



# Annual Audit Letter 2017/18

**Sandwell MBC**

—

October 2018



A group of business professionals, including a woman with dark hair and a man with grey hair, are seated around a table in a meeting. They are looking down at documents on the table. The image is partially obscured by a blue horizontal band containing text.

**Section one**

# Summary for Audit Committee

# Summary for Audit Committee

This Annual Audit Letter summarises the outcome from our audit work at Sandwell Metropolitan Borough Council ("the Council") in relation to the 2017-18 audit year.

Although it is addressed to Members of the Council, it is also intended to communicate these key messages to key external stakeholders, including members of the public, and will be placed on the Council's website.

## Audit opinion

We expect to issue an unqualified opinion on the Council's financial statements. This means that we believe the financial statements give a true and fair view of the financial position of the Council and of its expenditure and income for the year.

## Financial statements audit

Our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole. Materiality for the Council's accounts was set at £10 million which equates to around 1.23% of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

We report to the Audit Committee any misstatements of lesser amounts, other than those that are "clearly trivial", to the extent that these are identified by our audit work. In the context of the Council, an individual difference is considered to be clearly trivial if it is less than £0.5 million.

We have identified 6 audit adjustments. These adjustments result in a net decrease of £18.63 million in the reported surplus on provision of services and a net increase in total reserves of £77.59 million.

Our audit work was designed to specifically address the following significant risks:

- **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. There are no matters arising from our work to address this risk that we need to bring to your attention;
- **Fraudulent revenue recognition** – Professional accounting standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk. We rebutted this presumed risk, due to the nature of the Council's income streams. There has been no further impact on our audit work;
- **Valuation of PPE** – We considered the approach the Council has adopted to assess the risk that assets not subject to valuation in year are appropriately stated. The Council 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 believed the Council had not fully followed the guidance;
- **Pensions Liabilities** – We considered controls in place at the Council and at the Fund and noted no issues. We reviewed the appropriateness of key assumptions used in the valuation and consider that overall they are balanced. 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 noted 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 as recommendations in our report.

## Section one:

# Summary for Audit Committee (cont.)

## Other information accompanying the financial statements

Whilst not explicitly covered by our audit opinion, we review other information that accompanies the financial statements to consider its material consistency with the audited accounts. This year we reviewed the Annual Governance Statement and Narrative Report. We concluded that they were consistent with our understanding and did not identify any issues.

## Whole of Government Accounts

We reviewed the consolidation pack which the Council prepared to support the production of Whole of Government Accounts by HM Treasury.

## Value for Money conclusion

We expect to issue an 'except for' value for money conclusion on the Council's arrangements to secure value for money (VFM conclusion) for 2017-18. This means 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.

To arrive at our conclusion we looked at the Council's arrangements to make informed decision making, sustainable resource deployment and working with partners and third parties.

## Value for Money risk areas

We undertook a risk assessment as part of our VFM audit work to identify the key areas impacting on our VFM conclusion and considered the arrangements you have put in place to mitigate these risks.

Our work identified the following significant matters: **Delivery of Budgets** and **Children's Services**. We noted that 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, we concluded that for Children's services the Council did not have proper arrangements for informed decision making and sustainable resource deployment.

## High priority recommendations

We raised 5 high priority recommendations as a result of our 2017-18 work:

- Performance of bank reconciliations;
- Unrecorded liabilities and cut off procedure;
- Review of closedown / period 13 journals;
- School closedown process and accruals completeness;
- Valuation of Council Dwellings.

These are detailed in Appendix 1.

## Audit fee

Our fee for 2017-18 was £240,230, excluding VAT (2017: £233,446. Further detail is contained in Appendix 3.

# Appendices



**Appendix 1:**

# High risk recommendations

This appendix summarises the high risk recommendations raised as a result of our audit.

High risk recommendations are defined as those 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.

Details of lower risk recommendations can be found in our ISA260 Report 2017-18.

No.	Risk	Issue & Recommendation	Management Response
1	1	<p><b>Performance of bank reconciliations</b></p> <p>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.</p> <p>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.</p> <p>We note that the bank reconciliation process currently followed by the Council is complex.</p> <p><b>Risk</b></p> <p>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.</p> <p><b>Recommendation</b></p> <p>Management should ensure that bank reconciliations are completed and reviewed on a monthly basis.</p> <p>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.</p>	<p><i>Current process to be reviewed, with a view to rationalise and streamline, whilst maintaining the same level of assurance.</i></p> <p><b>Responsible Officer</b></p> <p><i>Rebecca Duffield - Revenue Principal Accountant, reporting to Clare Sandland - Strategic Finance Manager</i></p> <p><b>Implementation Deadline</b></p> <p><i>31st October 2018</i></p>

