KPMG

External audit report 2016/17

Sandwell Metropolitan Borough Council

—

August 2017

Summary for Audit and Risk Assurance Committee

Financial statements

This document summarises the key findings in relation to our 2016-17 external audit at Sandwell Metropolitan Borough Council ('the Council').

This report focusses on our on-site work, completed in June and July 2017, on the Council's significant risk areas, as well as other areas of your financial statements. Our findings are summarised on pages 3-13.

Our work is substantially complete. Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the Council's 2016/17 financial statements.

We have identified two audit adjustments, in addition to the planned valuation adjustment identified by the Council, but with no overall impact on the Council's Usable Reserves. See page 31 for details.

Based on our work, we have raised seven recommendations. Details on our recommendations can be found in Appendix 1.

Value for money

We have completed our risk-based work to consider whether in all significant respects the Council has proper arrangements to ensure it has taken properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. We have concluded that the Council has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources, except for Children's Services.

The Council was notified of a Statutory Direction in October 2016 to set up a Children's Trust to deliver children's social care services. In the Commissioner of Children's Services final quarterly report to Department for Education in 2016/17, he reported that he was not satisfied with the pace of progress, over the preceding six months, in delivering the required improvements in children's services.

We therefore anticipate issuing an 'except for' value for money opinion.

See further details on pages 14-20.

Acknowledgements

We would like to take this opportunity to thank officers and Members for their continuing help and co-operation throughout our audit work.

We ask the Audit and Risk Assurance Committee to note this report.

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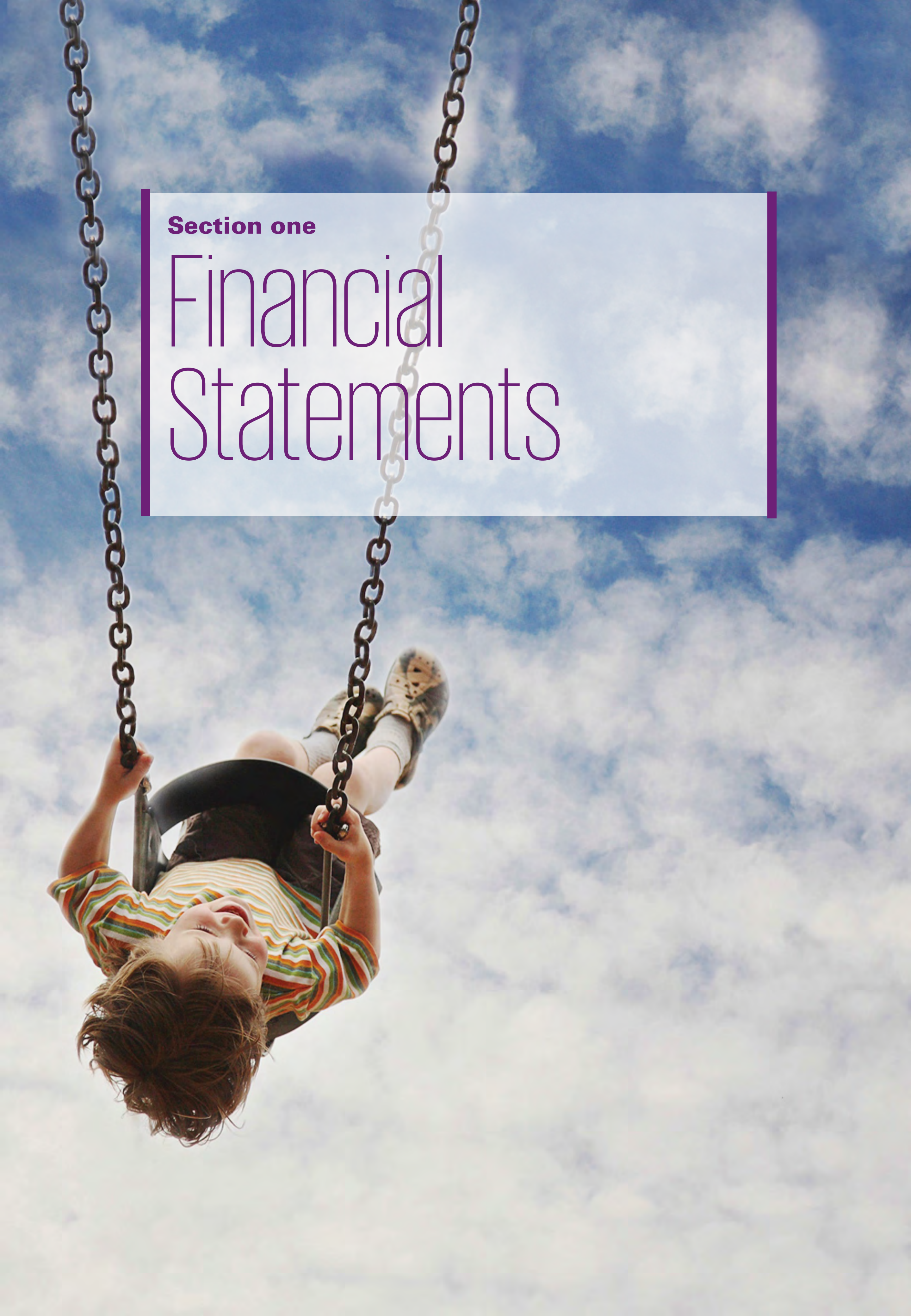
Section one

Financial Statements



We anticipate issuing an unqualified audit opinion on the Council’s 2016/17 financial statements.

We will also report that your Annual Governance Statement complies with the guidance issued by CIPFA/SOLACE (*‘Delivering Good Governance in Local Government’*) published in April 2016.

Significant audit risks

Our *External Audit Plan 2016/17* sets out our assessment of the Council's significant audit risks. We have completed our testing in these areas and set out our evaluation following our work:

Significant audit risks	Work performed
1. Changes in the pension liability due to LGPS Triennial Valuation	**Risk as set out in the Audit Plan** During the year, the Local Government Pension Scheme for West Midlands Pension Fund (the Pension Fund) has undergone a triennial valuation with an effective date of 31 March 2016 in line with the *Local Government Pension Scheme (Administration) Regulations 2013*. The Council's share of pension assets and liabilities is determined in detail, and a large volume of data is provided to the actuary to support this triennial valuation. The pension liability numbers to be included in the financial statements for 2016/17 will be based on the output of the triennial valuation rolled forward to 31 March 2017. For 2017/18 and 2018/19 the actuary will then roll forward the valuation for accounting purposes based on more limited data. There is a risk that the data provided to the actuary for the valuation exercise is inaccurate and that these inaccuracies affect the actuarial figures in the accounts. Most of the data is provided to the actuary by Wolverhampton City Council, who administer the Pension Fund. **Our work to address this risk** We have reviewed the data provided by the Council to the Pension Fund Actuary, and agreed selected items back to the relevant systems and reports from which it was derived, in addition to checking the accuracy of this data. Upon review of the assumptions, we identified an increase in the number of active members which was inconsistent with our understanding. We understand that this is due to a backlog of processing as the Council has had an increased number of people retiring in the past 12 months and the Council is working with the Pension Fund Actuary to resolve these items. We have raised a recommendation for the Council to ensure assumptions are robustly reviewed as part of collating the data for presentation to the Actuary in future years. We have liaised with the auditors of the Pension Fund to inform our assessment on whether the controls at the Pension Fund over the accuracy and completeness of source data provided to the actuary were designed, implemented and operating effectively. We have benchmarked the assumptions used by the Pension Fund actuary, and considered whether they fall within our acceptable ranges. Further detail is provided as part of our consideration of judgements on page 9. **Findings** The Council and Pension Administrator is confirming the validity of the split between the number of active, deferred and pensioner membership types ahead of evaluating whether there is any material impact on the pensions transactions in the accounts. We will evaluate our findings upon receipt of the Council's assessment.

Significant audit risks (cont.)

