Grant Thornton

The Annual Audit Letter for the West Midlands Combined Authority

Year ended 31 March 2020

January 2021

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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 the West Midlands Combined Authority (the Authority) for the year ended 31 March 2020.

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 Audit, Risk and Assurance Committee as those charged with governance in our Audit Findings Report on 14 July 2020 and Audit Update Report on 26 October 2020.

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 group's financial statements (section two)
- assess the 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 £6.5m, which is 1.8% of the Authority's total expenditure. The group materiality was £6.8m and this was determined on the same basis.
Financial Statements opinion	We gave an unqualified opinion on the group's financial statements on 30 November 2020. The opinion included an Emphasis of Matter paragraph in respect of the effects of Covid-19 on the valuation of investment properties within the pension scheme.
Whole of Government Accounts (WGA)	We completed work on the Authority's consolidation return following guidance issued by the NAO. Noting that the Authority was below the threshold for detailed procedures to be undertaken.
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 30 November 2020.
Certificate	We certified that we have completed the audit of the financial statements of West Midlands Combined Authority in accordance with the requirements of the Code of Audit Practice on 30 November 2020.

Working with the Authority

The outbreak of the Covid-19 pandemic has had a significant impact on the normal operations of the Authority and group. The most significant impact has been the negative impact on income streams, particularly in relation to bus, rail and tram travel. The Authority have adapted well to delivering in a remote environment, and we have worked with the finance team to deliver the audit under remote auditing arrangements.

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
January 2021

Audit of the Financial Statements

Our audit approach

Materiality

In our audit of the group'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.

We determined materiality for the audit of the group financial statements to be £6.8m, which is 1.8% of the group's total expenditure. We determined materiality for the audit of the Authority's financial statements to be £6.5m, which is 1.8% of the Authority's total 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 £340k for the group and £325k for the Authority, 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 of £25k. We consider the disclosures of senior manager's remuneration to be sensitive as we believe these disclosures are of specific interest to a reader of the accounts.

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 to check it is 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 was based on a thorough understanding of the group'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

Significant Audit Risks (Group and Authority)

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
Covid-19 The global outbreak of the Covid-19 virus pandemic has led to unprecedented uncertainty for all organisations, requiring urgent business continuity arrangements to be implemented. We expected circumstances to have an impact on the production and audit of the financial statements for the year ended 31 March 2020, included and not limited to: • Remote working arrangements and redeployment of staff to critical front line duties potentially impacting on the quality and timing of the production of the financial statements, and the evidence we could obtain through physical observation • Volatility of financial and property markets increasing the uncertainty of assumptions applied by management to asset valuation and receivable recovery estimates, and the reliability of evidence we could obtain to corroborate management estimates • Financial uncertainty requiring management to reconsider financial forecasts supporting their going concern assessment on whether material uncertainties for a period of at least 12 months from the anticipated date of approval of the audited financial statements have arisen; and • Disclosures within the financial statements required significant revision to reflect the unprecedented situation and its impact on the preparation of the financial statements as at 31 March 2020 in accordance with IAS1, particularly in relation to material uncertainties.	As part of our audit work we have: • worked with management to understand the implications the response to the Covid-19 pandemic had on the organisation's ability to prepare the financial statements and update financial forecasts and assessed the implications for our materiality calculations. No changes were made to materiality levels previously reported. The draft financial statements were provided on 18 May 2020; • liaised with other audit suppliers, regulators and government departments to co-ordinate practical cross-sector responses to issues as and when they arose. • evaluated the adequacy of the disclosures in the financial statements that arose in light of the Covid-19 pandemic; • evaluated whether sufficient audit evidence could be obtained through remote technology; • evaluated whether sufficient audit evidence could be obtained to corroborate significant management estimates such as the pension fund liability valuations; • evaluated management's assumptions that underpin the revised financial forecasts and the impact on management's going concern assessment; • discussed with management the implications for our audit report where we have been unable to obtain sufficient audit evidence.	Our audit work has not identified any issues in respect of Covid-19 specific risks. The Authority responded well to the challenge of remote working and were able to produce draft financial statements to a broadly similar timetable as in previous years, which at 18 May 2020 was still significantly ahead of the pre Covid-19 production date of 31 May. We are aware that nationally, this is one of the first set of draft financial statements produced and audited. Like many other authorities, the impact of Covid 19 lead to material uncertainties on the valuation of the Authority's share of directly held property assets held within the West Midlands Pension fund. The Authority disclosed this material uncertainty in the accounts, and this was the basis of an Emphasis of Matter Paragraph in our auditor's report. This does not affect our opinion that the statements give a true and fair view of the Authority's financial position and the income and expenditure for the year but are added to indicate a matter which is disclosed appropriately but which we consider is fundamental to a readers' understanding of the financial statements.

