External Audit ISA260 Report 2017/18

Sandwell Metropolitan Borough Council

October 2018

Summary for Audit and Risk Assurance Committee

This document summarises the key findings in relation to our 2017/18 external audit at Sandwell Metropolitan Borough Council ('the Council').

This report covers our final on-site work which was completed in May, June and July 2018 on the Council's significant risk areas, as well as other areas of your financial statements.

Financial statements

Subject to all outstanding queries being resolved to our satisfaction we anticipate issuing an unqualified audit opinion on the Council's financial statements.

Based upon our initial assessment of risks to the financial statements (as reported to you in our *External Audit Plan 2017/18* and updated during our audit) we identified the following significant risks (excluding those mandated by International Standards on Auditing – see page 7):

— **Valuation of PPE –** We have considered the approach the Council has adopted to assess the risk that assets not subject to valuation in year are appropriately stated. The Council has put through an adjustment of £70m to reflect the movement in market indices between the revaluation date (1 April 2017) and the year-end. In addition we have considered the Council's Beacon approach to valuation of Council Dwellings and noted a number of areas where we believe the Council has not fully followed the guidance (see Appendix 1).

— **Pensions Liabilities –** We have considered controls in place at the Council and at the Fund and noted no issues. We have reviewed the appropriateness of key assumptions used in the valuation and consider that overall they are balanced (see page 12, Judgements for further analysis). In addition we have reviewed the accounting treatment of the in-year early deficit contribution of £50.8m made by the Council to the Fund, noting a required adjustment which has been processed by the Council. We also note a required adjustment to reflect the pension asset value when calculated using the actual rate of return (compared to the estimated rate originally used).

— **Faster Close** – The timetable for the production of the financial statements has been significantly advanced with draft accounts having to be prepared by 31 May 2018 (30 September-2017). This has been a contributing factor to a challenging year end process. We have noted a number of areas where we believe the Closedown process can be strengthened (see Appendix 1).

We have identified 6 audit adjustments. These adjustments are set out within Appendix 3.

This year has been a challenging closedown and audit process, for a number of reasons as set out later on in this report. Based on our work, we have raised 11 recommendations. Details of our recommendations can be found in Appendix 1.

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Summary for Audit and Risk Assurance Committee (cont.)

Value for money arrangements

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, with the exception of Children's services, the Council has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

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

The Ofsted re-inspection of the Council's Children's services in November 2017 concluded that services remained inadequate and the effectiveness of some services had deteriorated. As such, consistent with our conclusion in 2016/17, for Children's services the Council did not have proper arrangements for informed decision making and sustainable resource deployment.

See further details in Section two: Value for Money arrangements.

Exercising of audit powers

We have a duty to consider whether to issue a report in the public interest about something we believe the Council should consider, or if the public should know about.

We have not identified any matters that would require us to issue a public interest report.

In addition, we have not had to exercise any other audit powers under the Local Audit & Accountability Act 2014.

Acknowledgements

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

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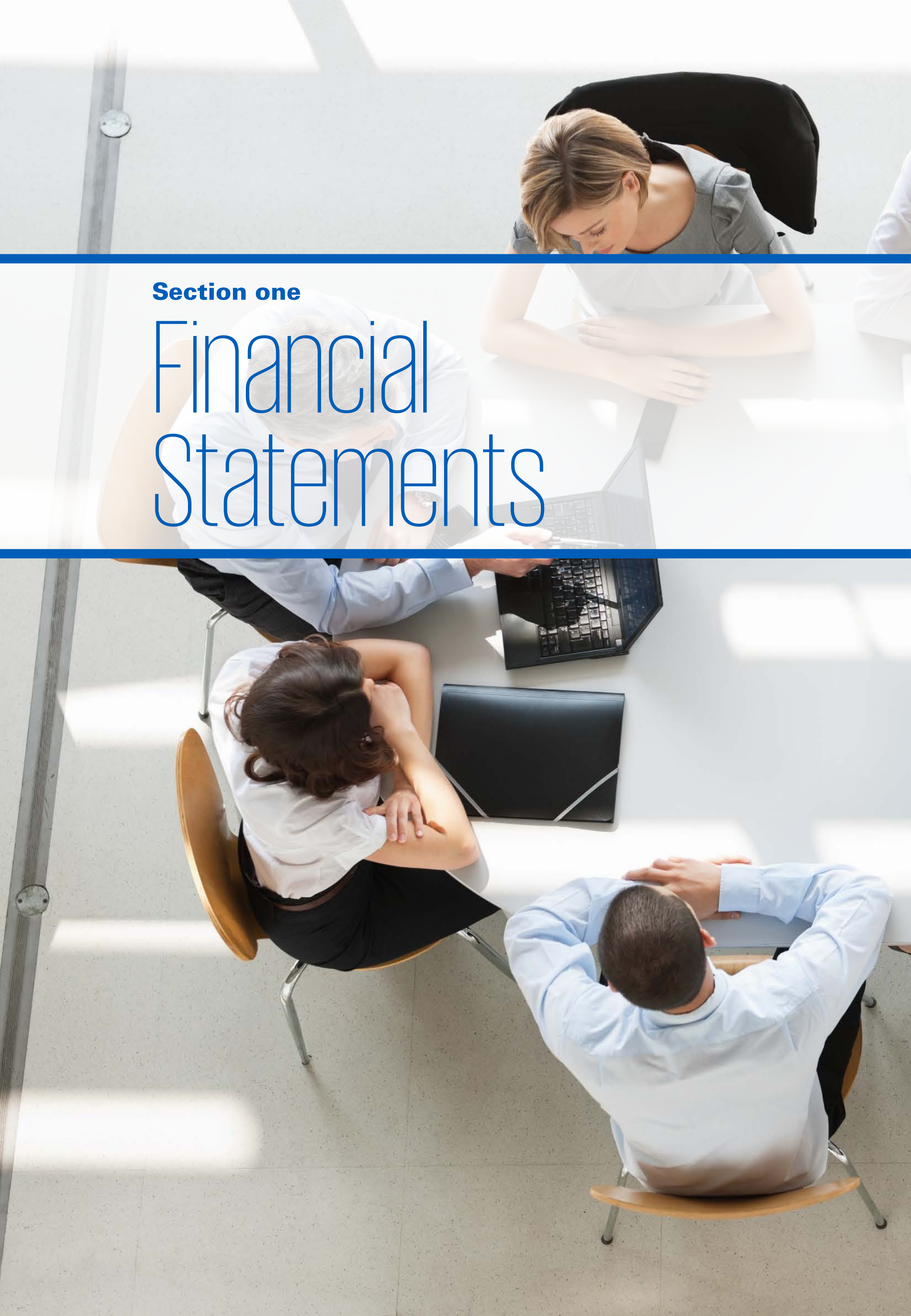

Section one

Financial Statements

Accounts production and audit process

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.

Overall we consider that the Council's overall process for the preparation of the financial statements is adequate, but have raised a number of recommendations where we believe the process needs to be improved.

The Council has implemented the majority of the recommendations in our ISA 260 Report 2016/17, this is set out in further detail in Appendix 2.

Accounts practices and production process

This has been a challenging accounts production and audit process for a number of reasons. The earlier closedown deadlines of 31 May and 31 July inevitably have created additional pressure on the whole team, made more difficult in the context of a number of key staff departures around the year end and the resource requirement for the establishment of the Children's Trust which went live on 1 April 2018.

