably more importance is placed on reserve accounting in UK local government than we see in other public or private organizations. Furthermore, because the setting of a balanced budget and the sufficiency of the general fund reserve to cover future commitments are not based on IFRS accounting, with large non-cash movements due to depreciation, amortisation, and various fair value adjustments stripped out, together with the apparent volatility of surpluses/deficits under full IFRS accounting, the normally decision critical 'accounting bottom line' becomes largely detached from organizational decision-making and wider financial accountability (Redmond, 2020, pp. 59–60).

It is important to emphasise that, while financial accountability remains a dominant form of accountability in UK local government, the accounting basis has become highly ambiguous. Add to this the latest crisis in the timely publication and audit of the annual accounts, and we are left in a situation in which authorities have become more reliant than ever on unaudited estimates of their financial position and judgment calls over the 'adequacy' of the general fund reserve.

## The Birmingham case

BCC is the largest local authority in Europe, serving a population of more than 1.1 million people across 10 parliamentary constituencies. As noted in the introduction, BCC reflects the sector-wide trend that has seen such authorities lose disproportionately more of their spending power since 2010. According to National Audit Office data (NAO, 2021), they lost 36.3% of their spending power in real terms between 2010/11 and 2020/21 against a sector average of 26% (see Figure 1). Accounting for the growth in population, this gave a fall in spending power *per head* of 40.8%—one of the largest falls of any local authority.

These figures, however, do not account for rising population need and the growing per unit costs of many services. A decade of low economic growth, an aging population, high inflation and the legacy of the Covid 19 pandemic have all increased local cost pressures. The population of those aged 85 years or older increased by 16.1% in the decade to 2020/21 (NAO, 2021), an increase of over 3,000 residents, while child poverty rates increased from 35.5% in 2014/15 to 46.4% in 2021/22 (JRF, 2024). Furthermore, due to the increasing complexity and severity of cases, more recent data shows that in the 2020 to 2022 period, the average unit cost of care in children's services increased by 11.6%, the unit cost of residential care increased 18%, and the unit cost of supported accommodation rose by 72% (see Table 1, document reference BCC 001). By October 2022, Consumer Prices Index (CPI) and Retail Prices Index (RPI) inflation had peaked at 9.6% and 14.2% respectively, and would remain high throughout 2022/23 and 2023/24 (ONS, 2024). Against these cost pressures, the BCC Financial Plan for 2022 shows that total external income (including grants, council tax, business rate retention, and ring-fenced schools grants) was expected to rise just 0.8% in 2022/23 and 1.7% in 2023/24 (to 3.03 billion) (BCC 003 in Table 1). It was therefore unsurprising that BCC, together with many other similarly deprived authorities, were set to face serious financial challenges in the 2022–24 period.

Despite this grim picture, BCC managed to maintain a sound financial position up to 31 March 2022 and largely achieved the necessary budget cuts to 'balance the books' up to that date. In 2021, CIPFA commended BCC on their

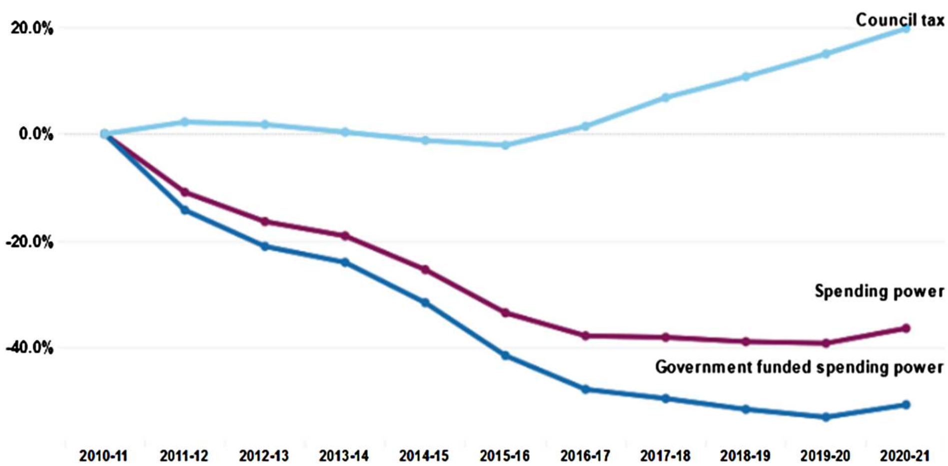


**Figure 1.** Spending power and its components, 2010/11 to 2020/21 (Birmingham).
*Source:* NAO financial sustainability data visualization.

