



The Audit Plan for West Midlands Integrated Transport Authority Pension Fund

Year ending 31 March 2016

22 May 2016

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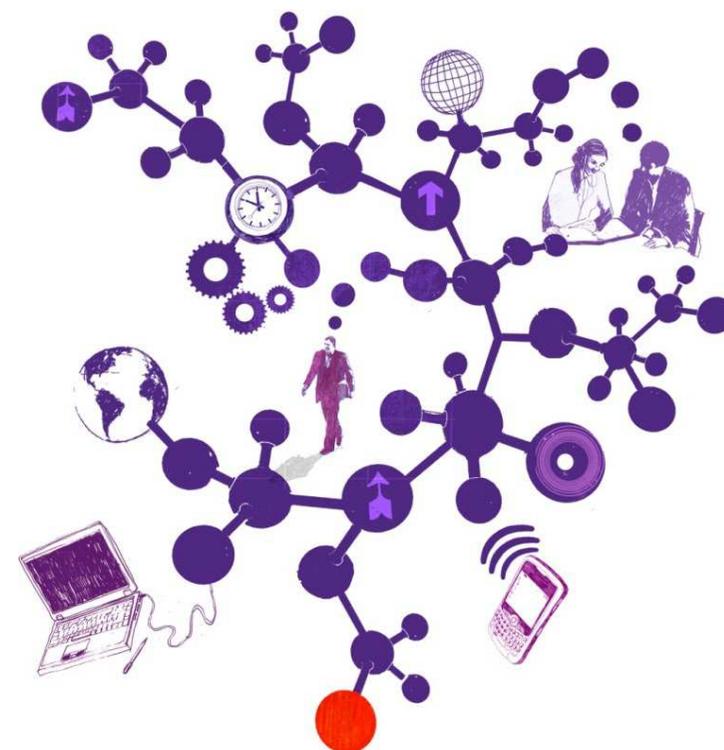
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The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our audit process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect the Pension Fund or any weaknesses in your internal controls. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

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13 May 2016

Dear Members of the Pensions Committee

Audit Plan for West Midlands Integrated Transport Authority Pension Fund for the year ending 31 March 2016

This Audit Plan sets out for the benefit of those charged with governance (in the case of West Midlands Integrated Transport Authority Pension Fund, the [Pensions Committee), an overview of the planned scope and timing of the audit, as required by International Standard on Auditing (UK & Ireland) 260. This document is to help you understand the consequences of our work, discuss issues of risk and the concept of materiality with us, and identify any areas where you may request us to undertake additional procedures. It also helps us gain a better understanding of the Pension Fund and your environment. The contents of the Plan have been discussed with management.

We are required to perform our audit in line with the Local Audit and Accountability Act 2014 and in accordance with the Code of Practice issued by the National Audit Office (NAO) on behalf of the Comptroller and Auditor General in April 2015.

Our responsibilities under the Code are to:

- give an opinion on the Fund's financial statements
- give an opinion on the Pension Fund Annual Report.

As auditors we are responsible for performing the audit, in accordance with International Standards on Auditing (UK & Ireland), which is directed towards forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities for the preparation of the financial statements.

Yours sincerely

Grant Patterson
Engagement Lead

Chartered Accountants

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Understanding your business

In planning our audit we need to understand the challenges and opportunities the Pension Fund is facing. We set out a summary of our understanding below.

Challenges/opportunities

1. Pooling of Investments

- As part of the summer budget 2015 the government has invited LGPS administering authorities to submit proposals for investing their assets through pools of at least £25 billion, with the intention of reducing investment management costs and potentially improving returns.
- The government anticipates that this will improve both capacity and capability to invest in large scale infrastructure projects.
- Initial proposals were submitted to DCLG in mid February, with final plans to be agreed by 15 July 2016.

2. Changes to the investment regulations

- In November 2015 DCLG published draft proposals in relation to the investment regulations governing LGPS funds.
- The proposals seek to remove some of the existing prescribed means of securing a diversified investment strategy and instead give funds greater responsibility to determine the balance of their investments and take account of risk.

3. Governance arrangements

- Local pension boards have been in place since April 2015, and were introduced to assist with compliance and effective governance and administration of the scheme.
- There remains a continued focus on the affordability, cost and management of the scheme, and as such it remains critical that appropriate governance arrangements are in place for the fund.