We have noted a number of key financial processes and controls that we do not believe to have been operating effectively in the run up to the year-end, most notably the bank reconciliations (see Appendix 1 for our summary of control issues and recommendations). In addition issues have arisen as part of the closedown process, including in relation to the posting of journals (resulting in some duplication) and identification of accruals by staff outside the Central Finance team.

Discrete areas such as the Council's five yearly Beacon Valuation and accounting for the early pension contribution have both proved complex, and have required a great deal of staff time and input to resolve.

These factors have all contributed to delays and placed additional pressures on the audit.

Despite these challenges we are pleased to report on how responsive staff have been throughout the audit process, as well as the assistance provided by the team to help resolve requests and matters arising on a timely basis.

Going concern

The financial statements of the Council have been prepared on a going concern basis. We confirm that we have identified no significant matters which would, in our view, affect the ability of the Council to continue as a going concern.

Implementation of recommendations

We raised seven recommendations in our ISA 260 Report 2016/17. The Council has now implemented the majority of the recommendations relating to the financial statements in line with the timescales of the action plan. These recommendations are set out in detail in Appendix 2.

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Accounts production and audit process (cont.)

Completeness of draft accounts

We received a set of draft accounts on 30 May 2018 which was in advance of the statutory deadline.

Quality of supporting working papers

In the majority of cases working papers provided were to a good standard. A small number of exceptions were raised with management and relate to areas referred to in Appendix 1.

Response to audit queries

As previously stated, we are pleased to report on how responsive staff have been throughout the audit process, as well as the assistance provided by the team to help resolve requests and matters arising on a timely basis.

Findings in relation to the Council's control environment for key financial systems

We have set out our findings, resulting from out testing of the Council's controls, as recommendations in Appendix 1.

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Specific audit areas

We anticipate issuing an unqualified audit opinion on the Council's 2017/18 financial statements by 31 July 2018. 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.

Auditing standards require us to consider two standard risks for all organisations. We consider these as a matter of course in our audit and will have set out the findings arising from our work in our ISA 260 Report below.

01

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.

02

Fraudulent 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 2017/18* 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.

Over the following pages we have set out our assessment of the specific significant risks and areas of audit focus we identified in relation to the audit of the Council's financial statements.

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Specific audit areas

Significant Audit Risks

Those risks requiring specific audit attention and procedures to address the likelihood of a material financial statement error in relation to the Council.

Risk:

Valuation of PPE

The Code requires that where assets are subject to revaluation, their year end carrying value should reflect the appropriate fair value at that date. The Council has adopted a rolling revaluation model which sees all land and buildings revalued over a five year cycle. As a result of this, however, individual assets may not be revalued for four years.

This creates a risk that the carrying value of those assets not revalued in year differs materially from the year-end fair value. In addition, as the valuation is undertaken as at 1 April 2017, there is a risk that the fair value is different at the year-end (31 March 2018).

Update:

A full valuation of the Council's Council Dwellings was undertaken in 2017/18. A full valuation is performed every 5 years, with desktop valuations performed in the interim.

Our assessment and work undertaken:

We have:

- reviewed the approach that the Council adopted to assess the risk that assets not subject to valuation were materially misstated and considered the robustness of that approach;
- considered movements in market indices between revaluation dates and the year-end in order to determine whether these indicate that fair values had moved materially over that time. As a result of this review an audit adjustment has been raised and put through by the Council to reflect the £70m increase in asset valuation since 1 April 2017 arising as a result of increases in the BCIS (Building Cost Information Service) indices provided by the valuer;
- assessed the valuer's qualifications, objectivity and independence to carry out such valuations and reviewed the methodology used (including testing the underlying data and assumptions).

In addition to the above we have also:

- reviewed the timing of valuations performed by the Council over previous years to ensure that all assets within the scope of the Council's five year rolling re-valuation have been revalued within the last five years;
- reviewed the approach taken by the Council as part of their full Beacon valuation. We have raised a recommendation where we feel the Council's compliance with the guidance could be improved (see Appendix 1).

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Specific audit areas (cont.)

Significant Audit Risks

Risk:

Pension Liabilities

The net pension liability represents a material element of the Council's balance sheet. The Council is an admitted body of West Midlands Pension Fund, which had its last triennial valuation completed as at 31 March 2016. This forms an integral basis of the valuation as at 31 March 2018.

The valuation of the Local Government Pension Scheme relies on a number of assumptions, most notably around the actuarial assumptions, and actuarial methodology which results in the Council's overall valuation.

There are financial assumptions and demographic assumptions used in the calculation of the Council's valuation, such as the discount rate, inflation rates, mortality rates etc. The assumptions should also reflect the profile of the Council's employees, and should be based on appropriate data. The basis of the assumptions is derived on a consistent basis year to year, or updated to reflect any changes.

There is a risk that the assumptions and methodology used in the valuation of the Council's pension obligation are not reasonable. This could have a material impact to net pension liability accounted for in the financial statements.

Our assessment and work undertaken:

We have:

- reviewed the controls that the Council has in place over the information sent directly to Barnett Waddingham, the scheme actuary;
- liaised with the auditors of the Pension Fund in order to confirm the effectiveness of those controls operated by the Pension Fund;
- evaluated the competency, objectivity and independence of the scheme actuary;
- reviewed the appropriateness of the methodology and key assumptions included within the valuation, and compared them to expected ranges with the assistance of our KPMG Actuary;
- considered the disclosure implications in the financial statements.

We have not identified any issues as a result of this work. We have set out our view of the assumptions used in valuing pension assets and liabilities at page 12.

We note one audit adjustment in relation to the accounting for the early pension deficit (made by the Council so as to receive a saving in its overall contributions over the current and next two years) payment which is set out in Appendix 3.

We also note an audit adjustment in relation to a correction required to pension assets due to difference arising between estimated asset value currently disclosed in the accounts and Council's share of actual assets, set out in Appendix 3.

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Specific audit areas (cont.)

Significant Audit Risks

Risk:

Faster Close

In prior years, the Council has been required to prepare draft financial statements by 30 June and then final signed accounts by 30 September. For years ending on and after 31 March 2018 however, revised deadlines apply which require draft accounts by 31 May and final signed accounts by 31 July.

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. During 2016/17, the Council continued to prepare for these revised deadlines and advanced its own accounts production timetable so that draft accounts were ready by 5 June 2017. This put the Council in a good position to meet the new 2017/18 deadline. Nonetheless, there is scope to improve the process further to ensure that the statutory deadlines for 2017/18 are met.

In order to meet the revised deadlines, the Council may need to make greater use of accounting estimates. In doing so, consideration will need to be given to ensuring that these estimates remain valid at the point of finalising the financial statements. In addition, there are a number of logistical challenges that will need to be managed. These include:

- Ensuring that any third parties involved in the production of the accounts (e.g. valuers, actuaries) are aware of the revised deadlines and have made arrangements to provide the output of their work in accordance with this;
- Revising the closedown and accounts production timetable in order to ensure that all working papers and other supporting documentation are available at the start of the audit process;
- Ensuring that the Audit and Risk Assurance Committee meeting schedules have been updated to permit signing in July; and
- Applying a shorter paper deadline to the July meeting of the Audit and Risk Assurance Committee meeting in order to accommodate the production of the final version of the accounts and our ISA 260 report.

In the event that the above areas are not effectively managed there is a significant risk that the audit will not be completed by the 31 July deadline.

There is also an increased likelihood that the Audit Certificate (which confirms that all audit work for the year has been completed) may be issued separately at a later date if work is still ongoing in relation to the Council's Whole of Government Accounts return. This is not a matter of concern and is not seen as a breach of deadlines.

