



Annual Audit Letter

Year ending 31 March 2018

West Midlands Combined Authority

16 August 2018



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Executive Summary

Purpose

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at West Midlands Combined Authority (the Authority) for the year ended 31 March 2018, including the West Midlands Integrated Transport Authority Pension Fund (the Pension Fund) accounts.

This Letter is intended to provide a commentary on the results of our work to the Authority and external stakeholders, and to highlight issues that we wish to draw to the attention of the public. In preparing this Letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'. We reported the detailed findings from our audit work to the Authority's Audit, Risk & Assurance Committee as those charged with governance in our Audit Findings Reports on 21 June 2018 with formal approval by the Authority's Board on 20 July 2018.

Our work

Materiality	We determined materiality for the audit of the Authority's financial statements to be £4.643m, which is 1.8% of the Authority's gross revenue expenditure. We determined materiality for the audit of the Pension Fund accounts administered by the Authority to be £4.92m, which is 1% of the Pension Fund's net assets.
Financial Statements opinion	We gave an unqualified opinion on the Authority's financial statements on 20 July 2018. We gave an unqualified opinion on the Pension Fund accounts of the West Midlands ITA Pension Fund on 20 July 2018.
Whole of Government Accounts (WGA)	We completed work on the Authority's consolidation return following guidance issued by the NAO.
Use of statutory powers	We did not identify any matters which required us to exercise our additional statutory powers.
Value for Money arrangements	We were satisfied that the Authority put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources. We reflected this in our audit report to the Authority on 20 July 2018.
Certificate	We are not able to certify the conclusion of the audit as we are required to give an opinion on the consistency of the Pension Fund financial statements of the Authority included in the Pension Fund Annual Report with the pension fund financial statements included in the Statement of Accounts. The Pension Fund Annual Report is not required to be published until 1 December 2018 and was not available at the time of our audit or this letter. We are therefore yet to issue our report on the consistency of the Pension Fund financial statements. Until we have done so, we are unable to certify that we have completed the audit of the financial statements.

Respective responsibilities

We have carried out our audit in accordance with the NAO's Code of Audit Practice, which reflects the requirements of the Local Audit and Accountability Act 2014 (the Act). Our key responsibilities are to:

- give an opinion on the Authority's and Pension Fund's financial statements (section two)
- assess the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources (the value for money conclusion) (section three).

In our audit of the Authority's financial statements (which include the Pension Fund), we comply with International Standards on Auditing (UK) (ISAs) and other guidance issued by the NAO.

Audit of the Accounts

Our audit approach

Working with the authority

We have delivered a number of successful outcomes working alongside you:

- **An efficient audit** – we delivered an efficient audit with you in May and June, delivering the accounts 28 working days before the deadline, releasing your finance team for other work.
- **Sharing our insight** – we provided regular audit committee updates covering best practice. We also shared our thought leadership reports
- **Providing training** – we provided your teams with training on financial accounts
- **Supporting development** – we provided training for the Audit, Risk & Assurance Committee on 19 January 2018.

We would like to record our appreciation for the assistance and co-operation provided to us during our audit by the Authority's staff.

Materiality

In our audit of the Authority's financial statements (including the Pension Fund), we use the concept of materiality to determine the nature, timing and extent of our work, and in evaluating the results of our work. We define materiality as the size of the misstatement in the financial statements that would lead a reasonably knowledgeable person to change or influence their economic decisions.

Authority Materiality

We determined materiality for the audit of the Authority's accounts to be £4.643m, which is 1.8% of the Authority's gross revenue expenditure. We used this benchmark as, in our view, users of Authority's financial statements are most interested in where the Authority has spent its revenue in the year.

We set a lower threshold of £100,000, above which any errors we identified in respect of senior officers remuneration would be reported to the Audit, Risk & Assurance Committee in our Audit Findings Report.

We also set a lower level of specific materiality of £100,000 for senior officer remuneration as we considered these disclosures to be sensitive and of specific interest to the reader of the accounts.

Pension Fund Materiality

For the audit of the West Midlands ITA Pension Fund accounts, we determined materiality to be £4.92m, which is 1% of the Fund's net assets. We used this benchmark as, in our view, users of the Pension Fund accounts are most interested in the value of assets available to fund pension benefits.

We considered the need to set lower levels of materiality for sensitive balances, transactions or disclosure in the accounts, and determined not to set any lower levels.

The scope of our audit

Our audit involves obtaining sufficient evidence about the amounts and disclosures in the financial statements to give reasonable assurance that they are free from material misstatement, whether caused by fraud or error. This includes assessing whether:

- the accounting policies are appropriate, have been consistently applied and adequately disclosed;
- the significant accounting estimates made by management are reasonable; and
- the overall presentation of the financial statements gives a true and fair view.