Audit of the Financial Statements

Significant Audit Risks (Group and Authority) - continued

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
The revenue cycle includes fraudulent transactions (rebutted) Under ISA (UK) 240 there is a rebuttable presumed risk that revenue may be misstated due to the improper recognition of revenue. In terms of this risk and how it relates to the Group we have also determined that the risk of fraud arising from revenue recognition can be rebutted because we do not consider there to be a risk of material misstatement in the accounts of Midland Metro Limited or WM5G Limited due to fraud in revenue recognition. We also believe, that the above bullet points also apply from a group perspective.	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 consider the risk factors set out in ISA (UK) 240 and the nature of the revenue streams at the Group and the Authority, we have determined that the risk of fraud arising from revenue recognition can 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 the West Midlands Combined Authority (the Authority), mean that all forms of fraud are seen as unacceptable.	Therefore we do not consider this to be a significant risk for the Authority.
Management override of internal 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 Group and Authority faces external scrutiny of its 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 one of the most significant assessed risks of material misstatement for both the Group and the Authority.	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 by management and considered their reasonableness with regard to corroborative evidence, and • Evaluated the rationale for any changes in accounting policies, estimates or significant unusual transactions.	Our audit work has not identified any issues in respect of management override of controls.

Audit of the Financial Statements

Significant Audit Risks (Group and Authority) - continued

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 pension fund net liability, as reflected in its balance sheet as the net pension 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 (£51.1m at 31 March 2019) in the Authority's balance sheet 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.	We have: • 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 evaluated the design of the associated controls, • Evaluated the instructions issued by management to their management expert 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 disclosures in the notes to the core financial statements with the actuarial report, • Undertaken procedures to confirm the reasonableness of the actuarial assumption made by reviewing the report of the consulting actuary (as an auditor's expert) and performed any additional procedures suggested with the report, and • Sought assurances from the auditor of West Midlands Pension Fund as to the controls surrounding the validity and accuracy of membership data, contributions data and benefits data sent to the actuary by the pension fund and the fund assets valuation in the pension fund financial statements.	The Authority's net pension liability at 31 March 2020 is £39.9m (PY £51.1m). A full actuarial valuation is required every three years. The latest full actuarial valuation was completed in 2019. A roll forward approach is used in intervening periods which utilises key assumptions such as life expectancy, discount rates, salary growth and investment returns. We have compared the assumptions used by the Authority's actuary against industry benchmarks. Based on the work performed we are able to conclude that management's assumptions overall are reasonable. Management obtained an updated actuary report to include asset valuations up to the 31 March 2020, to take account of the potential change in valuations due to Covid-19. There has been a £11.2m net actuarial gain during 2019/20. The draft financial statements were revised to take account of this updated actuary report. As noted on page 5, like many authorities, the impact of Covid-19 lead to material uncertainties on the valuation of the Authority's share of directly held property assets held within the West Midlands Pension fund. The Authority disclosed this material uncertainty in the accounts, and this was the basis of an Emphasis of Matter Paragraph in our auditor's report. Overall, our audit work has not identified any issues in respect of the valuation of the pension fund net liability.

Audit of the Financial Statements

Audit opinion

We gave an unqualified opinion on the group's financial statements on 30 November 2020.

Preparation of the financial statements

The Authority published its unaudited accounts on 18 May 2020 which was still significantly ahead of the pre Covid-19 preparation date of 31 May 2020. Working papers were provided that supported the balances in the accounts, and responded efficiently to our queries during the course of the audit. We made use of video calling to access the completeness and accuracy of the information provided by the entity.

Issues arising from the audit of the financial statements

We reported the key issues from our audit to the Authority's Audit, Risk and Assurance Committee on 14 July 2020 and in our Audit Update Report on 26 October 2020.