Our assessment and work undertaken:

We liaised with officers in preparation for our audit in order to understand the steps that the Council was taking to ensure it met the revised deadlines. We also advanced audit work into the interim visit in order to streamline the year-end audit work.

We have set out a summary of the challenges and issues that arose as part of the accounts production and audit process on page 4, and our recommendations set out in Appendix 1.

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Specific audit areas (cont.)

Other areas of audit focus

Those risks with less likelihood of giving rise to a material error but which are nevertheless worthy of audit understanding.

Issue:	**Formation of a separate entity in response to the Statutory Direction to form a Children's Services Trust** 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. A Memorandum of Understanding was agreed by the Cabinet in December 2016. The Sandwell Children's Social Care Trust was incorporated on 15 February 2017, with activity expected to transfer from the Council effective from 1 April 2018. The formation of a new legal entity will have implications for both accounting and tax treatment.
Our assessment and work undertaken:	We have liaised with management throughout the year to understand the plans and timetable for establishing the Children's Services Trust. Delivery of Children's Services transferred to the Trust on 1 April 2018. As a result there have been minimal accounting implications in 2017/18, but we expect the Council to re-evaluate its group boundary in 2018/19 to consider whether it has to produce group accounts.

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Judgements

We have considered the level of prudence within key judgements in your 2017/18 financial statements and accounting estimates. We have set out our view below across the following range of judgements.

Level of prudence

0	1	2	3	4	5	6
Audit Difference	Cautious		Balanced		Optimistic	**Audit Difference**
			Acceptable Range			

Subjective area	2016-17	2017-18	Commentary
Provisions (excluding Business Rates)	3	3	Current provisions primarily comprise Insurance, Collection Fund Provisions for NDR, and Termination Benefits. The main drivers for the decrease in provisions are the £1.85m decrease in termination benefits for staff expected to depart in the next year, offset to some extent by the increase in the Council's Collection Fund Provisions of £1.42m. We consider the provision disclosures to be proportionate, but note that exit packages and staff departures continue to have a large financial impact.
Accruals de minimis level	3	4	The Council has continued to utilise its de minimis accruals levels (£1,000 for revenue items and £10,000 for capital) in response to the shorter closedown period. We have previously engaged with management, who performed an assessment based on the prior year numbers on introduction of this change, in order to understand the impact of raising the threshold, and we were satisfied that the change in policy would not have created a material change. We have however noted one audit adjustment directly related to the Council's accruals process for larger items, set out in Appendix 3.
Property Plant & Equipment: HRA Assets	3	4	The Council continues its use of the beacon methodology in line with the DCLG's Stock Valuation for Resource Accounting. The latest version of this guidance was published in November 2016, and incorporated a number of changes to the Beacon Approach. We have noted a number of areas where we believe compliance with the Beacon guidance could be improved, which are set out in Appendix 1. In relation to its non-HRA assets the Council has utilised external expertise to provide valuation estimates. We have reviewed the valuation approach. We noted one adjustment to reflect the increases in indices for assets valued at depreciated replacement cost which has been set out in Appendix 3.

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Judgements (cont.)

<table>
<tr><th>Subjective area</th><th>2016-17</th><th>2017-18</th><th>Commentary</th></tr>
<tr><td>Valuation of pension assets and liabilities</td><td>3</td><td>3</td><td>
<p>The Council continues to engage Barnett Waddingham to provide actuarial valuations in relation to the assets and liabilities recognised as a result of participation in the Local Government Pension Scheme. Due to the overall value of the pension assets and liabilities, small movements in the assumptions can have a significant impact on the overall valuation.</p>
<p>The actual liability assumptions adopted by the Actuary fell within our expected ranges as set our below:</p>
<table>
<tr><th>Assumption</th><th>Actuary Value</th><th>KPMG Range</th><th>Assessment</th></tr>
<tr><td>Discount rate</td><td>2.55%</td><td>2.51%</td><td>3</td></tr>
<tr><td>Pension Increase Rate</td><td>2.30%</td><td>2.15%</td><td>2</td></tr>
<tr><td>Salary Increases</td><td>CPI plus 1.5%</td><td>CPI plus 0% to 2.0%</td><td>3</td></tr>
<tr><td>Life expectancy at retirement:
Males currently aged 45 / 65
Females currently aged 45 / 65</td><td>
24.0/21.9
26.6/24.3</td><td>
23.5/22.1
25.4/23.9</td><td>2</td></tr>
</table>
<p>The valuation of pension assets as included in the Council’s draft accounts was calculated using actual return on assets from April 2017 to February 2018, and estimated returns for March 2018. We have compared the estimated return to the actual returns for March 2018, and noted that the use of the estimated return understated the Council’s pension assets by £41,331,000 (see Appendix 3). This was corrected in the final accounts.</p>
</td></tr>
</table>

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Proposed opinion and audit differences

Subject to all outstanding queries being resolved to our satisfaction, we anticipate issuing an unqualified audit opinion on the Council's 2017/18 financial statements following approval of the Statement of Accounts by the Audit and Risk Assurance Committee.

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 this year's audit was set at £10 million. Audit differences below £0.5 million are not considered significant.

Our audit identified a total of 5 significant audit differences, which we set out in Appendix 3. It is our understanding that these will be adjusted in the final version of the financial statements.

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 Authority Accounting in the United Kingdom 2017/18 ('the Code'). We have set out details of significant presentational adjustments in Appendix 3. We understand that the Council will be addressing these where significant.

We are in the process of concluding our checks on the latest version of the Statement of Accounts received on 19 July.

Annual Governance Statement

We have reviewed the Council's 2017/18 Annual Governance Statement and confirmed that:

- It is not misleading and is consistent with other information we are aware of from our audit of the financial statements.

Narrative Report

We have reviewed the Council's 2017/18 Narrative Report and have confirmed that it is consistent with the financial statements and our understanding of the Council. As part of this review we noted a small number of areas where the report could be strengthened, and brought more in line with the Code and best practice as set out by the Accounting Standards Board. These comments have been reflected in the final draft.

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Completion

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Council's 2017/18 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 2018, 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.

We have provided a detailed declaration in Appendix 6 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 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 judgement, 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 others matters which we wish to draw to your attention in addition to those highlighted in this report or our previous reports relating to the audit of the Council's 2017/18 financial statements.