**Table 1.** Case documents.

| Document name | Date | Author | Reference |
|---|---|---|---|
| Cabinet agenda pack | 27 February 2024 | BCC | BCC 001 |
| Corporate parenting strategy 2023–26 | February 2023 | BCC | BCC 002 |
| BCC financial plan 2022 to 2026 | 2022 | BCC | BCC 003 |
| BCC financial plan 2023 to 2027 | 2023 | BCC | BCC 004 |
| BCC financial accounts 2021/22 | 2022 | BCC | BCC 005 |
| BCC financial accounts 2020/21 | 2021 | BCC | BCC 006 |
| BCC financial accounts 2019/20 | 2020 | BCC | BCC 007 |
| Audit committee agenda pack | 31 January 2024 | BCC | BCC 008 |
| Report to all elected members of BCC under Section 114 (3) of the Local Government Finance Act 1988 | 5 September 2023 | BCC | BCC 009 |
| BCC external audit 2020/21 to 2023/24 statutory recommendations | 29 September 2023 | Auditors | BCC 010 |
| Cabinet agenda pack | 12 December 2023 | BCC | BCC 011 |
| Full council agenda pack | 18 April 2023 | BCC | BCC 012 |
| Audit committee agenda pack | 18 October 2023 | BCC | BCC 013 |
| Audit committee agenda pack | 29 November 2023 | BCC | BCC 014 |
| Cabinet agenda pack | 16 January 2023 | BCC | BCC 015 |
| Full council agenda pack | 12 October 2023 | BCC | BCC 016 |
| Audit committee agenda pack | 22 May 2021 | BCC | BCC 017 |
| Audit committee agenda pack | 28 March 2023 | BCC | BCC 018 |

journey towards 'sound financial management' (CIPFA, 2021) and the draft financial accounts to the year ending 31 March 2022 showed a surplus of £85 million and a total useable reserves figure of £1.5 billion on an IFRS basis (BCC 005). On the funding basis, savings not delivered on the revenue budget for 2021/22 came to a modest £3.2 million, while a healthy £597 million remained in the general fund (BCC 004).

In their report to the March 2023 audit committee, the external auditors reported that their work on the 31 March 2022 accounts had been largely completed, with only minor work outstanding in relation to property valuations that would not affect the audit opinion (BCC 018). This included a confirmation that they were satisfied with a £121 million equal pay provision in the accounts, with only trivial issues noted. No issues were noted in relation to Going Concern. Yet just five months later, on 5 September 2023, BCC issued a s114 notice citing spiraling deficits through 2022/23 and 2023/24 that were set to wipe out the general fund by March 2026, together with a previously undisclosed £760 million equal pay liability (BCC 009; BCC 010).

### *The section 114 notice: what it was and why no one saw it coming*

While widely reported as an 'effective bankruptcy' in the media, an s114 notice was really nothing of the sort—the notice is issued by the senior financial officer when they judge that certain financial tests cannot be met. Under the Local Government Finance Acts 1988 and 1992 these tests relate to whether the council can balance its budget in year, and whether the council holds sufficient reserves in their general fund to cover future costs. The notice does not arise due to any inability to pay creditors and does not provide the council with any road map out of trouble, such as consolidation of debt or access to new long-term funding. Instead, the notice requires that the council formulate a plan to address the issues raised by the finance officer. In the case of BCC, the s114 notice was followed by a statutory 'best value' intervention (DLUHC, 2023), which included the appointment of commissioners by central government to oversee governance, financial planning, and senior appointments, and to draw up a recovery plan for the council.

Several reasons for the issuance are noted in the s114 notice itself (BCC 009). First, it cites concerns raised by the external auditors over an equal pay liability of up to £760 million. Second, it cites an £87 million overspend on the 2023/24 budget and an assessment that, together, these issues left the council in a negative general fund position and unable to set a balanced budget for the coming 2024/25 financial year. On 29 September 2023, the external auditors then issued their own statutory recommendations in which they state that, in their view, the equal pay liability was likely understated and could well exceed £1 billion (BCC 010).