Significant audit risks	Work performed
2. Adjustment of Minimum Revenue Provision	**Risk as set out in the Audit Plan** The Council is in the process of preparing an adjustment to the Minimum Revenue Provision (MRP). This may result in a material change to revenue in the 2016/17 financial statements. There is a need to ensure that the accounting treatment is correct and in line with the Council's statutory requirements. **Our work to address this risk** We have reviewed the Council's approach, and calculation of the MRP and the associated rationale. The change in methodology had the impact of reducing MRP by £2.7m. Further detail is provided as part of our consideration of judgements on page 9. **Findings** We do not have any issues to bring to your attention in relation to these matters.
3. CIPFA Code Changes for 2016/17 regarding Presentation of Financial Statements	**Risk as set out in the Audit Plan** New formats and reporting requirements have been introduced for the Comprehensive Income and Expenditure Statement and the Movement of Reserves Statement. There has also been the introduction of a new *Telling the Story* review of the presentation of local authority financial statements. CIPFA has introduced changes to the 2016/17 Local Government Accounting Code (Code): — Allowing local authorities to report on the same basis as they are organised by removing the requirement for the Service Reporting Code of Practice (SeRCOP) to be applied to the Comprehensive Income and Expenditure Statement (CIES); and — Introducing an Expenditure and Funding Analysis (EFA) which provides a direct reconciliation between the way local authorities are funded and prepare their budget and the CIES. This analysis is supported by a streamlined Movement in Reserves Statement (MiRS) and replaces the current segmental reporting note. The Council was required to make a retrospective restatement of its CIES (cost of services) and the MiRS. New disclosure requirements and restatement of accounts require compliance with relevant guidance and correct application of applicable accounting standards. **Our work to address this risk** We reviewed the presentation of the financial statements against the requirements of the Code. **Findings** We do not have any issues to bring to your attention in relation to these matters.

Significant audit risks (cont.)

Significant audit opinion risks	Work performed
4. Formation of a separate entity in response to the Statutory Direction to form a Children's Services Trust	**Why is this a risk?** On 19 October 2016 Cabinet was advised of the Government's Statutory Direction to set up a Children's Trust to deliver children's social care services for a period of time. This will include a TUPE agreement for the staff concerned and the agreement of a Service Level Agreement for 12 months with the Council for administrative and support services. A Memorandum of Understanding was agreed by the Cabinet in December 2016 with a view to the entity becoming operational in Spring/Summer 2017. The formation of a new legal entity will have implications for both accounting and tax treatment. At the present time it is not yet clear when the entity will formally come into existence and the timing of associated expenditure. **Our work to address this risk** We have liaised with management throughout the year to understand the plans and timetable for establishing the Children's Services Trust. The Trust has been set up as a legal entity but the delivery of Children's Services has not transferred in 2016/17 but this is expected to occur in December 2017. As a result there have been minimal accounting implications in 2016/17, but we expect the Council to re-evaluate its group boundary in 2017/18 to consider whether it has to produce group accounts. We understand management have been seeking advice as to the future tax implications of establishing and transferring the Service to the Trust as part of its planning arrangements.

Considerations required by professional standards

Fraud risk of revenue recognition

Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk.

In our *External Audit Plan 2016/17* we reported that we do not consider this to be a significant risk for Local Authorities as there is unlikely to be an incentive to fraudulently recognise revenue.

This is still the case. Since we have rebutted this presumed risk, there has been no impact on our audit work.

Management override of controls

Professional standards require us to communicate the fraud risk from management override of controls as significant because management is typically in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.

Our audit methodology incorporates the risk of management override as a default significant risk. We have not identified any specific additional risks of management override relating to this audit.

In line with our methodology, we carried out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business, or are otherwise unusual.

There are no matters arising from this work that we need to bring to your attention.

Judgements

We have considered the level of prudence within key judgements in your 2016/17 financial statements and accounting estimates. We have set out our view below across the following range of judgements.

Level of prudence

0 Audit difference | 1 Cautious | 2 | 3 Balanced | 4 | 5 Optimistic | 6 Audit difference

Acceptable range (1–5)

Subjective areas	2015/16	2016/17	Commentary
Pension liabilities – LGPS (funded)	5 £1,608m	5 £2,063m	The assumptions used, in aggregate, fall within our acceptable range. However, the proposed assumption for CPI is RPI less 0.9% p.a. giving an assumption of 2.70% p.a. which is slightly outside the optimistic end of our acceptable range. Moving to the edge of our usual tolerance range (2.65%) would reduce liabilities by 1.0% (£20 million). However, the net discount rate (i.e. difference between discount rate and CPI assumption) is within our acceptable range, and so considering the two assumptions in aggregate, we are comfortable that the end result falls just within our acceptable range.
Current Provisions (excluding NDR)	3 £5.07m	3 £7.79m	Current provisions primarily comprise Insurance, Collection Fund Provisions for NDR, and Termination Benefits. The main driver of the increase in provisions is the £2.93m increase in termination benefits. We consider the provision disclosures to be proportionate, but note that exit packages and staff departures continue to have a large financial impact.
Creditors - Accruals de minimis level	3 £79.7m	4 £72.5m	The Council has increased its de minimis accruals level (to £1,000 for revenue items and £10,000 for capital) in response to the shorter closedown period. We have been actively engaging with management, who have performed an assessment based on the prior year numbers in order to understand the impact of raising the threshold, and we are satisfied that the change in policy does not create a material change.
PPE: HRA assets	3 £789.3m	3 £930.4m	The Council continues its use of the beacon valuation methodology in line with the DCLG's *Stock Valuation for Resource Accounting* published in November 2016. We consider the methodology, and its application, to be appropriate. The increase from the prior year includes re-valuation gains totalling £103.0 million mainly due to an increase in the social housing discount factor from 34% to 40%. The discount factor of 40% is in accordance with the DCLG guidance.
Minimum Revenue Provision (MRP)	3 £30.2m	4 £27.6m	The Council has changed its policy for MRP (see significant risk 2). Management have determined that the previous method, the 'Capital Financing Method' is no longer appropriate to use on the basis that the main assumption was that the Government would continue to support the repayment of borrowing through the Revenue Support Grant, which is now significantly reduced. The new method, the 'Asset Life - Equal Instalments' method, involves applying a useful life to the debt that is based on the average useful life of the Council's depreciable operational assets. The change in methodology has the impact of reducing MRP by approximately £2.7 million.

Proposed opinion and audit differences

We anticipate issuing an unqualified audit opinion on the Council's 2016/17 financial statements following approval of the Statement of Accounts by the Audit and Risk Assurance Committee on 17 August 2017.

Audit differences

In accordance with ISA 260 we are required to report uncorrected audit differences to you. We also report any material misstatements which have been corrected and which we believe should be communicated to you to help you meet your governance responsibilities.

The final materiality (see Appendix 4 for more information on materiality) level for this year's audit was set at £10 million (PY:£10 million). Audit differences below £0.5m are not considered significant.

The audit identified a total of three audit differences, which we set out in Appendix 3. It is our understanding that two will be adjusted in the final version of the financial statements, one will not be on the basis of its low value.

The tables on the right illustrate the total impact of audit differences on the Council's movements on the General Fund and HRA for the year and balance sheet as at 31 March 2017.

The net impact on the General Fund and HRA as a result of audit adjustments is nil as at 31 March 2017. This is mainly the result of the increase in the valuation of the Council's shareholding in Birmingham Airport, which was, as in prior years, received after preparing the 2016/17 accounts.

In addition, we identified a small number of presentational adjustments required to ensure that the accounts are compliant with the Code of Practice on Local Council Accounting in the United Kingdom 2016/17 ('the Code'). We understand that the Council will be addressing these.

Movements on the general fund 2016/17

£m	Pre-audit	Post-audit	Ref[1]
Surplus on the provision of services	139.3	146.7	2
Adjustments between accounting basis and funding basis under Regulations	(143.9)	(151.3)	2
Decrease in Usable Reserves	**(4.6)**	**(4.6)**	

Balance sheet as at 31 March 2017

£m	Pre-audit	Post-audit	Ref[1]
Property, plant & equipment	1,759.5	1,759.5	
Other long term assets	121.8	129.2	2
Current assets	99.1	106.3	1
Current liabilities	(183.6)	(190.8)	1
Long term liabilities	(1,419.0)	(1,419.0)	
Net worth	**377.8**	**385.2**	
General Fund	(126.2)	(126.2)	
Other usable reserves	(59.2)	(59.2)	
Unusable reserves	(192.4)	(199.8)	2
Total reserves	**(377.8)**	**(385.2)**	

[1] See referenced adjustments in Appendix 3.