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Section two

Value for Money Arrangements

Specific value for money risk areas

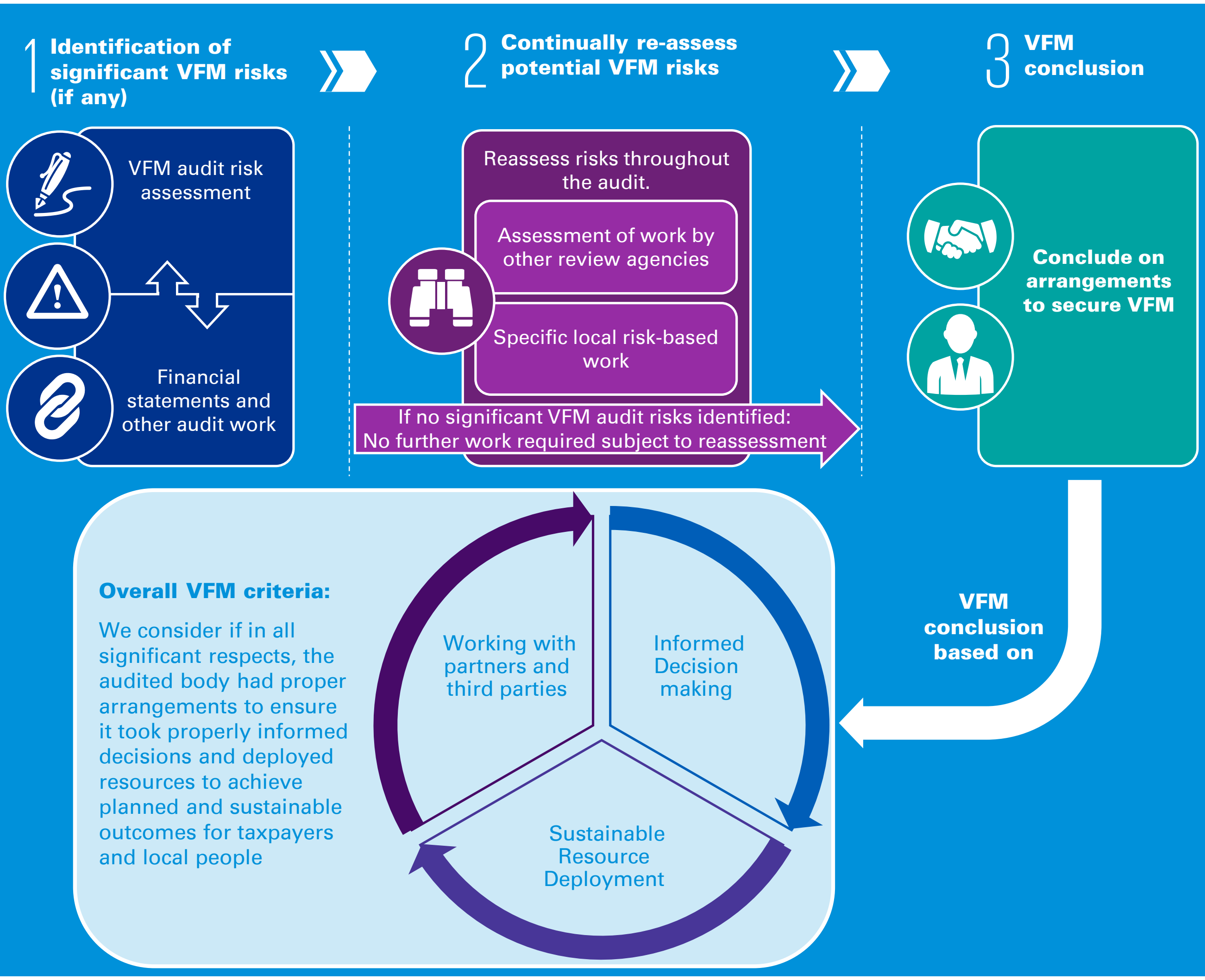
Our 2017/18 VFM conclusion considers whether the Council had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

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.

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.'

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)**

2 **Continually re-assess potential VFM risks**

3 **VFM conclusion**

VFM audit risk assessment

Financial statements and other audit work

Reassess risks throughout the audit.

Assessment of work by other review agencies

Specific local risk-based work

If no significant VFM audit risks identified: No further work required subject to reassessment

Conclude on arrangements to secure VFM

VFM conclusion based on

Overall VFM criteria:

We consider if in all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people

Working with partners and third parties

Informed Decision making

Sustainable Resource Deployment

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Specific value for money risk areas (cont.)

The table below summarises our assessment of the individual VFM risks identified against the three sub-criteria. This directly feeds into the overall VFM criteria and our value for money opinion.

Applicability of VFM Risks to VFM sub-criteria

VFM Risk	Informed decision making	Sustainable resource deployment	Working with partner and third parties
Delivery of budgets	✓	✓	✓
Children's services	×	×	

In consideration of the above, we have concluded that in 2017/18, with the exception of 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.

In reaching our conclusion, we have continued to consider the findings of inspectorates in respect of Children's Services, in particular the re-inspection in November 2017 that concluded that services remained inadequate and the effectiveness of some services had deteriorated.

We concluded that for Children's Services, for the year ended 31 March 2018, the Council did not have proper arrangements for informed decision making and sustainable resource deployment.

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Specific value for money risk areas (cont.)

As communicated to you in our *External Audit Plan 2017/18* we have identified two risks requiring specific audit attention and procedures to address the likelihood that proper arrangements are not in place to deliver value for money.

We have provided below a summary of the risk areas identified, our work undertaken and the conclusions reached.

Risk:

Delivery of budgets

The Council operates a multi-year rolling budget planning process. Services delivered reported savings of £20.8m in 2016/17 and are expected to deliver a further £16.7m of savings in 2017/18. It is expected that a further £16.6m of savings will be required by 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.

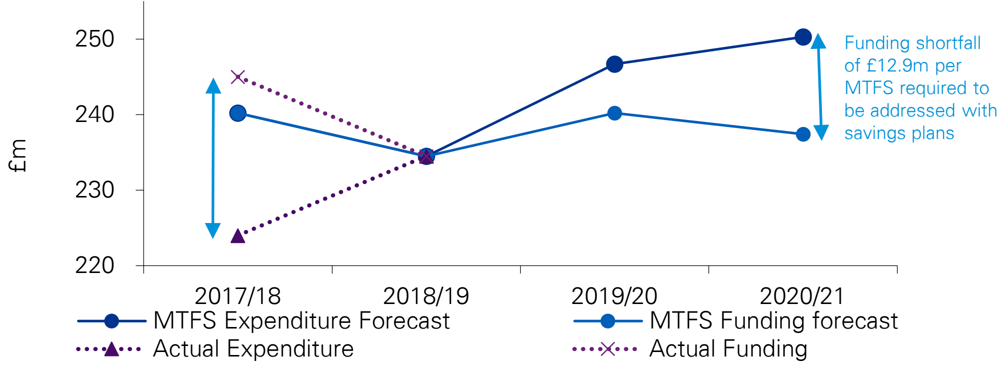
The need for savings will continue to have a significant impact on the Council's financial resilience.

Our assessment and work undertaken:

We have reviewed the controls the Council has in place to ensure financial resilience, specifically that the Medium Term Financial Strategy has duly taken into consideration factors such as funding reductions, salary and general inflation, demand pressures, restructuring costs and sensitivity analysis given the degree of variability in the above factors.

Like most of local government, the Council faces a challenging future driven by funding reductions and an increase in demand for services. In particular, the Council has faced ongoing pressures around the delivery of Adult Social Care and Children's Safeguarding due to continued pressures on both volume and unit costs.

The Council has reported a General Fund balance increase for 2017/18 of £4m to £75.2m and has delivered savings of £13m. This follows delivery of savings of £23m in 2015/16 and £24m overall in 2016/17. As a result of the Council's savings delivery, the Council has exceeded its 2017/18 outturn forecast within its Medium Term Financial Strategy 2018-2021. This provided for a balanced budget but funding of £245m exceeded net expenditure of £224m as set out below.



Funding shortfall of £12.9m per MTFS required to be addressed with savings plans

Source: Council Medium Term Financial Strategy and Financial Outturn 2017/18

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Specific value for money risk areas (cont.)

Significant VFM Risks

Our assessment and work undertaken:

Delivery of Budgets

We have considered how the Council has ensured informed decision making through reporting of financial information to Cabinet and Council. Through review of papers and discussions with officers we have also obtained an understanding of the key assumptions made within the 2018/19 budget, as well as considering the appropriateness of those assumptions.