This did not, however, give the full picture. On investigation of the equal pay liability, observers noted that the external auditors had neither audited this figure nor received the model upon which it was based (BCC 013). A point that is not made clear in either the s114 notice itself, or in the auditor's lengthy statutory recommendations. It also remained highly ambiguous as to the accounting basis that was used for the equal pay figure. IAS 37 and the CIPFA code both appear to suggest that provisions should be prepared on the basis of a best estimate of the present obligation based on likely future settlements (CIPFA, 2023; Deloitte, 2024) but, in the BCC case, we see the commissioners, with reference to the auditors, arguing that it should reflect the 'worst case' legal exposure to both present and future obligations (Wallis, 2024).

Meanwhile, the budgetary deficits were not being driven by actual in-year equal pay settlements, and, indeed, that by February the following year the council had still not received any formal equal pay claims (BCC 001). Instead, the large in-year deficits appeared to be the result of pressures on statutory services, together with the disastrous launch of a new Oracle IT system that went live on 11 April 2022. Points that were entirely omitted from the seven-page narrative in the s114 notice (BCC 009).

There were two reasons why these issues were not identified—first, was the very limited disclosure of the real and present issues presented by the Oracle IT failure (which was not mentioned in the s114 notice); and, second, contrastingly, was the highly speculative and unaudited nature of the equal pay liability (cited as the primary reason for the s114 notice) which relied on a shift in crucial management estimates between March and July of 2023

In April 2022 Birmingham City Council went 'live' with a new Enterprise Resource Planning (ERP) IT system—'Oracle Cloud Fusion' ('Oracle'). This IT system integrated finance, payroll, HR, procurement, supply chain management, and customer relationship management into a single system. Oracle replaced the previous SAP system, that had been in place since 1997. Crucially, the system would integrate the council's accounting ledger with purchase and payment systems. This was later to produce significant problems. Initially budgeted at £19 million in July 2019, by February 2024 the Oracle budget had grown to £131 million.

**Figure 2.** The new Oracle IT system

(see Figures 2 and 3 for an explanation of these cases). Neither of these issues were disclosed in the most recent 2022 accounts and neither were raised with the audit committee through 2022/23. Together with a delay to the publication of the draft 2023 accounts, the issuance of the s114 notice created considerable questions over transparency (Birkinshaw, 2006), with the accounting basis rendered highly opaque and almost entirely reliant on unaudited management judgments.

### *Background to the Oracle and equal pay issues*

Starting with *Oracle*, despite a disastrous implementation in April 2022, relatively little information on the extent of the disaster was disclosed via the democratic structures of the council in the year after implementation. This was true at least until the audit committee on 28 March 2023 (BCC 007) and full council on 18 April 2023 (BCC 012), at which questions on the Oracle implementation were described as routine teething problems or played down as not being significant. It was only in the Autumn of 2023 that the extent of the failure began to be fully disclosed via the cabinet, audit committee, and other public meetings, and only in January and February 2024 that the true extent of the failure was finally disclosed, almost two years on from its launch.

With reference to these documents, the failure itself was quite astonishing. A post-implementation assessment (BCC 008) showed that the council had to employ a small army of temporary staff to clear down more than 70,000 transaction errors between their bank accounts and their cash accounting system. By December 2022, 10,000 individual IT service desk issues had been raised. Originally budgeted at £19 million, by February 2024 cabinet papers showed that the direct costs had run to £131 million (BCC 001). The failed implementation also meant that BCC were unable to effectively collect council tax or business rate debt through to January 2023 or monitor their budgets through much of 2022/23 and 2023/24, leading to major knock-on costs in the form of savings write-offs and bad debt (BCC 008).

In their January 2023 value-for-money report, the external auditors conclude that (BCC 008): 'No budget monitoring reports have been provided to Directorates during 2022-23 or 2023-24' while, in the 27 February 2024 cabinet papers (BCC 001), the chief financial officer stated that: 'Reliance could not be placed on the most basic of financial information from the system'. Following the s114 notice, the council were therefore in the position such that they did not know what their core structural deficit was or how much of this deficit related to temporary Oracle issues, while having to deliver the first £149 million of the total £300 million estimated savings on an accelerated timeframe.

