Report to those charged with governance (ISA 260) 2014/15

Sheffield City Region Combined Authority

September 2015

Contents

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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. The Audit Commission issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies summarising where the responsibilities of auditors begin and end and what is expected from audited bodies. We draw your attention to this document 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 trevor.rees@kpmg.co.uk ,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, Trevor Rees (on 0161 246 4000, or by email to trevor.rees@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.

Section one
Introduction

This document summarises:

- **the key issues identified during our audit of the financial statements for the year ended 31 March 2015 for both the Authority and its pension fund; and**
- **our assessment of the Authority's arrangements to secure value for money.**

Scope of this report

This report summarises the key findings arising from:

- our audit work at Sheffield City Region Combined Authority ('the Authority') in relation to the Authority's 2014/15 financial statements and those of the Local Government Pension Scheme it administers ('the Pension Fund'); and
- the work to support our 2014/15 conclusion on the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources ('VFM conclusion').

Financial statements

Our *External Audit Plan 2014/15*, presented to you in March 2015, set out the four stages of our financial statements audit process.

This report focuses on the third stage of the process: substantive procedures. Our on site work for this took place during August 2015 (year end audit).

We are now in the final phase of the audit, the completion stage. Some aspects of this stage are also discharged through this report.

VFM conclusion

Our *External Audit Plan 2014/15* explained our risk-based approach to VFM work. We have now completed the work to support our 2014/15 VFM conclusion. This included:

- assessing the potential VFM risks and identifying the residual audit risks for our VFM conclusion;
- considering the results of any relevant work by the Authority and other inspectorates and review agencies in relation to these risk areas.

Structure of this report

This report is structured as follows:

- Section 2 summarises the headline messages.
- Section 3 sets out our key findings from our audit work in relation to the 2014/15 financial statements of the Authority and the fund.
- Section 4 outlines our key findings from our work on the VFM conclusion.

Our recommendations are included in Appendix 1. We have also reviewed your progress in implementing prior recommendations and this is detailed in Appendix 2.

Acknowledgements

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

Headlines

This table summarises the headline messages for the Authority and the Fund. Sections three and four of this report provide further details on each area.

Proposed audit opinion	We anticipate issuing an unqualified audit opinion on the Authority's financial statements by 30 September 2015. We will also report that your Annual Governance Statement complies with guidance issued by CIPFA/SOLACE in June 2007. We also anticipate issuing an unqualified audit opinion in relation to the Fund's financial statements, as contained both in the Authority's Statement of Accounts and the Pension Fund Annual Report by 30 September 2015.
Audit adjustments	We are pleased to report that there were no adjusted or unadjusted audit differences for the Authority's single entity or the pension fund accounts. There were however material adjusted audit differences in relation to the Authority's group accounts as a consequence of the South Yorkshire Passenger Transport Executive (SYPTE) accounts being amended following its audit. All of these were adjusted by the Authority. In addition we identified a number of non-material presentational adjustments relating to single entity and the group accounts. Again all of these were adjusted by the Authority.
Key financial statements audit risks	We review risks to the financial statements of the Authority and the Pension Fund on an ongoing basis. During 2014/15, we identified one significant risk (Capital grant to SYPTE) and one area of audit focus (Group accounts) for the Authority. We have worked with officers throughout the year on these issues. Further details are provided in section three but in summary there are no issues arising. We also identified a significant risk (pensions administration system) specific to the financial statements of the Pension Fund. In response to issues arising from the move to a new pensions administration system the Pension Authority (who administer the Fund) have put alternative arrangements in place to ensure payments to pensioners are valid, appropriate and timely, and has been working hard to address the backlog of administrative tasks that have built up as a result of the system not working satisfactorily. This issue is reflected in the Annual Governance Statement of the Authority (but the responsibility for addressing this is outside its control).

Headlines (continued)

Accounts production and audit process	Although the scale and complexity of has increased compared to its predecessor, the quality of the accounts have improved compared to previous years and are well supported working papers. In particular the Authority has produced and made available its working papers electronically, which greatly facilitates our audit. Officers dealt efficiently with audit queries and the audit process has been completed within the planned timescales. These strong processes meant that only limited (mainly presentational) amendments were made following our audit of the single entity accounts. The group accounts required audit adjustments as a result of SYPTE accounts being amended post audit. The Authority has addressed most of the recommendations in the *ISA 260 Report 2013/14* relating to the predecessor body (SYITA).
Control Environment	The Authority's organisational control environment is effective overall. However, during our interim audit we did identify some areas for improvement in controls over key financial systems (cash/bank and budgetary control). It is pleasing to report that these controls had improved by the year end however we have made some recommendations to ensure these are fully addressed for 2015/16.
Completion	At the date of this report our audit of the financial statements is substantially complete subject to completion of the following areas: ■ Whole Government Accounts ■ Public Transport Coordination (CIES) ■ Transport Planning Policy and Strategy (CIES). Before we can issue our opinion we require a signed management representation letter, which covers the financial statements of both the Authority and the Fund. We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's and Pension Fund's financial statements. However, we are disclosing a specific issue relating to a tax engagement which was entered into before we became your external auditors. The details are set out in Appendix 3.
VFM conclusion and risk areas	We anticipate issuing a qualified VFM conclusion by 30 September 2015 which draws attention to the Authority's developing governance arrangements and financial plans. Section four provides further details.

Financial Statements
Proposed opinion and audit differences

We have not identified any issues in the course of the audit that are considered to be material (except for issues arising from the audit of PTE on the group financial statements).