We also read the remainder of the Statement of Accounts and the narrative report, and annual governance statement published alongside the Statement of Accounts to check they are consistent with our understanding of the Authority and with the financial statements included in the Statement of Accounts on which we gave our opinion.

We carry out our audit in accordance with ISAs (UK) and the NAO Code of Audit Practice. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our audit approach is based on a thorough understanding of the Authority's business and is risk based.

We identified key risks and set out overleaf the work we performed in response to these risks and the results of this work.

Audit of the Accounts

Authority Significant Audit Risks

These are the significant risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>Improper revenue recognition</p> <p>Under ISA 240 there is a presumed risk that revenue may be misstated due to the improper recognition of revenue.</p> <p>This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.</p>	<p>Having considered the risk factors set out in ISA 240 and the nature of the revenue streams at the Authority, we determined that the risk of fraud arising from revenue recognition could be rebutted, because:</p> <ul style="list-style-type: none"> • there is little incentive to manipulate revenue recognition • opportunities to manipulate revenue recognition are very limited • the culture and ethical frameworks of local authorities, including West Midlands Combined Authority, mean that all forms of fraud are seen as unacceptable 	<p>Based on the rebuttable we did not consider this to be a significant risk for West Midlands Combined Authority and we identified no issues in respect of revenue recognition in the course of our work.</p>
<p>Management override of internal controls</p> <p>Under ISA 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities.</p> <p>The Authority faces external scrutiny of its spending, and this could potentially place management under undue pressure in terms of how they report performance.</p> <p>We identified management override of controls as a risk requiring special audit consideration.</p>	<p>As part of our audit work we:</p> <ul style="list-style-type: none"> • documented an understanding of the accounting estimates, judgements applied and decisions made by management and • considered their reasonableness • obtained a full listing of journal entries, identify and tested unusual journal entries for appropriateness • evaluated the rationale for any changes in accounting policies or significant unusual transactions. 	<p>Our audit work has not identified any issues in respect of management override of controls.</p>

Audit of the Accounts

Authority Significant Audit Risks (continued)

These are the significant risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>Valuation of the Authority's pension fund net liability</p> <p>The Authority's pension fund asset and liability as reflected in its balance sheet represent a significant estimate in the financial statements.</p> <p>We identified the valuation of the pension fund net liability as a risk requiring special audit consideration.</p>	<p>As part of our audit work we:</p> <ul style="list-style-type: none"> • reviewed the pensions prepayment paid by the Authority to the West Midlands Pension Fund in April 2017 • identified the controls put in place by management to ensure that the pension fund liability is not materially misstated and also assessed whether these controls were implemented as expected and whether they were sufficient to mitigate the risk of material misstatement • evaluated the competence, expertise and objectivity of the actuary who carried out your pension fund valuation and gained an understanding of the basis on which the valuation is carried out • undertook procedures to confirm the reasonableness of the actuarial assumptions made • checked the consistency of the pension fund asset and liability and disclosures in the notes to the financial statements with the actuarial report from your actuary. 	<p>Through our review of the pensions prepayment we were satisfied it was subject to due process and has been accounted for in the financial statements correctly.</p> <p>PwC were engaged by the Audit Commission (and subsequently the NAO) as consulting actuary to undertake a central review of the actuaries used by the Local Government Pension Scheme (LGPS).</p> <p>PwC produced a report designed to provide support to auditors when assessing the competence and objectivity of, and assumptions and approach adopted by, actuaries producing IAS 19 figures in respect of the LGPS, Police and Fire schemes as at 31 March 2018.</p> <p>We used this report to inform our assessment of the valuation of the pension fund liability in the Authority's accounts.</p> <p>The liability as at 31 March 2017 was £57.166m. This has reduced during the year by £6.953m to £50.213m.</p> <p>We compared the assumptions used by the Authority's actuary against industry benchmarks and based on the work performed we are able to conclude that management's assumptions overall are reasonable.</p> <p>The value of the net pension liability in the balance sheet is not equal to the pension reserve of £55.377m. We are satisfied that this is appropriate, as the difference is due to the prepayment of £5.164m referred to above.</p> <p>Our audit work has therefore not identified any issues in respect of the pension fund net liability.</p>

