

Informing the audit risk assessment for the West Midlands Combined Authority

Year Ended 31 March 2018

Contents

Section	Page
Purpose	03
Fraud	04
Fraud risk assessment	05
Laws and regulations	08
Impact of laws and regulations	09
Going Concern	11
Related Parties	14
Accounting estimates	16
Accounting estimates considerations	17
Appendix A – Accounting Estimates	18

Purpose

The purpose of this report is to contribute towards the effective two-way communication between those charged with governance for the Combined Authority, and Grant Thornton as your external auditor. The report covers some important areas of the auditor risk assessment where we are required to make inquiries of the Combined Authority under auditing standards.

Background Under International Standards on Auditing (UK and Ireland) (ISA(UK&I)) auditors have specific responsibilities to communicate with the Audit, Risk and Assurance Committee. ISA(UK&I) emphasise the importance of two-way communication between the auditor and the Combined Authority and also specify matters that should be communicated.

This two-way communication assists both the auditor and the Audit, Risk and Assurance Committee 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 the Combined Authority and supports the Audit, Risk and Assurance Committee 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 the Combined Authority management processes and the Audit, Risk and Assurance Committee's oversight of the following areas:

- fraud
- laws and regulations
- going concern
- related parties
- accounting estimates.

This report includes a series of questions on each of these areas and the response we have received from the Combined Authority's management. These responses have been reviewed and agreed by the relevant heads of departments. The Committee should consider whether these responses are consistent with its understanding and whether there are any further comments it wishes to make.

Fraud

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 Audit, Risk and Assurance Committee and the Combined Authority management. Management, with the oversight of the Audit, Risk and Assurance Committee, needs to ensure a strong emphasis on fraud prevention and deterrence and encourage a culture of honest and ethical behaviour. As part of its oversight, the Audit, Risk and Assurance Committee should consider the potential for override of controls and inappropriate influence over the financial reporting process.

As the Combined Authority's external auditors, 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 the Audit, Risk and Assurance 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 Audit, Risk and Assurance Committee oversees the above processes. We are also required to make inquiries of both the Combined Authority management and the Audit, Risk and Assurance 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 the Combined Authority's management.

Fraud risk assessment

Question	Management response
<p>Has the Combined Authority assessed the risk of material misstatement in the financial statements due to fraud or error?</p> <p>Is this consistent with the feedback from your risk management processes?</p>	<p>Considered to be low risk.</p> <p>Yes, and consistent with findings in the Internal Audit of Key Processes. Of five key financial systems audits undertaken, four received substantial assurance and one satisfactory.</p>
<p>Are you aware of any instances of fraud, either within the Combined Authority as a whole or within specific departments since 01 April 2017?</p> <p>If so how does the Audit, Risk and Assurance Committee respond to these?</p>	<p>No.</p> <p>If a potential fraud were to be reported, there is a known process in place to contact the Corporate Assurance Manager who would then commission Wolverhampton Audit Services to conduct an investigation. Wolverhampton Audit Team now supply our Internal Audit services by contract.</p>
<p>Do you suspect fraud may be occurring, either within the Combined Authority or within specific departments?</p> <ul style="list-style-type: none"> • Have you identified any specific fraud risks? • Do you have any concerns there are areas that are at risk of fraud? <p>Are there particular locations within the Combined Authority where fraud is more likely to occur?</p>	<p>No.</p> <p>No.</p> <p>No.</p> <p>No.</p>

Fraud risk assessment (continued)

Question	Management response
<p>Are you satisfied that the overall control environment is robust, including:</p> <ul style="list-style-type: none"> the process for reviewing the system of internal control; internal controls, including segregation of duties; exist and work effectively? <p>If not where are the risk areas?</p> <p>What other controls are in place to help prevent, deter or detect fraud?</p> <p>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)?</p>	<p>Yes. Wolverhampton Internal Audit regularly review the key systems and processes and their recommendations and observations have been acted upon.</p> <p>N/A.</p> <p>Monthly financial reporting including account reconciliation which is a robust process.</p> <p>No.</p>
<p>How do you encourage, and communicate to, employees about your views on business practices and ethical behaviour?</p> <p>How do you encourage staff to report their concerns about fraud? What concerns are staff expected to report about fraud?</p>	<p>Policies and procedures are published on the Intranet covering theft and fraud and the process staff should follow if they suspect anything. These procedures also state the escalation procedure if required.</p> <p>As part of all new staff and member inductions they are given an overview of business practices and ethical behaviours and their roles in identifying or responding to fraud.</p> <p>Regular Director briefing sessions are held where staff can raise any concerns and business practice and ethical behaviour can be reinforced.</p>

Fraud risk assessment (continued)