We anticipate issuing an unqualified audit opinion on both the Authority's and Fund's financial statements, by 30 September 2015.

The wording of your Annual Governance Statement accords with our understanding.

Proposed audit opinion

We anticipate issuing an unqualified audit opinion on:

- The Authority's financial statements; and
- The Pension Fund's financial statements

following approval of the Statement of Accounts by the Audit Committee on 14th September 2015.

Audit differences

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

The final materiality (see Appendix 4 for more information on materiality) level for this year's audit was set at £2.9 million. Audit differences below £80,000 are not considered significant.

The Authority's own (single-entity) financial statements

There were no audit differences above materiality in the single entity accounts. We identified a small number of presentational adjustments required to ensure that the accounts are compliant with the *Code of Practice on Local Council Accounting in the United Kingdom 2014/15 ('the Code')*. We understand that the Authority will be addressing these where significant.

The Authority's Group financial statements

Various amendments (some above materiality) were made to the group figures to reflect agreed changes in SYPTE's financial statements following the audit of these statements. Details on these changes are contained in our report to SYPTE.

In addition, we identified a small number of presentational adjustments required to ensure that the accounts are compliant with the *Code of Practice on Local Council Accounting in the United Kingdom 2014/15 ('the Code')*. We understand that the Authority will be addressing these where significant.

Pension fund

The final materiality level (see Appendix 4 for more information on materiality) for this year's audit of the Pension Fund was set at £4.2m. Audit differences below £210,000 are not considered significant.

We did not identify any corrected or uncorrected audit differences above £210,000. 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 the United Kingdom 2013/14 ('the Code')*.

Annual Governance Statement

We have reviewed the Annual Governance Statement and confirmed that:

- it complies with *Delivering Good Governance in Local Government: A Framework* published by CIPFA/SOLACE; and
- it is not misleading or inconsistent with other information we are aware of from our audit of the financial statements.

Pension Fund Annual Report and Accounts

We have reviewed the Pension Fund Annual Report and Accounts and confirmed that the financial and non-financial information it contains is not inconsistent with the financial information contained in the audited financial statements.

We anticipate issuing an unqualified opinion on the Pension Fund Annual Report and Accounts at the same time as our opinion on the Statement of Accounts.

Financial Statements (continued)
Significant risks and key areas of audit focus

We have worked with the Authority throughout the year to discuss significant risks and key areas of audit focus

This section sets out our detailed findings on those risks

In our *External Audit Plan 2014/15*, presented to you in March 2015, we identified the significant risks affecting the Authority and the Fund's 2014/15 financial statements. We have now completed our testing of these areas and set out our evaluation following our substantive work.

The table below sets out our detailed findings for each of the significant risks that are specific to the Authority and the Pension Fund.

Significant audit risk	Issue	Findings
PTE Capital Grant **Audit areas affected** ■ Grants/ Exceptional Items	**Risk** We reported in our plan that we understood that the Authority was intending to award SYPTE a retrospective capital grant of approximately £62m for the outstanding element of the capital works completed by SYPTE on behalf of the former Integrated Transport Authority in relation to the Sheffield tram network. This transaction is unusual in nature, and involves large values and potentially complex accounting. **Our audit work** We will review the accounting transactions to ensure the treatment is materially accurate.	We have reviewed the accounting transactions to ensure the treatment was materially accurate. We liaised with the PTE's officers and the audit team to ensure consistency of approach. The lawfulness of making such a retrospective payment was established during 2013/14. Our focus this year was in ensuring that the assets had not been previously grant funded, identifying the asset groupings to be funded and confirming that the assets had an appropriate residual life. We are satisfied that the treatment by the Authority is materially accurate.

Financial Statements (continued)
Significant risks and key areas of audit focus (continued)

In this section we set out our assessment of the significant risks or other key areas of audit focus of the Authority's financial statements for 2014/15.

For each key risk area we have outlined the impact on our audit plan

Significant audit risk	Issue	Findings
Pension Administration System **Audit areas affected** ▪ Financial Statements of the Passenger Transport Pension Fund	During 2014/15 the South Yorkshire Pensions Authority (SYPA) purchased a new pensions administration system. The introduction of the new system has caused problems for the Authority as it was not working as designed. Workaround systems have been put in place, for example on pensioners payroll to ensure members receive their entitlements. However, discussions with officers have confirmed that, as at February 2015, the new system is still causing some concerns and officers continue to work through a large processing backlog. This impacts on the Combined Authority because the financial statements of the Passenger Transport Pension Fund are presented alongside the accounts of the Combined Authority.	Discussions with SYPA officers confirm that, as at June 2015, there is still a high processing backlog but this is reducing. We carried out substantive testing on benefits paid received during the year. This is the area of the accounts that we perceive to be related to this risk. We have not identified any issues to report. We also reviewed the accrual for benefits payable (Note 22). The draft financial statements included a nil value for this due to the pensions administration system not being capable of producing the correct accrual. We therefore requested management to provide an estimate of what the accrual would have been. We are satisfied that the estimate was reasonable, the value was clearly trivial, and it confirmed that the nil value in Note 22 was not materially incorrect. We conclude that the accounts are materially correct in relation to benefits paid and contributions received.

Financial Statements (continued)
Significant risks and key areas of audit focus

In our *External Audit Plan 2014/15* we reported that we would consider two risk areas that are specifically required by professional standards and report our findings to you. These risk areas were Management override of controls and the Fraud risk of revenue recognition.