Annual governance statement

We have reviewed the Council's 2016/17 Annual Governance Statement and confirmed that:

— It complies with *Delivering Good Governance in Local Government: A Framework published by CIPFA/SOLACE*; and

— It is not misleading or inconsistent with other information we are aware of from our audit of the financial statements.

Narrative report

We have reviewed the Council's 2016/17 narrative report and have confirmed that it is consistent with the financial statements and our understanding of the Council.

Accounts production and audit process

Our audit standards (*ISA 260*) require us to communicate our views on the significant qualitative aspects of the Council's accounting practices and financial reporting.

We also assessed the Council's process for preparing the accounts and its support for an efficient audit. The efficient production of the financial statements and good-quality working papers are critical to meeting the tighter deadlines.

KPMG Central

The Council continues to use KPMG Central, which was first introduced to the audit process in 2015/16. KPMG Central has allowed the team to securely transfer large amounts of data between the Council and the audit team. KPMG Central aligns to our Accounts Audit Protocol and allows the Council's finance team to efficiently share requested information, and allows us to keep track of uploaded documents.

Accounting practices and financial reporting

We have reported previously that the Council has recognised the additional pressures which the earlier closedown in 2017/18 will bring. Over the last two years we have proactively engaged with the Council in order to continue to address issues as they emerge and bring forward the reporting timetable.

The Council has looked to strengthen its financial reporting by finalising the accounts in a shorter timescale. This puts the Council in a good position to meet the new 2017/18 deadline. Nonetheless, there is scope to improve the process further, see recommendation 6..

We consider the Council's accounting practices appropriate.

Completeness of draft accounts

We received a complete set of draft accounts on 5 June 2017, ten days earlier than in 2016. This unaudited set of accounts, in addition to a public inspection notice, was made available on the Council's website on the same day in accordance with the DCLG deadline of 30 June.

Quality of supporting working papers

We issued our *Accounts Audit Protocol 2016/17* ("Prepared by Client" request) in January 2017 which outlines our documentation request. This helps the Council to provide audit evidence in line with our expectations. We followed this up through liaising with Management to discuss specific requirements of the document request list.

We worked with management to ensure that working paper requirements are understood and aligned to our expectations. We are pleased to report that this has resulted in generally good-quality working papers with clear audit trails. We will continue to work with management on any areas where we feel improvements can be made.

Response to audit queries

We are pleased to report that, in general, turnaround time of our audit queries was kept to a minimum. Where this was not the case, and where we experienced any delays, we will work with management to agree how this will be addressed to ensure that the Council is in a strong position to take on the 2017/18 earlier closedown.

Group audit

Management have considered the requirement to prepare Group accounts. On the basis of the current Group structure, and size of the entities that would potentially form the Group, management have determined that Group accounts are not required.

We note that next year, following the transfer of delivery of Children's Services to the Trust, Group accounts will be required.

Prior year recommendations

As part of our audit we have followed up the Council's progress in addressing the recommendations in last year's ISA 260 report.

The Council has implemented, or made progress against, the majority of the recommendations in our ISA 260 Report 2015/16.

Appendix 2 provides further details.

Controls over key financial systems

We have tested controls as part of our focus on significant audit risks and other parts of your key financial systems on which we rely as part of our audit. The strength of the control framework informs the substantive testing we complete during our final accounts visit.

Based on the work performed, we are satisfied that the majority of controls in place are performing effectively. We are able to place reliance on the Council's control framework.

We have, however, identified a small number of exceptions on the effective operation of the Council's control environment:

Review of operational assets: The annual review of the Council's operational assets found that five schools were excluded from the Council's balance sheet in 2014/15 when a full assessment had been undertaken following the introduction of the Accounting for LA Maintained Schools guidance. As a result, a prior period adjustment has been made increasing Other Land & Buildings by £17.582 million.

Review of pension assumptions: Management are required to review the assumptions provided to and subsequently utilised by the Pension Fund Actuary, Barnett Waddingham, to inform the Council's Pension Liabilities and other transactions. Upon review of the assumptions, we identified a large movement in the number of active members which was not consistent with management records provided to us. We understand that this is due to a backlog of processing as the Council has had an increased number of people retiring in the past 12 months.

Journal documentation: Following provision of the draft accounts for audit, management identified one adjustment where a journal totalling £7.5m was incorrectly posted which resulted in income and expenditure both being understated (nil net effect). We have made a recommendation in Appendix 3 for the Finance team to ensure journals are robustly reviewed ahead of being posted.

Completion

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Council's 2016/17 financial statements.

Before we can issue our opinion we require a signed management representation letter.

Once we have finalised our opinions and conclusions we will prepare our Annual Audit Letter and close our audit.

Declaration of independence and objectivity

As part of the finalisation process we are required to provide you with representations concerning our independence.

In relation to the audit of the financial statements of Sandwell Metropolitan Borough Council for the year ending 31 March 2017, we confirm that there were no relationships between KPMG LLP and the Council, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

We have provided a detailed declaration in Appendix 5 in accordance with ISA 260.

Management representations

You are required to provide us with representations on specific matters such as your financial standing and whether the transactions within the accounts are legal and unaffected by fraud. We have provided a template to the Executive Director of Resources for presentation to the Audit and Risk Assurance Committee. We require a signed copy of your management representations before we issue our audit opinion.

Other matters

ISA 260 requires us to communicate to you by exception 'audit matters of governance interest that arise from the audit of the financial statements' which include:

- Significant difficulties encountered during the audit;
- Significant matters arising from the audit that were discussed, or subject to correspondence with management;
- Other matters, if arising from the audit that, in the auditor's professional judgment, are significant to the oversight of the financial reporting process; and
- Matters specifically required by other auditing standards to be communicated to those charged with governance (e.g. significant deficiencies in internal control; issues relating to fraud, compliance with laws and regulations, subsequent events, non disclosure, related party, public interest reporting, questions/objections, opening balances etc.).

There are no other matters which we wish to draw to your attention in addition to those highlighted in this report.

We have received an objection from an elector in July 2017 on the 2016/17 Statement of Accounts and are currently evaluating the impact of this. We will provide an update in our Annual Audit Letter.

Section two

Value for money

Our 2016/17 VFM conclusion considers whether the Council had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

We have concluded that, except for Children's Services, the Council has made proper arrangements to ensure it took properly-informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

For Children's Services, we have concluded that proper arrangements were not in place.

VFM conclusion

The Local Audit and Accountability Act 2014 requires auditors of local government bodies to be satisfied that the authority 'has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources'.

This is supported by the Code of Audit Practice, published by the NAO in April 2015, which requires auditors to 'take into account their knowledge of the relevant local sector as a whole, and the audited body specifically, to identify any risks that, in the auditor's judgement, have the potential to cause the auditor to reach an inappropriate conclusion on the audited body's arrangements.'

Our VFM conclusion considers whether the Council had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

We follow a risk based approach to target audit effort on the areas of greatest audit risk.