4. Earlier closedown of accounts

- The Accounts and Audit Regulations 2015 require fund's to bring forward the approval of draft accounts and the audit of financial statements to the 31 May and 31 July respectively by the 2017/18 financial year.

5. Devolution and the West Midlands Combined Authority

- The Autumn Statement 2015 included proposals to devolve further powers to localities.
- During the 2016/17 financial year, the ITA's functions and services will be transferred into the West Midlands Combined Authority which we understand will become the new Administering Authority for the pension fund.



Our response

- Eight LGPS across the Midlands have developed a plan to pool their assets into a £35 billion single investment fund as part of the government backed reforms to the sector.
- We will continue to discuss with officers their plans for asset pooling and the implications that this will have on both the investment policy and governance arrangements of the fund.

- We will discuss with officers their plans to respond to these changes and consider the impact on the fund's investment strategy and its risk management approach to investments.

- We will continue our on-going dialogue with officers around their governance arrangements, particularly in light of their proposals for pooling investments and the formation of the West Midlands Combined Authority.
- We will continue to share emerging good practice with officers.

- The pension fund already has culture of early closure. We will continue to work with you to look to identify if there are areas of your accounts production where you can learn further from good practice in others.
- We aim to complete all substantive work in our audit of your financial statements by 29th July 2016 as a 'dry run'.

- Whilst there will be no direct impact upon the 2015/16 audit we will liaise with management in respect of their plans for the transition of responsibilities and governance of the Scheme to the Combined Authority.
- We are able to provide support and challenge to your plans based on our knowledge of devolution elsewhere in the country.

Developments and other requirements relevant to your audit

In planning our audit we also consider the impact of key developments in the sector and take account of national audit requirements as set out in the Code of Audit Practice and associated guidance.

Developments and other requirements

1. Financial Pressures

- Pension funds are increasingly disinvesting from investment assets to fund cash flow demands on benefit and leaver payments that are not covered by contributions and investment income.
- Pension fund investment strategies need to be able to respond to these demands as well as the changing nature of the investment markets

2. Financial Reporting

- There are no significant changes to the Pension Fund financial reporting framework as set out in the CIPFA Code of Practice for Local Authority Accounting (the Code) for the year ending 31 March 2016, however the Pension Fund needs to ensure on going compliance with the Code.

3. LGPS 2014

- Funds have implemented the requirements of LGPS 2014 and moved to a career average scheme.
- This will continue to increase the complexity of the benefit calculations and the arrangements needed to ensure the correct payment of contributions.

4. Accounting for Fund management costs

- There continues to be a spotlight on the costs of managing the LGPS, and in particular investment management costs.
- Last year CIPFA produced guidance aimed at improving the transparency of management cost data and suggested that funds should include in the notes to the accounts a breakdown of management costs across the areas of investment management expenses, administration expenses and oversight and governance costs.
- This guidance has been updated for 2015/16.



