



## **Audit, Risk & Assurance Committee**

**Date:** Friday 16 March 2018

**Time:** 10.00 am                      **Public meeting**                      Yes

**Venue:** Room 116, West Midlands Combined Authority, 16 Summer Lane, Birmingham, B19 3SD

If you have any queries about this meeting, please contact:

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## **SUPPLEMENTARY AGENDA**

| <b>No.</b>                    | <b>Item</b>   | <b>Presenting</b> | <b>Pages</b> |
|-------------------------------|---|-------------------|--------------|
| <b>Meeting Business Items</b> |   |                   |              |
| 10.1                          | Informing the Audit Risk Assessment for West Midlands Integrated Transport Authority Pension Fund | Terry Tobin       | 1 - 22       |

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## Audit, Risk & Assurance Committee

|  |   |
|--|---|
| <b>Date</b>                                | 16 <sup>th</sup> March 2018   |
| <b>Report title</b>                        | Informing the Audit Risk Assessment for West Midlands Integrated Transport Authority Pension Fund             |
| <b>Accountable Chief Executive</b>         | Deborah Cadman, OBE<br>Chief Executive of the WMCA<br>Email: deborah.cadman@wmca.org.uk<br>Tel: 0121 214 7552 |
| <b>Accountable Employee</b>                | Sean Pearce<br>WMCA Director of Finance<br>Email: sean.pearce@wmca.org.uk<br>Tel: 0121 214 7936               |
| <b>Report to be/has been considered by</b> | None  |

**Recommendation(s) for action or decision:**

**The Audit, Risk and Assurance Committee is recommended to:**

1. Review and note the contents of the report, and consider whether the responses are consistent with its understanding and whether there are any further comments it wishes to make.

## **1.0 Purpose**

1.1 The purpose of this report is to contribute towards the effective two-way communication between auditors and the Authority's Audit, Risk & Assurance Committee, as 'those charged with governance'. The report covers some important areas of the auditor risk assessment where we are required to make inquiries of the Audit, Risk & Assurance Committee under auditing standards.

1.2 As part of our risk assessment procedures we are required to obtain an understanding of management processes and the Audit, Risk & Assurance Committee's oversight of the following areas:

- Fraud
- Laws and regulations
- Going concern
- Related party transactions
- Accounting estimates

1.3 This report includes a series of questions on each of these areas and the response we have received from the Combined Authority's management.

## **2.0 Background**

2.1 The statutory responsibilities of the external audit function are:

- To be satisfied that the accounts comply with the requirements of the enactments that apply to them
- To be satisfied that proper practices have been observed in the preparation of the statement of accounts and that the statement presents a true and fair view
- To be satisfied that the audited body has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

## **3.0 Wider WMCA Implications**

3.1 None

## **4.0 Progress, options, discussion, etc.**

4.1 N/A

## **5.0 Financial implications**

5.1 The financial implications are included within the body of the report.

## **6.0 Legal implications**

6.1 There are no direct legal implications.

## **7.0 Equalities implications**

7.1 There are no implications.

**7.0 Other implications**

7.1 None.

**8.0 Schedule of background papers**

8.1 N/A

**9.0 Appendices**

ARAC – Informing the audit risk assessment for West Midlands Integrated Transport Authority Pension Fund

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# Informing the audit risk assessment for West Midlands Integrated Transport Authority Pension Fund

Year ended 31 March 2018

March 2018

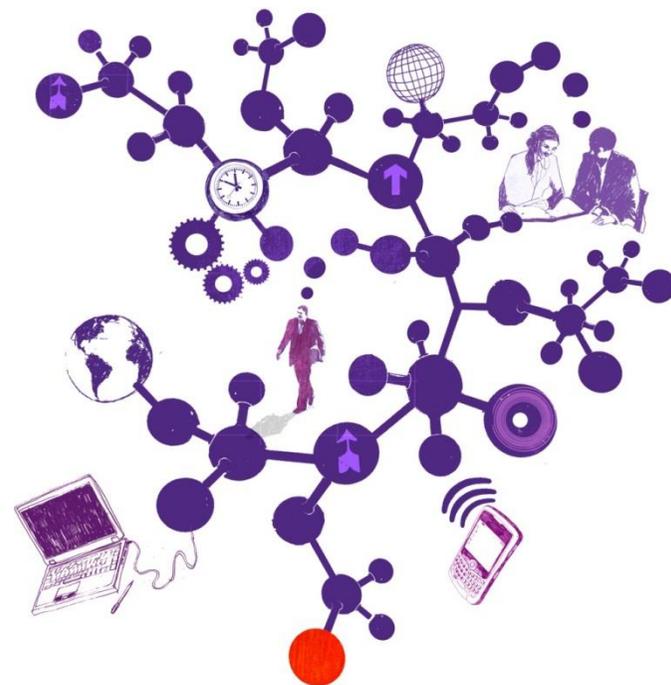
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The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our audit process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect your business or any weaknesses in your internal controls. 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.