The budget includes pay increase assumption of 2.7% for 2018/19 and 2019/20, which is in excess of the national pay award to reflect changes in spinal points and the impact of the National Living Wage.

The Council, as outlined in the Medium Term Financial Strategy 2018/19 to 2020/21 report presented to Cabinet on 28 February 2018, will seek to raise additional revenue through a council tax increase of 4.99% in 2018/19, reducing to 3.99% in 2019/20 and 2.99% in 2020/21. This increase by itself will not offset the funding reductions imposed elsewhere. We note that any increase in council tax has a compounding effect on the Council revenue in future years as further annual increases are applied.

Local authorities do not know what their overall funding settlement will be from 2020/21 onwards. This presents yet another unknown in already uncertain times in the wider economy as the UK prepares to leave the European Union. The Council's current strategy has been to try and maintain strong reserves, but clearly this has presented a challenge given the pressure caused by successive funding reductions that have occurred since 2010/11. The Council has maintained strong reserves, but in the absence of future funding security reliance. on drawing down reserves and other methods such as borrowing would not be a sustainable option.

Decisions about future local authority funding are expected from Government. This includes how much local business rates an authority can keep and how local business rates will be distributed in the future (currently being looked at as part of the Fair Funding Review), as well as proposals for long-term and sustainable solutions for adult social care. The timing of when such decisions will be made is unclear but is unlikely to take place until 2019 as part of the next Spending Review which will set the total amount of government funding available for local authorities.

Without such funding increasingly difficult decisions around savings plans will continue, including looking at the ways in which services are delivered. Further consideration may need to be given to potential income generating activities and associated risks.

Our 2017/18 VFM conclusion, as stated on page 16, has considered 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, as well as how the Council worked with partners and third parties.

We concluded that proper arrangements were in place during the year, however we note that in the absence of any clarity over future funding arrangements and sources of revenue, for the Council to continue to demonstrate that it has been able to make proper arrangements in the medium term will be an increasing challenge.

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Specific value for money risk areas (cont.)

Significant VFM Risks

Risk:

Children's Services

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. 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.

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 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'. As a consequence we reported that we had reached an 'except for' Value for Money conclusion.

This risk is related to the following Value For Money sub-criterion

— Informed decision making;

— Sustainable resource deployment.

Our assessment and work undertaken:

We have reviewed the Commissioner and Ofsted's findings along with those of other regulatory bodies and have considered action taken by the Council in response to these findings, and Statutory Direction.

The Council received a re-inspection in November 2017. The report received in January 2018 concluded that the overall provision of children's services at the Council were inadequate. It reported that:

— Since the last inspection, some services had deteriorated, in particular services for children looked after and adoption;

— Most of the recommendations from the Ofsted 2015 inspection had not been fully met and some services had declined in effectiveness; and

— The pace of change to address service deficits had been too slow.

The Council has responded to the Government Statutory Direction under section 479A of the Education Act 1996 to set up a new arrangement in the form of Sandwell Children's Trust to deliver Children's services and this commenced on 1 April 2018.

The most recent Ofsted monitoring visit to the new Sandwell Children's Trust in May 2018 has reported that the Trust has made a positive start to improve services for children and young people in Sandwell, with a renewed energy and determination to improve services for children and families in the Borough. It does however draw out since its previous re-inspection there has been a lack of urgency to develop partnership working in the Borough and long standing barriers remain such as the instability of the workforce.

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 requirement of the sub-criteria relating to 'informed decision making' and 'sustainable resource deployment'.

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Appendices

Appendix 1:

Key issues and recommendations

Our audit work on the Council's 2017/18 financial statements has identified 11 issues. We have listed these issues in this appendix together with our recommendations which we have agreed with Management. 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 have given each recommendation a risk rating and agreed what action management will need to take.

Priority Rating for Recommendations

1	**Priority One:** 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.	2	**Priority Two:** 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.	3	**Priority Three:** Issues that would, if corrected, improve the internal control in general but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.

The following is a summary of the issues and recommendations raised in the year 2017/18.

Priority	Total
High	**5**
Medium	**5**
Low	**1**
Total	**11**

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Key issues and recommendations (cont.)

No.	Risk	Issue & Recommendation	Management Response
1	1	***Performance of bank reconciliations*** During the latter part of the year bank reconciliations were not performed on a timely basis. When we started our year-end visit, the December reconciliation was still in being completed. When we received the March reconciliation we would consider it not to have been performed effectively due to the fact that there were duplicate postings that were not identified. We note that the bank reconciliation process currently followed by the Council is complex. ***Risk*** Not completing the bank reconciliation on a timely basis can, and has, led to errors occurring and not being identified until the year end audit. ***Recommendation*** Management should ensure that bank reconciliations are completed and reviewed on a monthly basis. Management should review the current process for performing bank reconciliations to identify if it can be made more efficient, whilst still providing the same assurance.	*Current process to be reviewed, with a view to rationalise and streamline, whilst maintaining the same level of assurance.* ***Responsible Officer*** *Rebecca Duffield - Revenue Principal Accountant, reporting to Clare Sandland - Strategic Finance Manager* ***Implementation Deadline*** *31st October 2018*
2	1	***Unrecorded liabilities & cut off procedure*** As part of out audit testing over cut off, we identified that an amount of £1.64m in relation to construction invoices had not been accrued for. Enquires as to the root cause of this error identified that it had occurred due to a lack of understanding as to the budgetary and closedown processes by individuals outside of the Central Finance team, who had been aware of the amount and timing but not of the requirement to accrue. ***Risk*** Where the accruals process is not properly followed or understood there is a risk that transactions are recorded in the incorrect period resulting in incorrect information being produced for the budgetary monitoring process, and errors occurring in the year end accounts. ***Recommendation*** Management should refresh financial training, and circulation of guidance to the wider team involved in the closedown process to ensure that they understand what is required. Also see recommendation 11 review of closedown process.	*Budget Holder training to be undertaken, as well as training of all staff involved in the procurement process. Council wide communications to be sent.* ***Responsible Officer*** *Darren Carter - Section 151 Officer & Director of Resources, supported by Rebecca Griffiths - Head of Finance* ***Implementation Deadline*** *31st March 2019*

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Key issues and recommendations (cont.)

No.	Risk	Issue & Recommendation	Management Response
3	1	***Review of closedown /period 13 journals*** Our audit misstatements included duplicate creditor postings and errors with the pension early payment journals. These issues could have been identified by a more robust journal review process. ***Risk*** There is a risk of incorrect journal postings being made and those postings not being identified, particularly during the closedown period where less typical and routine postings are being made. ***Recommendation*** Management should review their journal review process, in particular around period 13 journals made as part of the close-down process. This could include analysis of all journal postings made during this period and an assessment of which of those should be reviewed in more detail.	*All P13 journals to be reviewed and authorised by a Principal Accountant before being input and posted. All P13 journals processed after 31st May 2019 to be reviewed and authorised by a Service Manager before being input and processed. Daily/weekly reports to be run by the Financial Systems Team and checked to ensure review and authorisation is in place (for all P13 journals).* ***Responsible Officer*** *All Principal Accountants and Service Managers within Finance. Led by Rebecca Griffiths - Head of Finance, supported by Rozina Hussein - Financial Systems Principal Accountant* ***Implementation Deadline*** *31st May 2019*
4	1	***School closedown process and accruals completeness*** Similarly to item 3, issues were identified that had arisen from the schools closedown and accruals process. This included lack of review of journals and a consolidation approach which lead to duplicate journals. In addition the approach taken around use of estimates, and schools unpresented cheques resulted in a substantial amount of work to audit the schools bank balances. ***Risk*** There is a risk of incorrect postings being made and those postings not being identified, particularly during the closedown period where less typical and routine postings are being made. ***Recommendation*** Management should review their schools close-down process, in particular around the use of estimates, unpresented cheques and school bank account reconciliations.	*Review to be undertaken, action plan to be drafted, agreed and implemented.* ***Responsible Officer*** *Rose Kerr - Schools Principal Accountant, reporting to Steve Lilley - Finance Service Manager* ***Implementation Deadline*** *Review by 30th November 2018, implement by 31st May 2019*

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Appendix 1:

Key issues and recommendations (cont.)