Our response

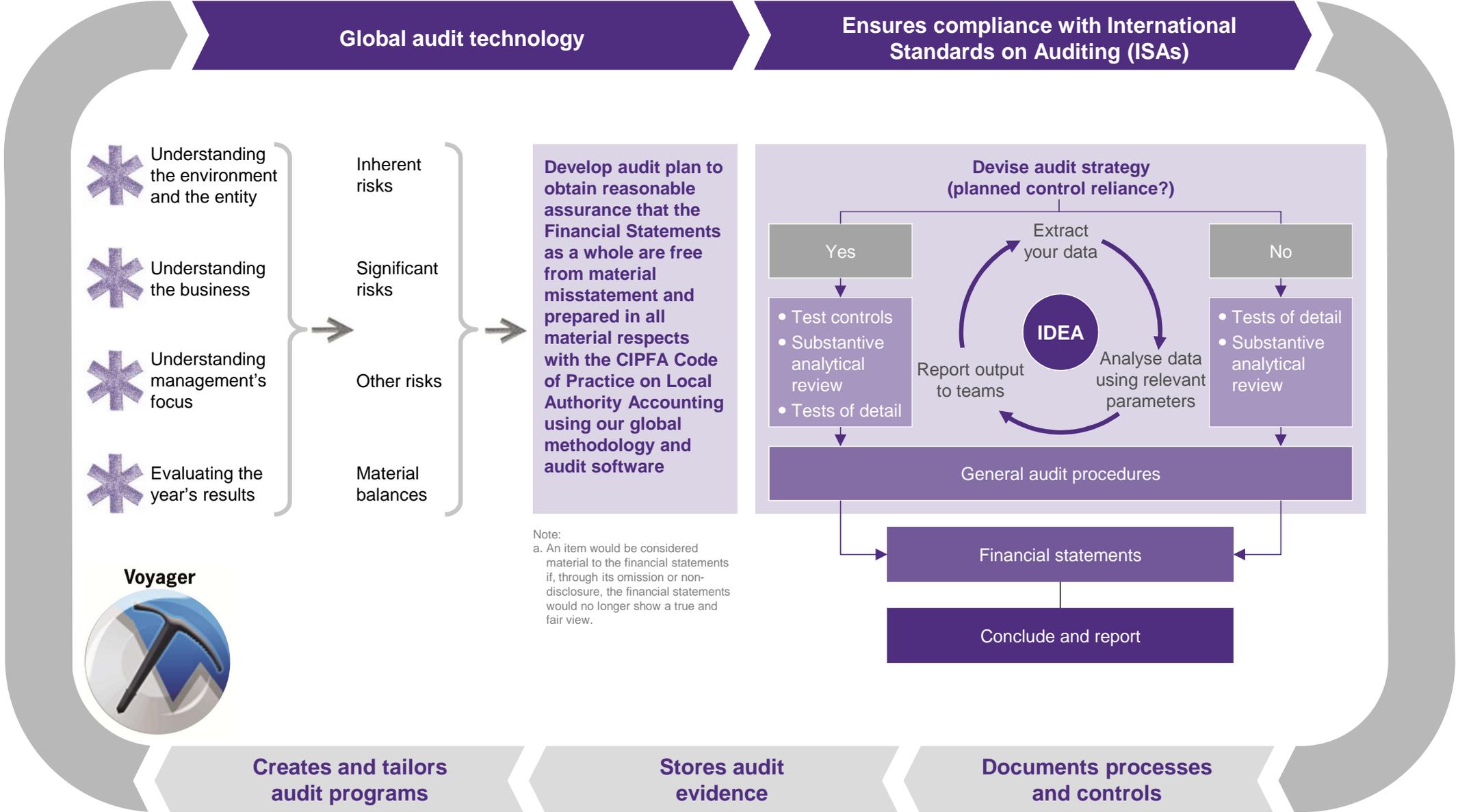
- The fund has an insurance buy-in and last year contracted with Newton for a new DGF. We will monitor any changes to the Pension Fund investment strategy through our regular meetings with management.
- We will consider the impact of changes on the nature of investments held by the Pension Fund and adjust our testing strategy as appropriate.

- We will ensure that the Pension Fund financial statements comply with the requirements of the Code through our substantive testing.

- We will continue to review the arrangements that the fund has in place for the quality of its' membership data.

- We will continue to discuss with officers their plans for increasing the level of transparency associated with the costs of managing the fund.

Our audit approach



Note:
a. An item would be considered material to the financial statements if, through its omission or non-disclosure, the financial statements would no longer show a true and fair view.

Materiality

In performing our audit, we apply the concept of materiality, following the requirements of International Standard on Auditing (UK & Ireland) (ISA) 320: Materiality in planning and performing an audit.

The standard states that 'misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements'.

As is usual in pension schemes, we have determined materiality for the statements as a whole as a proportion of net assets for the fund. For purposes of planning the audit we have determined overall materiality to be £4,759,000 (being 1% of net assets). We will consider whether this level is appropriate during the course of the audit and will advise you if we revise this.

Under ISA 450, auditors also set an amount below which misstatements would be clearly trivial and would not need to be accumulated or reported to those charged with governance because we would not expect that the accumulation of such amounts would have a material effect on the financial statements. "Trivial" matters are clearly inconsequential, whether taken individually or in aggregate and whether judged by any criteria of size, nature or circumstances. We have defined the amount below which misstatements would be clearly trivial to be £237,950.

ISA 320 also requires auditors to determine separate, lower, materiality levels where there are 'particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users'.