1 Identification of significant VFM risks (if any)

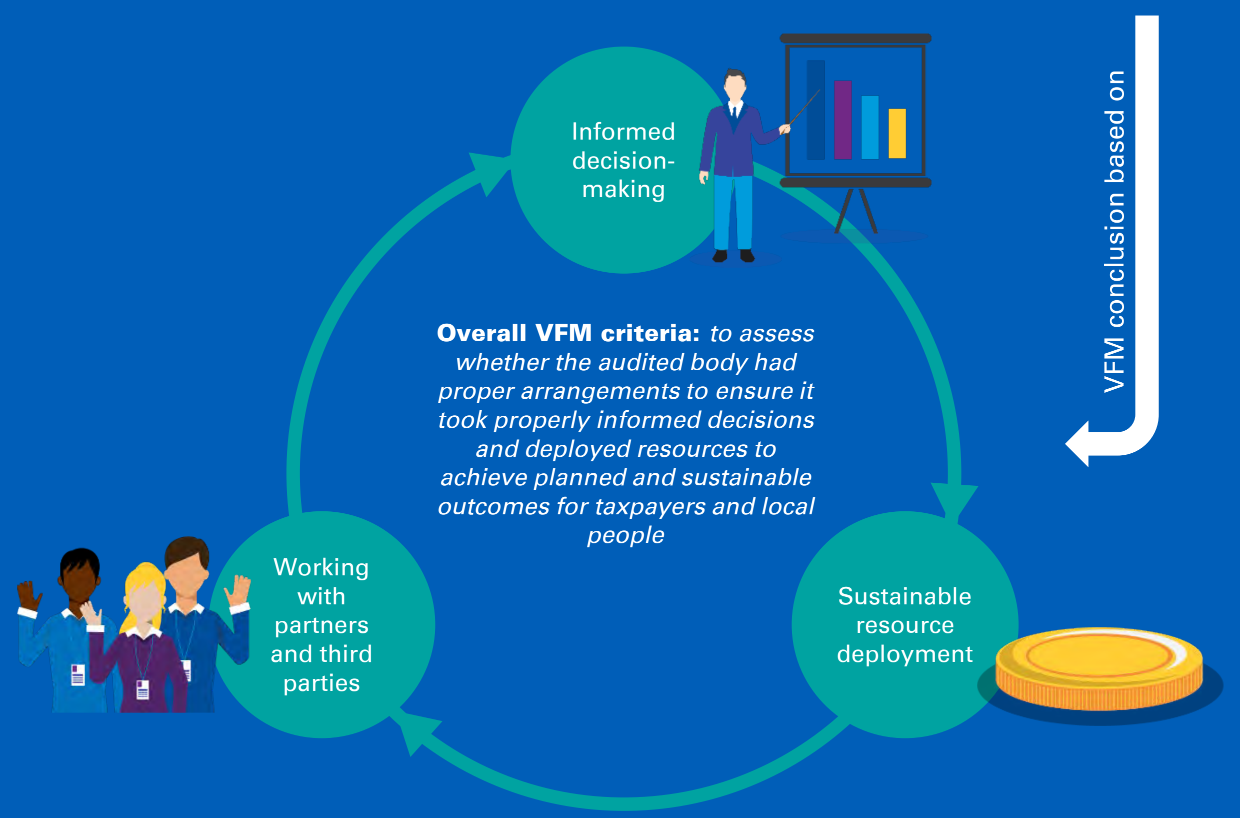
- VFM audit risk assessment
- Financial statements and other audit work

2 Continually re-assess potential VFM risks

- Assessment of work by other review agencies
- Specific local risk-based work

3 VFM conclusion

- **Conclude on arrangements to secure VFM**



VFM conclusion (cont.)

We have reached an 'except for' conclusion. This means that we have identified weaknesses that are sufficiently significant, in our professional judgement, to warrant reporting on in the auditor's general report, but they are limited to specific issues or areas.

VFM guidance

In accordance with the NAO guidance, the auditor's work should be designed to provide the auditor with sufficient assurance to enable them to report as appropriate to provide a conclusion that in all significant respects, the audited body has (or has not) put in place proper arrangements to secure value for money through economic, efficient and effective use of its resources for the relevant period.

Our conclusion relates only to the same period as the statement of accounts, that is the year ending 31 March 2017. Evidence of actions taken by the Council since year end in respect of weaknesses in arrangements are not relevant to our conclusion.

Auditors are required to reach their statutory conclusion on arrangements to secure VFM based on an overall evaluation criterion:

- informed decision making;
- sustainable resource deployment; and
- working with partners and other third parties.

VFM risks

On pages 18 to 20 we set out the VFM risks that were identified in our External Audit Plan:

- Financial Standing;
- Children's Services; and
- Changes in Senior Staff.

We have set out the work we have performed against those risks, and our findings in detail.

Reaching our conclusion

Drawing on the relevant requirements applicable to local bodies, proper arrangements for informed decision making include understanding and using appropriate and reliable financial and performance information (including, where relevant, information from regulatory/monitoring bodies) to support informed decision making and performance management.

Proper arrangements for sustainable resource deployment include; managing and utilising assets effectively to support the delivery of strategic priorities, and planning, organising and developing the workforce effectively to deliver strategic priorities.

In reaching our conclusion we have considered the findings of the Children's Services Commissioner for Sandwell and other inspectorates, in particular those of Ofsted and the CQC who, between 16 January and 20 January 2017, conducted a joint inspection of the local area of Sandwell.

In our view, based on the recent findings of the Children's Services Commissioner for Sandwell, and Ofsted and the CQC, the VFM evaluation criterion were not being met.

We have therefore concluded that for Children's Services, for the year ended 31 March 2017, the Council did not have proper arrangements for informed decision making and sustainable resource deployment.

With the exception of Children's Services, we are satisfied that, in all significant respects, the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2017.

Significant VFM risks

We have identified three significant VFM risks, as communicated to you in our *2016/17 External Audit Plan*. In most cases we are satisfied that external or internal scrutiny provides sufficient assurance that the Council's current arrangements in relation to these risk areas are adequate.

Significant VFM risks	Work performed
1. Financial standing	**Why is this a risk?** *There has been a significant shift in the national outlook over the last 12 months, primarily driven by the outcome of the referendum on 23 June 2016 on the UK's membership of the European Union. Consequently GDP growth forecasts have been revised downwards, which potentially reduces the level of any growth in business rates income. Inflationary pressures, service pressures, and a reduction in the local government finance settlement will impact on the Council's finances.* The Council has considered the impact of the provisional Local Government Finance Settlement announced by the Secretary of State for Communities and Local Government on 15 December 2016. The provisional settlement is in line with Sandwell's planning assumptions contained in the MTFS, and would result in a cumulative shortfall of £16.7 million for the period from 2018/19 to 2019/20. A balanced budget for this period will be delivered through the Council's Facing the Future programme. The Facing the Future programme is collectively managed and consists of cross cutting savings and change management projects. The savings targets are held as a central item and then allocated to relevant directorates once projects are sufficiently developed. The original programme identified 11 projects to deliver savings totalling £22 million through reduced expenditure or increased income over 2015/16 and 2016/17. A number of these projects have been delivered and the savings transferred to individual directorate budgets, with an identified forecast surplus of £6.6 million at a service level as at November 2016. **Summary of our work** We have assessed the controls the Council has in place to ensure a sound financial standing, specifically that its Medium Term Financial Plan has duly taken into consideration the potential funding reductions and that it is sufficiently robust to ensure that the Council can continue to provide services effectively. We have reviewed how the Council is planning and managing its savings plans. The Medium Term Financial Strategy (MTFS) was approved by Council on 7 March 2017. The Council operates multi-year budget planning process that gives services the ability to manage budgets across financial years, which has delivered reported savings of £23 million in 2015/16 and £24 million in 2016/17. For 2017/18 the Council has reported that all savings required, totalling £13.3 million, have been achieved through the Facing the Future programme. Delivery of the MTFS is considered a strategic risk, and the Council recognise a number of uncertainties and pressures arising from several areas. Specific risk based work required: No

Significant VFM risks (cont.)

