Grant Thornton

The Annual Audit Letter for West Midlands Combined Authority and the West Midlands ITA Pension Fund

Year ended 31 March 2019

31 August 2019

Contents

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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') and the preparation of the group and Authority's financial statements for the year ended 31 March 2019 which include those for the West Midlands ITA Pension Fund (the Pension Fund) for the year ended 31 March 2019.

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 (ARAC) as those charged with governance in our Audit Findings Reports (AFR) on the Authority and Pension Fund on 21 June 2019.

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 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, we comply with International Standards on Auditing (UK) (ISAs) and other guidance issued by the NAO.

Our work

Materiality	We determined materiality for the audit of the Authority's financial statements to be £4,600k, which is approximately 1.8% of the Authority's total 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 31 July 2019. We gave an unqualified opinion on the Pension Fund accounts of the West Midlands ITA Pension Fund on 31 July 2019.
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 have not exercised any of our additional statutory powers or duties.
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 AFR to the Authority on 21 June 2019 and our unqualified conclusion on 31 July 2019.
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 2019 and was not available at the time of our audit or this letter. We anticipate the Pension Fund Annual Report being available for our review in September 2019. 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 Authority's financial statements.

Executive Summary

Working with the Authority

During the year we have delivered a number of successful outcomes with you:

- An efficient audit – we delivered an efficient audit with you in July, delivering the financial statements before the deadline, releasing your finance team for other work.
- Understanding your operational health – through the value for money conclusion we provided you with assurance on your operational effectiveness.
- Sharing our insight – we provided regular audit committee updates covering best practice. We also shared our guide to the accounts for Audit and Risk Assurance Committee members
- Providing training – we provided your teams with training on financial statements and annual reporting
- Supporting development – we provided training for the Audit and Risk Assurance Committee on the work of external audit

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

Grant Thornton UK LLP
August 2019

Audit of the Financial Statements

Our audit approach

Materiality

In our audit of the Authority's and Pension Fund's financial statements, 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 and group materiality

We determined materiality for the audit of the group financial statements to be £4.601m, which is 1.8**%** of the group's gross revenue expenditure. We determined materiality for the audit of the Authority's financial statements to be £4.60m, which is 1.8**%** of the Authority's gross revenue expenditure. We used this benchmark as, in our view, users of the group and Authority's financial statements are most interested in where the group and Authority has spent its revenue in the year.

We set a lower threshold of £230,000 above which we reported errors to the Audit, Risk and Assurance Committee in our Audit Findings Report.

We also set a lower level of specific materiality for senior officer remuneration. This was £25,000 above which we reported errors to the Audit Risk & Assurance Committee in our Audit Findings Report.

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 set a lower threshold of £246,000 above which we reported errors to the Audit, Risk and Assurance Committee in our Audit Findings Report.

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 financial statements and the Narrative Report, Annual Governance Statement and Penson Fund Financial Statements published alongside the audited financial statements to check it is consistent with our understanding of the Authority and with the financial statements included in 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 was based on a thorough understanding of the Authority's and Pension Fund'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 Financial Statements (continued)

Authority and Pension Fund 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
The revenue cycle includes fraudulent transactions Under ISA (UK) 240 – *the Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements* - there is a rebuttable presumed risk that revenue may be misstated due to the improper recognition of revenue. This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.	Having considered the risk factors set out in ISA240 and the nature of the revenue streams at the Authority. Group and the Pension Fund, we determined that the risk of fraud arising from revenue recognition could be rebutted, because: • 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 and the Pension Fund, mean that all forms of fraud are seen as unacceptable.	We have not altered our assessment as reported in the audit plan and whilst not a significant risk, as part of our audit work we did undertake work on material revenue items. Our work did not identify any matters that would indicate our rebuttal was incorrect. We therefore have no issues to report in this regard
Management override of controls Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities The Authority, Group and Pension Fund face external scrutiny of their spending and this could potentially place management under undue pressure in terms of how they report performance. We therefore identified management override of control, in particular journals, management estimates and transactions outside the course of business as a significant risk for both the Authority, Group and the Pension Fund.	We have: • evaluated the design effectiveness of management controls over journals • analysed the journals listing and determined the criteria for selecting high risk unusual journals • tested unusual journals recorded during the year and after the draft accounts stage for appropriateness and corroboration • gained an understanding of the accounting estimates and critical judgements applied made by management and considered their reasonableness with regard to corroborative evidence • evaluated the rationale for any changes in accounting policies, estimates or significant unusual transactions.	Our audit work at the Authority and the Pension Fund has not identified any issues in respect of management override of controls.