We have not identified items where we believe separate materiality levels are required, but have noted items that in our judgement are sensitive due to the level of potential public interest.

| Balance/transaction/disclosure | Explanation |
|--------------------------------|--|
| Investment Management Expenses | In 2015 these totalled £678k. Due to public interest in these disclosures, and the statutory requirement for them to be made and the changes to the disclosure guidance in 2015/16 we will be completing specific testing to ensure the accuracy of the disclosure. |
| Related party transactions | West Midlands Passenger Transport Executive recharges administrative costs incurred to the Fund. The charges for the year ended 31 March 2015 were £33,000. The pension fund has not identified further related party disclosures, as none of the members of the Pension Committee or employees of the Fund's advisors and officers who hold key positions are members of the Fund. Given the sums and anticipated public interest in these disclosures and the statutory requirement for them to be made we will be completing specific testing to ensure the accuracy of the disclosure. |

Significant risks identified

"Significant risks often relate to significant non-routine transactions and judgmental matters. Non-routine transactions are transactions that are unusual, either due to size or nature, and that therefore occur infrequently. Judgmental matters may include the development of accounting estimates for which there is significant measurement uncertainty" (ISA 315). In this section we outline the significant risks of material misstatement which we have identified. There are two presumed significant risks which are applicable to all audits under auditing standards (International Standards on Auditing - ISAs) which are listed below:

| Significant risk | Description | Substantive audit procedures |
|--|---|---|
| The revenue cycle includes fraudulent transactions | <p>Under ISA 240 there is a presumed risk that revenue may be misstated due to the improper recognition of revenue.</p> <p>This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.</p> | <p>Having considered the risk factors set out in ISA240 and the nature of the revenue streams at West Midlands ITA Pension Fund, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because:</p> <ul style="list-style-type: none"> • there is little incentive to manipulate revenue recognition • opportunities to manipulate revenue recognition are very limited • the culture and ethical frameworks of local authorities, including West Midlands Integrated Transport Authority as the administering authority, mean that all forms of fraud are seen as unacceptable. |
| Management over-ride of controls | Under ISA 240 it is presumed that the risk of management over-ride of controls is present in all entities. | <p>Work completed to date:</p> <ul style="list-style-type: none"> • Review of accounting estimates, judgments and decisions made by management <p>Further work planned:</p> <ul style="list-style-type: none"> • Testing of journal entries • Review of unusual significant transactions |
| Level 3 Investments – Valuation is incorrect | Under ISA 315 significant risks often relate to significant, non-routine transactions and judgmental matters. Level 3 investments by their very nature require a significant degree of judgement to reach an appropriate valuation at year end. | <p>Work planned:</p> <p>The Prudential buy-in is the only material, directly held, 'hard to value' investment held by WM ITA Pension Fund and this will be valued by the Fund's actuary (Barnett Waddington). We will gain assurance over this by:</p> <ul style="list-style-type: none"> • reviewing the basis of the valuation and assumptions made; • using our own experts, Grant Thornton's in-house valuation team, to review the assumptions and calculations and to provide assurance that the valuation is reasonable – this work will cover the nature and the basis of the estimated values. |

Other risks identified

"The auditor should evaluate the design and determine the implementation of the entity's controls, including relevant control activities, over those risks for which, in the auditor's judgment, it is not possible or practicable to reduce the risks of material misstatement at the assertion level to an acceptably low level with audit evidence obtained only from substantive procedures"(ISA (UK & Ireland) 315).

In this section we outline the other risks of material misstatement which we have identified as a result of our planning.

| Other risks | Description | Audit approach |
|---|---|---|
| Investment income | Investment activity not valid. Investment income not accurate. (Accuracy) | <p>Work planned:</p> <ul style="list-style-type: none"> The only material investment income comes from the Prudential Insurance Buy-In arrangement to cover benefits underwritten. We will obtain a breakdown of the income received , agree this to source documentation and that the receipt have been received as expected. |
| Investment purchases and sales | Investment activity not valid. Investment valuation not correct. | <p>Work planned:</p> <ul style="list-style-type: none"> We will review the reconciliation of information provided by the fund managers and the Pension Fund 's own records and seek explanations for variances. Test a sample of purchases and sales to ensure they are appropriate. |
| Investment values – Level 2 investments | Valuation is incorrect. (Valuation net) | <p>Work planned:</p> <ul style="list-style-type: none"> We will review the reconciliation of information provided by the fund managers and the Pension Fund's own records and seek explanations for variances, Test a sample of level 2 investments to independent information from manager on units and on unit prices. |
| Contributions | Recorded contributions not correct (Occurrence) | <p>Work completed to date:</p> <ul style="list-style-type: none"> We have completed walkthrough tests in relation to the occurrence assertion which we consider to present a risk of material misstatement to the financial statements. We have been able to rely on controls testing over occurrence, completeness and accuracy of contributions completed in the prior year as no changes were identified in the controls and processes for the contributions system. <p>Further work planned:</p> <ul style="list-style-type: none"> Rationalise contributions received with reference to changes in member body payrolls and numbers of contributing pensioners to ensure that any unexpected trends are satisfactorily explained. |

