

AUDIT & STANDARDS COMMITTEE

23rd January 2020

Annual Audit Letter – year ended 31st March 2019

Purpose of Report

This report presents the Annual Audit Letter.

Freedom of Information and Schedule 12A of the Local Government Act 1972

Under the Freedom of Information Act this paper and any appendices will be made available under the Mayoral Combined Authority Publication Scheme. This scheme commits the Authority to make information about how decisions are made available to the public as part of its normal business activities.

Recommendations

The Audit and Standards Committee is asked to consider the annual audit letter to Sheffield City Region Mayoral Combined Authority following completion of audit procedures for the year ended 31 March 2019.



**Sheffield City Region
Mayoral Combined
Authority**

Annual Audit Letter for the year
ended 31 March 2019

23 January 2020



EY

Building a better
working world

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Focused on your future



Public Sector Audit Appointments Ltd (PSAA) have issued a 'Statement of responsibilities of auditors and audited bodies'. It is available from the Chief Executive of each audited body and via the PSAA website (www.psa.co.uk).

This Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The 'Terms of Appointment (updated April 2018)' issued by PSAA set out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

This Annual Audit Letter is prepared in the context of the Statement of responsibilities and Terms of Appointment. It is addressed to the Members of the audited body, and is prepared for their sole use. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure - If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.



01 Executive Summary



Executive Summary

We are required to issue an annual audit letter to Sheffield City Region Mayoral Combined Authority (the Authority) following completion of our audit procedures for the year ended 31 March 2019. Below are the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on the Authority's:	Unqualified - the financial statements give a true and fair view of the financial position of the Authority as at 31 March 2019 and of its expenditure and income for the year then ended
▶ Financial statements	
▶ Consistency of other information published with the financial statements	Other information published with the financial statements was consistent with the Annual Accounts.
Concluding on the Authority's arrangements for securing economy, efficiency and effectiveness	We concluded that you have put in place proper arrangements to secure value for money in your use of resources.

Area of Work	Conclusion
Reports by exception:	
▶ Consistency of Governance Statement	The Governance Statement was consistent with our understanding of the Authority.
▶ Public interest report	We had no matters to report in the public interest.
▶ Written recommendations to the Authority, which should be copied to the Secretary of State	We had no matters to report.
▶ Other actions taken in relation to our responsibilities under the Local Audit and Accountability Act 2014	We had no matters to report.

Area of Work	Conclusion
Reporting to the National Audit Office (NAO) on our review of the Authority's Whole of Government Accounts return (WGA).	We had no matters to report.

Area of Work	Conclusion
Issued a report to those charged with governance of the Authority communicating significant findings resulting from our audit.	Our Audit Results Report was issued on 11 July 2019.
Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.	Our certificate was issued on 8 October 2019.

We would like to take this opportunity to thank the Authority's staff for their assistance during the course of our work.

Stephen Clark
 Partner
 For and on behalf of Ernst & Young LLP



02 Purpose and Responsibilities

Purpose and Responsibilities

The Purpose of this Letter

The purpose of this annual audit letter is to communicate to Members and external stakeholders, including members of the public, the key issues arising from our work, which we consider should be brought to the attention of the Authority.

We have already reported the detailed findings from our audit work in our 2018/19 Audit Results Report to the 11 July 2019 Audit and Standards Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Authority.

Responsibilities of the Appointed Auditor

Our 2018/19 audit work has been undertaken in accordance with the Audit Plan that we issued on 18 April 2019 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- ▶ Expressing an opinion:
 - ▶ On the 2018/19 financial statements; and
 - ▶ On the consistency of other information published with the financial statements.
- ▶ Forming a conclusion on the arrangements the Authority has to secure economy, efficiency and effectiveness in its use of resources.
- ▶ Reporting by exception:
 - ▶ If the annual governance statement is misleading or not consistent with our understanding of the Authority;
 - ▶ Any significant matters that are in the public interest;
 - ▶ Any written recommendations to the Authority, which should be copied to the Secretary of State; and
 - ▶ If we have discharged our duties and responsibilities as established by the Local Audit and Accountability Act 2014 and Code of Audit Practice.