In addition to the key audit risks reported earlier we discussed the accounting treatment of the Authority's Land Fund. This is a ring-fenced capital grant from the Ministry of Housing, Communities & Local Government (MHCLG) of up to £100m awarded to the Authority as part of the £350m Housing Deal announced in March 2018. The Fund is to be deployed by the Authority, monitored by Homes England on behalf of MHCLG, to deliver new homes on brownfield land where market failure can be demonstrated.

The Authority originally accounted for Land Fund assets as Assets Under Construction (AUC). Our review of CIPFA's Accounting Code and accounting standards suggested that the assets were more closely aligned to classification as Inventory. This is an unusual transaction and following discussions the Authority determined that inventory was the most appropriate accounting treatment. The impact on the Authority's Balance Sheet was:

- Reduction in AUC - £12.4m
- Increase inventories - £12.4m

Therefore there was no net impact upon the Authority's overall net assets position but additional disclosures in respect of inventory were made and an accounting policy added.

Annual Governance Statement and Narrative Report

We are also required to review the Authority's Annual Governance Statement and Narrative Report. These were published within the Authority's audited Statement of Accounts in November.

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 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 certified that we have completed the audit of the financial statements of West Midlands Combined Authority in accordance with the requirements of the Code of Audit Practice on 30 November 2020.

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 April 2020 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 below and overleaf. As part of our Audit Findings report agreed with the Authority in November 2020, we agreed recommendations to address our findings.

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 2020.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Delivery of Adult Education workstream One significant new workstream for 2019-20 was the Adult Education Budget. The budget had £84m in relation to this, but the actual allocation is in the region of £120m. Given the introduction of this in the year we were keen to understand the arrangements in place for the delivery of this service. We determined to review the outcomes of the internal audit work that is planned in this area, and then consider if any further work is needed against the identified risk.	Given this is the first year of a new area of service delivery, both officers and members have been keen to understand how this service has been delivered and what improvements needs to be made going forward. A review of Board minutes confirms that there has been reporting through Overview and Scrutiny Committee. In April 2019, the Committee agreed a series of recommendations in relation to Adult Education. An update on the recommendations was reported in March 2020. There is clear evidence of progress being made in this area, with a reduction from over 400 providers to 94. This has enabled the Authority to work much more closely with the providers and ensure a clear focus on meeting priorities and getting better progression for learners. There is a much greater focus on encouraging learning that leads to improved employments chances. There is a clear plan in place for improvements in the service and to make the most of the new arrangements. Work remains ongoing against the detailed recommendations first made in April 2019. that were put in place from the initial review. Our discussions with officers and internal audit have confirmed that there remains an external investigation ongoing in relation to one provider. This is a joint investigation with the Education and Skills Funding Agency and is in line with the terms of the contract. As a result of this ongoing investigation the work of internal audit has been put on hold until the outcome of these reviews is known.	• We have seen from our review of relevant Board and Combined Authority papers and regular discussion with management and key officers that work remains ongoing in terms of the delivery of the Adult Education workstream. • Our review has identified that there are appropriate arrangements in place around this risk.

Value for Money conclusion (continued)

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Investment Programme Delivery The Authority has identified the financial assumptions for the investment programme as a risk. This is being mitigated by a review of the governance and appraisal process associated with the investment programme. The spend to date remains behind forecast, and a cap has been placed on the programme at £801m to keep it within the current affordable limit based on income secured to date. We will review the Authority's arrangements for managing the Investment programme.	As noted by the initial risk assessment failure to deliver the Investment Programme may risk achievement of the overall strategic objectives of the Authority. Steps have been taken to leverage in more investment, but the £801m cap remains in place to ensure that the programme remains affordable. To help the Authority ensure that objectives were being met an enhanced assurance framework has been developed, and this was reported to the Audit, Risk and Assurance Committee in January 2020. Alongside the enhanced assurance framework, enhancements were also made to the performance management and reporting framework. This included a review of the dashboard used to report to the Investment Programme Board. The revised dashboard has since been implemented, with the first reporting to the meeting in April 2020. The Chair welcomed the greater clarity provided by this updated dashboard. As part of the enhanced assurance framework the intention would be to review all projects, including those within the capital programme. An update on this report was due to ARAC in April 2020, however due to the global events this has been delayed. Discussion with officers confirm that significant work is now needed in relation to the investment and capital programme as the Authority plans how it will support the Covid-19 recovery. Existing schemes are being reviewed to determine the risk associated with them and while new contracts are being entered into, the Authority have introduced an additional layer of scrutiny to them with a specifically designed checklist.	• We have seen from our review of relevant Board and Combined Authority papers and regular discussions with management and key officers that work remains ongoing to review the Investment Programme and how this will impact on the ability of the Authority to deliver its strategic objective in the longer term. The changes to the economy as a result of Covid-19 are likely to have a significant impact on the nature of the projects in the programme. • Our review has identified that there are appropriate arrangements in place around this risk.
Governance of WM5G WM5G has been set up as subsidiary company of the Authority to deploy 5G and fibre networks to areas with poor coverage. 5G is new technology and a new funding stream for the Authority. Our initial risk assessment has demonstrated that funding from central government is lagged, and therefore alternative sources of start-up funding is also needed. We will review the outcomes of the internal audit work that is planned in this area, and then consider if any further work is needed against the identified risk.	We reviewed the work of internal audit who reported in September 2020. The report gave substantial assurance and raised no recommendations.	• We concluded that there are appropriate arrangements in place around this risk.