No.	Risk	Issue & Recommendation	Management Response
5	1	***Valuation of Council Dwellings*** Incorrect guidance was initially used to perform the beacon valuation (in line with 2010 rather than 2016 guidance) so the wrong approach was followed. The new guidance places much greater emphasis on senior staff (e.g. CFO level) involvement at the start of the process and documentation of judgements, but as the new guidance wasn't initially followed this wasn't identified so had to be performed retrospectively. Certain key stages of the approach remain where we feel improvements could be made. ***Risk*** Where guidance is not followed there is a risk that the valuation performed is not suitably precise. Retrospective review takes away a lot of the opportunity to direct how the valuation is performed. In addition it can take a long time to complete adding delays to the audit process. ***Recommendation*** Management should ensure that all key guidance is followed, and that checks are made for updated guidance on a timely basis. Management should undertake a review of the guidance to identify areas where improvements can be made.	*Review to be undertaken, improvements to be recommended.* ***Responsible Officer*** *Darren Carter - Section 151 Officer & Director of Resources* ***Implementation Deadline*** *31st August 2018*
6	2	***TB mapping*** There were differences between the TB and draft accounts presented to audit that should have been identified as part of the accounts production and audit preparation process. A subsequent trial balance was produced but was not available until a late stage of the audit. ***Risk*** Where incorrect information is provided this creates delays in the audit timetable and necessitates additional work and checking. ***Recommendation*** Management should ensure that key accounts production documentation is reviewed, and made available at the start of the audit process.	*Review the TB and make available sooner in the audit process.* ***Responsible Officer*** *Rozina Hussein - Financial Systems Principal Accountant, reporting to Rebecca Griffiths - Head of Finance* ***Implementation Deadline*** *31st May 2019*

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Key issues and recommendations (cont.)

No.	Risk	Issue & Recommendation	Management Response
7	2	***Non-current asset (Academy School) de-recognition*** The 1.7m of ‘de-recognition’ took place to correct from previous periods, the process of disposing of assets where schools convert to academies is poor in that Finance aren’t always notified. In previous years disposals of non-current assets have been a high profile area. This case is a different 'type' in that we note that in this instance the Council retained legal title of the asset, but the transfer of use to the academy meant that the asset was no longer usable by the Council, or its consolidated entities, as such was recognised as nil in the accounts. ***Risk*** Where finance are not notified on a timely basis of disposals or changes in the status of non-current assets there is a risk that the correct accounting treatment is not applied. Similar issues have occurred in prior years where a disposal has not been notified to Finance therefore not reflected in the financial statements. ***Recommendation*** Management should review the process by which finance are notified of any changes in status of land.	*Process will be reviewed, and any necessary improvements implemented.* ***Responsible Officer*** *Carl Burke - Capital & Treasury Management Principal Accountant, reporting to Clare Sandland - Strategic Finance Manager* ***Implementation Deadline*** *30th November 2018*
8	2	***Contract monitoring*** There was an inconsistent approach taken in contacting budget holders to understand the status of contracts as at year-end. Insufficient record of who had been contacted, or the responses received, was maintained. ***Risk*** The Council incurs a large amount of expenditure driven through its contracts. It is important that a clear position is identified at year-end to ensure this is accurately reflected in the Statement of Accounts. ***Recommendation*** Ensure that the contract monitoring process is improved by obtaining a clear position of each large contract as at year-end, and maintaining a clear audit trail as to how this position has been derived.	*Process to be reviewed, potential improvements to be suggested, authorised and implemented as required.* ***Responsible Officer*** *Kate Ashley - Procurement Manager, reporting to Rebecca Griffiths - Head of Finance* ***Implementation Deadline*** *Ongoing and by 31st March 2019*

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Appendix 1:

Key issues and recommendations (cont.)

No.	Risk	Issue & Recommendation	Management Response
9	2	***Payroll reconciliation*** When completing our work over the payroll reconciliation we noted that there were a number of different unexplained reconciling items remaining. Understanding the reason for, and clearing these items took a long time to resolve during the audit process. We would expect all reconciliations to be completed, and reconciling items followed up, at the start of the audit. This was an area we also experienced difficulties and delay in resolving in the prior year. ***Risk*** Where incorrect or insufficient information is provided this creates delays in the audit timetable and necessitates additional work and checking. ***Recommendation*** Management should ensure that the payroll reconciliation (and all other key financial control reconciliations) are completed on a timely basis, and that reconciling items are appropriately investigated.	*Current processes to be reviewed, with deadlines and steps added as appropriate.* ***Responsible Officer*** *Rebecca Duffield - Revenue Principal Accountant, reporting to Clare Sandland - Strategic Finance Manager* ***Implementation Deadline*** *31st October 2018*
10	2	***Closedown process*** This year has been a challenging closedown and audit process, for a number of different reasons as set out earlier on in this report. ***Risk*** Key stages of the closedown process should be reviewed to avoid delays in future years. ***Recommendation*** Management should review the closedown process. This should include; clarification of key deliverables and the timetable on which they should be provided; updating of roles and responsibilities; as well as identifying training needs particularly of staff outside the core Finance team who are involved in the close-down process. This should also factor in the other recommendations as set out above, with a particular focus on journals and accruals made (or missing) during closedown.	*Review undertaken by Strategic Finance Manager - 14 recommendations made to Director of Resources (DoR) and Head of Finance (HoF) 22nd June 2018. Further discussed by Finance Service Managers, DoR and HoF 27th July 2018, Action Plan meeting scheduled for 24th August 2018 and Finance wide review and learning sessions scheduled for 11th October 2018.* ***Responsible Officer*** *Rebecca Griffiths - Head of Finance and Clare Sandland - Strategic Finance Manager* ***Implementation Deadline*** *Ongoing and by 31st March 2019*

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Appendix 1:

Key issues and recommendations (cont.)

No.	Risk	Issue & Recommendation	Management Response
11	3	***Monthly review of journals process*** A list of journal postings is sent round each month but there is no confirmation required that a review takes place i.e. no nil returns. As such, whilst it might be useful for budget holders to have such information, we would not consider the control to provide any assurance as it is not possible to evidence the review. ***Risk*** There is a risk that the process taking place would indicate to management, and those charged with governance, a level of assurance which, due to the lack of audit trail, we do not believe it provides. ***Recommendation*** Management may wish to consider review of the control over circularisation of monthly journal postings and consider whether additional assurance is required. This could include requiring returns from budget holders (with evidence of what has been reviewed), or identifying key or unusual postings for which individual confirmation of review is required.	*Review of current process to be undertaken, with recommendations for improvement (where required) to be implemented.* ***Responsible Officer*** *Clare Sandland - Strategic Finance Manager* ***Implementation Deadline*** *Review by 30th September 2018, implement by 31st October 2018*

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Appendix 2:

Follow-up of prior year recommendations

The Council has implemented all of the recommendations raised through our previous audit work.