Question	Management response
From a fraud and corruption perspective, what are considered to be high-risk posts?	Treasury team.
How are the risks relating to these posts identified, assessed and managed?	Treasury Management Group and clear segregation of duties and segregated approval limits.
Are you aware of any related party relationships or transactions that could give rise to instances of fraud?	No.
How do you mitigate the risks associated with fraud related to related party relationships and transactions?	Robust procurement procedures.
What arrangements are in place to report fraud issues to Audit, Risk and Assurance Committee? How does the Audit, Risk and Assurance Committee exercise oversight over management's processes for identifying and responding to risks of fraud and breaches of internal control?	Policies and Procedures are published on the Intranet covering theft and fraud and the process staff should follow if they suspect anything. These procedures also state the escalation procedure if required. The Internal Audit function is now delivered by Wolverhampton Internal Audit Services and presents audit reports to each Audit, Risk and Assurance Committee. The Client Manager from Wolverhampton has access to both the Chief Audit Executive and the Chair and Vice Chair of the Audit, Risk and Assurance Committee
Are you aware of any whistle-blower reports under the Bribery Act since 01 April 2017? If so how does the Audit, Risk and Assurance Committee respond to these?	No.

Laws and regulations

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 the Combined Authority, is responsible for ensuring that the Combined Authority'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 and the Combined Authority 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
<p>How does management gain assurance that all relevant laws and regulations have been complied with? What arrangements does the Combined Authority have in place to prevent and detect non-compliance with laws and regulations?</p>	<p>Responsibility for ensuring compliance with relevant laws and regulations lies with the Head of Governance who advises the Combined Authority. The constitution and governance arrangements within the Combined Authority have been reviewed and confirmed that they are appropriate and robust. All governance arrangements are currently monitored to ensure that they comply with relevant legislation and are fit for purpose. Individual experts also take responsibility within their own areas of expertise and where relevant appoint external advisors.</p>
<p>How is the Audit, Risk and Assurance Committee provided with assurance that all relevant laws and regulations have been complied with?</p>	<p>The Chief Audit Executive is the Head of Governance and a qualified solicitor, as well as the Monitoring Officer. It is the duty of care of all these roles to ensure laws and regulations have been adhered to. The West Midlands Combined Authority legal team report to the Head of Governance and are also the custodians of the West Midlands Combined Authority Constitution. The Chief Audit Executive would flag to the committee if any breaches to the constitution had been made. Where the Chief Audit Executive is not present at an Audit, Risk and Assurance Committee meeting, it is advised that a legal representative is present at the committee.</p>
<p>Have there been any instances of non-compliance with law and regulation since 01 April 2017 with on-going impact on the 2017/18 financial statements?</p>	<p>None.</p>

Impact of laws and regulations (continued)

Question	Management response
Is there any actual or potential litigation or claims that would affect the 2017/18 financial statements?	Cover is in place through Municipal Mutual Insurance – currently administered via Zurich on behalf of Municipal Mutual – with an excess of £25k. Finance are kept up to date with any claims and potential claims. Whilst the West Midlands Combined Authority have a number of potential claims at investigation stage, there are no significant litigation claims at this time.
What arrangements does the Combined Authority have in place to identify, evaluate and account for litigation or claims?	All claims are controlled by the legal team, in conjunction with our insurers. Where appropriate these are taken to the Board for approval.
Have there been any reports from other regulatory bodies, such as HM Revenues and Customs which indicate non-compliance?	No.

Going Concern

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.

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

Going concern considerations

Question	Management response
Has a report been received from management forming a view on going concern?	A detailed Business Plan for the Combined Authority is approved each year. Monthly management reporting is produced for the Combined Authority indicating positive trading performance of the business, which is reported monthly to the WMCA Leadership Team and bi-monthly to the Transport Delivery Committee, Programme Board, WMCA Finance Directors' Workstream and WMCA Main Board
Are the financial assumptions in that report (e.g., future levels of income and expenditure) consistent with the Combined Authority Business Plan and the financial information provided to the Combined Authority throughout the year?	N/A
Are the implications of statutory or policy changes appropriately reflected in the Business Plan, financial forecasts and report on going concern?	Yes
Have there been any significant issues raised with the Audit, Risk and Assurance Committee during the year which could cast doubts on the assumptions made? (Examples include adverse comments raised by internal and external audit regarding financial performance or significant weaknesses in systems of financial control).	No

Going concern considerations (continued)

Question	Management response
Does a review of available financial information identify any adverse financial indicators including negative cash flow or poor or deteriorating performance against the better payment practice code? If so, what action is being taken to improve financial performance?	No.
Does the Combined Authority have sufficient staff in post, with the appropriate skills and experience, particularly at senior manager level, to ensure the delivery of the Combined Authority's objectives? If not, what action is being taken to obtain those skills?	A review of capability and vacancy risk is being developed and will be presented to the Audit, Risk and Assurance Committee in March 2018.
Does the Combined Authority have procedures in place to assess the Combined Authority ability to continue as a going concern?	Yes– continued medium term financial planning
Is management aware of the existence of events or conditions that may cast doubt on the Combined Authority ability to continue as a going concern?	No.
Are arrangements in place to report the going concern assessment to the Audit, Risk and Assurance Committee?	Yes. Financial monitoring takes place on a monthly basis to the WMCA Leadership Team and bi-monthly to the WMCA Board. In addition the Audit, Risk and Assurance Committee will receive a financial update at each of their meetings.