Other risks identified (continued)

| Other risks | Description | Audit approach |
|------------------|---|--|
| Benefits payable | Benefits improperly computed/claims liability understated (Completeness, accuracy and occurrence) | <p>Work completed to date:</p> <ul style="list-style-type: none"> ● We have completed walkthrough tests in relation to the completeness, accuracy and occurrence assertions which we consider to present a risk of material misstatement to the financial statements. ● We have been able to rely on controls testing over occurrence, completeness and accuracy of benefit payments completed in the prior year as no changes were identified in the controls and processes for the benefit payments system. <p>Further work planned:</p> <ul style="list-style-type: none"> ● Test a sample of individual pensions in payment by reference to member files. ● We will rationalise pensions paid with reference to changes in pensioner numbers and increases applied in the year to ensure that any unusual trends are satisfactorily explained. |
| Member Data | Member data not correct. (Rights and Obligations) | <p>Work completed to date:</p> <ul style="list-style-type: none"> ● We have completed walkthrough tests in relation to the rights and obligations of member data. ● We have been able to rely on controls testing over annual/monthly reconciliations and verifications with individual members completed in the prior year as no changes were identified in the controls and processes for capturing member data. <p>Further work planned:</p> <ul style="list-style-type: none"> ● Sample testing of changes to member data made during the year to source documentation |

Other risks identified (continued)

Other material balances and transactions

Under International Standards on Auditing, "irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance and disclosure". All other material balances and transaction streams will therefore be audited. However, the procedures will not be as extensive as the procedures adopted for the risks identified in the previous section but will include

- Non current assets
- Actuarial Valuation and Actuarial Present Value of Promised Retirement Benefits
- Financial Instruments

Other audit responsibilities

- We will read the Narrative Statement and check that it is consistent with the statements on which we give an opinion and disclosures are in line with the requirements of the CIPFA Code of Practice.

Results of interim audit work

The findings of our interim audit work, and the impact of our findings on the accounts audit approach, are summarised in the table below:

| | Work performed | Conclusion |
|--|---|--|
| Internal audit | We have completed a high level review of internal audit's overall arrangements. Our work has not identified any issues which we wish to bring to your attention. | Overall, we have concluded that the internal audit service provides an independent and satisfactory service to the Administering Authority and that internal audit work contributes to an effective internal control environment for the Fund. |
| Entity level controls | We have obtained an understanding of the overall control environment relevant to the preparation of the financial statements including: <ul style="list-style-type: none"> • Communication and enforcement of integrity and ethical values • Commitment to competence • Participation by those charged with governance • Management's philosophy and operating style • Organisational structure • Assignment of authority and responsibility • Human resource policies and practices | Our work has identified no material weaknesses which are likely to adversely impact on the fund's financial statements. |
| Review of information technology controls | We performed a high level review of the general IT control environment, as part of the overall review of the internal controls system. IT (information technology) controls were observed to have been implemented in accordance with our documented understanding. | Our work has identified no material weaknesses which are likely to adversely impact on the fund's financial statements. |
| Walkthrough testing | We have completed walkthrough tests of the Fund's controls operating in areas where we consider that there is a risk of material misstatement to the financial statements. Our work has not identified any issues which we wish to bring to your attention. Internal controls have been implemented by the Fund in accordance with our documented understanding. | Our work has not identified any weaknesses which impact on our audit approach. |
| Journal entry controls | We have reviewed the Fund's journal entry policies and procedures as part of determining our journal entry testing strategy and have not identified any material weaknesses which are likely to adversely impact on the Fund's control environment or financial statements. | Overall, we have concluded that there are no significant weaknesses in the journal control environment and we will undertake further detailed testing as part of our year end audit work. |