In terms of the in-year deficit position for 2023/24, of the £87 million deficit cited in the s114 notice, £69 million related to savings that had to be written off due to Oracle (BCC 001). The overall savings delivery rate dropped from 91% in 2021/22 to 18% in 2022/23 (BCC 004; BCC 001). This non-delivery of savings, together with a further £16.5 million of bad debt write-offs, were ultimately rolled into a

Birmingham City Council has been subject of several high-profile equal pay claims since the implementation of the Equalities Act 2010. The latest round of claims, cited in the council's 2023 'bankruptcy' notice, related to: (1) liabilities arising under 'task and finish', a practice in which predominantly male workers were able to leave work early and still get paid for a full shift, potentially resulting in them being paid more than some female workers on the same grade. And (2) an unfair 'job evaluation' system which related to unequal grading and progression within pay grades across the Council. Initially estimated at £760 million, the claims were later settled for a figure closer to £250 million.

**Figure 3.** Birmingham's equal pay liability

total overall projected deficit figure of £300 million by April 2026, which, despite much of this amount relating to Oracle issues, was treated as an overspend on core services. There can be little doubt, therefore, that the excessive costs of Oracle and the wider disruption associated with the failed implementation played a significant role in the overall financial distress of the council.

Turning to *equal pay*, without providing a full technical summary of the liability, we can note that it consisted of two elements—a 'task and finish' liability that arose as a result of flexible working arrangements for some elements of the workforce and a 'job enrichment' element that related to the grading of roles (Haynes, 2023). Both of these elements were known to the auditors and it remains unclear what changed between March 2023 and September 2023, with both auditors and officers declining to disclose the equal pay model underpinning the new estimates. Documents from February 2024 (BCC 001), do show that much of this liability related to possible future claims, rather than existing claims, while disclosures by the auditors and the commissioners suggest that the crucial £760 million figure was based on some form of 'worst case' analysis, with the commissioners finally putting a figure to the 'best estimate' as being as little as £250 million (Wallis, 2024).

This presents a complex picture, therefore, in which a somewhat speculative and unaudited equal pay figure was cited as the reason for a s114 notice, when in fact the financial distress of the authority related, primarily, to other factors. Namely, an Oracle IT failure and austerity. The failure to release the 2023 accounts, the failure of the auditors to flag the equal pay issue earlier or, conversely, to question the much higher £760 million figure quoted in September 2023, and confusion over the relevant measurement basis, all played a part in shifting public scrutiny and public accountability (Ferry et al., 2015) from one set of issues to another. As a result, the commissioners, without the benefit of a prior best value assessment, were assigned the task of delivering £300 million in savings as quickly as possible, notwithstanding that a proportion of that amount might not be structural deficit, and delivering asset sales of £750 million by December 2025, notwithstanding that the corresponding £760 million equal pay liability driving those sales was significantly overstated.

### *Transparency, accountability and public scrutiny of the section 114 notice*

With reference to RQs 1 and 2, we therefore see an undesirable situation play out in relation to the intervention at BCC when analysed from the ideals of transparency (Birkinshaw, 2006), public accountability (Mulgan, 2003; Hood, 2010), and the language of the post 2010 legislative arrangements. Furthermore, this lack of transparency did not appear to be politically neutral. As was subsequently covered by myself and others in the media, the issuance of the s114 notice on the basis of a speculative and unaudited equal pay liability had the effect of shifting the focus away from the Oracle IT disaster and austerity cuts, and onto the council's political relationship with the trade unions (Brackley, 2024b; Haynes, 2024a; Murray, 2024). This was both because of historical issues with a previous Labour leader of the council, who ended an industrial dispute in 2017 in a manner that potentially created part of the current liability (Haynes, 2023) and ongoing negotiations between the council and the unions over how a new 'job evaluation' scheme would be drawn up. With this latter issue, in particular, leading the external auditors to conclude in their statutory recommendations that 'we consider that this initial [£760 million] estimate is now likely to be understated and the final liability the council would have to settle in the future could well exceed £1 billion' (BCC 010). This scenario did not play out—but the damage had already been done, with the s114 leading to rising borrowing costs (BCC 008) and the deepest austerity cuts any authority had ever faced.