Audit of the Financial Statements

Authority Significant Audit Risks

These are the 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
Valuation of pension fund net liability The Authority's employees are part of the West Midlands Pension Fund. The Authority's pension fund net liability, as reflected in its balance sheet as the net defined benefit liability, represents a significant estimate in the financial statements and group accounts. The pension fund net liability is considered a significant estimate due to the size of the numbers involved (£51.113m) and the sensitivity of the estimate to changes in key assumptions. We therefore identified valuation of the Authority's pension fund net liability as a significant risk, which was one of the most significant assessed risks of material misstatement.	As part of our audit work we completed; • updated our understanding of the processes and controls put in place by management to ensure that the Authority's pension fund net liability is not materially misstated and evaluate the design of the associated controls; • evaluated the instructions issued by management to their management expert (an actuary) for this estimate and the scope of the actuary's work; • assessed the competence, capabilities and objectivity of the actuary who carried out the Authority's pension fund valuation; • assessed the accuracy and completeness of the information provided by the Authority to the actuary to estimate the liability; • tested the consistency of the pension fund asset and liability and disclosures in the notes to the core financial statements with the actuarial report from the actuary; • undertaken procedures to confirm the reasonableness of the actuarial assumptions made by reviewing the report of the consulting actuary (as auditor's expert) and performing any additional procedures suggested within the report; and • reviewed the pensions prepayment paid by the Authority to the West Midlands Pension Fund and are satisfied it was subject to due process and has been accounted for in the financial statements correctly.	Our audit identified one issue in relation to accounting for the impact of the McCloud Court of Appeal judgement. The Court of Appeal has ruled that there was age discrimination in the judges and firefighters pension schemes where transitional protections were given to scheme members. The legal ruling has implications not just for pension funds, but also for other pension schemes where they have implemented transitional arrangements on changing benefits, such as the Local Government Pension Scheme (LGPS). Our Grant Thornton view was that the McCloud judgement gave rise to a past service cost and liability which should be recognised as the ruling created a new obligation. As a result of the ruling we have worked with the Authority to consider the implications of the judgement. As a result, during the course of the audit the Authority sought a revised report from the actuary in order to account for the impact of the recent "McCloud" judgement. This was provided in July and the accounts updated accordingly. It has led to the inclusion of a past service cost of £1.257m which has been taken to the Comprehensive Income and Expenditure Statement through Transport Services. There is an equal increase to the net defined liability which has increased from £49.856m to £51.113m. The Authority has also added some narrative into the financial statements at Note 30 to explain the adjustment made. We are satisfied that these adjustments have been reflected in the revised financial statements and confirmed that the pension liability is not materially misstated in the financial statements after these adjustments