The table below sets out the outcome of our audit procedures and assessment on these risk areas.

Areas of significant risker	Summary of findings
Management override of controls Audit areas affected ■ All areas	Our audit methodology incorporates the risk of management override as a default significant risk. 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. 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. Our approach to the testing of journals includes additional testing in recognition that journals are self authorised. There are no matters arising from this work that we need to bring to your attention.
Fraud risk of revenue recognition Audit areas affected ■ None	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 2014/15 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.

Financial Statements (continued)
Significant risks and key areas of audit focus

In our External Audit Plan 2014/15, presented to you in March 2015, we identified an area of audit focus. This is not considered as significant risks but area of importance where we would carry out some substantive audit procedures to ensure there is no risk of material misstatement.

Since then we have added another area of audit focus relating specifically to investments by the Pension Fund.

We have now completed our testing. The table sets out our detailed findings for each of such areas of audit focus.

Areas of audit focus	Issue	Findings
Group Accounts **Audit areas affected** ■ Group Accounts	Although the Authority's accounts are relatively straightforward, it must also prepare group accounts to consolidate the accounts of the South Yorkshire Passenger Transport Executive and South Yorkshire Integrated Transport Authority Property Limited. Additionally, the Authority is the administering body for the South Yorkshire Passenger Transport Pension Fund which, although not consolidated, requires additional notes to be presented in the financial statements. These additional transactions create complexities in the accounts and a thorough understanding of the inter-relationships between the three consolidated bodies is important to ensure inter-group transactions are properly accounted for. A particular focus of our work will be on ensuring that there is a thorough understanding of SYITA Properties Ltd and its operations.	We designed our audit work to ensure we reviewed that the transactions are correctly accounted for and that the consolidation is materially accurate. Following the audit of SY PTE, a number of material audit differences were identified which had to be reflected in the Authority's group accounts. During the year the Authority's Internal Audit undertook a preliminary review of SYITA Properties Ltd which highlighted a number of governance deficiencies. A further independent review of the company has been commissioned with a view to consideration of the appropriateness of the current operation of the Company. This is adequately reflected in the Authority's Annual Governance Statement. We will follow up on the action taken as part of the 2015/16 audit.
Investments **Audit areas affected** ■ Pension Fund	SYPA has mostly its own, in-house, investment management systems for the SYPTA PF. As a result we are unable to place as much reliance on the external reviews of external managers as would be the case in an investment function that is managed and valued wholly or almost wholly by external managers. Whilst previous years' testing has not identified any audit issues or recommendations in relation to investments, we do consider investments as a whole to require a specific audit focus.	We reviewed the controls in place for valuing unquoted investments and we substantively tested the investment portfolio as a whole. We found there is no control in place relating to the valuation of unquoted investments. Detailed valuation calculations are prepared by the Head of Investments but no independent check or review of these calculations is undertaken. We have made a recommendation in this respect (see Appendix 1). Our other controls and substantive testing on investments did not identify any issues to report.

Financial Statements (continued)
Accounts production and audit process

The Authority has produced good quality accounts, well supported by working papers. These strong processes meant that only limited amendments were made following our audit.

Officers dealt efficiently with audit queries and the audit process could be completed within the planned timescales.

Accounts production and audit process

ISA 260 requires us to communicate to you our views about the significant qualitative aspects of the Authority's accounting practices and financial reporting. We also assessed the Authority's process for preparing the accounts and its support for an efficient audit.

We considered the following criteria:

Element	Commentary
Accounting practices and financial reporting	The Authority has a strong financial reporting process and produces statement of accounts to a good standard. We consider that accounting practices are appropriate.
Completeness of draft accounts	We received a complete set of draft accounts on 30 June 2015, which had been signed on the 29th June 2015. The Authority have made a small number of presentational changes to the accounts presented for audit however there have been no changes which we consider to be fundamental.
Quality of supporting working papers	The quality of working papers provided was high and fully met the standards specified in our *Accounts Audit Protocol*.
Response to audit queries	Officers resolved all audit queries in a timely manner.

Element	Commentary
Group audit	To gain assurance over the Authority's group accounts, we placed reliance on work completed by the KPMG team on the financial statements of South Yorkshire PTE, and SY Passenger Transport Pension Fund. We also confirmed entries as necessary to the audited statements of SY Properties Ltd (a non significant component). Various amendments were made to the group figures to reflect agreed changes in SYPTE's financial statements following the audit of these statements. Details on these changes are contained in our report to SY PTE.
Pension Fund Audit	The audit of the Pension Fund was completed by a separate team alongside the audit of the South Yorkshire Pension Authority who manages the fund on the Combined Authority's behalf. There are no specific matters to bring to your attention relating to this.

Prior year recommendations

As part of our audit we have specifically followed up the Authority's progress in addressing the recommendations in last years ISA 260 report. These were in relation to the predecessor body (SYITA).

The Authority has implemented most of the recommendations in our *ISA 260 Report 2013/14*. Further liaison with SY PTE could be beneficial in securing improvement which would help with the consolidation process.

Appendix 2 provides further details.

Financial Statements (continued)
Completion

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's and Pension Fund's 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 Sheffield City Region Combined Authority and South Yorkshire Passenger Transport Pension Fund for the year ending 31 March 2015, we confirm that there were no relationships between KPMG LLP and Sheffield City Region Combined Authority and South Yorkshire Passenger Transport Pension Fund , 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.