Alongside our work on the financial statements, we also review and report to the National Audit Office (NAO) on your Whole of Government Accounts return. The Authority is below the specified audit threshold of £500m. Therefore, we did not perform any audit procedures on the return.

Responsibilities of the Authority

The Authority is responsible for preparing and publishing its statement of accounts accompanied by an Annual Governance Statement (AGS). In the AGS, the Authority reports publicly each year on how far it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in year, and any changes planned in the coming period.

The Authority is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.



03

Financial Statement Audit

Financial Statement Audit

Key Issues

The Authority's Statement of Accounts is an important tool to show how it has used public money and how it can demonstrate its financial management and financial health.

We audited the Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK), and other guidance issued by the National Audit Office and issued an unqualified audit report on 8 October 2019.

Our detailed findings were reported to the 11 July 2019 Audit and Standards Committee.

The key issues identified as part of our audit were as follows:

Fraud Risk	Conclusion
<p>Misstatements due to fraud or error</p> <p>The financial statements as a whole are not free of material misstatements whether caused by fraud or error.</p> <p>As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.</p>	<p>We did not identify any material weaknesses in controls or evidence of material management override.</p> <p>Through our testing of journals, we did not identify any matters to report.</p> <p>We did not identify any instances of inappropriate judgements being applied or bias within significant accounting estimates.</p>
<p>Risk of fraud in revenue and expenditure recognition</p> <p>Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition. In the public sector, this requirement is modified by Practice Note 10 issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.</p> <p>We consider that this significant risk is associated to the following specific areas:</p> <ul style="list-style-type: none">• Improper capitalisation of revenue expenditure in order to reduce the impact on the general fund• Understatement of expenditure recognised as liabilities in the balance sheet at the year-end• Improper application of revenue cut-off.	<p>Our testing did not identify any material misstatements with respect to revenue and expenditure recognition.</p> <p>Overall our audit work did not identify any material issues or unusual transactions which may have indicated that the financial position had been misreported.</p> <p>Our testing of asset additions did not identify any inappropriate capitalisation.</p> <p>Our work testing cut-off of both debtors and creditors did not yield any errors. We covered large samples as this was our first year and reviewed all payments made in the month after the year-end over £74,000.</p> <p>There were no further matters to report.</p>

Financial Statement Audit (cont'd)

The other risk identified as part of our audit were as follows:

Risk	Conclusion
<p>Valuation of Property, Plant and Equipment</p> <p>The Authority has a large and complex asset base that makes up a significant proportion of its balance sheet. Valuation of assets is an area subject to professional estimation and therefore a higher inherent risk of misstatement.</p> <p>The fair value of Property, Plant and Equipment (PPE) represents a significant balance in the Authority's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Management are required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet, including the use of valuation experts.</p>	<p>Although we did not identify any errors in our work, management had identified errors relating to the treatment of valuations and impairments in previous financial periods. This led to prior year adjustments of £7.2m. We reviewed the work that management performed to correct the errors and performed work to ensure that no material residual issues exist.</p> <p>Our work in assessing the competency of management's expert in this area of judgement has concluded with no issues identified.</p>
<p>Local Government Pension Scheme</p> <p>The accounting entries relating to the Local Government Pension Schemes are underpinned by significant assumptions and estimates. There is therefore an increased risk of misstatement and error.</p> <p>The Authority's pension fund deficit is a material estimated balance and the Code requires that this liability be disclosed on the Authority's balance sheet. At 31 March 2018 this totalled £35.9 million.</p> <p>Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.</p>	<p>In the year we reported the following findings:</p> <p>We requested that, due to uncertainty in the valuation of assets disclosed in relation to the South Yorkshire Pension Fund, that management obtain an updated IAS19 results report to ensure that the most up to date assets figure is used. This was obtained and the appropriate adjustments made to the financial statements</p> <p>In the year; a high court ruling (The McCloud Judgement) created an constructive obligation at the balance sheet date which would increase the liability of SYPTE to the Pension Fund. Our assessment identified a potentially material difference yielded by the outcome of this judgement. As such, management requested updated information from the Pension Fund Actuary (Mercer's) to obtain a more accurate assessment of the increased liability that occurred as a result of this ruling. Additional liabilities of £768k were recognised following this exercise.</p> <p>In relation to rulings around GMP Equalisation, the scheme actuary stated that any additional impact not disclosed would be immaterial. We performed our own work in this area and have reported an immaterial judgmental difference that management did not adjust for.</p> <p>Our conclusion in this area was delayed due to us being unable to place assurance on the report received from the pension fund auditor, a key part of our assurance in this area. We performed additional testing of our own in this area with the co-operation of South Yorkshire Pensions Authority. We were subsequently able to obtain sufficient evidence to be able to conclude that the Pension Fund assets included in the Authority's Group statements are stated free from material error.</p>