# Purpose

The purpose of this report is to contribute towards the effective two-way communication between auditors and the West Midlands Combined Authority Audit, Risk and Assurance Committee (ARAC), as 'those charged with governance'. The West Midlands Combined Authority has, however, delegated its functions to the West Midlands Pension Fund Pensions Committee (Pensions Committee) and is therefore considered as the sub-group of those charged with governance. The report covers some important areas of the auditor risk assessment where we are required to make inquiries of ARAC and the West Midlands Pension Fund Pensions Committee under auditing standards.

## Background

Under International Standards on Auditing (UK and Ireland) (ISA(UK&I)) auditors have specific responsibilities to communicate with ARAC as they are deemed Those Charged with Governance. ISA(UK&I) emphasise the importance of two-way communication between the auditor and ARAC and also specify matters that should be communicated.

This two-way communication assists both the auditor ARAC in understanding matters relating to the audit and developing a constructive working relationship. It also enables the auditor to obtain information relevant to the audit from ARAC and supports ARAC in fulfilling its responsibilities in relation to the financial reporting process.

## Communication

As part of our risk assessment procedures we are required to obtain an understanding of management processes and the Pensions Committee's oversight of the following areas:

- fraud
- laws and regulations
- going concern
- accounting estimates
- related party transactions

This report includes a series of questions on each of these areas and the response we have received from management and the Pensions Committee. ARAC should consider whether these responses are consistent with its understanding and whether there are any further comments it wishes to make.

# Fraud

## Issue

### Matters in relation to fraud

ISA (UK&I) 240 covers auditors responsibilities relating to fraud in an audit of financial statements.

The primary responsibility to prevent and detect fraud rests with both the management and ARAC. Management, with the oversight of ARAC and the Pensions Committee, needs to ensure a strong emphasis on fraud prevention and deterrence and encourage a culture of honest and ethical behaviour. As part of their oversight, ARAC and the Pensions Committee should consider the potential for override of controls and inappropriate influence over the financial reporting process.

As an auditor, we are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement due to fraud or error. We are required to maintain professional scepticism throughout the audit, considering the potential for management override of controls. As part of our audit risk assessment procedures we are required to consider risks of fraud. This includes considering the arrangements management has put in place with regard to fraud risks including:

- assessment that the financial statements could be materially misstated due to fraud
- process for identifying and responding to risks of fraud, including any identified specific risks
- communication with ARAC and the Pensions Committee regarding its processes for identifying and responding to risks of fraud
- communication to employees regarding business practices and ethical behaviour.

We need to understand how the ARAC and the Pensions Committee oversee the above processes. We are also required to make inquiries of management and, ARAC and the Pensions Committee as to their knowledge of any actual, suspected or alleged fraud. These areas have been set out in the fraud risk assessment questions below together with responses from management.