However, we are disclosing a specific issue relating to a tax engagement involving a contingent fee arrangement which was entered into before we became your external auditors. In response we have therefore proposed that the success fee element of our remuneration is removed. PSAA is fully aware of this position. We have concluded that our objectivity has not been compromised by this issue.

We have provided a detailed declaration in Appendix 3 in accordance with ISA 260.

Management representations

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

As a result of the issues relating to the new pensions administration system, we are requesting a specific management representation in respect of the benefits payable estimate.

Other matters

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

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

There are no 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 Authority's 2014/15 financial statements.

VFM conclusion

Our approach to VFM work follows guidance provided by the Audit Commission and adopted by PSAA Ltd.

We will be noting a number of matters within our opinion in relation to VFM. These all relate to the fact that the Authority was still developing its governance and financial planning arrangements throughout the year.

It has recognised that its arrangements are still developing through its Annual Governance Statement.

Background

In meeting their statutory responsibilities relating to economy, efficiency and effectiveness, the Commission's *Code of Audit Practice* requires auditors to:

- plan their work based on consideration of the significant risks of giving a wrong conclusion (audit risk); and
- carry out only as much work as is appropriate to enable them to give a safe VFM conclusion.

For other Local Government bodies such as Sheffield City Region Combined Authority, the approach is structured to cover three areas, as summarised below.

- plan their work reviewing the other local government body's Annual Governance Statement;
- reviewing the results of the work of Commission and other relevant regulatory bodies or inspectorates to consider whether there is any impact on the auditor's responsibilities at the audited body; and
- undertaking local risk-based work as required, or any work mandated by the Commission.

Work completed

We performed a risk assessment earlier in the year and have reviewed this throughout the year.

At the planning stage we identified two VFM risks and our findings against these risks are set out in the table below.

Whilst we have identified significant risks to our VFM conclusion, we have not completed any additional work as the issues are clear and well understood by the Authority.

Conclusion

We are not required to draw an explicit conclusion as to whether the Authority has made proper arrangements to secure economy, efficiency and effectiveness in its use of resources. Instead we are required to note by exception on any specific matters within our opinion.

We will be reporting on the following matters within our opinion:

- This is the first year of the Authority's existence. As a consequence, the Authority did not have a fully functioning governance framework in place during the year. This position is adequately disclosed in the Annual Governance Statement which sets out the key areas to be addressed in 2015/16, specifically:
  - Establish a Code of Corporate Governance
  - Establish a robust risk management process
  - Establish a performance management framework
  - Review the operation of South Yorkshire ITA Properties Ltd
  - Address the backlog and performance issues at the pension fund following the implementation of new software.
- The Authority does not have a Medium Term Financial Plan, currently relying on a single year budget. A plan is starting to be developed now that the Authority has more clarity about its structure, work streams, remit and resources going forward.

Specific VFM risks

We identified two specific VFM risks at the planning stage.

Key VFM risk	Risk description and link to VFM conclusion	Assessment
	Pressures on the finances of the South Yorkshire Councils and the need to make savings at South Yorkshire Passenger Transport Executive (the ‘Executive’) have led to reduced funding and budgets. The Authority has plans in place to address these reductions, whilst seeking to ensure that service delivery can be maintained at acceptable levels.	The Authority has a balanced budget in place for 2015/16 and underspent its 2014/15 budget, demonstrating that effective financial control is in place and developing. The Authority has not yet produced a Medium Term Financial Strategy, as its boards and structures were still developing during 2014/15 – its first year of operation (although the Passenger Transport Executive, the Authority’s main constituent element does have such a Strategy). Business plans are currently being formalised now that the Authority has more clarity about its structure, work streams, remit and resources going forward, and will result in a MTFS being approved by the Authority early in 2016.

Specific VFM risks (continued)

Key VFM risk	Risk description and link to VFM conclusion	Assessment
Governance Arrangements	The new Authority was created at 1st April 2014. Whenever a transfer of powers occurs, there is a risk that governance arrangements are disrupted and new processes need to be developed. Additionally, processes for securing value for money will need to be reviewed and revised.	We have discussed the emerging governance arrangements with key officers throughout the audit. We have also reviewed the Authority's Annual governance Statements and have concluded that the Authority did not have a fully functioning governance framework in place during the year. This was as a result of this being the first year of its operation. This position is adequately disclosed in the Annual Governance Statement which sets out the key areas to be addressed in 2015/16, specifically: ■ Establish a Code of Corporate Governance ■ Establish a robust risk management process ■ Establish a performance management framework ■ Review the operation of South Yorkshire ITA Properties Ltd ■ Recover the data processing performance of the pension fund following the implementation of new software. Work is in hand to develop each of these areas in 2015/16.

Appendix 1: Key issues and recommendations

We have given each recommendation a risk rating and agreed what action management will need to take.

The Authority should closely monitor progress in addressing specific risks and implementing our recommendations.

We will formally follow up these recommendations next year.

Priority rating for recommendations		
❶ ***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.	❷ ***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.	❸ ***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.