Audit of the Financial Statements

Pension Fund 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
Level 3 Investments Valuation is incorrect The Fund revalues its investments on an annual basis to ensure that the carrying value is not materially different from the fair value at the financial statements date. By their nature Level 3 investment valuations lack observable inputs. These valuations therefore represent a significant estimate by management in the financial statements due to the size of the numbers involved and the sensitivity of this estimate to changes in key assumptions Under ISA (UK) 315 - *Identifying and Assessing the risks of Material Misstatement through Understanding the Entity and its Environment*, 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. We have identified the valuation of Level 3 investments as a risk requiring special audit consideration. The Prudential buy-in (£224.548m) is the only material, directly held, 'hard to value' investment held by WM ITA Pension Fund and this is valued by the Fund's actuary (Barnett Waddingham). We therefore identified valuation of Level 3 investments as a significant risk.	The Prudential buy-in is the only material, directly held, 'hard to value' investment held by WM ITA Pension Fund and this was valued by the Fund's actuary (Barnett Waddingham). We: • gained an understanding of the Fund's process for valuing level 3 investments and evaluated the design of the associated controls • 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 valuation was reasonable • assessed the competence, capabilities and objectivity of the actuary who carried out the valuation.	A bulk annuity insurance buy-in was put in place in 2012/13 as part of the Fund's risk strategy. This cover means that the insurer underwrites the risk of meeting the future liabilities relating to West Midlands Travel Limited pensioners on the pension payroll at 11 August 2011 in return for a one-off premium. This buy-in was valued on the balance sheet as at 31 March 2019 at £224.548m. The value of this buy-in has decreased by £13.8m in 2018/19 compared to 2017/18, largely due to pension payments of £16m in year and a change in demographic (mortality) assumptions of £9m. This was mitigated by an actuarial gain of £7.6m due to a reduction in the discount rate. We have independently estimated the value of the insurance buy-in to be £226.163m compared to the actuarial valuation of £224.548m. The valuation of this estimate is complex and the difference is within 0.72% of the actuary's result and within the expected range we set. From this we concluded that the valuation is reasonable and not materially misstated

Audit of the Financial Statements

Audit opinion
We gave an unqualified opinion on both the Authority and Group financial statements as well as the accounts of the West Midlands ITA Pension Fund on 31 July 2019.

Preparation of the financial statements
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 financial statements
We reported the key issues from our audit to the Authority's Audit Risk & Assurance Committee on 21 June 2019.

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 website 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.

Whole of Government Accounts (WGA)
We carried out work on the Authority's Data Collection Tool in line with instructions provided by the NAO . We issued an assurance statement which confirmed the Authority was below the audit threshold.

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 2019 and was not available at the time of our audit or this letter. We anticipate the Pension Fund Annual Report being available for our review in September 2019. 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 Authority's financial statements.

Value for Money conclusion

Background

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.

Key findings

Our first step in carrying out our work was to perform a risk assessment and identify the risks where we concentrated our work.

The risks we identified and the work we performed are set out overleaf.

Overall Value for Money conclusion

We are satisfied that in all significant respects the Authority put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2019.

Value for Money conclusion (continued)

Value for Money Risks

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Preparedness of the Combined Authority to receive the West Midlands Fire Authority within its governance structure Subject to the Order being approved in Parliament, the West Midlands Fire Service could come within the governance structure of the West Midlands Combined Authority from as early as 1 April 2019. This represented a significant change both to the remit of the West Midlands Combined Authority as well as to its governance arrangements. There is a risk that arrangements may not appropriately reflect changing responsibilities of the Authority and heighten the risk of actual or perceived instances of inadequate governance.	• We reported to ARAC in our progress report, dated 15 April 2019, that the transfer of the Fire Service was originally proposed to be on 1 April 2019, but that due to the delay in finalising the draft Order to put before Parliament this timing has now been moved into the 2019/20 financial year, with an exact timeline to be confirmed. • Our understanding is that this has now been postponed indefinitely. This therefore removes this risk from being "significant" in respect of the impact on the VFM conclusion, as our reasoning for including it as such was to ensure that arrangements were in place to ensure that the transfer happened smoothly.	There was no residual risk remaining to our value for money conclusion. We have seen from our review of relevant Board and Combined Authority papers and regular discussions with management and key officers that work has been underway to prepare for the proposed changes in structure. We have therefore identified no evidence that is indicative of inadequate arrangements being in place at the Combined Authority in relation to this risk.
Developing Capacity and Capability Given the evolution of the Combined Authority, as exemplified by the potential extended remit to include the Fire Authority (as well the Police and Crime Commissioner in future years), there is a risk that the Authority does not have the capacity or capability to continue to manage and absorb the increased levels of activity that are expected.	• We reviewed relevant Board and Combined Authority papers and held discussions with management and key officers to gain assurance that the Authority has an appropriate framework in place to assess its capacity and capability and ensure its establishment is fit for purpose. • Subsequent to our initial risk assessment being undertaken and capacity and capability being identified as a significant risk, internal audit undertook a review of the Authority's Workforce Planning Arrangements, the outcome of which was presented to ARAC on 14 January 2019.	See next page.