Key dates



| Date | Activity |
|-------------------------|---|
| January - February 2016 | Planning |
| March 2016 | Interim site visit |
| April 2016 | Presentation of audit plan to Chair of Pensions Committee |
| June 2016 | Year end fieldwork |
| TBC | Audit findings clearance meeting with Treasurer to the Pension Fund |
| TBC | Report audit findings to those charged with governance (Pensions Committee) |
| TBC | Sign financial statements opinion |

Fees and independence

Fees

| | Fees £ |
|---|---------------|
| Pension Fund Scale Fee | 21,000 |
| Total audit fees (excluding VAT) | 21,000 |

Our fee assumptions include:

- Supporting schedules to all figures in the accounts are supplied by the agreed dates and in accordance with the agreed upon information request list.
- The scope of the audit, and the Fund and its activities, have not changed significantly.
- The Fund will make available management and accounting staff to help us locate information and to provide explanations.
- The accounts presented for audit are materially accurate, supporting working papers and evidence agree to the accounts, and all audit queries are resolved promptly.

Fees for other services

| Service | Fees £ |
|-------------|------------|
| None | Nil |

Fees for other services

Fees for other services reflect those agreed at the time of issuing our Audit Plan. Any changes will be reported in our Audit Findings Report and the Annual Audit Letter of the Administering Authority.

Independence and ethics

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

Full details of all fees charged for audit and non-audit services will be included in our Audit Findings Report at the conclusion of the audit.

We confirm that we have implemented policies and procedures to meet the requirements of the Auditing Practices Board's Ethical Standards.

Communication of audit matters with those charged with governance

International Standards on Auditing (UK & Ireland) (ISA) 260, as well as other ISAs, prescribe matters which we are required to communicate with those charged with governance, and which we set out in the table opposite.

This document, The Audit Plan, outlines our audit strategy and plan to deliver the audit, while The Audit Findings Report will be issued prior to approval of the financial statements and will present key issues and other matters arising from the audit, together with an explanation as to how these have been resolved.

We will communicate any adverse or unexpected findings affecting the audit on a timely basis, either informally or via a report to those charged with governance.

Respective responsibilities

This plan has been prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by Public Sector Audit Appointments Limited (<http://www.psa.co.uk/appointing-auditors/terms-of-appointment/>)

We have been appointed as the Administering Authority's independent external auditors by the Audit Commission, the body responsible for appointing external auditors to local public bodies in England at the time of our appointment. As external auditors, we have a broad remit covering finance and governance matters.

Our annual work programme is set in accordance with the Code of Audit Practice ('the Code') issued by the NAO and includes nationally prescribed and locally determined work (<https://www.nao.org.uk/code-audit-practice/about-code/>). Our work considers the fund's key risks when reaching our conclusions under the Code.

It is the responsibility of the fund to ensure that proper arrangements are in place for the conduct of its business, and that public money is safeguarded and properly accounted for. We have considered how the fund is fulfilling these responsibilities.

| Our communication plan | Audit Plan | Audit Findings |
|---|------------|----------------|
| Respective responsibilities of auditor and management/those charged with governance | ✓ | |
| Overview of the planned scope and timing of the audit. Form, timing and expected general content of communications | ✓ | |
| Views about the qualitative aspects of the entity's accounting and financial reporting practices, significant matters and issues arising during the audit and written representations that have been sought | | ✓ |
| Confirmation of independence and objectivity | ✓ | ✓ |
| A statement that we have complied with relevant ethical requirements regarding independence, relationships and other matters which might be thought to bear on independence. Details of non-audit work performed by Grant Thornton UK LLP and network firms, together with fees charged. Details of safeguards applied to threats to independence | ✓ | ✓ |
| Material weaknesses in internal control identified during the audit | | ✓ |
| Identification or suspicion of fraud involving management and/or others which results in material misstatement of the financial statements | | ✓ |
| Non compliance with laws and regulations | | ✓ |
| Expected modifications to the auditor's report, or emphasis of matter | | ✓ |
| Uncorrected misstatements | | ✓ |
| Significant matters arising in connection with related parties | | ✓ |
| Significant matters in relation to going concern | | ✓ |



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