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
1	❷	**Bank reconciliations** During the year we reviewed a sample of the Authority's bank reconciliations and found that improvements were required in documentation and that none had been formally reviewed until February 2015. This resulted in significant reconciling items building up over the year which had to be resolved before the year end audit (our year end audit confirmed that these differences had been resolved). **Recommendation** Bank reconciliations for the Combined Authority should follow an agreed, established model and be completed on a regular basis.	CA Finance Manager – April 2015 The CA Finance Manager will ensure that the processes adopted for the reconciliation of the Authority's bank accounts are in line with SCC's model and that they are maintained over the course of 2015/16. Furthermore, the Authority has procured new bank reconciliation software that is compatible with the Authority's new bank accounts and will facilitate monthly, regulated reconciliations.
2	❷	**Budgetary control** Budget monitoring reporting to Chief Executives and Leaders was scheduled to take place quarterly in 14/15. Reporting to Leaders was not of a timely nature, reflecting to some extent, the six weekly cycle for reports. The Q2 monitoring report was shared with the regional Directors of Finance but not submitted to Leaders. **Recommendation** Budget monitoring reports should be produced at least quarterly in the future and as the scale of the Authority's activities extends increased to monthly (this will also improve the timeliness of the reporting).	CA Finance Manager – April 2015 The CA Finance Manager will work within the CA's governance and reporting cycles to ensure that Leaders remain promptly appraised of the financial position of the Authority. Consideration will be given to monthly reporting in consultation with senior officers and Leaders.

Appendix 1: Key issues and recommendations (continued)

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
3	❶	**Medium Term Financial Plan** The Authority has not yet produced a Medium Term Financial Strategy, as its boards and structures were still developing during 2014/15 – its first year of operation (although the Passenger Transport Executive, the Authority's main constituent element does have such a Strategy). **Recommendation** Ensure that a Medium Term Financial Strategy is produced and approved as part of the 2016/17 budget setting process at the latest.	CA Finance Manager – March 2016 The Section 151 officer has instigated financial and business planning arrangements to enable a Medium Term Financial Strategy to be developed as part of the 2016/17 budget planning process. These plans are informed by the CA/LEP's revised governance mechanisms, and the flexibility garnered on SY transport issues through the CA's award of the capital grant to SYPTE. Regional Directors of Finance are involved in financial planning exercises, and a proposed engagement model has been submitted to Chief Executives and Leaders.
4	❶	**Governance Framework** We concur with the Authority's own assessment that it did not have a fully functioning governance framework in place during the year. This was as a result of this being the first year of its operation. Specifically the Authority need to address the improvement priorities highlighted in the Annual Governance Statement, namely: ▪ Establish a Code of Corporate Governance ▪ Establish a robust risk management process ▪ Establish a performance management framework ▪ Review the operation of South Yorkshire Properties Ltd ▪ Recover the data processing performance of the pension fund following the implementation of new software. **Recommendation** Ensure that the programme to establish a governance framework is completed in time to demonstrate it is operating effectively during 2015/16 financial year.	CA Monitoring Officer – November 2015 Work is complete in identifying discrete areas of governance which will support the development of a robust assurance framework (risk management, assurance framework, ethical/integrity framework, Scheme of Delegation, performance management / VfM framework, Scrutiny and Overview and Audit Committee arrangements, information governance and publication scheme, private sector involvement, third party governance, business continuity and emergency resilience, HR governance and general transparency requirements). A Governance Assurance Group has been convened to oversee the drafting and endorsement of all documents, policies and procedures required to manage the implementation of the framework. Progress will be reported to the SCR Audit Committee, which has in place a scheduled meeting programme so as to ensure a platform for effective challenge and scrutiny takes place .

Appendix 1: Key issues and recommendations (continued)

No.	Risk	Issue and recommendation	Management response / responsible officer / due date
5	2	**Pensions Administration System** The introduction of the new Pensions Administration System at SYPA has not been as smooth a process as intended. The new system has not been capable of producing the processes and calculations previously produced by the old system and so workarounds have been put in place by officers to ensure business, specifically in relation to payments to members, has continued correctly and with minimal disruption to members. It is recognised that the issues with the new system are largely outside of the SYPA's control. Due to the previous provider withdrawing the service earlier than expected, SYPA had no choice but to implement the new system earlier than planned. **Recommendation** Continue to clear any backlog created as a result of the new system inadequacies and maintain rigorous reporting to members on the position.	**Management response** We intend to clear the backlog by 31st December 2015. Automated data upload processes are due to go live shortly and these will stop further backlogs of work arising. Overtime working is continuing along with other office wide initiatives aimed at eliminating the backlog by the target date. Reporting will naturally continue and an extensive UPM position report is to presented to the October SYPA meeting. **Responsible officer** Gary Chapman, SYPA **Due date** 31 December 2015

Appendix 2: Follow up of prior year recommendations

The Authority has implemented most of the recommendations in our ISA 260 Report 2013/14.

This appendix summarises the progress made to implement the recommendations identified in our *ISA 260 Report 2013/14* and re-iterates any recommendations still outstanding.

Number of recommendations that were:	
Included in original report	3
Implemented in year or superseded	2
Remain outstanding (re-iterated below)	1

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at September 2015
1	❶	**Preparation and presentation of accounts** The ITAs draft accounts were not approved until mid August 2014, as the Combined Authority's s151 Officer requested improvements in the presentation to be made to the draft prepared for the deadline of end June 2014. **Recommendation** Officers should critically review the format and presentation of the 2013/14 financial statements to ensure that an appropriate and clear presentation for the 2014/15 financial statements is agreed well in advance of the June 2015 deadline. This review should include liaison with SYPTE to ensure their accounts are also in the appropriate format.	Clair Sharratt (Senior Finance Manager) in liaison with SY PTE's officers.	Ongoing. From 2014/15 the Combined Authority group accounts closely follow CIPFA's recommended practice for the presentation of financial statements. SYPTE has also partially adopted the CIPFA format, with further improvements planned for 2015/16, in order to facilitate group consolidation and comparability between other public bodies.