This appendix summarises the progress made to implement the recommendations identified in our *ISA 260 Report 2016/17* and re-iterates any recommendations still outstanding.

Number of recommendations that were	
Included in the original report	7
Implemented in year or superseded	7

No.	Risk	Issue & Recommendation	Management Response	Status as at July 2018
1	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.	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. ***Responsible Officer*** Darren Carter- S151 officer ***Implementation Deadline*** 31 March 2018	**Implemented**

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Appendix 2:

Follow-up of prior year recommendations cont.

No.	Risk	Issue & Recommendation	Management Response	Status as at July 2018
1	**1**	***Risk*** The Council may 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.	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. ***Responsible Officer*** Darren Carter- S151 officer ***Implementation Deadline*** 31 March 2018	
2	**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. ***Risk*** ***Recommendation*** The Council undertake a robust review of assumptions provided to the actuary and ensure it is consistent with underlying staffing trends.	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. ***Responsible Officer*** Srategic Finance Manager / Pensions Manager ***Implementation Deadline*** To be effective from the next interim audit scheduled for January/February 2018.	**Implemented**

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Follow-up of prior year recommendations cont.

No.	Risk	Issue & Recommendation	Management Response	Status as at July 2018
3	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. ***Risk*** 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.	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. ***Responsible Officer*** Strategic Finance Manager ***Implementation Deadline*** 31 January 2018	**Partial – see Appendix 1**
4	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. ***Risk*** 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.	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. ***Responsible Officer*** All Schools Budget Officers/ Principal Accountant -Schools	**Partial – see Appendix 1**

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Appendix 2:

Follow-up of prior year recommendations cont.

No.	Risk	Issue & Recommendation	Management Response	Status as at July 2018
4	4	***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.	***Implementation Deadline*** 1 October 2017	
5	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.	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.	**Implemented**
6	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 Assurance 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.	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 ***Responsible Officer*** Principal Accountant –Financial Systems Team / Strategic Finance Mange ***Implementation Deadline*** 31 January 2018	**Partial – see Appendix 1**

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Appendix 2:

Follow-up of prior year recommendations cont.

No.	Risk	Issue & Recommendation	Management Response	Status as at July 2018
7	7	**Work force 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 ***Risk*** 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 ensure 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.	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. ***Responsible Officer*** Service Manager – Human Resources ***Implementation Deadline*** 31 March 2018	**Implemented**

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Appendix 3:

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 amendments focused on presentational improvements have also been made to the 2017/18 draft financial statements.

Adjusted audit differences

The following table sets out the significant adjusted audit differences identified by our audit of Sandwell Metropolitan Borough Council's financial statements for the year ended 31 March 2018.

Table 1: Adjusted audit differences (£'000)

No.	Income and expenditure statement	Movement in reserves statement	Assets	Liabilities	Reserves	Basis of audit difference
1	Dr Other Expenditure £1,352,841			Cr Short Term Creditors £1,352,841		Creditor accrual that should have been made in relation to unpresented cheques.
2	Cr Other Expenditure £5,442,363			Dr Short Term Creditors £5,442,363		Reversal of incorrect creditor accrual that had arisen due to duplication of entries within a treasury management journal.
3	Dr Other Expenditure £1,640,000			Cr Short Term Creditors £1,640,000		Contract expenditure relating to March 2018 that was not accrued for.
4	Cr Service Accounts £15,273,983	Dr MIRS £15,273,983	Dr Non-Current Assets £70,156,881		Dr Reserves £70,156,881	Adjustment to reflect the increase in valuation of depreciated replacement cost valued assets in relation to the 11.5% BCIS Uplift from 1 April 2017 to 31 March 2018.
5	Dr Service Accounts £33,900,000	Dr MIRS £33,900,000	Cr Short-ter, Debtors £33,900,000		Cr Reserves £33,900,000	Correction of pensions early deficit payment posted incorrectly to debtors.
6	Cr Actuarial Gain £41,331,000		Dr Pension Assets £41,331,000			Correction to pension assets due to difference arising in calculation of asset values using actual return rather than estimated return for March (as used in draft accounts).

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Appendix 4:

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.

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 2017/18*, presented to you in January 2018.

Materiality for the Authority's accounts was set at £10 million which equates to around 1.2 percent 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 Authority, an individual difference is considered to be clearly trivial if it is less than £0.5 million for the Authority.

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.

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Appendix 5:

Required communications with the Audit and Risk Assurance Committee

We have provided below at-a-glance summary of the information we are required to report to you in writing by International Accounting Standards.

Required Communication	Commentary
Our draft management representation letter	We have not requested any specific representations in addition to those areas normally covered by our standard representation letter for the year ended 31 March 2018.
Adjusted audit differences	We have identified 5 adjusted audit differences. See Appendix 3 for details.
Unadjusted audit differences	We have not identified any unadjusted audit differences. See Appendix 3 for further details.
Related parties	There were no significant matters that arose during the audit in connection with the entity's related parties.
Other matters warranting attention by the Audit Committee	There were no matters to report arising from the audit that, in our professional judgement, are significant to the oversight of the financial reporting process.
Control deficiencies	We have set out our assessment of the Council's internal control environment, including details of significant deficiencies identified in Appendix 1. We communicate to management in writing all deficiencies in internal control over financial reporting of a lesser magnitude than significant deficiencies identified during the audit.
Actual or suspected fraud, noncompliance with laws or regulations or illegal acts	We identified no actual or suspected fraud involving the Authority's Member or officers with significant roles in internal control, or where the fraud resulted in a material misstatement in the financial statements.
Significant difficulties	No significant difficulties were encountered during the audit.
Modifications to auditor's report	There are no modifications to our audit report.
Disagreements with management or scope limitations	The engagement team had no disagreements with management and no scope limitations were imposed by management during the audit.

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Appendix 5:

Required communications with the Audit and Risk Assurance Committee (cont.)

Required Communication	Commentary
Other information	No material inconsistencies were identified related to other information in the Narrative Report or Annual Governance Statement. These reports were found to be fair, balanced and comprehensive, and compliant with applicable requirements.
Our declaration of independence and any breaches of independence	No matters to report. The engagement team have complied with relevant ethical requirements regarding independence. See Appendix 6 for further details.
Accounting practices	Over the course of our audit, we have evaluated the appropriateness of the Authority's accounting policies, accounting estimates and financial statement disclosures. In general, we believe these are appropriate. We have set out our view of the assumptions used in valuing pension assets and liabilities at page 12.
Significant matters discussed or subject to correspondence with management	There were no significant matters arising from the audit which were not discussed, or subject to correspondence, with management that have not been otherwise referred to in this report.

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Declaration of independence

ASSESSMENT OF OUR OBJECTIVITY AND INDEPENDENCE AS AUDITOR OF SANDWELL METROPOLITAN BOROUGH COUNCIL

Professional ethical standards require us to provide to you at the conclusion of the audit a written disclosure of relationships (including the provision of non-audit services) that bear on KPMG LLP's objectivity and independence, the threats to KPMG LLP's independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP's objectivity and independence to be assessed.

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code of Audit Practice, the provisions of Public Sector Audit Appointments Limited's ('PSAA's') Terms of Appointment relating to independence, the requirements of the FRC Ethical Standard and the requirements of Auditor Guidance Note 1 - General Guidance Supporting Local Audit (AGN01) issued by the National Audit Office ('NAO') on behalf of the Comptroller and Auditor General.

