

Informing the audit risk assessment for West Midlands Combined Authority 2019/20

13 January 2020



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.

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Purpose

The purpose of this report is to contribute towards the effective two-way communication between the West Midlands Combined Authority's (the Authority) external 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.

Background

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

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

- General Enquiries of Management
- Fraud,
- Laws and Regulations,
- Going Concern,
- Related Parties, and
- Accounting Estimates.

This report includes a series of questions on each of these areas and the response we have received from the Authority's management. **The Audit, Risk & Assurance Committee should consider whether these responses are consistent with its understanding and whether there are any further comments it wishes to make.**

General Enquiries of Management

Question	Management response
<p>1. What do you regard as the key events or issues that will have a significant impact on the financial statements for 2019/20?</p>	<p>The key events are:</p> <ul style="list-style-type: none"> i) Adult Education Budget ii) Land Fund
<p>2. Have you considered the appropriateness of the accounting policies adopted by the Authority?</p> <p>Have there been any events or transactions that may cause you to change or adopt new accounting policies?</p>	<p>Yes, and there have not been any events or transactions that may cause WMCA to change or adopt new accounting policies in 2019/20.</p>
<p>3. Is there any use of financial instruments, including derivatives?</p>	<p>Yes, the financial instruments will consist of investments, cash and cash equivalents, short-term debtors and creditors, borrowings and transferred debt.</p>
<p>4. Are you aware of any significant transaction outside the normal course of business?</p>	<p>No, we are not aware of any significant transaction outside the normal course of business.</p>
<p>5. Are you aware of any changes in circumstances that would lead to impairment of non-current assets?</p>	<p>No, we are not aware of any changes in circumstances that would lead to impairment of non-current assets.</p>

General Enquiries of Management

Question	Management response
6. Are you aware of any guarantee contracts?	Yes. WMCA has guarantees with Sandwell and Birmingham City Council lodged with the bank in connection with works undertaken at various car parks.
7. Are you aware of the existence of loss contingencies and/or un-asserted claims that may affect the financial statements?	No, we are not aware of any.
8. Other than in house solicitors, can you provide details of those solicitors utilised by the Authority during the year. Please indicate where they are working on open litigation or contingencies from prior years?	<p>They are as follows:</p> <ul style="list-style-type: none"> i) Trowers and Hamlin are representing us in relation to a procurement challenge arising from the Adult Education Budget tender. The advice at this stage is that any outcome is unlikely to be material. ii) Evershed Sutherland is dealing with an employment tribunal case. iii) Solicitors on behalf of our insurers are dealing with personal injury cases. Please also refer to our response to question 4 on the impact of laws and regulations. <p>We are in dispute with a bus company over the calculation of concessionary fares. However, no proceedings have been issued.</p>
9. Have any of the Authority's service providers reported any items of fraud, non-compliance with laws and regulations or uncorrected misstatements which would affect the financial statements?	None has been reported. However, one of our service providers has reported a suspected irregularity with one of its sub-contractors and an investigation have been instructed by the service provider. We expect this to have either no impact or minimal impact to our financial statements.
10. Can you provide details of other advisors consulted during the year and the issue on which they were consulted?	WMCA consults a wide range of advisors in many areas of its business. None of these are likely to have a material impact on the financial statements.

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 Audit, Risk & Assurance Committee and management. Management, with the oversight of the Audit, Risk & 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 & Assurance Committee should consider the potential for override of controls and inappropriate influence over the financial reporting process.

As the Authority's external 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 the Audit, Risk & Assurance Committee regarding its processes for identifying and responding to risks of fraud, and
- communication to employees regarding business practices and ethical behaviour.

We need to understand how the Audit, Risk & Assurance Committee oversees the above processes. We are also required to make inquiries of both management and the Audit, Risk & 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 Authority's management.

Fraud risk assessment

Question	Management response
<p>1. Have the Authority assessed the risk of material misstatement in the financial statements due to fraud?</p> <p>How has the process of identifying and responding to the risk of fraud been undertaken and what are the results of this process?</p> <p>How do the Authority's risk management processes link to financial reporting?</p>	<p>Yes, the risk is considered to be low.</p> <p>This is undertaken via the Anti-Fraud & Corruption Policy and the Whistleblowing Policy.</p> <p>Key financial systems audit are undertaken annually by Wolverhampton Audit Services and their findings are reported in their internal audit reports which are presented to the Audit, Risk & Assurance Committee. Additionally, their recommendations and observations are acted upon.</p>
<p>2. What have you determined to be the classes of accounts, transactions and disclosures most at risk to fraud?</p>	<p>Treasury-related transactions.</p>
<p>3. Are you aware of any instances of actual, suspected or alleged fraud, errors or other irregularities either within the Authority as a whole or within specific departments since 1 April 2019?</p> <p>As a management team, how do you communicate risk issues (including fraud) to those charged with governance?</p>	<p>No.</p> <p>Risk issues including fraud feature as a standing item in the Audit, Risk & Assurance Committee agenda.</p>