Value for Money conclusion (continued)

Value for Money Risks

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Developing Capacity and Capability (continued) Given the evolution of the Combined Authority, as exemplified by the potential extended remit to include the Fire Authority (as well the Police and Crime Commissioner in future years), there is a risk that the Authority does not have the capacity or capability to continue to manage and absorb the increased levels of activity that are expected.	• Internal audit were able to give satisfactory assurance as part of the process to mitigate risks to an acceptable level. Their scope was to seek assurance that "appropriate arrangements are in place for effective workforce planning that supports and aligns with organisational strategy and business planning to ensure appropriate skills and capacity are developed to achieve organisational success in delivering services in the future." • This resulted in one broad recommendation being made, which was to translate the work that had been undertaken into a "clearly defined strategy and operational workforce planning framework to support strategic level consideration of workforce planning implications for the achievement of the WMCA's strategic and organisational aims and objectives." • We acknowledge that while the risk identified for the Value for Money Conclusion is not exactly the same as that covered by the scope of the internal audit review, we note that there is some overlap. For our purposes we are concerned with the capacity and capability of the Authority (i.e. does it have the right people, with the right skills in the right place doing the right things at the right time), at least some of which can be dealt with though robust workforce planning and consideration of future needs. • In terms of future needs, consideration of current workforce and achievement of deliverables over the next few years are considered as part of the business planning process and when the budget is being set. Heads of Service outline their key deliverables for the year and the budget implications are tracked and monitored against by finance. However, from our review of these documents, they consider workforce requirements implicitly rather than explicitly. • Work on forward planning has improved during the year, aided by a more fluent use throughout the organisation of the HR dashboard: it charts, recruitment, vacancies, and long-term sickness, which enables cohesive discussions between the business manager, finance business partner and the manager. • Posts are aligned with funding sources to ensure that each post is appropriately justified and financed. • To get the rights skills in place and ensure employees are performing, there has been a process in place but no policy. In June 2019, the corporate management team agreed a managing performance policy which will be ratified and then published in the coming months.	While we identified no residual risk to our value for money conclusion, we recommended that workforce considerations are made a more explicit element of business processes.

A. Reports issued and fees

We confirm below our final reports issued and fees charged for the audit. There were no fees for the provision of non audit services.

Reports issued

Report	Date issued
Audit Plans	14 January 2019
Audit Findings Reports	21 June 2019
Annual Audit Letter	31 August 2019

Fees

	Planned £	Actual fees £	2017/18 fees £
Statutory audit *	35,805	46,500	46,500
Audit of Pension Fund	16,170	16,170	21,000
Total fees	**51,975**	**46,500**	**67,500**

We reported in our Audit Plan that our proposed audit fee is above the PSAA scale fee of £35,805. Our view is that because of the increased scope and associated risk, and the additional challenge that the Authority will no doubt be seeking from its external auditors, a fee reduction at this time would not be commensurate with the current risks.

Therefore a fee of £46,500 is proposed, which was consistent with the fee charged in 2017/18. This constitutes a fee variation, which is subject to approval from PSAA.

Fees for non-audit services

Service	Fees £
Audit related services - None	Nil
Non-Audit related services - None	Nil

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 and Pension Fund. The table above confirmed that no non-audit services have been identified.