According to the local audit code of practice, auditors should be 'mindful of the unique position they hold as a public auditor and ensure that they have open and transparent arrangements in place that recognize their responsibilities to both the audited body and also to local taxpayers and residents' (CIPFA, 2023). The auditors in the BCC case, however, found themselves in a difficult position in relation to the issuance of the s114 notice and their duty to the wider public. On the one hand, they were providing advice to the council in relation to the issuance of the s114 notice (BCC 009). On the other, they were expected to comment on the best value arrangements in relation to matters which they had not audited, in the case of equal pay, or had not been fully disclosed to them, in the case of Oracle. As a result, their widely cited comments that it was 'likely' that the equal pay liability 'could well exceed £1 billion' placed them in a position of considerable difficulty when it came to subsequently auditing this figure. A task they began in October 2023 and had still not concluded more than a year later. This job was also made all the more difficult when various council sources, including the lead commissioner, were quoted in the media as stating that the figure would likely be closer to £250 million:

> *The commissioner appointed by Michael Gove … said the original estimate far exceeded any likely payout. The real liability may be closer to £250mn … [lead commissioner] Caller told the FT that the auditors had insisted on the maximum provision 'The £760mn is a provision in the accounts … it is probably a worst-case position because when it was calculated there was no prospect of a negotiated process between the council and the trade unions to re-evaluate the jobs and settle the claims'* (Wallis, 2024).

The recognition of this liability, and the failure of key actors to recognize that this figure was unaudited and potentially overstated, therefore led to a considerable shift in accountability—away from the Oracle IT failure and austerity and, instead, towards how such a large equal pay figure could have been allowed to accumulate. This, in turn, shifted accountability from central government and unelected senior executives in the council, towards the relationship between the council's political leadership and the trade unions. The politicized nature of the intervention, and the attempt to shift the public scrutiny away from the issues that immediately led to the crisis was further evidenced in the then Secretary of State Michael Gove's speech to parliament on BCC s114 notice on 19 September 2023, in which he set out his mission for the commissioners:

> *For years now, the city has suffered as the council has failed to grip underperformance. Poor leadership, weak governance, woeful mismanagement of employee relations and ineffective service delivery have harmed the city … I believe strongly in local*

> *government, local decision-making and devolution of power to local communities. But I also believe that when failures in local government occur, we must act. As we devolve more power to local government overall, we must demand sharper accountability* (HC Deb, September, 2023).

Once again, as with the Localism Act 2011, and other austerity localism reforms, we see the mobilization of the language of 'accountability'. Yet, contrary to the spirit of that act, the accountability mechanism was not greater accountability to local citizens, but greater accountability to central government via the imposition of commissioners.

The issuance of the s114 notice and the subsequent intervention in Birmingham were therefore laden with political meaning and implication, at both the national and local level. We see how the language of public accountability can be useful to mobilize for political reasons, but in practice led to the appointment of unelected commissioners with the power to force through unprecedented cuts and assets sales on local residents without any real assessment of the council's financial situation.

## The capitalization direction and the shift in 'best value': from achieving outcomes to achieving austerity

Following the statutory intervention in October 2023, the Department for Levelling Up Housing and Communities, would go on to negotiate the council's £1.255 billion 'capitalization direction' in February 2024, which would provide the overall framework for how the council would subsequently 'balance the books'. With reference to RQ 2, this would have crucial implications for how BCC would assess 'best value' in the subsequent cuts programme.

Like much of the accounting in relation to the BCC case, the £1.255 billion capitalization figure was widely misquoted in the media as being a 'bailout' (Wilcock, 2024) or a 'bailout loan' (Gilbert & Sandiford, 2024). This was seemingly referencing the council's finance officer who, in their report on the 2024/25 budget, described the package as follows:

> *For the avoidance of doubt EFS [Exceptional Financial Support] is really nothing more than a loan from government that must be paid back through asset sales. There are conditions for this loan* (BCC 001).