Fraud risk assessment

Question	Management response
<p>4. Have you identified any specific fraud risks?</p> <p>Do you have any concerns there are areas that are at risk of fraud?</p> <p>Are there particular locations within the Authority where fraud is more likely to occur?</p>	<p>No.</p> <p>No.</p> <p>No.</p>
<p>5. What processes do the Authority have in place to identify and respond to risks of 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>If a potential fraud is reported, the Corporate Assurance Manager would be contacted who will then commission Wolverhampton Audit Services to conduct an investigation.</p>
<p>6. How would you assess the overall control environment for the Authority, including:</p> <ul style="list-style-type: none"> • the process for reviewing the effectiveness the system of internal control; • internal controls, including segregation of duties; • exist and work effectively? <p>If not where are the risk areas and what mitigating actions have been taken?</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>The overall control environment is assessed as robust.</p> <p>N/A.</p> <p>Monthly financial reporting including account reconciliation which is a robust process.</p> <p>No.</p>

Fraud risk assessment

Question	Management response
7. Are there any areas where there is potential for misreporting?	There is potential for misreporting but this is mitigated by processes and controls in place.
<p>8. How do the Authority communicate and encourage ethical behaviours and business processes of it's staff and contractors?</p> <p>How do you encourage staff to report their concerns about fraud?</p> <p>What concerns are staff expected to report about fraud?</p> <p>Have any significant issues been reported?</p>	<p>This is communicated through the policies and procedures published on the Intranet.</p> <p>Inductions are provided to new staff where they are given an overview of business practices and ethical behaviours and their role in identifying or responding to fraud.</p> <p>Regular team briefing sessions are held where staff can raise any concerns and business practice and ethical behaviour can be reinforced.</p> <p>No significant issues have been reported.</p>
<p>9. From a fraud and corruption perspective, what are considered to be high-risk posts?</p> <p>How are the risks relating to these posts identified, assessed and managed?</p>	<p>Treasury team.</p> <p>These risks are identified, assessed and managed through Treasury Management Group, clear segregation of duties and segregated approval limits.</p>
<p>10. Are you aware of any related party relationships or transactions that could give rise to instances of fraud?</p> <p>How do you mitigate the risks associated with fraud related to related party relationships and transactions?</p>	<p>No.</p> <p>These risks are mitigated by robust procurement procedures.</p>

Fraud risk assessment

Question	Management response
<p>11. What arrangements are in place to report fraud issues and risks to the Audit, Risk & Assurance Committee?</p> <p>How does the Audit, Risk & Assurance Committee exercise oversight over management's processes for identifying and responding to risks of fraud and breaches of internal control?</p> <p>What has been the outcome of these arrangements so far this year?</p>	<p>Policies and procedures are published on the Intranet and these procedures also state the escalation procedure if required. Additionally, there is a standing agenda item for risks issues including fraud in the Audit, Risk & Assurance Committee meetings.</p> <p>The internal audit function delivered by Wolverhampton Audit Services presents audit reports to the Audit, Risk & 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 & Assurance Committee.</p>
<p>12. Are you aware of any whistle blowing potential or complaints by potential whistle blowers? If so, what has been your response?</p>	<p>The WMCA has a Whistleblowing policy and a number of means by which referrals can be made. Any referrals are considered and investigated as appropriate. Some of the referrals do not relate to the WMCA activities but those of constituent authorities and have been passed on to the appropriate authorities.</p> <p>During the year, one matter was raised which resulted in further investigation and some remedial action and advice was given by the Monitoring Officer to strengthen processes.</p>
<p>13. Have any reports been made under the Bribery Act?</p>	<p>No.</p>

Law 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 the Audit, Risk & Assurance Committee, is responsible for ensuring that the 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 Audit, Risk & Assurance 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
<p>1. How does management gain assurance that all relevant laws and regulations have been complied with?</p> <p>What arrangements does the Authority have in place to prevent and detect non-compliance with laws and regulations?</p> <p>Are you aware of any changes to the Authority's regulatory environment that may have a significant impact on the Authority's financial statements?</p>	<p>Responsibility for ensuring compliance with relevant laws and regulations lies with the Head of Governance (Monitoring Officer) who advises the WMCA.</p> <p>The Constitution and governance arrangements within the WMCA have been reviewed and confirmed that they are appropriate and robust. All governance arrangements are monitored to ensure that they comply with relevant legislation and are fit for purpose.</p> <p>Individual experts also take responsibility within their own areas of expertise and where relevant appoint external advisors.</p> <p>No, we are not aware of any changes to WMCA's regulatory environment that may have a significant impact on the financial statements.</p>
<p>2. How is the Audit, Risk & 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 Monitoring Officer. It is the duty of care of all these roles to ensure laws and regulations have been adhered to. The WMCA legal team reports to the Head of Governance and are also the custodians of the WMCA 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 & Assurance Committee, it is advised that a legal representative is present at the committee.</p>
<p>3. Have there been any instances of non-compliance or suspected non-compliance with laws and regulation since 1 April 2019 with an on-going impact on the 2019/2020 financial statements?</p>	<p>None.</p>
<p>4. Is there any actual or potential litigation or claims that would affect the financial statements?</p>	<p>Cover is in place through Municipal Mutual Insurance which is 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 WMCA have a number of potential claims at investigation stage, there are no significant litigation claims at this time.</p>

Impact of laws and regulations

Question	Management response
5. What arrangements does the 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 WMCA Board for approval.
6. Have there been any report from other regulatory bodies, such as HM Revenues and Customs which indicate non-compliance?	No.