# Key issues and recommendations (cont.)

No.	Risk	Issue & Recommendation	Management Response
2	1	<p><b>Unrecorded liabilities &amp; cut off procedure</b></p> <p>As part of our 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.</p> <p><b>Risk</b></p> <p>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.</p> <p><b>Recommendation</b></p> <p>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.</p> <p>Also see recommendation 11 review of closedown process.</p>	<p><i>Budget Holder training to be undertaken, as well as training of all staff involved in the procurement process. Council wide communications to be sent.</i></p> <p><b>Responsible Officer</b></p> <p><i>Darren Carter - Section 151 Officer &amp; Director of Resources, supported by Rebecca Griffiths - Head of Finance</i></p> <p><b>Implementation Deadline</b></p> <p><i>31st March 2019</i></p>
3	1	<p><b>Review of closedown /period 13 journals</b></p> <p>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.</p> <p><b>Risk</b></p> <p>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.</p> <p><b>Recommendation</b></p> <p>Management should review their journal review process, in particular around period 13 journals made as part of the close-down process.</p> <p>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.</p>	<p><i>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).</i></p> <p><b>Responsible Officer</b></p> <p><i>All Principal Accountants and Service Managers within Finance. Led by Rebecca Griffiths - Head of Finance, supported by Rozina Hussein - Financial Systems Principal Accountant</i></p> <p><b>Implementation Deadline</b></p> <p><i>31st May 2019</i></p>

# Key issues and recommendations (cont.)

No.	Risk	Issue & Recommendation	Management Response
4	1	<p><b>School closedown process and accruals completeness</b></p> <p>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 unrepresented cheques resulted in a substantial amount of work to audit the schools bank balances.</p> <p><b>Risk</b></p> <p>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.</p> <p><b>Recommendation</b></p> <p>Management should review their schools close-down process, in particular around the use of estimates, unrepresented cheques and school bank account reconciliations.</p>	<p><i>Review to be undertaken, action plan to be drafted, agreed and implemented.</i></p> <p><b>Responsible Officer</b></p> <p><i>Rose Kerr - Schools Principal Accountant, reporting to Steve Lilley - Finance Service Manager</i></p> <p><b>Implementation Deadline</b></p> <p><i>Review by 30th November 2018, implement by 31st May 2019</i></p>
5	1	<p><b>Valuation of Council Dwellings</b></p> <p>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.</p> <p>Certain key stages of the approach remain where we feel improvements could be made.</p> <p><b>Risk</b></p> <p>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.</p> <p><b>Recommendation</b></p> <p>Management should ensure that all key guidance is followed, and that checks are made for updated guidance on a timely basis.</p> <p>Management should consider undertaking a review of the guidance to identify areas where improvements can be made.</p>	<p><i>Review to be undertaken, improvements to be recommended.</i></p> <p><b>Responsible Officer</b></p> <p><i>Darren Carter - Section 151 Officer &amp; Director of Resources</i></p> <p><b>Implementation Deadline</b></p> <p><i>31st August 2018</i></p>

## Appendix 2:

# Summary of reports issued

This appendix summarises the reports we issued since our last Annual Audit Letter. These reports can be accessed via the Audit Committee pages on the Council's website.

### Certification of Grants and Returns

This letter summarised the outcome of our certification work on the Council's 2016-17 grants and returns.

### External Audit Plan

The External Audit Plan set out our approach to the audit of the Council's financial statements and to support the VFM conclusion.

### Report to Those Charged with Governance

The Report to Those Charged with Governance summarised the results of our audit work for 2017-18 including key issues and recommendations raised as a result of our observations.

We also provided the mandatory declarations required under auditing standards as part of this report.

### Annual Audit Letter

This Annual Audit Letter provides a summary of the results of our audit for 2017-18.

2018

January

February

March

April

May

June

July

August

September

October

## Appendix 1:

# Audit fees

This appendix provides information on our final fees for the 2017-18 audit.

### External audit

Our final fee for the 2017-18 audit of the Council was £240,230. This compares to a planned fee of £198,878. The reasons for this variance are additional work, not allowed for in our initial plan, including:

- 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.
- 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.

Our fees are still subject to final determination by Public Sector Audit Appointments.

### Certification of grants and returns

Under our terms of engagement with Public Sector Audit Appointments we undertake prescribed work in order to certify the Council's housing benefit grant claim. This certification work is still ongoing. The planned fee for this work is £16,129 and the final fee will be confirmed through our reporting on the outcome of that work.

Component of the audit	2017-18 Planned Fee £	2016-17 Actual Fee £
<b>Accounts opinion and value for money work</b>		
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	-
<b>Total audit services</b>	<b>240,230</b>	<b>233,446</b>



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