Significant VFM risks	Work performed
2. Children's Services	**Why is this a risk?** The Council has been subject to an improvement notice since March 2010. In June 2015 Ofsted reported findings with an overall judgement that children's services were inadequate, and that there were serious failures that leave children being harmed or at risk of harm. There was a subsequent monitoring visit in September 2016 which concluded that positive changes to processes had been made, but the Council was yet to demonstrate improved outcomes for children. The Council continues to implement the agreed action plan arising from the inspection. The Secretary of State for Education has appointed a commissioner for children's services in Sandwell to direct the Council to ensure that all the Council's children's social care functions are performed to an adequate standard. On 6 October 2016 the Council was formally notified of the Government's Statutory Direction to set up a Children's Trust to deliver children's social care services. **Summary of our work** The Statutory Direction on 6 October 2016 coincided with the appointment of a new Commissioner for Children's Services reporting to the Department for Education (DfE), the arrangement in place to support the improvement in children's social care. On 14 March 2017 as part of his quarterly reporting to DfE, the Commissioner for Children's Services reported that whilst the Council had made excellent progress with setting up the Trust itself, he was not satisfied with the pace of progress, over the preceding six months, in delivering the required improvements in children's services. In considering the arrangements the Council has put in place to challenge how it secures economy, efficiency, and effectiveness during 2016/17, we have taken into consideration: ▪ the Statutory Direction enforced in 2016/17; ▪ the quarterly reports from the Commissioner; and ▪ the findings of the recent Ofsted and CQC inspection of local area services for children and young people with special educational needs and/or disabilities, published on 27 March 2017. These highlighted that some improvements had been made, but were not being made quickly enough with a lack of accountability and a range of different weaknesses with the service provision. We note that the Commissioner's first quarterly report in 2017/18 (June 2017) subsequently provided commentary on: ▪ the acceleration of progress on the improvement programme; ▪ an increased focus and grip, replicating that shown to set up the Trust in late 2017; ▪ stronger leadership from within the service and Chief Executive; and ▪ an optimism that the approach being adopted will begin to deliver the improvements required. Children's services are a strategic priority but in the 2016/17 period, despite the considerable mobilisation of resources, the Council had yet to demonstrate the delivery of required service improvements. Having considered the findings and conclusions of the above inspections, together with the results of our audit work, we have concluded that the Council did not have proper arrangements in place to meet the requirements of the sub-criteria relating to 'informed decision making' and 'sustainable resource deployment'. Specific risk based work required: No

Significant VFM risks (cont.)

Significant VFM risks	Work performed
3. Changes in Senior Staff	**Why is this a risk?** There have been a number of senior departures over the past year, including the Assistant Chief Executive, Director of Governance, and Director of Neighbourhoods as well as members of the management team. In addition there are a number of planned departures across the Council ahead of 31 March 2017. These changes present the following risks: ▪ Maintaining sufficient capacity at a senior level with the experience to manage the pressures facing all Councils as a result of the wider Local Government Landscape, and other factors specifically affecting the Council such as WMCA; ▪ Ensuring that where exit packages are provided that they represent value for money for the Council; and ▪ We note a number of planned departures within the core finance team. It is important that the team maintains sufficient capacity to deliver the accounts, in particular given the earlier close down timetable. **Summary of our work** ***Capacity at senior level*** The Council has continued to have significant staff changes at a senior level as documented in our risk assessment. During the year the Council has confirmed substantive appointment to the Executive Director of Resources post. The Council navigated the approval of the West Midlands Combined Authority, allowing for senior staff to revert focus back on the Council's management. In March 2017, a report was presented to Council proposing a number of changes in the Chief Officer Structure and Senior Management Board membership, including the creation of the Resources Directorate to replace the former Assistant Chief Executive directorate. ***Exit packages*** We have reviewed compliance regarding the authorisation of exit packages for senior staff and for the approval of the appointment of new senior staff, including the three senior officers. From our work, we identified that the governance process for approving exit packages in some cases has been not operated consistently and in some cases has been informal. As a result, we are not satisfied that some of the exit packages demonstrate value for money for the Council. However. because we look at the performance across the whole Council we have not considered this as part of our overall value for money conclusion criteria. See recommendation 1 in Appendix 1. ***Finance team*** The Council has embedded the Director of Resources role during the year and the senior finance team. There were a number of planned departures within the core finance team, but capacity was maintained and the Council has navigated the earlier close down as it moves towards 31 July approval and publication in 2017/18. More broadly across the Council, at a more junior level there have been changes in staff due primarily to the planned leavers programme. High staff turnover presents a risk of loss of knowledge and experience. The council needs to ensure it has succession planning. See recommendation 7 in Appendix 1. Specific risk based work required: No

Appendices

Key issues and recommendations

Our objective is to use our knowledge of the Council gained during our routine audit work to make useful recommendations for you to consider, where we believe the Council's processes and controls can be strengthened. We have set out these recommendations in this appendix. We have also included Management's responses to these recommendations.

The Council should closely monitor progress in addressing the risks, including the implementation of our recommendations. We will formally follow up these recommendations next year.

Each issue and recommendation have been given a priority rating, which is explained below.

High priority – Issues that are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.

Medium priority – Issues that have an important effect on internal controls but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately but the weakness remains in the system.

Low priority – Issues that would, if corrected, improve internal control in general but are not vital to the overall system. These are generally issues of good practice that we feel would benefit if introduced.

The following is a summary of the issues and recommendations raised in the year 2016/17.

2016/17 recommendations summary

Priority	Total raised for 2016/17
High	2
Medium	5
Low	0
Total	7

Key issues and recommendations (cont.)

High priority	**1. Approval of senior staff exit packages** There has been a number of senior officer departures from the Council over recent years. We have reviewed the audit trail maintained to document the process of senior departures from the Council over the course of the financial year, in addition to reviewing the exit packages granted including how they were approved and how the business case was made. From our review we noted two instances where a satisfactory audit trail was not retained to evidence the decision and approvals prior to staff departure. We also noted two instances where we could not see how the business case had been made or approved. The exit packages governance process for senior staff does not appear to consistently follow a set process. Where this is not followed there is a greater risk for the Council to breach laws or regulations, or not achieve value for money. **Recommendation** We recommend that the Council ensures it has a robust and workable governance approval process in place that is followed consistently across the organisation, and that it ensures that the process for approving departures is documented and an audit trail maintained.	**Management Response** Business Cases are now in place for these exit packages but it is acknowledged that these were not completed in full prior to the staff exiting. It is not anticipated that this situation will arise again in the future but, if it does, a more robust and comprehensive audit trail will be maintained. **Owner** Darren Carter (S151 Officer) **Deadline** 31 March 2018
High priority	**2. Review of Pension Assumptions** Management are required to review the assumptions provided to and subsequently utilised by the Pension Fund Actuary, Barnett Waddingham to inform the Council's Pension Liabilities and other transactions. Upon review of the assumptions, we identified a large movement in the number of active members which was not consistent with management records provided to us. We understand that this is due to a backlog of processing as the Council has had an increased number of people retiring in the past 12 months. The Council and Pension Administrator is confirming the validity of the split between the number of active, deferred and pensioner membership types ahead of evaluating whether there is any material impact on the pensions transactions in the accounts. **Recommendation** The Council undertake a robust review of assumptions provided to the actuary and ensure it is consistent with underlying staffing trends.	**Management Response** There were approximately 700 SMBC members who had left the service prior to 31 March 2016 valuation date but were still technically classified as active by the West Midlands Pension Fund as of that date. The records held by SMBC pensions team reflected the correct number. West Midlands Pension Fund have now reclassified these members and the figures reported in the latest actuarial report are in line with the numbers held by SMBC pensions team. A more robust reconciliation process will be implemented before the next planned interim audit in 2018. **Owner** Strategic Finance Manager / Pensions Manager **Deadline** To be effective from the next interim audit scheduled for January/February 2018.

Key issues and recommendations (cont.)

Medium priority

3. Journal documentation

The Council's financial reporting process is reliant on officers across the organisation submitting documentation for central finance to review to then post journals onto the ledger.

In Appendix Three we document one adjustment, identified by management following provision of the draft accounts, where a journal totalling £7.5m was incorrectly posted which had the effect of understating both income and expenditure.

There is a risk that misstatements are made again in following years, incurring unnecessary time, and creating audit adjustments by not getting things right first time.

Recommendation

Journal templates and working papers should be robustly reviewed to ensure they contain sufficient detail and supporting evidence to post the journal appropriately. Training should be provided to ensure that teams are aware of the detail of documentation requirements.

Management Response

The incorrect accounting entries were identified by management during the closedown process and a correcting journal was posted.

The correct presentation of this transaction has also been reflected in the Statement of Accounts.

Further training will be provided to Accounting Teams in preparation for the 2017/18 closedown process.

Owner

Strategic Finance Manager

Deadline

31 January 2018

Medium priority

4. Review and challenge over reconciling items

From review of school bank reconciliations we identified a high value cheque (>£100k from Holly Lodge High School to the Council) that had not been cashed and remained uncashed for three months.