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.

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

Going concern considerations

Question	Management response
<p>1. Has the management team carried out an assessment of the going concern basis for preparing the financial statements for the Authority? What was the outcome of that assessment?</p>	<p>Yes. A detailed business plan is approved each year. Regular management reporting is produced for the WMCA indicating positive trading performance of the business, which is report to the Senior Leadership Team, Transport Delivery Committee, Programme Board, Audit, Risk & Assurance Committee and the WMCA Board.</p> <p>In section 10.2 of the draft budget report for 2020/21, the S151 officer has stated her opinion that the budget currently provides for the financial implications of the WMCA's policies to the extent that these are known or can reasonably be assessed.</p>
<p>2. Are the financial assumptions in that report (e.g., future levels of income and expenditure) consistent with the Authority's Business Plan and the financial information provided to the Authority throughout the year?</p>	<p>Yes, they are. Appendices 1 and 2 to the draft budget report clearly establish the link between business plan deliverables and proposed budgets for each directorate and portfolio.</p>

Going concern considerations

Question	Management response
3. Are the implications of statutory or policy changes appropriately reflected in the Business Plan, financial forecasts and report on going concern?	Yes, with the exception of a new accounting standard, IFRS 16 Leases, which becomes effective from 1 April 2020. We do not consider the impact of IFRS 16 to be material or significant.
4. Have there been any significant issues raised with the Audit, Risk & 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.
5. 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.

Going concern considerations

Question	Management response
<p>6. Does the 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?</p> <p>If not, what action is being taken to obtain those skills?</p>	<p>Yes, with ongoing monitoring to ensure we have the necessary skills and experience to deliver the WMCA’s objectives.</p>
<p>7. Does the Authority have procedures in place to assess their ability to continue as a going concern?</p>	<p>Yes – continued medium-term financial planning.</p>
<p>8. Is management aware of the existence of events or conditions that may cast doubt on the Authority’s ability to continue as a going concern?</p>	<p>No.</p>
<p>9. Are arrangements in place to report the going concern assessment to the Audit, Risk & Assurance Committee ?</p> <p>How has the Audit, Risk & Assurance Committee satisfied itself that it is appropriate to adopt the going concern basis in preparing financial statements?</p>	<p>Yes. Financial monitoring takes place on a monthly basis to the Senior Leadership Team and bi-monthly to the WMCA Board and Audit, Risk & Assurance Committee.</p>

Related Parties

Issue

Matters in relation to Related Parties

Local Authorities 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 authority (i.e. subsidiaries);
- associates;
- joint ventures;
- an entity that has an interest in the authority that gives it significant influence over the 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 authority, or of any entity that is a related party of the 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 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.

Relating Parties

Question	Management response
1. What controls does the Authority have 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

Issue

Matters in relation to Related Accounting estimates

Local Authorities 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 1 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 Audit, Risk & Assurance Committee to satisfy itself that the arrangements for accounting estimates are adequate.

Accounting Estimates

Question	Management response
1. Are management aware of transactions, events, conditions (or changes in these) that may give rise to recognition or disclosure of significant accounting estimates that require significant judgement (other than those in Appendix A)?	No significant judgements expected over and above those already outlined in Appendix A.
2. Are the management arrangements for the accounting estimates, as detailed in Appendix A reasonable?	Yes.
3. How is the Audit, Risk & 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 & Assurance Committee, Transport Delivery Committee, Senior Leadership Team, Programme Board and WMCA board by the Finance Director.

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 annually 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 will be considered in 2019/20.	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 significant cost 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 the valuer.	Depreciation is calculated on a straight line basis as this reflects consumption of assets and is a reasonable assumption.	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?
Depreciation and Amortisation	See above	See above	See above	See above	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.
Measurement of Financial Instruments	Financial instruments consist of investments (Collective Investment Fund (CIF)). Measured initially at cost and subsequently at amortised cost using the effective interest method.	Knowledge by the Investment team who manages the CIF portfolio in assessing the potential risk in credit losses.	Fund advisers – West Midlands Development Capital Limited	The CIF portfolio is assessed on an individual borrower for its expected credit losses using: i) Probability of default ii) Loss of given default	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?
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.
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 Accounts Receivables team in likelihood of recoverability and the aging of the debts. Finance Director signs off the write off.	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?
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.
Non-adjusting events – events after the Balance Sheet date	Monthly management accounts prepared would flag any adjusting/non-adjusting events.	See left.	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?
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 Authority responds to queries raised by the administering body, Wolverhampton Council.	The 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.



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