# Fraud risk assessment

| Question   | Management response  |
|--|--|
| <p>Has the Pension Fund assessed the risk of material misstatement in the financial statements due to fraud?<br/>What are the results of this process?</p>                           | <p>The Pension Fund is consolidated into the accounts of West Midlands Combined Authority, as well as producing its own set of accounts. Fraud risks are identified by Internal Audit in their audit plan covering the Combined Authority and the Pension Fund, and all fundamental systems which feed the statement including the Pension Fund accounts are reviewed annually to ensure that controls in place are satisfactory.</p> <p>The statement of Pension Fund accounts is also subject to an analytical review each year which considers any significant or material changes to figures, to confirm that the accounts are presented without such misstatements.</p>   |
| <p>What processes does the Pension Fund have in place to identify and respond to risks of fraud?</p> <p style="writing-mode: vertical-rl; transform: rotate(180deg);">Page 9</p>     | <p>Specific fraud risks are identified in the internal audit planning process noted above; in identifying key controls to be assessed as part of an audit; in targeted fraud prevention work and by raising awareness of the potential for fraud with staff, members and people working and involved with the Combined Authority and Pension Fund. This is done through the Anti-Fraud, Bribery and Corruption Policy, Whistle Blowing Policy, and supporting training. In addition systems and processes are designed by managers and users to minimise the risk of fraud and corruption.</p> <p>In relation to pensioner payroll, the Fund takes part in the National Fraud Initiative scheme. Any queries identified are investigated and resolved. Fund Managers and their Administrators send internal control reports and these are reviewed by the pension team and any exceptions reported on. Internal Audit also reviews the internal control reports as part of their annual audit cycle. Pensions Committee meetings monitor the Fund's investment managers and business risk including fraud will be communicated to 'those charged with governance'.</p> |
| <p>Have any specific fraud risks, or areas with a high risk of fraud, been identified and what has been done to mitigate these risks?</p>  | <p>No areas with a high risk of material fraud have been identified. If any risks are identified, recommendations for mitigation are made to managers who then implement as necessary.</p>   |
| <p>Are internal controls, including segregation of duties, in place and operating effectively?<br/>If not, where are the risk areas and what mitigating actions have been taken?</p> | <p>Internal controls, including whether segregation of duties exist, are reviewed by Internal Audit as part of their routine and investigative work; exceptions are reported to managers and inform the Internal audit opinion.</p>  |

# Fraud risk assessment

| Question  | Management response  |
|---|--|
| Are there any areas where there is a potential for override of controls or inappropriate influence over the financial reporting process (for example because of undue pressure to achieve financial targets)?                                 | There is always the potential for an override of controls within systems, however our control framework has established secondary compensatory controls in place that would identify any such override has taken place. Financial reporting is produced and balanced from the financial system, and the reporting hierarchy allows for checks to be performed throughout the process, for example by the S151 Officer, Senior Management Team, the Audit, Risk & Assurance Committee and the Pensions Committee.   |
| Are there any areas where there is a potential for misreporting override of controls or inappropriate influence over the financial reporting process?   | No, as detailed above, there are compensatory controls in place to flag any overrides of controls.   |
| How does ARAC and the Pensions Committee exercise oversight over management's processes for identifying and responding to risks of fraud? What arrangements are in place to report fraud issues and risks to ARAC and the Pensions Committee? | The Internal Audit Risk Based Plan is approved by Audit, Risk & Assurance Committee of the Combined Authority and the West Midlands Pension Fund Pensions Committee in relation to pensions issues before commencement each year. Internal Audit complete a robust review of internal controls on a risk basis and reports regularly to the Committee. The Pensions Committee are informed of the audit opinions and seek management reassurance on the improvement of controls where the consequences are considered high risk. At each meeting the Audit, Risk & Assurance Committee receives an update on instances of actual, suspected or alleged fraud investigations that have occurred since the last meeting and their outcomes. The Pension Fund members are informed at their meetings of any pension based issues. |
| How does the Pension Fund communicate and encourage ethical behaviour of its staff and contractors?   | The Pension Fund follows the Combined Authority's Whistleblowing policy and guidelines. The Whistleblowing policy is available to the public and all contractors. The terms and conditions within Pension Fund contracts also include ethical considerations for contractors and suppliers. The vision and values for the Pension Fund identify the need for staff to act with integrity in all the undertakings.  |
| How do you encourage staff to report their concerns about fraud? Have any significant issues been reported?   | Staff are encouraged to report their concerns about fraud as set out in the Speaking up about wrongdoing (Whistleblowing) policy and the Combined Authority's Counter Fraud, Bribery and Anti-Corruption Strategy.   |
| Are you aware of any related party relationships or transactions that could give rise to risks of fraud?  | None identified.   |
| Are you aware of any instances of actual, suspected or alleged, Fraud within the Pension Fund as a whole since 1 April 2017.  | No   |

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# Laws and regulations

## Issue

### Matters in relation to laws and regulations

ISA (UK&I) 250 requires us to consider the impact of laws and regulations in an audit of the financial statements.

Management, with the oversight of ARAC and the Pensions Committee, is responsible for ensuring that the Pension Fund's operations are conducted in accordance with laws and regulations including those that determine amounts in the financial statements.

As auditor, we are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement due to fraud or error, taking into account the appropriate legal and regulatory framework. As part of our risk assessment procedures we are required to make inquiries of management, ARAC and the Pensions Committee as to whether the entity is in compliance with laws and regulations. Where we become aware of information of non-compliance or suspected non-compliance we need to gain an understanding of the non-compliance and the possible effect on the financial statements.