Audit of the Accounts

Pension Fund Significant Audit Risks

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work on the pension fund.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>Improper revenue recognition</p> <p>Under ISA 240 there is a presumed risk that revenue may be misstated due to the improper recognition of revenue.</p> <p>This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.</p>	<p>Having considered the risk factors set out in ISA 240 and the nature of the revenue streams at the Authority, we determined that the risk of fraud arising from revenue recognition could be rebutted, because:</p> <ul style="list-style-type: none"> • there is little incentive to manipulate revenue recognition • opportunities to manipulate revenue recognition are very limited • the culture and ethical frameworks of local authorities, including West Midlands Combined Authority as the administering body, mean that all forms of fraud are seen as unacceptable 	<p>Based on the rebuttable we did not consider this to be a significant risk for West Midlands ITA Pension Fund and we identified no issues in respect of revenue recognition in the course of our work.</p>
<p>Management override of internal controls</p> <p>Under ISA 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities.</p> <p>The Pension Fund faces external scrutiny of its spending, and this could potentially place management under undue pressure in terms of how they report performance.</p> <p>We identified management override of controls as a risk requiring special audit consideration.</p>	<p>As part of our audit work we:</p> <ul style="list-style-type: none"> • documented an understanding of the accounting estimates, judgements applied and decisions made by management and considered their reasonableness • obtained a full listing of journal entries, identify and tested unusual journal entries for appropriateness • evaluated the rationale for any changes in accounting policies or significant unusual transactions. 	<p>Our audit work has not identified any issues in respect of management override of controls.</p>
<p>Valuation of level 3 investments</p> <p>Under ISA 315 significant risks often relate to significant non-routine transactions and judgemental matters. Level 3 investments by their very nature require a significant degree of judgement to reach an appropriate valuation at year end.</p> <p>We identified the valuation of level 3 investments as a risk requiring special audit consideration.</p>	<p>As part of our audit work we have:</p> <ul style="list-style-type: none"> • gained an understanding of the Fund's process for valuing level 3 investments and evaluated the design of the associated controls • reviewed the qualifications of the expert, Barnett Waddingham, to value Level 3 investments at year end • reviewed the nature and basis of estimated values and consider what assurance management has over the year end valuations provided by these types of investments. We used our in-house experts, the Grant Thornton valuation team, to assist us in doing this. We reviewed the assumptions and calculations to provide assurance that the Pension Fund's valuation model was reasonable. 	<p>We independently estimated the value of the insurance buy-in to be £238,296,000 compared to the Pension Fund's actuarial valuation of £238,333,000.</p> <p>The valuation of this estimate is complex and is within 0.02% of the actuary's result and within our expected range. From this we have concluded that the valuation is reasonable and not materially misstated.</p>

Audit of the Accounts

Audit opinion

We gave unqualified opinions on both the Authority's financial statements and the pension fund accounts of West Midlands ITA Pension Fund on 20 July 2018, in advance of the national deadline.

Preparation of the accounts

The Authority and Pension Fund presented us with draft accounts in accordance with the national deadline, and provided a good set of working papers to support them. The finance team responded promptly and efficiently to our queries during the course of the audits.

Issues arising from the audit of the accounts

We reported the detailed findings from our audit work to the Authority's Audit, Risk & Assurance Committee as those charged with governance in our Audit Findings Reports on 21 June 2018.

Due to quoracy issues formal authorisation and approval to publish the financial statements (before which we cannot issue our opinion and which had been delegated to the Committee) had to be deferred to the WMCA Board at its meeting on 20 July 2018. The Authority is seeking to amend the Establishment Order in order to modernise the quoracy requirements to reduce the risk of this occurring again.

Annual Governance Statement and Narrative Report

We are required to review the Authority's Annual Governance Statement and Narrative Report. It published them on its in the Statement of Accounts in line with the national deadlines.

Both documents were prepared in line with the CIPFA Code and relevant supporting guidance. We confirmed that both documents were consistent with the financial statements prepared by the Authority and with our knowledge of the Authority.

Certificate of closure of the audit

We are also required to certify that we have completed the audit of the accounts of the West Midlands Combined Authority in accordance with the requirements of the Code of Audit Practice.

We are not able to certify the conclusion of the audit at this time as we are required to give an opinion on the consistency of the Pension Fund financial statements of the Authority included in the Pension Fund Annual Report with the pension fund financial statements included in the Statement of Accounts. The Pension Fund Annual Report is not required to be published until 1 December 2018 and was not available at the time of our audit or this letter. We are therefore yet to issue our report on the consistency of the Pension Fund financial statements. Until we have done so, we are unable to certify that we have completed the audit of the financial statements.

Value for Money conclusion

Background and key findings

We carried out our review in accordance with the NAO Code of Audit Practice, following the guidance issued by the NAO in November 2017 which specified the criterion for auditors to evaluate: *In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.* Our first step in carrying out our work was to perform a risk assessment and identify the key risks where we concentrated our work. The key risks we identified and the work we performed are set out below.