Financial Statement Audit (cont'd)

The other risk identified as part of our audit were as follows:

Risk	Conclusion
<p>Implementation of new accounting standards:</p> <ul style="list-style-type: none"> - IFRS 9 - Financial Instruments - IFRS 15 - Revenue contracts with customers <p>These are new accounting standards applicable for local authority accounts from the 2018/19 financial year. There is a risk that the Authority does not implement the requirements of the standards correctly</p> <p>IFRS 9 is applicable for local authority accounts from the 2018/19 financial year and will change; how financial assets are classified and measured; How the impairment of financial assets are calculated; and the disclosure requirements for financial assets.</p> <p>There are transitional arrangements within the standard; and the 2018/19 Cipfa Code of practice on local authority accounting provides guidance on the application of IFRS 9. However, until the Guidance Notes are issued and any statutory overrides are confirmed there remains some uncertainty on the accounting treatment.</p> <p>IFRS15 is applicable for local authority accounts from the 2018/19 financial year. The key requirements of the standard cover the identification of performance obligations under customer contracts and the linking of income to the meeting of those performance obligations.</p> <p>The 2018/19 Cipfa Code of practice on local authority accounting provides guidance on the application of IFRS 15 and includes a useful flow diagram and commentary on the main sources of LG revenue and how they should be recognised. The impact on local authority accounting is likely to be limited as large revenue streams like council tax, non-domestic rates and government grants will be outside the scope of IFRS 15. If the Authority has not assessed if standard is relevant, there may be a risk of material misstatement if recognition of revenue is incorrect and new disclosure requirements are not included in the financial statements.</p>	<p>We have reviewed the work performed by management to determine the impact the new standards have on the financial statements. A five step process was followed for significant income streams and they were deemed to be in line with the appropriate treatment under IFRS 15 and as such didn't require any changes.</p> <p>Management have provided a full consideration of the changes that have been necessary. We have nothing to report in regards to these changes.</p>

Financial Statement Audit (cont'd)

Our application of materiality

When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole.

Item	Thresholds applied
Planning materiality	We determined planning materiality to be £2,956k, which is 2% of gross revenue expenditure reported in the accounts of £148million. We consider gross revenue expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Authority.
Reporting threshold	We agreed with the Audit and Standards Committee that we would report to the Committee all audit differences in excess of £147k.

We also identified the following areas where misstatement at a level lower than our overall materiality level might influence the reader. For these areas we developed an audit strategy specific to these areas. The areas identified and audit strategy applied include:

- ▶ Remuneration disclosures including any severance payments, exit packages and termination benefits:
- ▶ Related party transactions.

We set a materiality of £1k for remuneration disclosures including any severance payments, exit packages and termination benefits and related party transactions which reflects our understanding that an amount less than our materiality would influence the economic decisions of users of the financial statements in relation to this. We identified only minor misstatements in relation to these notes.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations.