Appendix 2: Follow up of prior year recommendations (continued)

The Authority has implemented most of the recommendations in our ISA 260 Report 2013/14.

This appendix summarises the progress made to implement the recommendations identified in our *ISA 260 Report 2013/14* and re-iterates any recommendations still outstanding.

Number of recommendations that were:	
Included in original report	3
Implemented in year or superseded	2
Remain outstanding (re-iterated below)	1

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at September 2015
2	2	**Cash-flow statements** Significant amendments were made following our audit to both the ITAs own (single entity) and the group's cash-flow statements. **Recommendation** Officers should review the changes needed in 2013/14, to ensure that compliant cash-flow statements are produced for the 2014/15 financial statements.	Clair Sharratt (Senior Finance Manager)	Complete. For 2014/15 the Combined Authority used the recommended CIPFA Cash flow Toolkit to produce the group's cash flow statements and notes. The software has been designed to assist with the calculation and preparation of the cash flow statement and also generates detailed working papers to evidence compliance with the Code of Practice.

Appendix 2: Follow up of prior year recommendations (continued)

The Authority has implemented most of the recommendations in our ISA 260 Report 2013/14.

This appendix summarises the progress made to implement the recommendations identified in our *ISA 260 Report 2013/14* and re-iterates any recommendations still outstanding.

Number of recommendations that were:	
Included in original report	3
Implemented in year or superseded	2
Remain outstanding (re-iterated below)	1

No.	Risk	Issue and recommendation	Officer responsible and due date	Status as at September 2015
3	2	**Dividend due for SY ITA Property Ltd** The ITAs accounts include a long-term debtor of £6.0m and associated investment of £0.7m in respect of a dividend receivable from SY ITA Property Ltd. This dividend was voted in 2007, but has not yet been paid. It is due to be paid in tranches by 2024. Although we are satisfied that the accounting for this dividend is correct. **Recommendation** The Combined Authority should review the position and anticipated payments of this amount.	Gareth Sutton (Finance Manager)	Complete. During financial year 2014/15 the Section 151 Officer instigated an Internal Audit review into the company. This review focussed on appraising the relationship between the company and the Combined Authority, and testing broader company operations. This review identified governance and process weaknesses, but no evidence of impropriety. The Section 151 Officer moved to complement this report by commissioning PWC to examine the suitability of the company as a vehicle for managing the CA's transport property assets in the most efficient manner. This review will evidence the company's ability to meet its obligations to the Combined Authority, including the dividend payment due. During the year, the Combined Authority also moved to appoint three nominated directors onto the company board. The SCR Executive Director has been appointed Chair of the Board. Following meetings of the Board the company voted to advance the Combined Authority £2.5m of the outstanding amount due ahead of schedule. This was received by the Combined Authority in August 2015. The residual amounts due will be advanced contingent on the forecast accrual of cash from operating surplus

Appendix 3: Declaration of independence and objectivity

The Code of Audit Practice requires us to exercise our professional judgement and act independently of both Public Sector Audit Appointments Ltd and the Authority.

Requirements

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

"Auditors and their staff should exercise their professional judgement and act independently of both the Commission and the audited body. Auditors, or any firm with which an auditor is associated, should not carry out work for an audited body that does not relate directly to the discharge of auditors' functions, if it would impair the auditors' independence or might give rise to a reasonable perception that their independence could be impaired."

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

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

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

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

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

General procedures to safeguard independence and objectivity

KPMG's reputation is built, in great part, upon the conduct of our professionals and their ability to deliver objective and independent advice and opinions. That integrity and objectivity underpins the work that KPMG performs and is important to the regulatory environments in which we operate. All partners and staff have an obligation to maintain the relevant level of required independence and to identify and evaluate circumstances and relationships that may impair that independence.

Appendix 3: Declaration of independence and objectivity (continued)

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements, however we disclose action concerning a tax engagement with South Yorkshire Passenger Transport Pension Fund.

Acting as an auditor places specific obligations on the firm, partners and staff in order to demonstrate the firm's required independence. KPMG's policies and procedures regarding independence matters are detailed in the *Ethics and Independence Manual* ('the Manual'). The Manual sets out the overriding principles and summarises the policies and regulations which all partners and staff must adhere to in the area of professional conduct and in dealings with clients and others.

KPMG is committed to ensuring that all partners and staff are aware of these principles. To facilitate this, a hard copy of the Manual is provided to everyone annually. The Manual is divided into two parts. Part 1 sets out KPMG's ethics and independence policies which partners and staff must observe both in relation to their personal dealings and in relation to the professional services they provide. Part 2 of the Manual summarises the key risk management policies which partners and staff are required to follow when providing such services.

All partners and staff must understand the personal responsibilities they have towards complying with the policies outlined in the Manual and follow them at all times. To acknowledge understanding of and adherence to the policies set out in the Manual, all partners and staff are required to submit an annual ethics and independence confirmation. Failure to follow these policies can result in disciplinary action.

Disclosure of action concerning tax engagement with South Yorkshire Passenger Transport Pension Fund.

KPMG member firms and KPMG professionals are required to comply with independence standards that meet or exceed those set out in the IESBA Code of Ethics. In addition, the UK firm and our professionals are also required to comply with the requirements of the APB Ethical Standards. We also adhere to the Public Sector Audit Appointment's (PSAA) specific requirements regarding non-audit services.