Related Parties

Matters in relation to Related Parties

Local Government bodies are required to comply with IAS 24 and disclose transactions with entities/individuals that would be classed as related parties. These may include:

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

A disclosure is required if a transaction (or series of transactions) is material on either side, i.e. if a transaction is immaterial from the Combined Authority's perspective but material from a related party viewpoint then the Combined Authority must disclose it.

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 Parties considerations

Question	Management response
Who have the Combined Authority identified as related parties?	Currently reviewing related parties for the 2017/18 statutory accounts.
What are the controls in place to identify, account for, and disclose, related party transactions and relationships?	Key officers complete a disclosure form detailing their interests. These are reviewed annually. Robust procurement procedures are in place to provide assurance that all expenditure is carried out on a commercial basis.

Accounting estimates

Matters in relation to accounting estimates

Local government bodies apply appropriate estimates in the preparation of their financial statements. ISA (UK&I) 540 sets out requirements for auditing accounting estimates. The objective is to gain evidence that the accounting estimates are reasonable and the related disclosures are adequate.

Under this standard we have to identify and assess the risks of material misstatement for accounting estimates by understanding how the Combined Authority identifies the transactions, events and conditions that may give rise to the need for an accounting estimate.

Accounting estimates are used when it is not possible to measure precisely a figure in the accounts. We need to be aware of all estimates that the Combined Authority is using as part of its accounts preparation; these are detailed in Appendix A to this report. The audit procedures we conduct on the accounting estimate will demonstrate that:

- the estimate is reasonable; and
- estimates have been calculated consistently with other accounting estimates within the financial statements.

We would ask the Combined Authority to satisfy itself that the arrangements for accounting estimates are adequate.

Accounting estimates considerations

Question	Management response
Are management aware of transactions, events and conditions (or changes in these) that may give rise to recognition or disclosure of significant accounting estimates that require significant judgement?	No significant judgements expected over and above those already outlined at Appendix A.
Are the management arrangements for the accounting estimates, as detailed in Appendix A, reasonable?	Yes.
How is the Audit, Risk and Assurance Committee provided with assurance that the arrangements for accounting estimates are adequate?	These are explained as appropriate as part of the financial monitoring to the Audit, Risk and Assurance Committee, Transport Delivery Committee, WMCA Leadership Team and WMCA Main Board by the Director of Finance.

Appendix A – Accounting Estimates

Appendix A - Accounting estimates

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Property plant & equipment valuations	Fair value for land/buildings defined as 'existing use' by The Code.	Valuations are performed frequently to ensure that the fair value of a revalued asset does not differ materially from its carrying amount. For land and buildings all material assets were revalued in 2013/14.	Bruton Knowles	Degree of uncertainty inherent with any revaluation. We employ professional valuers and rely on expert opinion.	No
Estimated remaining useful lives of PPE	Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost is depreciated separately. Depreciation methods, useful lives and residual values are reviewed each financial year and adjusted if appropriate.	See left box	Discussion with internal asset team and where applicable Bruton Knowles as valuer.	Depreciation is calculated on a straight line basis as this reflects consumption of assets and is a reasonable assumption.	No
Depreciation & Amortisation	See above	See above	See above	See above	No

Appendix A - Accounting estimates (continued)

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Pension Fund (LGPS) Actuarial gains/losses	The actuarial gains and losses figures are calculated by the actuarial expert Barnett Waddingham. These figures are based on making % adjustments to the closing values of assets/liabilities.	The Combined Authority responds to queries raised by the administering body, Wolverhampton Council.	The Combined Authority are provided with an actuarial report by Barnett Waddingham (LGPS).	The nature of these figures forecasting into the future are based upon the best information held at the current time and are developed by experts in their field.	No.
Impairments	Review of all assets undertaken annually in line with the code.	See left.	Discussion with internal asset team as appropriate.	N/A.	No.
Non adjusting events -events after the BS date	Monthly management accounts prepared would flag any adjusting/non-adjusting events.	See left.	N/A.	N/A.	No.
Accruals	We use standard accruals accounting –accruals are based on expenses incurred that have not yet been paid.	Monthly management accounts provides rigorous analysis so that any accruals are highlighted and actioned throughout the year	N/A.	N/A.	No.

Appendix A - Accounting estimates (continued)

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Measurement of Financial Instruments	Financial instruments consist of finance leases and bank overdraft. Measured initially at cost and subsequently at amortised cost using the effective interest method.	N/A	Tram lease calculations use RBS information in order to calculate the yearly refund.	N/A	No.
Bad Debt Provision	Debts are reviewed monthly and any debts that are deemed to be irrecoverable are written off to the CIES.	Knowledge by the Trade Receivables team in likelihood of recoverability and the aging of the debts. Head of Finance signs off the write off.	N/A	N/A	No.
Provisions for liabilities	Provisions are identified through detailed monthly management accounts which flags any potential issues to management.	Each provision is separately reviewed by financial accounts and a working is put together to support the calculation.	As necessary on an individual basis	Each provision is assessed on an individual basis to ensure that it meets the criteria of a provision per IAS 37. The degree of uncertainty is assessed when determining whether a provision is the correct treatment for an item.	No.