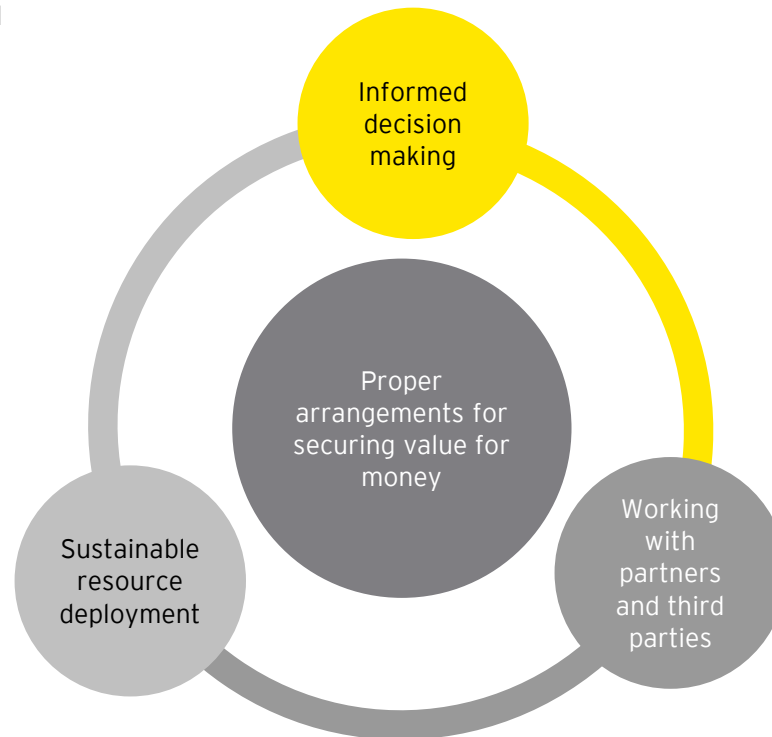
04 Value for Money

£ Value for Money

We are required to consider whether the Authority has put in place 'proper arrangements' to secure economy, efficiency and effectiveness in its use of resources. This is known as our value for money conclusion.

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

- ▶ Take informed decisions;
- ▶ Deploy resources in a sustainable manner; and
- ▶ Work with partners and other third parties.



We did not identify any significant risks in relation to these criteria.



05

Other Reporting Issues



Other Reporting Issues

Whole of Government Accounts

We are required to perform the procedures specified by the National Audit Office on the accuracy of the consolidation pack prepared by the Authority for Whole of Government Accounts purposes. The Authority is below the specified audit threshold of £500mn. Therefore, we were not required to perform any audit procedures on the consolidation pack.

Annual Governance Statement

We are required to consider the completeness of disclosures in the Authority's annual governance statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it is misleading.

We completed this work and did not identify any areas of concern.

Report in the Public Interest

We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by the Authority or brought to the attention of the public.

We did not identify any issues which required us to issue a report in the public interest.

Written Recommendations

We have a duty under the Local Audit and Accountability Act 2014 to designate any audit recommendation as one that requires the Authority to consider it at a public meeting and to decide what action to take in response.

We did not identify any issues which required us to issue a written recommendation.

Objections Received

We did not receive any objections to the 2018/19 financial statements from members of the public.

Other Powers and Duties

We identified no issues during our audit that required us to use our additional powers under the Local Audit and Accountability Act 2014.

Independence

We communicated our assessment of independence in our Audit Results Report to the Audit and Standards Committee and again to the Mayoral Combined Authority Board in July. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning regulatory and professional requirements.

Control Themes and Observations

As part of our work, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Although our audit was not designed to express an opinion on the effectiveness of internal control, we are required to communicate to you significant deficiencies in internal control identified during our audit.

We have adopted a fully substantive audit approach and have therefore not tested the operation of controls.



06 Focused on your future



Focused on your future

The Code of Practice on Local Authority Accounting in the United Kingdom introduces the application of new accounting standards in future years. The impact on the Authority is summarised in the table below.