Risk assessment questions have been set out below together with responses from management.

# Impact of laws and regulations

| Question   | Management response   |
|--|---|
| What arrangements does the Pension Fund have in place to identify, evaluate and account for litigation or claims?        | Risk management, insurance and legal work together to identify and evaluate any potential litigation or claims against the Pension Fund. Any potential liabilities are highlighted each year in the Pension Fund's Statement of Accounts, which includes consideration of the Pension Fund, which is consolidated into the Combined Authority's financial statements. |
| Is there any actual or potential litigation or claims that would affect the financial statements?                        | The Director of Finance is not aware of any actual or potential litigation or claims that would affect the financial statements.  |
| Have there been any reports from other regulatory bodies, such as HM Revenues and Customs which indicate non-compliance? | No such reports have been received.   |

# Impact of laws and regulations

| Question  | Management response   |
|---|---|
| What arrangements does the Pension Fund have in place to prevent and detect non-compliance with laws and regulations?   | Each year the Pension and Combined Authority's corporate governance arrangements and risk management arrangements are reviewed and reported upon by Internal Audit and Risk Management teams. This would include the Pension Fund if applicable. The Pension Fund has a robust corporate governance and risk management process in place, which are based on approved policies and procedures.  |
| How does management gain assurance that all relevant laws and regulations have been complied with?  | The Combined Authority has a Monitoring Officer and Director of Finance (S151 officer) who provide assurance that all relevant laws and regulations have been complied with. The Director of Pensions at the West Midlands Pension Fund provides expertise and advice via the inclusion of the ITA Pension Fund within all of the wider West Midlands Pension Fund requirements. The Pension Fund has adopted the Local Government Pensions Scheme Regulations. The Pensions Committee receive reports of compliance from officers, who are suitably qualified. Any non compliance would be reported to management via Internal Audit reports and appropriate plans are put in place to remedy such issues. These would cover the Pension Fund as applicable. |
| How is ARAC and the Pensions Committee provided with assurance that all relevant laws and regulations have been complied with?  | See above   |
| Have there been any instances of non-compliance or suspected non-compliance with law and regulation since 1 April 2017, or earlier with an on-going impact on the 2017/18 financial statements? | No - The Director of Finance and the Chair of ARAC are not aware of any instances of non-compliance with relevant laws and regulations in 2017-18. The Chair of the Pensions Committee is not aware of any instances of non-compliance during 2017-18.  |

# Going concern

## Issue

### Matters in relation to going concern

ISA (UK&I) 570 covers auditor responsibilities in the audit of financial statements relating to management's use of the going concern assumption in the financial statements.

The going concern assumption is a fundamental principle in the preparation of financial statements. Under this assumption entities are viewed as continuing in business for the foreseeable future. Assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business.

The code of practice on local authority accounting requires an authority's financial statements to be prepared on a going concern basis. Although the Pension Fund is not subject to the same future trading uncertainties as private sector entities, consideration of the key features of the going concern provides an indication of the pensions fund's financial resilience.

As auditor, we are responsible for considering the appropriateness of use of the going concern assumption in preparing the financial statements and to consider whether there are material uncertainties about the Pension Fund's ability to continue as a going concern that need to be disclosed in the financial statements. We discuss the going concern assumption with management and review the Pension Fund's financial and operating performance.

Going concern considerations have been set out below and management has provided its response.

# Going concern considerations

| Question   | Management response   |
|--|---|
| Are management or members of ARAC and the Pensions Committee aware of the existence of events or circumstances that have or will lead to the winding up of the scheme or an entry into a Pensions Protection Fund assessment period. | No such events or circumstances are known of or considered likely in the foreseeable future.  |
| Is management aware of the existence of other events or conditions that may cast doubt on the Pension Fund's ability to continue as a going concern?   | No events or conditions have been identified.   |
| Are arrangements in place to report the going concern assessment to the Pensions Committee and Pension Fund?   | Yes, the Audit, Risk & Assurance Committee and the Pensions Committee consider a number of financial reports which provide them with assurance that the Pension Fund continues as a going concern. They also receive reports stating that all controls and risks have been managed appropriately and as Members will have access to all reports produced across the Pension Fund whether public or exempt. The Tri-annual pension fund valuation has just been completed which also provides an independent view as to the financial viability of the fund. |

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# Estimates

## Issue

### Matters in relation to accounting estimates

ISA (UK&I) 540 covers auditor responsibilities relating to estimates in an audit of financial statements.