Risks identified in our audit plan and how we responded to the risk	Findings
<p>Evolution of the governance arrangements</p> <p>As noted in our prior year Audit Findings Report, the governance arrangements at the Authority are continuing to develop as the Authority itself evolves. Since last year the Authority has appointed its substantive senior management team which will pave the way for further evolution of governance arrangements. A second devolution deal to promote growth was announced in November 2017 and there are on-going discussions in respect of responsibilities for fire and rescue services in the region.</p> <p>There is a risk that arrangements may not appropriately reflect the changing responsibilities of the Authority and heighten the risk of actual or perceived instances of inadequate governance.</p> <p>Our response</p> <p>As part of our work we have reviewed relevant Board and Combined Authority papers and held discussions with management and key officers about any changes to the governance structure as well as to understand how decisions are made and reported to the Board.</p>	<p>During the 2016/17 financial year the Authority made a number of changes to its governance structure to as it has developed from the Centro group. Key elements included:</p> <ul style="list-style-type: none"> • revising the Constitution including the Scheme of Delegation • setting up a Committee to oversee audit, risk and assurance • establishing a new Assurance Framework • developing a Risk Management Strategy and risk register <p>Since then the Authority has continued to evolve and is starting to embed the above elements. Risk discussions have been formalised with directors on an ongoing basis. The Strategic Risk Register is developing further and is reviewed on a quarterly basis at Senior Leadership Team meetings. The ownership of the risk register is more established than as at 31 March 2017, at which time the senior leadership team, including the Mayor, were not yet in place. That they have been in a position as a team now, for approximately 5 months as at 31 March 2018, is reflected in the achievements noted in the Review of the Year section of the Narrative Report.</p> <p>We are cognisant of the fact that the Authority is, at times, beholden to activities, requests and demands upon it that are outside of its control. Therefore it behoves the Authority to be as nimble and agile as possible in order to respond to these demands, and, where possible to be proactive as much as reactive.</p> <p>We note from our review of the Narrative Report within the financial statements at Table 1 that as at February 2018 there were 105.5 vacancies being carried. Left unresolved, this is a risk to the Authority's ability to continue to manage and absorb the increased levels of activity that are expected, especially with the ever widening remit of the Combined Authority expected over the coming 12 to 24 months. For example the Authority will see the West Midlands Fire and Rescue Services come within its governance structure as well as the transfer of the adult skills funding, which brings with it a budget of £112 million per annum. The Authority acknowledge this risk and are tracking vacancies as part of its recruitment drive. The latest tracker provided to us shows that approximately a third of the vacancies are currently appointed or being recruited to, with plans in place to fill the remainder across the course of the year.</p> <p>The Authority recognise that it doesn't necessarily have to do everything itself but can convene and blend where appropriate. As an example, it has commissioned Arcadis to carry out a controls and assurance review of the Investment Programme with a view to maximising delivery of benefits and outcomes, by recommending improvements to the Investment Programme governance. Arcadis has also undertaken an audit on the corporate risk management process, provided commentary and recommendations across the key themes of: Risk Strategy & Governance, Risk Management Process, Culture & People and Systems & Tools. Lessons learned from these reviews can then be applied to other areas, as with appropriate governance arrangements in place, alongside capacity, resourcing and capability sufficiency, the Authority will be able to mobilise quickly, whilst still being clear on purpose.</p>

Overall Value for Money conclusion

On the basis of the work performed we have concluded that the risk was sufficiently mitigated and we are therefore satisfied that the Authority put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2018.

A. Reports issued and fees

We confirm below our final reports issued and fees charged for the audit and the following non-audit service was identified:

Reports issued

Report	Date issued
Audit Plan	19 January 2018
Audit Findings Report	21 June 2018
Annual Audit Letter	August 2018

Fees

	Planned £	Actual fees £	2016/17 fees £
Statutory Authority audit	46,500	46,500	46,500
Audit of Pension Fund	21,000	21,000	21,000
Total fees	67,500	67,500	67,500

The planned fees for the year were in line with the scale fee set by Public Sector Audit Appointments Ltd (PSAA).

Fees for non-audit services

Service	Fees £
Audit related services	Nil
- None	
Non-Audit related services	
- Strategic Financial Management Development Programme: attendance of 1 delegate from the Authority	£2,750

Non-audit services

- For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Authority. The table above summarises all non-audit services which were identified.
- We have considered whether non-audit services might be perceived as a threat to our independence as the Authority's auditor and have ensured that appropriate safeguards are put in place.

The above non-audit services are consistent with the Authority's policy on the allotment of non-audit work to your auditor.



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