A. Reports issued and fees

We confirm below our final reports issued and fees charged for the audit and that no non-audit services were provided during the year.

Fees

	Planned £	Actual Fees (Proposed) £	2018/19 fees £
Statutory audit scale fee	35,805	35,805	35,805
Additional proposed audit fees at planning stage	10,695	10,695	
Total proposed audit fee at planning	46,500	46,500	35,805
Further additional fees proposed at completion		9,475	10,695
Total fees	**46,500**	**55,975**	**46,500**

Reports issued

Report	Date issued
Audit Plan and Addendum	January 2020 and April 2020
Audit Findings Report	July 2020
Annual Audit Letter	January 2021

The Audit Plan presented in January 2020 included £10,695 of proposed addition fees to the scale fee to take account of the additional scepticism required on the audit and the raising of the bar by our regulator. This is reflected in the total proposed audit fees at planning above of £46,500.

Since the presentation of the audit plan, and an addendum issued in April 2020 in respect of Covid-19 risks, we have now reflected on the additional time taken to discharge our responsibilities as a result of Covid-19. The impact of Covid-19 on the audit of the financial statements for 2019/20 has been multifaceted including an additional significant risk being added to our Audit Plan and the move to remote working impacting upon delivery. To date, we estimate that the issues highlighted are increasing the time taken on audits by an average of around 25%, in some cases higher. We understand from discussions with the ICAEW that this is similar to other firms. We have looked to mitigate this as far as possible through reduced travel time and travel costs and will absorb some of the remaining overrun ourselves. However, it is unlikely that this will be sufficient to cover the full additional cost. As a result of this extra work and time taken we are proposing a further increase in fees of £6,975 (15%) in addition to those proposed at the planning stage of the audit. This further charge has not been entered into lightly but reflects only a proportion of the significant additional work we have had to undertake this year to discharge our responsibilities.

We have been discussing this issue with PSAA over the last few months and note these issues are similar to those experienced in the commercial sector and NHS. In both sectors there has been a recognition that audits will take longer with local government and commercial audit deadlines being extended by 4 months and NHS deadline by a month. The Financial Reporting Council (FRC) has also issued guidance to companies and auditors setting out its expectation that audit standards remain high and of additional work needed across all audits. The link attached https://www.frc.org.uk/covid-19-guidance-and-advice (see guidance for auditors) sets out the expectations of the FRC.

There was also additional work relating to our consideration of the accounting treatment for the land fund (see page 8) which required input from our national technical team, which attracted an additional fee of £2,500. This brings the total proposed audit fee up to £55,975. Please note that these proposed additional fees are subject to approval by PSAA in line with the Terms of Appointment.

Non- audit services

For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams and confirm that no non-audit services were identified. However, Grant Thornton UK LLP has been appointed by the Department for Transport (DfT) to carry out work in connection with the reconciliation exercise for Light Rail Revenue Grants (LRRGs) including those distributed to the Authority. We recognise that as the Authority's auditor there is the potential for perceptions of a conflict of interest in undertaking this work. We have put safeguards in place and are therefore satisfied that our independence is maintained.