Local authorities use estimates in the preparation of their financial statements. We need to obtain an understanding of:

- how management identifies the transactions, events and conditions that give rise to the need for an accounting estimate.
- how management actually make the estimates, including the control procedures in place to minimise the risk of misstatement.

We need to be aware of all estimates that the Pension Fund use as part of their accounts preparation. These are set out overleaf.

# Estimate considerations

| Estimate                      | Method   | Controls used to identify estimates  | Use of an expert   | Underlying assumptions<br>- Assessment of degree of uncertainty<br>- Consideration of alternative estimates   | Change in accounting method in year? |
|-------------------------------|--|--|--------------------|---|--------------------------------------|
| Pension fund liability        | The administering authority engage the Actuary who provides the estimate of the pension liability.   | Payroll data is provided to the Actuary.<br><br>Management reconcile this estimate of contributions to the actuals paid out in the year. | Consulting actuary | As disclosed in the actuary's report. Complex judgements including the discount rate used, rate at which salaries are projected to increase, changes in retirement ages, mortality rates and expected returns on pension fund assets. | No                                   |
| Bulk Annuity Insurance Buy-In | The value of the buy-in is recalculated at each year end by the consulting actuary. The value as at 31 March 2018 is based on the roll-forward of the actuarial valuation as at 31 March 2017 and adjusted for estimated pension payments and discount rate. The key underlying inputs for the buy-in valuation are the discount rate and life expectancy. | The data is provided to the Actuary  | Consulting actuary | As disclosed in the actuary's report. Complex judgements including the discount rate used, changes in retirement ages, mortality rates and expected returns on Pension Fund assets.   | No                                   |

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# Estimate considerations

| Estimate | Method  | Controls used to identify estimates   | Use of an expert | Underlying assumptions<br>- Assessment of degree of uncertainty<br>- Consideration of alternative estimates                             | Change in accounting method in year? |
|----------|---|---|------------------|---|--------------------------------------|
| Accruals | Finance team collate accruals of expenditure and income. Activity is accounted for in the financial year that it takes place, not when money is paid or received. | Review financial systems to identified where goods have been received but not paid for. Requests of service managers to identify any other goods or services received or provided but not paid for. | No               | Accruals for income and expenditure often based on known values. Where accruals are estimated the latest available information is used. | No                                   |

# Related parties

## Issue

### Matters in relation to related parties

ISA (UK&I) 550 covers auditor responsibilities relating to related party transactions.

Many related party transactions are in the normal course of business and may not carry a higher risk of material misstatement. However in some circumstances the nature of the relationships and transaction may give rise to higher risks.

For local government bodies, the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) requires compliance with IAS 24: related party disclosures. The Code identifies the following as related parties to local government bodies:

- entities that directly, or indirectly through one or more intermediaries, control, or are controlled by the Pension Fund (i.e. subsidiaries)
- associates
- joint ventures in which the Pension Fund is a venturer
- an entity that has an interest in the Pension Fund that gives it significant influence
- key officers, and close members of the family of key officers
- post-employment benefit plan (pension fund) for the benefit of employees of the Authority, or of any entity that is a related party of the Authority.

The Code notes that, in considering materiality, regard should be had to the definition of materiality, which requires materiality to be judged from the viewpoint of both the Pension Fund and the related party.

ISA (UK&I) 550 requires us to review your procedures for identifying related party transactions and obtain an understanding of the controls that you have established to identify such transactions. We will also carry out testing to ensure the related party transaction disclosures you make in the financial statements are complete and accurate.

# Related party considerations

| Question   | Management response   |
|--|---|
| Who are the Pension Fund's related parties?  | The Pension Fund's main related party is West Midlands Combined Authority, with some disclosures in relation to employees who hold key responsibilities.  |
| What are the controls in place to identify, account for, and disclose, related party transactions and relationships? | A number of arrangements are in place for identifying the nature of a related party and reported value including: <ul style="list-style-type: none"><li>• Maintenance of a Register of Interests for Members, a register for pecuniary interests in contracts for Officers and Senior Managers requiring disclosure of related party transactions.</li><li>• Annual return from senior managers/officers requiring confirmation that read and understood the declaration requirements and stating details of any known related party interests.</li></ul> |

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