Standard	Issue	Impact
IFRS 16 Leases	<p>It is currently proposed that IFRS 16 will be applicable for local authority accounts from the 2020/21 financial year.</p> <p>Whilst the definition of a lease remains similar to the current leasing standard; IAS 17, for local authorities who lease a large number of assets the new standard will have a significant impact, with nearly all current leases being included on the balance sheet.</p> <p>There are transitional arrangements within the standard and although the 2020/21 Accounting Code of Practice for Local Authorities has yet to be issued, CIPFA have issued some limited provisional information which begins to clarify what the impact on local authority accounting will be. Whether any accounting statutory overrides will be introduced to mitigate any impact remains an outstanding issue.</p>	<p>Until the 2020/21 Accounting Code is issued and any statutory overrides are confirmed there remains some uncertainty in this area.</p> <p>However, what is clear is that the Authority will need to undertake a detailed exercise to identify all of its leases and capture the relevant information for them. The Authority must therefore ensure that all lease arrangements are fully documented.</p>
IASB Conceptual Framework	<p>The revised IASB Conceptual Framework for Financial Reporting (Conceptual Framework) will be applicable for local authority accounts from the 2019/20 financial year.</p> <p>This introduces;</p> <ul style="list-style-type: none">- new definitions of assets, liabilities, income and expenses- updates for the inclusion of the recognition process and criteria and new provisions on derecognition- enhanced guidance on accounting measurement bases- enhanced objectives for financial reporting and the qualitative aspects of financial information. <p>The conceptual frameworks is not in itself an accounting standard and as such it cannot be used to override or disapply the requirements of any applicable accounting standards.</p> <p>However, an understanding of concepts and principles can be helpful to preparers of local authority financial statements when considering the treatment of transactions or events where standards do not provide specific guidance, or where a choice of accounting policies is available.</p>	<p>It is not anticipated that this change to the Code will have a material impact on Local Authority financial statements.</p> <p>However, Authorities will need to undertake a review to determine whether current classifications and accounting remains valid under the revised definitions.</p>

A close-up photograph of a person's hand reaching into a filing cabinet to touch a folder. The cabinet is filled with numerous folders of various colors (yellow, blue, white) and sizes, each containing stacks of papers. The background is a textured, light-colored wall.

07 Audit Fees

Audit Fees

Our fee for 2018/19 is in line with the scale fee set by the PSAA reported in our Audit Planning Report.

Description	Final Fee 2018-19 £	Planned Fee 2018-19 £	Scale Fee 2018-19 £	Final Fee 2017-18 £
Sheffield City Region Mayoral Combined Authority and Group consolidated financial statements	29,414	29,414	29,414	38,200
Proposed Scale Fee Variation to be agreed by the Audit and Standards Committee *	11,377	-	-	
Proposed Scale Fee Variation contested by management **	1,556			
South Yorkshire Passenger Transport Executive	27,613	27,613	27,613	35,861
Proposed Scale Fee Variation agreed by SYPTE Audit and Risk Committee	5,477	-	-	
Proposed Scale Fee Variation contested by management **	10,695			
Total Audit Fee	86,132	57,027	57,027	74,061

All fees exclude VAT

*The proposed variation to the scale fee is subject to PSAA approval and relates to additional audit work performed to:

- Gain assurance over the additional defined benefit obligation liabilities arising from the McCloud Judgement;
- Review of prior period adjustments relating to the accounting treatment for SYITA Properties Ltd; and
- Review of prior period adjustment relating to accounting entries for historic impairments.

** Contested element that will be submitted to PSAA for arbitration relates to:

- Additional work performed to obtain assurance over the pension assets held as part of the South Yorkshire Pensions Authority. (SYPTE Only)
- Additional work performed on prior period adjustment for upfront payments to SYPA made to reduce pensions deficit. (SYPTE with a group element for SCRMCMA)

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