This, however, was at best a loose analogy. The capitalization direction was, in fact, an internal transfer between reserves, with the £1.255 billion being borrowed from the council's capital budget to fund the gap in the revenue budget. No money was received from central government, and the capitalization was more accurately described as permission to temporarily breach the statutory conditions on the general fund via an accounting loophole. Framing it as a 'loan' that had to be 'repaid' via asset sales on the 'condition' that the council make cuts therefore appeared to be a discursive move to legitimize a programme of asset sales and cuts for a wider lay audience.

Turning to the detail of the direction, by February 2024 the still unaudited equal pay estimate had grown to £815 million, which, together with the outstanding deficit in 2024/25, and additional redundancy and contingency reserves, would arrive at the total £1.255 billion 'capitalization direction' (Brackley, 2024c). The 'conditions' of this direction required £300 million of savings over two years, by April 2026, and asset sales of £750 million by December 2025. On investigation of audit committee papers and a special budgetary scrutiny committee that was set up to review the 2024/25 proposals, it was noted that 'risk' was defined exclusively in relation to whether or not input reductions could be delivered, with little to no documentation of 'risk' in terms of value for money or operational delivery of services. With regards to this definition of 'risk', it was noted in the final report of the budgetary scrutiny committee to cabinet that nine specific savings were at high risk of judicial review (BCC 001). The mitigations discussed in relation to these related to the cost impact of delaying the cuts rather than the implications this would have for service delivery, or, indeed, whether the council was potentially breaking the law in cutting advisory services, youth services, early help interventions, home school transport, and children's services (Brackley & Leaver, 2024). Similarly, little analysis of outcomes would be made in the preparation of the 2024/25 budget; in particular, in relation to whether the reductions would leave the council in breach of their statutory duties or create further unaccounted for knock-on costs (Brackley & Leaver, 2024).

Once again, as has been noted in the prior literature (Bracci et al., 2015; Hyndman & Lapsley, 2016; Brackley et al., 2021; Ferry et al., 2022; Brackley, 2024a), financial accountability under 'austerity localism' would serve, in practice, to shift the focus away from achieving organizational outcome objectives and towards input reductions that would be highly likely to damage those outcomes. All of which took place on a foundation of a questionable equal pay figure, a lack of reliable information on what the authority's structural deficit actually was, and on a time scale that made assessing the impact of the proposals very difficult, if not impossible.

## Discussion: 'austerity localism' in UK local government in times of crisis

In introducing this article, I noted the importance of the UK local government sector both as a forerunner of NPM reforms historically (Ferry et al., 2015) and as leading the move towards 'austerity localism' as a particular iteration of NPM in recent times (Ferry & Murphy, 2018; Ferry et al., 2019). The review of the literature suggested that these reforms could be characterized by a move towards transparency and local accountability in the context of severe spending reductions, but also that such reforms tended to prioritize private sector interests and transactional accountability over wider public scrutiny (Ellwood, 2014; Ferry & Murphy, 2018; Research for Action, 2023).

The case contributes to these discussions in several important ways. In addressing RQ 1 I draw attention to the relationship between national and local accountability in a manner that has been subject to little empirical research (Ferry & Murphy, 2018), finding that, despite the 'localism agenda' under austerity localism, accountability to national government ultimately takes precedence over local forms of accountability in times of crisis. Furthermore, by developing prior literature on transparency and accountability under austerity localism (Bovens, 2007; Hood, 2010; Ferry et al., 2015), I note that the current crisis in audit and reporting erodes 'transparency' (Birkinshaw, 2006) to the wider public at a crucial time, leaving the current system more reliant than ever on unaudited management judgements. The case therefore suggests that the hoped for improvements to transparency following the adoption of IFRS and the abolition of the Audit Commission in UK local government have not been realized, and have, to the contrary, contributed to the current crisis in audit and reporting (Ellwood, 2014; Redmond, 2020).

Reflecting on the financial accounting and audit arrangements under RQ 2, I show that in the BCC case that the mismatch between the accounting basis under IFRS and funding basis under statute, together with the increasingly difficult audit issues of going concern and best value in times of austerity, prepared the ground for an unaudited and ultimately overstated management estimate to (according to the media) 'bankrupt' the council. These dynamics could contribute to audit failure in the sector more widely as authorities come under increasing financial pressure, with auditors auditing IFRS figures that are several years out of date and detached from the 'funding basis' of accounting, and then, at the moment of crisis, being asked to comment at short notice on unaudited estimates prepared under the funding basis. In their advice on s114 notices and statutory recommendations, it remains unclear to what extent it is appropriate for the auditors to adopt a quasi-management position, working closely with the audit client to make operational recommendations under their best value duties, or, instead, attempt to remain more independent, and comment only when they have fully audited the figures.