This Statement is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence and addresses:

- General procedures to safeguard independence and objectivity;
- Independence and objectivity considerations relating to the provision of non-audit services; and
- Independence and objectivity considerations relating to other matters.

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 partners, Audit Directors and staff annually confirm their compliance with our ethics and independence policies and procedures. Our ethics and independence policies and procedures are fully consistent with the requirements of the FRC Ethical Standard. As a result we have underlying safeguards in place to maintain independence through:

- Instilling professional values
- Communications
- Internal accountability
- Risk management
- Independent reviews.

The conclusion of the audit engagement leader as to our compliance with the FRC Ethical Standard in relation to this audit engagement and that the safeguards we have applied are appropriate and adequate is subject to review by an engagement quality control reviewer, who is an Audit Partner not otherwise involved in your affairs.

We are satisfied that our general procedures support our independence and objectivity except for those detailed below where additional safeguards are in place.

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Appendix 6:

Declaration of independence (cont.)

Independence and objectivity considerations relating to the provision of non-audit services

Summary of fees

We have considered the fees charged by us to the Council and its controlled entities for professional services provided by us during the reporting period. We have detailed the fees charged by us to the Council and its controlled entities for significant professional services provided by us during the reporting period in Appendix 7, as well as the amounts of any future services which have been contracted or where a written proposal has been submitted. Total fees charged by us for the period ended 31 March 2018 can be analysed as follows:

	2017-18 £	2016-17 £
Audit of the Council	240,230	233,446
Total audit services	**240,230**	**233,446**
Allowable non-audit services	-	4,250
Audit related assurance services	9,000	9,000
Mandatory assurance services	16,129	14,340
Total Non Audit Services	**25,129**	**27,590**

We are required by AGN 01 to limit the proportion of fees charged for non-audit services (excluding mandatory assurance services) to 70% of the total fee for all audit work carried out in respect of the Council under the Code of Audit Practice for the year. The ratio of non-audit fees to audit fees for the year was 0.13:1. We do not consider that the total of non-audit fees creates a self-interest threat since the absolute level of fees is not significant to our firm as a whole.

Facts and matters related to the provision of non-audit services and the safeguards put in place that bear upon our independence and objectivity, are set out table on the following page.

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Appendix 6:

Declaration of independence (cont.)

Analysis of Non-audit services for the year ended 31 March 2018

Description of scope of services	Principal threats to independence and Safeguards applied	Basis of fee	Value of services delivered in the year ended 31 March 2018 £	Value of services committed but not yet delivered £
Audit-related assurance services				
Grant Certification – Teachers Pensions Return and Pooling of Housing Capital Receipts Return	The nature of these audit-related services is to provide independent assurance on each of these returns. As such we do not consider them to create any independence threats. **Self-interest:** These engagements are performed under a separate engagement letter and following an externally specified work program. The proposed engagements 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:** All decisions will be made Council so there is no threat. **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.	Fixed Fee	9,000	9,000
Mandatory assurance services				
Grant Certification – Housing Benefit Subsidy Return	The nature of this mandatory assurance service is to provide independent assurance on each of the returns. As such we do not consider it to create any independence threats.	Fixed Fee	16,129	16,129

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Appendix 6:

Declaration of independence (cont.)

Independence and objectivity considerations relating to other matters

There are no other matters that, in our professional judgment, bear on our independence which need to be disclosed to the Audit and Risk Assurance Committee.

Confirmation of audit independence

We confirm that as of the date of this report, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Director and audit staff is not impaired.

This report is intended solely for the information of the Audit and Risk Assurance Committee of the Council and should not be used for any other purposes.

We would be very happy to discuss the matters identified above (or any other matters relating to our objectivity and independence) should you wish to do so.

KPMG LLP

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Appendix 7:

Audit fees

As communicated to you in our *External Audit Plan 2017-18*, the scale fee set for the audit is £198,878 plus VAT (£198,878 in 2016/17), which is consistent with the scale fee in the prior year.

However, our 2016/17 audit incurred additional costs agreed with the Council on 11 October 2017 and subsequently approved by Public Sector Audit Appointments Ltd pending formal completion of the objection resulting in the delay in the 2016/17 accounts.

Due to the nature of the technical matters considered during our 2017/18 audit we have incurred additional costs in bringing these to a conclusion. Once complete we will discuss and agreed the additional fee in relation to the work in relation to PPE valuation and Pension adjustments with the S151 officer. This will still be subject to the PSAA's final determination.

Our work on the certification of the Council's Housing Benefit Subsidy return is not yet complete. The planned scale fee for this is £16,129 plus VAT (£14,340 in 2016/17). Planned fees for other grants and claims which do not fall under the PSAA arrangements amount to £9,000 plus VAT (£9,000 in 2016/17), see further details below.

Component of the audit	2017-18 Planned Fee £	2016-17 Actual Fee £
Accounts opinion and value for money work		
PSAA Scale fee (Sandwell Metropolitan Borough Council)	198,878	198,878
Additional fee in relation to matters brought into our attention in relation to external investigations and judicial review in relation to Council Member conduct	-	14,528
Additional fee in relation to 2016/17 audit matters including accounting for minimum revenue provision changes, review of senior management redundancies, pension scheme triennial valuation and Children's services value for money conclusion	-	20,040
Additional fee in relation to objection in connection to PFI scheme resulting in delay of 2016/17 audit opinion and certificate to July 2018	-	TBC
Additional fee in relation to 2017/18 audit matters including additional risk based work, beacon valuation approach review, engagement of valuation specialists, pension prepayment, and pension asset adjustments.	22,651	-
Additional fee in relation to 2017/18 additional work performed in relation to the control environment including around bank reconciliations, cut off, trial balance mapping, payroll reconciliation and closedown process.	18,701	-
Total audit services	**240,230**	**233,446**
Mandatory assurance services		
Housing Benefits Certification	16,129	14,340
Total mandatory assurance services	**16,129**	**14,340**
Audit-related assurance services		
Teachers' Pension Return	5,000	5,000
Pooling of Housing Capital Receipts	4,000	4,000
Total audit-related assurance services	**9,000**	**9,000**
Total non-audit services	**25,129**	**23,340**
Total fees	**265,359**	**256,786**

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The key contacts in relation to our audit are:

Andrew Cardoza
Director

T: +44 0121 232 3689
E: andrew.cardoza@kpmg.co.uk

Robert Chidlow
Senior Manager

T: +44 0121 232 3074
E: robert.chidlow@kpmg.co.uk

Mark Breese
Manager

T: +44 0121 232 3620
E: mark.breese@kpmg.co.uk

Elsa Conaty
Assistant Manager

T: +44 0121 609 6096
E: elsa.conaty@kpmg.co.uk

kpmg.com/uk

This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. We draw your attention to the Statement of Responsibilities of auditors and audited bodies, which is available on Public Sector Audit Appointment's website (www.psaa.co.uk).

External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

We are committed to providing you with a high quality service. If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Andrew Cardoza, the engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact the national lead partner for all of KPMG's work under our contract with Public Sector Audit Appointments Limited, Andrew Sayers, by email to Andrew.Sayers@kpmg.co.uk. After this, if you are still dissatisfied with how your complaint has been handled you can access PSAA's complaints procedure by emailing generalenquiries@psaa.co.uk by telephoning 020 7072 7445 or by writing to Public Sector Audit Appointments Limited, 3rd Floor, Local Government House, Smith Square, London, SW1P 3HZ.

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