These professional standards require that where the firm has determined that a breach of an audit independence standard has occurred, we discuss this and the actions we have taken or propose to take with you as soon as possible, communicate with you in writing all matters discussed and obtain your concurrence that action can be, or has been, taken to satisfactorily address the issue. This section of the report summarises such an instance requiring action.

In December 2006 South Yorkshire Pensions Authority (SYPA) engaged KPMG to provide services to assist SYPA with Foreign Income Dividend and Manninen claims filed to recover tax credits on foreign dividend income. The fee agreed for these services was fixed at £20,000 with a success (contingent) fee up to a maximum of £150,000 in total. This Engagement also covered the South Yorkshire Passenger Transport Pension Fund (SYPTPF) and, acknowledging that SYPTPF was specifically covered in our related report to SYPA in April 2007, a variation letter was issued to SYPA, to include the SYPTPF as a related party, in December 2014. The contingent fee element relating to SYPTPF amounted to £5,177 and would be paid from any amounts recovered from HMRC if the claim was ultimately successful.

In April 2012, KPMG LLP was appointed as auditor of the 2012/13 year of account and subsequent financial years. No work has been carried out in relation to this tax engagement in the period since KPMG LLP was appointed auditor, as the test case (not relating to SYPA or SYPTPF) is being dealt with by another firm and so we have had limited involvement whilst this is progressing. Therefore no contingent fees have been paid to date.

Appendix 3: Declaration of independence and objectivity (continued)

We confirm that we have complied with requirements on objectivity and independence in relation to this year's audit of the Authority's financial statements, however we disclose action concerning a tax engagement with South Yorkshire Passenger Transport Pension Fund.

Prior to 2010, the APB Ethical Standards did not prohibit contingent fee arrangements, however in 2010 the standards were changed and paragraph 95 of APB Ethical Standard Number 5 now provides that an audit firm cannot provide services on a wholly or partly contingent basis where the outcome of those services is dependent upon the proposed application of tax law which is uncertain or has not been established. As the tax law applying to the subject matter of this engagement was and remains uncertain, following KPMG LLP's appointment as auditor the fee basis should have been revised to remove the contingent element in order to comply with this requirement. Action was therefore required to ensure compliance with the ethical standards. We have therefore proposed that the success fee element of our remuneration is removed. PSAA is fully aware of this position and in line with its usual rules on the acceptance of non-audit work we have sought its approval for the standard fee which was £740. This amount has been calculated on the basis of the ratio of the contingent fee element relating to the SYPA and the SYPTPF.

This position was identified as our firm undertook a special exercise to ensure that any grandfathered tax contingent fee arrangements that were entered into with audit clients prior to the change in rules in 2010 had been correctly dealt with before 31 December 2014 which was the end of the grandfathering period provided for in the standard.

We have considered this matter, and given the following factors we have determined this to be a less than significant breach of the APB Ethical Standards because:

- statements.
- no amounts are recognised in the Pension Fund's accounts for the potential recovery of this tax;
- the amount of tax that is potentially recoverable is, in any event, not material to the Pension Fund;
- KPMG has not received any contingent fee income in respect of this engagement and has not performed any work in relation to this engagement since the date of appointment as auditor; and
- the potential contingent fee that KPMG could have received in respect of this engagement of £5,177 is not material to our firm.

Based on the above in our professional judgment we concluded that our objectivity has not been compromised and the firm and the engagement team are independent of the Authority and the Pension Fund.

Auditor declaration

In relation to the audit of the financial statements of Sheffield City Region Combined Authority and South Yorkshire Passenger Transport Pension Fund for the financial year ending 31 March 2015, we confirm that there were no relationships between KPMG LLP and Sheffield City Region Combined Authority and South Yorkshire Passenger Transport Pension Fund , its directors and senior management and its affiliates that we consider may reasonably be thought to bear on the objectivity and independence of the audit engagement lead and audit staff. We also confirm that we have complied with Ethical Standards and the Public Sector Audit Appointments Ltd requirements in relation to independence and objectivity.

Appendix 4: Materiality and reporting of audit differences

For 2014/15 our materiality is £2.9 million for the Authority's accounts. For the Pension Fund it is £4.2 million.

We have reported all audit differences over £80k for the Authority's accounts and £210k for the Pension Fund, to the Audit Committee.

Materiality

The assessment of what is material is a matter of professional judgment 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 2014/15, presented to you in February, 2015

Materiality for the Authority's accounts was set at £2.9 m which equates to around 1.9 percent of gross expenditure. We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the Leader's Board

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 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, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £80,000 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 Leaders Board to assist it in fulfilling its governance responsibilities.

Materiality – pension fund audit

The same principles apply in setting materiality for the Pension Fund audit. Materiality for the Pension Fund was set at £4.2 million which is approximately 3 percent of gross assets.

We design our procedures to detect errors at a lower level of precision.

Appendix 5: KPMG Audit Quality Framework

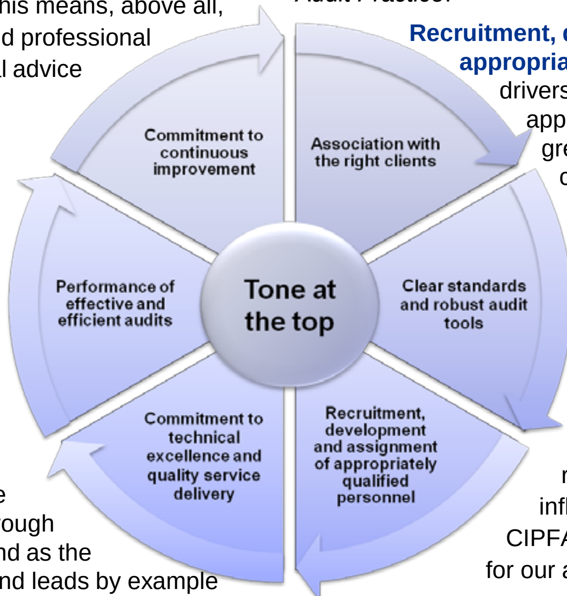
We continually focus on delivering a high quality audit.