Therefore, with respect to RQ 2, the current audit and best value arrangements in the UK are found to be dysfunctional in times of crisis - auditors are unlikely to be in a position to highlight issues in good time, government led top-down interventions are likely to erode local democracy and the deliverability of statutory services. All of which is consistent with broader findings in the literature that accounting under austerity tends to shift the focus from achieving outcomes to input reduction (Bracci et al., 2015; Ferry & Murphy, 2018; Brackley et al., 2021; Ferry et al., 2022), but adds important clarity as to how this dysfunctional dynamic plays out in the 'austerity localism' context of UK local government.

### *Transparency and accountability under austerity localism*

Further examining RQ 1, while many of the reforms of austerity localism were put forward in the UK context in the name of local autonomy and transparency (Ellwood, 2014; Ferry et al., 2022), and IFRS claims to true and fair representation hold 'transparency' at their heart (FRC, 2014), the BCC case shows that the current arrangements are perhaps less 'transparent' (with reference to Birkinshaw, 2006) than ever before. Delays to the preparation and audit of accounts left audit committees years behind current developments, and when public committees did ask the right questions they were not provided with crucial information (BCC 012). This appeared to be the case both in relation to the Oracle IT disaster that devastated the council's financial position, and the prematurely disclosed and reportedly overstated (Wallis, 2024) equal pay liability that triggered the s114 notice. Possible political motives and vested interests were allowed to play out backstage, subject to little public scrutiny, with crucial models withheld, estimates left unaudited, and a public enquiry delayed (Haynes, 2024b).

In particular, the lack of transparency around the various issues in this case—the Oracle IT disaster, the equal pay estimate that triggered the 'bankruptcy' notice, and the subsequent recovery plan—created strong information asymmetries between senior officers of the council and other unelected ostensibly non-political actors, on the one hand, and the public facing governance committees of the council (such as the audit committee). We therefore see that 'public transparency' (Birkinshaw, 2006) as envisioned under the 'localism agenda' (Ferry et al., 2015) becomes a necessary condition for effective local scrutiny, good governance, and ultimately local democracy. The result in this case was a shift in public accountability: from public 'accountability for' Oracle IT failure and austerity to an 'accountability for' an unprecedent (but ultimately overstated) equal pay liability. Meanwhile, the other side of the accountability equation saw a shift from a local 'accountability to' the residents of Birmingham to a more hierarchal 'accountability to' central government. Precisely the opposite of the supposed 'localism' agenda that underpinned the 2010–2015 reforms.

In relation to financial accountability, the above lack of transparency and shift in emphasis from outcomes to input reductions (Ellwood, 2014; Ferry et al., 2022) led to a devastating short-term budget for 2024/25, forced through under the commissioner led intervention. This narrow emphasis on input reduction in this budget was reminiscent of financial accountability as 'financial conformance' as suggested by Ferry et al. (2015) and other recent literature on the increasingly short-term focus of the austerity localism model (Ferry & Murphy, 2018; Ferry et al., 2022). As a result, this budget was subject to little public consultation and was at risk of breaching various statutory duties the council held to vulnerable people, particularly looked after children, disabled people, and the elderly. This created the seemingly contradictory position in which cuts were being rushed through that undermined services and damaged outcomes in the name of a supposedly 'best value' intervention.

### *IFRS accounting and audit failure*

Crucial to both financial accountability and the transparency agenda was the adoption of IFRS in UK local government in 2011. The background literature on the adoption of full accrual accounting in the public sector suggests that adoption helps the sector develop a more complete picture, particularly with reference to their net asset and debt positions (Mellett, 1997; Connolly & Hyndman, 2006). Our case, however, and the UK local government sector more widely, presents a rare example in which the underlying statutory basis of accounting departs significantly from the accounting standards, thus creating complex reconciliation movements in reserves. Together with the difficulty in applying fair value accounting to the complex asset bases, defined benefit pension schemes, and financial instruments in the local government sector, and the increasing delays to the audit of the accounts, this created a sense in which the IFRS bottom line is unimportant or not reflective of the 'real' financial position of the authority. In the BCC case, we see strong performance on an IFRS basis in their most recent annual accounts (BCC 005), but note that this was largely ignored in the s114 notice (BCC 009), which instead focused on possible future 'worst case' exposure to equal pay risks and future deficits estimated on the 'funding basis' of accounting.