There is a risk that the reconciliation is not effective if such items are not followed up, in this case so as to understand why it had not been cashed. In addition the cash being held as a cheque to the Council does not enable the Council to make best use of its resources.

Recommendation

Schools Budget Officers should ensure that they review reconciling items in a timely manner, particular where these relate to cash payments to the Council.

Management Response

A review of large unpresented cheques on Schools Bank Accounts payable to the council should be undertaken on a regular and timely basis by all School Budget Officers. These should be reported to the Schools Accounting Team on a regular basis for review and challenge.

The specific circumstances relating to this particular transaction have been referred to the Internal Audit Team for further investigation.

Owner

All Schools Budget Officers / Principal Accountant - Schools

Deadline

1 October 2017

Medium priority

5. Contract finalisation

As part of our cut off testing we identified cash payments being made relating to the 2015/16 financial year. There had been delays in agreeing final payments with the NHS provider as there was no formal contract in place. In addition the Council has held provisions linked to contractual disputes with CCG partners due to agreement not being made in a timely manner.

Recommendation

The Council should ensure that contracts are drafted and agreed in a timely manner.

Management Response

The financial uncertainty associated with CCG contributions to joint packages of care will significantly reduce from April 2017, for placements made after this date each partner will commission their element of the package individually. This will reduce the transactions between both organisations.

Key issues and recommendations (cont.)

Medium priority

6. Financial Reporting Process

Over the last two years the Finance team has demonstrated a strong track record of bringing forward closure of the accounts. 2017/18 represents the first year of the earlier deadline of 31 July for approval and publishing of the accounts, brought forward from 31 September.

There were, however, some isolated areas where we experienced some delays in the receipt of data such as

- non pay expenditure; and
- payroll reports.

Recommendation

The Council should plan to bring forward its Audit and Risk Committee meeting to receive the accounts, further evaluate where the year end timetable could be streamlined and ensure audit requirements are met to facilitate an earlier audit in 2017/18.

Management Response

This specific issue will be addressed as part of the internal post closedown review meeting with Principal Accountants.

The year-end closedown timetable for future years will incorporate strict deadlines for the production of these reports.

The production of these reports will be produced and validated both at an interim and final year end stage in a timely manner.

The corporate closedown timetable will be reviewed as part of the planning of the 2017/18 accounts closure process to ensure the statutory accounts deadline continues to be met

Owner

Principal Accountant – Financial Systems Team / Strategic Finance Manger

Deadline

31 January 2018

Medium priority

7. Workforce succession planning

There has been a marked increase in the turnover of senior staff within different services as a result of retirements. This is in part an intended consequence of the planned leavers programme that has encouraged individuals to highlight their intentions in regards to early retirement to facilitate succession planning.

There have also been ongoing shortages in Children's social workers and disagreements over the required staff mix. This has impacted on the quality of services and is being addressed as part of the agreed improvement programme.

In addition, the Council has had a large number of exit packages that have been agreed with senior employees and this has seen a significant revision in the Council's executive structures.

Workforce planning arrangements are captured across a range of different policy and procedure documents. If workforce planning is not done effectively there is a risk that services will be effected and the Council will incur additional and unnecessary costs.

Recommendation

The Council should revisit its workforce planning provision in light of the issues above and ensures that an overall workforce planning strategy is clearly articulated. Specifically, we would recommend that the Council review the workforce planning cycle to identify how these issues can be identified at an earlier stage and where possible avoided.

Management Response

Sandwell MBC has a comprehensive and successful range of workforce planning strategy tools that are designed to deliver significant savings and allow managers and staff to plan ahead for the departure of staff at all levels of the organisation. It is intended to collate these into a single, comprehensive workforce planning strategy to assist in ensuring these tools are widely and consistently used across the organisation.

Owner

Service Manager – Human Resources

Deadline

31 March 2018

Follow-up of prior year recommendations

In the previous year, we raised six recommendations which we reported in our *External Audit Report 2015/16 (ISA 260)*. The Council has implemented or made progress against each of the recommendations. We re-iterate the importance of the outstanding recommendations and recommend that these are implemented by the Council.

We have used the same rating system as explained in Appendix 1.

Each recommendation is assessed during our 2016/17 work, and we have obtained the recommendation's status to date. We have also obtained Management's assessment of each outstanding recommendation.

Below is a summary of the prior year's recommendations.

2015/16 recommendations status summary

Priority	Number raised	Number implemented / superseded	Number outstanding
High	1	1	**0**
Medium	5	5	**0**
Total	**6**	**6**	**0**

High priority

1. Fixed assets – best consideration for disposals

Within our fixed asset disposal sample we identified an instance in year where a site had been sold to a developer at nil value, utilising a valuation by the developer. The most recent internal valuation obtained by the Council during the financial year was £0.5million. The disposal was actioned following approval from legal services, in accordance with a development framework. Whilst we are informed that an officer would have reviewed the valuation obtained by the developer that resulted in a disposal at nil value, there is insufficient audit trail to provide evidence that best consideration was obtained by the Council in relation to this disposal. The current process means that this issue could reoccur.

Recommendation

We are aware that the Council is reviewing its policy and procedures regarding the disposal of fixed assets. These procedures should ensure that an audit trail is maintained for all disposals. In particular if a disposal is made for less than the Council's previously held valuation this should document how the Council is satisfied that the disposal is providing best value.

Management original response

The valuation process for dealing with disposals will in future be applied consistently across the Council. The process is being formalised as part the new Land Sales Protocol.

In addition the Council will in future ensure a full audit trail is maintained for all property valuations and disposals.

Owner

Darren Carter (S151 Officer) & Lee Constable (Asset Management Team)

Original deadline

September 2016

KPMG's August 2017 assessment

In progress

The Sale of Land and Buildings Protocol was presented to the September 2016 Audit Committee meeting.

Since this date there have been limited disposals made that would be required to follow the new protocol, so are not yet able to conclude on whether a full audit trail is now maintained.

Management's August 2017 response

The revised valuation process is now incorporated into Council Policy.

Follow-up of prior year recommendations (cont.)

Medium priority

2. Fixed assets – notification of finance team and valuation

As stated in recommendation 1, within our fixed asset disposal sample we identified an instance where a site had been sold to a developer at nil value. The most recent internal valuation obtained by the Council during the financial year was £0.5million. As there was no monetary receipt the finance team were not notified of the disposal in order to transact and there be clear visibility against the Council's asset records. In addition we noted a further instance where there had been substantial delay in notification to the finance team of a disposal.

Recommendation

Finance should be notified of all fixed asset disposals regardless of the consideration received. This is important not only to keep the asset register up to date, but where an asset is disposed of at an amount that differs from its carrying value separate accounting transactions will be required to show a profit or loss on disposal.

In addition the Council should ensure that valuations are being obtained on an appropriate basis. There are also additional considerations including whether an external or internal valuation should be obtained, and at what timing to ensure the Council can not only meet its financial reporting requirements but is ensuring that best consideration is obtained on disposal.

Management original response

As part of the council's new disposal policy all parties are to be notified and consulted in advance of any disposal by way of formalised officer group. Valuations and Audit Files will be obtained and retained in accordance with the new Land Sales Protocol.

Owner

Lee Constable (Asset Management Team), Carl Burke (Principal Accountant Capital) & The Asset Management Group

Original deadline

September 2016

KPMG's August 2017 assessment

In progress

The Sale of Land and Buildings Protocol was presented to the September 2016 Audit Committee meeting.

Since this date there have been limited disposals made that would be required to follow the new protocol, so are not yet able to conclude on whether a full audit trail is now maintained.

Management's August 2017 response

The revised valuation process is now incorporated into Council Policy.

Follow-up of prior year recommendations (cont.)

Medium priority

3. Fixed asset register

We understand that the Council is continuing to develop its asset management system, Atrium, to provide a single source of information which both Strategic Asset Management and Strategic Finance can use and rely upon. Development of this system has been taking place for a number of years, we last reported in our prior year ISA in relation to a recommendation raised in the 2013/14 financial year.

In the absence of the system, we have continued to find anomalies in the information held on assets by the separate teams as referred to in recommendations 1, 2 and 3.