This means building robust quality control procedures into the core audit process rather than bolting them on at the end, and embedding the right attitude and approaches into management and staff.

KPMG's Audit Quality Framework consists of seven key drivers combined with the commitment of each individual in KPMG.

The diagram summarises our approach and each level is expanded upon.

At KPMG we consider audit quality is not just about reaching the right opinion, but how we reach that opinion. KPMG views the outcome of a quality audit as the delivery of an appropriate and independent opinion in compliance with the auditing standards. It is about the processes, thought and integrity behind the audit report. This means, above all, being independent, compliant with our legal and professional requirements, and offering insight and impartial advice to you, our client.



KPMG's Audit Quality Framework consists of seven key drivers combined with the commitment of each individual in KPMG. We use our seven drivers of audit quality to articulate what audit quality means to KPMG.

We believe it is important to be transparent about the processes that sit behind a KPMG audit report, so you can have absolute confidence in us and in the quality of our audit.

Tone at the top: We make it clear that audit quality is part of our culture and values and therefore non-negotiable. Tone at the top is the umbrella that covers all the drives of quality through a focused and consistent voice. Sue Sunderland as the Engagement Lead sets the tone on the audit and leads by example with a clearly articulated audit strategy and commits a significant proportion of his time throughout the audit directing and supporting the team.

Association with right clients: We undertake rigorous client and engagement acceptance and continuance procedures which are vital to the ability of KPMG to provide high-quality professional services to our clients.

Clear standards and robust audit tools: We expect our audit professionals to adhere to the clear standards we set and we provide a range of tools to support them in meeting these expectations. The global rollout of KPMG's eAudIT application has significantly enhanced existing audit functionality. eAudIT enables KPMG to deliver a highly technically enabled audit. All of our staff have a searchable data base, Accounting Research Online, that includes all published accounting standards, the KPMG Audit Manual Guidance as well as other relevant sector specific publications, such as the Audit Commission's *Code of Audit Practice*.

Recruitment, development and assignment of appropriately qualified personnel: One of the key drivers of audit quality is assigning professionals appropriate to the Authority's risks. We take great care to assign the right people to the right clients based on a number of factors including their skill set, capacity and relevant experience.

We have a well developed technical infrastructure across the firm that puts us in a strong position to deal with any emerging issues. This includes:

- A national public sector technical director who has responsibility for co-ordinating our response to emerging accounting issues, influencing accounting bodies (such as CIPFA) as well as acting as a sounding board for our auditors.

- A national technical network of public sector audit professionals is established that meets on a monthly basis and is chaired by our national technical director.

- All of our staff have a searchable data base, Accounting Research Online, that includes all published accounting standards, the KPMG Audit Manual Guidance as well as other relevant sector specific publications, such as the Audit Commission's *Code of Audit Practice*.

- A dedicated Department of Professional Practice comprised of over 100 staff that provide support to our audit teams and deliver our web-based quarterly technical training.

Appendix 5: KPMG Audit Quality Framework

We continually focus on delivering a high quality audit.

This means building robust quality control procedures into the core audit process rather than bolting them on at the end, and embedding the right attitude and approaches into management and staff.

Quality must build on the foundations of well trained staff and a robust methodology.

Commitment to technical excellence and quality service delivery: Our professionals bring you up- the-minute and accurate technical solutions and together with our specialists are capable of solving complex audit issues and delivering valued insights.

Our audit team draws upon specialist resources including Forensic, Corporate Finance, Transaction Services, Advisory, Taxation, Actuarial and IT. We promote technical excellence and quality service delivery through training and accreditation, developing business understanding and sector knowledge, investment in technical support, development of specialist networks and effective consultation processes.

Performance of effective and efficient audits: We understand that how an audit is conducted is as important as the final result. Our drivers of audit quality maximise the performance of the engagement team during the conduct of every audit. We expect our people to demonstrate certain key behaviors in the performance of effective and efficient audits. The key behaviors that our auditors apply throughout the audit process to deliver effective and efficient audits are outlined below:

- timely Engagement Lead and manager involvement;
- critical assessment of audit evidence;
- exercise of professional judgment and professional scepticism;
- ongoing mentoring and on the job coaching, supervision and review;
- appropriately supported and documented conclusions;
- if relevant, appropriate involvement of the Engagement Quality Control reviewer (EQC review);
- clear reporting of significant findings;
- insightful, open and honest two-way communication with those charged with governance; and
- client confidentiality, information security and data privacy.

Commitment to continuous improvement: We employ a broad range of mechanisms to monitor our performance, respond to feedback and understand our opportunities for improvement.

Our quality review results

Public Sector Audit Appointments Ltd publishes information on the quality of work provided by us (and all other firms) for audits undertaken on behalf of them (http://www.psaa.co.uk/audit-quality/principal-audits/kpmg-audit-quality/).

The latest Annual Regulatory Compliance and Quality Report issued June 2015 showed that we are meeting the overall audit quality and regulatory compliance requirements.

cutting through complexity