The result was that financial accountability shifted from broad public accountability based on user-friendly accounting information, as envisioned under IFRS, to a highly opaque accountability to central government that relied heavily on unaudited management estimates. The volatility of the IFRS surplus figure, together with the fact that statute in the UK focuses on the adequacy of the general fund and the balancing of the budget on a partial-cash basis (Redmond, 2020), rendered the annual accounts peripheral. In the extreme case of BCC, these factors combine such that the council moved from having a healthy set of accounts reported to the audit committee on the 28th March 2023, with no going concern issues, to a highly opaque s114 notice on the 5th September 2023. This was then followed by a highly punitive statutory intervention (Brackley, 2024c) in which a transfer between reserves was authorized to prop up the general fund reserve, on the condition that the authority make significant budget cuts and asset sales, at pace, with very little value-for-money assessment. Much of which, it later transpired, was in fact due to the failed implementation of a new Oracle IT system. The opaque nature of the accounting and the political interests at play allowed this punitive intervention, which came with no additional funds for the council, to be variously misreported in the media as a 'bailout', a 'loan', and a 'support package', when in fact it was little more than a programme of further cuts and privatization.

All of which left the auditors in a position of considerable difficulty. On the one hand they held a 'best value duty', which is normally defined as delivering good outcomes. On the other hand, 'best value' had been redefined to refer to input reductions and balancing the books (Bracci et al., 2015; Ferry et al., 2022). The best value duty and their power to make statutory recommendations also gave them considerable power over the operations of the council at a politically complex and sensitive time. Caught between the horns of this dilemma, the auditors both failed to identify any new equal pay issues when they reported in March 2023, and then failed to publicly challenge the £760 million figure when this was cited in the s114 notice—appearing to back two wildly differing management estimates of the same figure within the space of a few months. Having been widely cited in the media in relation to the unprecedented scale of the £760m liability, they were then given the difficult task of auditing this figure.

The auditors therefore played a significant role in shifting accountability away from the Oracle IT failure and austerity to, instead, how such an equal pay figure could have been allowed to accumulate. The accounting basis and underlying audit practices therefore played a central role in shifting public scrutiny from unelected senior executives and the national austerity agenda, towards the relationship between the council's political leadership and the trade unions.

## Concluding remarks: an international problem

This article has investigated the extreme case of BCC to better understand the accountability and transparency arrangements in the UK local government system. I chose this case following the guidance of Lee and Saunders (2017) on the basis that it is in such extreme cases that proper safeguards over transparency and accountability are most needed. I also note that given the sector-wide funding gap and the number of authorities facing similar s114 notices, BCC may be a forerunner of a more widespread crisis in the sector under the 'austerity localism' model.

This is of interest to a wider international audience as we find that the austerity localism model in the UK, while put forward in the name of transparency and local accountability, has created a highly opaque system that is heavily reliant on unaudited management judgements and hierarchal accountability to central government in times of financial stress. The austerity localism reforms shifted financial accountability from an assessment of outcomes, under the old regime of best value inspections, to input reduction—to the point that severe input reductions are put forward that are likely to harm outcomes and breach statutory duties. Finally, the case highlights the mismatch between the accounting basis under IFRS and the funding basis under statute and the associated difficulty of applying fair value accounting in local government. We then see how this ambiguity in the accounting basis leaves the auditors auditing the wrong figures years too late. This both damages transparency (Birkinshaw, 2006; Hood, 2010), in any meaningful sense of the term, and puts the auditors in a difficult position during the s114 process—heavily reliant on management when it comes to making their statutory recommendations and then in a position in which they will have to audit the claims made in their own recommendations at a later date.

In sum, the 'austerity localism' model has created a system that is both poorly equipped to deal with crisis in a rational and transparent manner and is increasingly putting authorities on the road to the very financial crisis it is so poorly equipped to address.

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