Recommendation

The Council should review progress made in relation to the development of its asset management system, and consider what steps are needed to enable its implementation.

Management original response

The Atrium system is now available to view by all officers across the council by way of an interface system called "Map-That". In addition reports can be set up to come out of Atrium in order to inform current asset data. These reports can be regularised over any given period. By the end of 2016/17 a separate spatial layer on the councils GIS system will be in place to enable a check and balance regarding valuations v's assets held.

A review will be undertaken by the autumn 2016 to identify current progress to date of asset management systems within Sandwell.

Owner

Lee Constable (Asset Management Team) & Carl Burke (Principal Accountant – Capital)

Original deadline

September/October 2016

KPMG's August 2017 assessment

Implemented

The valuation layer has since been added.

Medium priority

4. Debtors – recoverability

The Council's provision for doubtful debts has risen significantly in year, from £24.45million to £30.55million. Whilst the Council has applied its methodology consistently and the increase relates to specific provisions, we have identified an opportunity for the Council to regularly review the aging of debt to enhance transparency.

Recommendation

The Council should ensure sufficient visibility and monitoring of collectability of aged debt. It should periodically report on collectability of aged debt to ensure that aged debtors are escalated to management in a timely manner so that appropriate action can be taken.

Management original response

With effect from 30th September 2016 (Period 6 Monitoring) an aged debtor report will be presented to Cabinet as part of the quarterly budget monitoring reporting cycle.

Owner

Lee Constable (Asset Management Team) & Carl Burke (Principal Accountant – Capital)

Original deadline

September 2016

KPMG's August 2017 assessment

Implemented

A summary report has been developed showing the value of aged debt by financial year for Council Tax, Business Rates and Sundry Debt. This was first reported to Cabinet in quarter 4 of 2016/17.

Follow-up of prior year recommendations (cont.)

Medium priority

5. Accounts payable – purchase orders

Our review of accounts payable, summarised in appendix three, identified a significant number of purchase orders raised after the invoice date. This equated to 43.7% of all payments made by value for which a purchase order was raised. We understand that there are some types of expenditure for which this is permitted e.g. utility bills, grocery orders, emergency orders, and licences and subscriptions. In addition the Council has a process in place whereby subsequent approval can be obtained. However given the significant volume and value the Council should ensure that sufficiently robust procedures and monitoring are in place.

Recommendation

The Council should ensure that within its payment process there is challenge, where appropriate, of spend without purchase orders. Regular analysis and reporting should be produced to enhance compliance with purchasing controls.

Management original response

Actions already taken to reduce occurrence of retrospective purchase orders

- Encouraging use of 'blanket' purchase orders for known spend over a period where appropriate, e.g. utilities, where spend can be receipted against the order as it is made
- Started move of payment methods to direct debit where appropriate, e.g. BT One Bill process, other utilities & licences. This will eliminate the need to raise retrospective purchase orders for these types of service.
- Set up Standing Orders for regular lease payments (not a standard approach, Standing Order used as an exception for this kind of payment).

Additional activity to be carried out

- Communication to all services reminding requisitioners and budget holders of the process to raise purchase orders in advance of receiving the goods/services, supplier to include purchase order number on invoice, receipt the order as the goods/services are received and send invoices immediately to Invoice Management for processing – no need to hold on to invoices within the service.
- Introduction of procurement cards for low value one off spend by individual card holders, and investigate feasibility of moving suppliers from purchase orders/invoice payments to 'embedded cards'.
- Generate report from SBS that includes the date that the purchase order was raised, the date of the invoice and the date of invoice payment – use this as the basis for a programme of identifying and challenging services for non-compliant activity (Financial Systems Team).
- Review of non-compliant invoice process (Financial Systems Team).
- The Council's Financial Regulations & Contract procedure rules are in the process of being re-written. Once these have been approved by Council (Provisional date October 2016) all Council Officers who have responsibility for procurement activity and approval of expenditure on goods and services will have to undergo mandatory procurement training.

Owner

Kate Ashley/Karen Stringer (Procurement Leads) & Mark Morgan (Principal Accountant – Financial Systems Team)

Original deadline

September/October 2016

KPMG's August 2017 assessment

Implemented

Where payment is requested with no pre-existing purchase order is in place the Council has a system in place that requires a form to be attached to identify the reasons for the non-compliance with Financial regulations.

The numbers involved are monitored by the Financial System Team to identify potential problem areas for further monitoring or investigation.

Follow-up of prior year recommendations (cont.)

Medium priority

6. Accounts payable – old invoices

The majority of payments made (against invoices with a purchase order) were paid within 90 days. However, 8.2% were made in excess of 90 days, with 0.6% being paid after a year.

Recommendation

The Council needs to ensure that it maintains oversight of all payments, in particular where such a length of time has passed. Prior to such payments being made the Council should consider if it is appropriate that they are being paid, and if sufficient approval is obtained or should be re-obtained after a certain period of time.

Management original response

Issue arises from

Services receiving invoices into the service areas and not passing them on to Invoice Management for processing in a timely manner.

Invoices being received by Invoice Management with no purchase order – requires Invoice Management staff to chase services for information, but can often result in being passed around to find the right contact.

Actions already taken to reduce payment time

'Open Orders' Report identifies where orders are on hold due to non-receipting/closing by services – issued on a weekly basis to all services, has seen a reduction in number of open orders which in turn has seen a reduction in invoices being unpaid due to non-receipting.

Additional activity to be carried out

Communication to all services reminding requisitioners and budget holders of the process to raise purchase orders in advance of receiving the goods/services, supplier to include purchase order number on invoice, receipt the order as the goods/services are received and send invoices immediately to Invoice Management for processing – no need to hold on to invoices within the service.

Consider feasibility of additional approval for payment of invoices over 90 days old being embedded into SBS system via additional workflow notifications or development of a standard exception report. (Financial Systems Team).

Owner

Kate Ashley/Karen Stringer (Procurement Leads) & Mark Morgan (Principal Accountant – Financial Systems Team)

Original deadline

September 2016

KPMG's August 2017 assessment

Implemented

Monitoring of the receipt of older invoices into procurement is now taking place, to determine why these invoices are already aged debt before they are received, and to identify any problematic suppliers or service area's so the issues can be addressed.

Audit differences

We are required by ISA 260 to report all uncorrected misstatements, other than those that we believe are clearly trivial, to those charged with governance (which in your case is the Audit and Risk Assurance Committee). We are also required to report all material misstatements that have been corrected but that we believe should be communicated to you to assist you in fulfilling your governance responsibilities.

A number of minor amendments focused on presentational improvements have also been made to the 2016/17 draft financial statements.

Adjusted audit differences

The following table sets out the significant audit differences identified by our audit of Sandwell Metropolitan Borough Council's financial statements for the year ended 31 March 2017. It is our understanding that these will be adjusted.

Table 1: Adjusted audit differences

#	Income and expenditure statement	Movement in reserves statement	Assets	Liabilities	Reserves	Basis of audit difference
1	Dr PFI Income £378k Dr PFI Expenditure £7,192k Cr PFI Income £7,570k		Cr PFI Debtors £378k Dr PFI Debtors £7,570k	Cr PFI Creditors £7,192k		The net value of Rowley Campus PFI Income (£378k) was journaled initially. The separate balances for income and expenditure (£7,570k and £7,191k) should have been journaled instead.
2	Cr Investment Income £7,410k	Dr MIRS £7,410k	Dr Available for Sale Financial Assets £7,410k		Cr Unusable Reserves £7,410k	The Birmingham Airport Holdings Limited valuation was released on 24 May 2017 per the Council's planned timetable. As the Council deem this to be a material change it will be adjusted within the financial statements.

Table 2: Unadjusted audit differences

#	Income and expenditure statement	Movement in reserves statement	Assets	Liabilities	Reserves	Basis of audit difference
3	Cr £778k HRA Interest Expenditure	Dr MIRS £778k		Dr £778k HRA Interest Creditor	Cr HRA £778k	The Housing Revenue Account calculation for interest was revised. Interest of £778k had been overcharged.

Materiality and reporting of audit differences

The assessment of what is material is a matter of professional judgement and includes consideration of three aspects: materiality by value, nature and context.

Materiality

Material errors by value are those which are simply of significant numerical size to distort the reader's perception of the financial statements. Our assessment of the threshold for this depends upon the size of key figures in the financial statements, as well as other factors such as the level of public interest in the financial statements.

Errors which are material by nature may not be large in value, but may concern accounting disclosures of key importance and sensitivity, for example the salaries of senior staff.

Errors that are material by context are those that would alter key figures in the financial statements from one result to another – for example, errors that change successful performance against a target to failure.

We used the same planning materiality reported in our External Audit Plan 2016/17, dated January 2017.

Materiality for the Council's accounts was set at £10 million which equates to around 1.1% of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the Audit and Risk Assurance Committee

Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Audit and Risk Assurance Committee any misstatements of lesser amounts to the extent that these are identified by our audit work.

Under *ISA 260*, we are obliged to report omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. *ISA 260* defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.

ISA 450 requires us to request that uncorrected misstatements are corrected.

In the context of the Council, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £0.5 million for the Council.

Where management have corrected material misstatements identified during the course of the audit, we will consider whether those corrections should be communicated to the Audit and Risk Assurance Committee to assist it in fulfilling its governance responsibilities.

Appendix 5

Declaration of independence and objectivity

Auditors appointed by Public Sector Audit Appointments Ltd must comply with the Code of Audit Practice (the 'Code') which states that:

> *"The auditor should carry out their work with integrity, objectivity and independence, and in accordance with the ethical framework applicable to auditors, including the ethical standards for auditors set by the Financial Reporting Council, and any additional requirements set out by the auditor's recognised supervisory body, or any other body charged with oversight of the auditor's independence. The auditor should be, and should be seen to be, impartial and independent. Accordingly, the auditor should not carry out any other work for an audited body if that work would impair their independence in carrying out any of their statutory duties, or might reasonably be perceived as doing so."*

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code, the detailed provisions of the Statement of Independence included within the Public Sector Audit Appointments Ltd Terms of Appointment ('Public Sector Audit Appointments Ltd Guidance') and the requirements of APB Ethical Standard 1 Integrity, Objectivity and Independence ('Ethical Standards').

The Code states that, in carrying out their audit of the financial statements, auditors should comply with auditing standards currently in force, and as may be amended from time to time. Public Sector Audit Appointments Ltd guidance requires appointed auditors to follow the provisions of *ISA (UK&I) 260 'Communication of Audit Matters with Those Charged with Governance'* that are applicable to the audit of listed companies. This means that the appointed auditor must disclose in writing:

- Details of all relationships between the auditor and the client, its directors and senior management and its affiliates, including all services provided by the audit firm and its network to the client, its directors and senior management and its affiliates, that the auditor considers may reasonably be thought to bear on the auditor's objectivity and independence.
- The related safeguards that are in place.
- The total amount of fees that the auditor and the auditor's network firms have charged to the client and its affiliates for the provision of services during the reporting period, analysed into appropriate categories, for example, statutory audit services, further audit services, tax advisory services and other non-audit services. For each category, the amounts of any future services which have been contracted or where a written proposal has been submitted are separately disclosed. We do this in our Annual Audit Letter.

Appointed auditors are also required to confirm in writing that they have complied with Ethical Standards and that, in the auditor's professional judgement, the auditor is independent and the auditor's objectivity is not compromised, or otherwise declare that the auditor has concerns that the auditor's objectivity and independence may be compromised and explaining the actions which necessarily follow from this. These matters should be discussed with the Audit Committee.

Ethical Standards require us to communicate to those charged with governance in writing at least annually all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place that, in our professional judgement, may reasonably be thought to bear on our independence and the objectivity of the Engagement Lead and the audit team.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP Audit Partners and staff annually confirm their compliance with our Ethics and Independence Manual including in particular that they have no prohibited shareholdings.

Our Ethics and Independence Manual is fully consistent with the requirements of the Ethical Standards issued by the UK Auditing Practices Board. As a result we have underlying safeguards in place to maintain independence through: Instilling professional values, Communications, Internal accountability, Risk management and Independent reviews.

We would be happy to discuss any of these aspects of our procedures in more detail.

Auditor declaration

In relation to the audit of the financial statements of Sandwell Metropolitan Borough Council for the financial year ending 31 March 2017, we confirm that there were no relationships between KPMG LLP and Sandwell Metropolitan Borough Council, its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

Appendix 5

Declaration of independence and objectivity (cont.)

Non-audit work and independence

Below we have listed the non-audit work performed and set out how we have considered and mitigated (where necessary) potential threats to our independence.

Summary of non-audit work		
Description	**Fee**	**Potential threat to auditor independence and associated safeguards in place**
IR35 workshop	£4,250	Our tax team facilitated a workshop for the Council on processes to prepare for the implementation of the IR35 legislation from April 2017. **Self-interest:** This engagement is entirely separate from the audit through a separate contract, engagement team and lead partner. In addition, the audit fee scale rates were set independently to KPMG by the PSAA. Therefore, the proposed engagement will have no perceived or actual impact on the audit team and the audit team resources that will be deployed to perform a robust and thorough audit. **Self-review:** The nature of this work is to highlight robust processes required to comply with the legislation. There was no review of individual data or assessments made. Therefore, it does not impact on our opinion and we do not consider that the outcome of this work will be a threat to our role as external auditors. The existence of a separate team for this work is a further safeguard. Consequently, we consider we have appropriately managed this threat. **Management threat:** This work will be advice and support only. All decisions will be made Council. **Familiarity:** This threat is limited given the scale, nature and timing of the work. The existence of the separate team for this work is the key safeguard. **Advocacy:** We did not act as advocates for the Council in any aspect of this work. **Intimidation:** Not applicable
Grant Certification	£9,000	We carry out certification work on the Teachers Pension, and Pooling of Housing Capital Receipts returns. **Self-interest:** This engagement is performed under a separate engagement letter and following an externally specified work program. The proposed engagement will have no perceived or actual impact on the audit team and the audit team resources that will be deployed to perform a robust and thorough audit. **Self-review:** The financial information included in the grant claim submissions is not extracted from the financial statements, but is compiled separately. The work is undertaken at various points throughout the year and is not linked to the financial statements reporting process. Therefore, it does not impact on our opinion and we do not consider that the outcome of this work will be a threat to our role as external auditors. **Management threat:** This work will be advice and support only. All decisions will be made Council. **Familiarity:** This threat is limited given the scale, nature and timing of the work. **Advocacy:** We will not act as advocates for the Council in any aspect of this work. **Intimidation:** Not applicable
Total fees	£13,250	
Total fees as a percentage of the external audit fees	6.6%	

Audit fees

Audit fees

As communicated to you in our External Audit Plan 2016/17, our scale fee for the audit was £198,878 plus VAT *(£198,878 in 2015/16*). The scale fee is set by Public Sector Audit Appointments Limited and is based on the scale fee for the previous year. Subsequent variations to scale fee are expected fee to occur where the auditor's assessment of risk and complexity change. We have undertaken additional work to address the risks identified as part of our updated risk assessment including work undertaken in relation to the CIES restatement, triennial pension revaluation and VFM risks.

Our work on the certification of Housing Benefits (BEN01) is due to report by November 2017. The planned fee for this is £14,340 plus VAT. Planned fees for other grants and claims which do not fall under the PSAA arrangements are £9,000 plus VAT (£8,000 in 2016/17).

PSAA fee table

Component of audit	2016/17 *(planned fee)* £	2015/16 *(actual fee)* £
Accounts opinion and use of resources work		
PSAA scale fee	198,878	198,878
Additional work to address the additional risks and work arising from our risk assessment (note 1)	TBC	-
Additional work to respond to objections and matters brought to our attention (note 1)	TBC	8,637
Subtotal	**[X]**	**207,515**
Housing benefits (BEN01) certification work		
PSAA scale fee	14,340	16,129
Total fee for the Council	**213,218**	**223,644**

All fees are quoted exclusive of VAT.

Note 1: Accounts opinion and use of resources work

For 2016/17, we are in the process of agreeing our final fees with the S151 officer. This is still subject to PSAA determination.