

# Informing the audit risk assessment for West Mercia Energy 2018/19



# Agenda

Purpose	3
Fraud	4
Fraud risk assessment	5-6
Laws and regulations	7
Impact of laws and regulations	8-10
Going concern	11
Going concern considerations	12-13
Related parties	14-15
Accounting estimates	16-17
Appendix A – Accounting estimates	18- 19

# Purpose

The purpose of this report is to contribute towards the effective two-way communication between auditors and the West Mercia Energy Joint Committee, as 'those charged with governance'. The report covers some important areas of the auditor risk assessment where we are required to make inquiries of the Joint Committee under auditing standards.

## Background

Under International Standards on Auditing (UK and Ireland) (ISA(UK&I)) auditors have specific responsibilities to communicate with the Joint Committee. ISA(UK&I) emphasise the importance of two-way communication between the auditor and the Joint Committee and also specify matters that should be communicated.

This two-way communication assists both the auditor and the Joint Committee in understanding matters relating to the audit and developing a constructive working relationship. It also enables the auditor to obtain information relevant to the audit from the Joint Committee and supports the Joint Committee in fulfilling its responsibilities in relation to the financial reporting process.

## Communication

As part of our risk assessment procedures we are required to obtain an understanding of management processes and the Joint Committee's oversight of the following areas:

- fraud
- laws and regulations
- going concern
- related parties
- accounting estimates.

This report includes a series of questions on each of these areas and the response we have received from West Mercia Energy management. The Joint Committee should consider whether these responses are consistent with its understanding and whether there are any further comments it wishes to make.

# Fraud

## Matters in relation to fraud

ISA(UK&I)240 covers auditors responsibilities relating to fraud in an audit of financial statements.

The primary responsibility to prevent and detect fraud rests with both the Joint Committee and management. Management, with the oversight of the Joint Committee, needs to ensure a strong emphasis on fraud prevention and deterrence and encourage a culture of honest and ethical behaviour. As part of its oversight, the Joint Committee should consider the potential for override of controls and inappropriate influence over the financial reporting process.

As auditor, we are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement due to fraud or error. We are required to maintain professional scepticism throughout the audit, considering the potential for management override of controls.

As part of our audit risk assessment procedures we are required to consider risks of fraud. This includes considering the arrangements management has put in place with regard to fraud risks including:

- assessment that the financial statements could be materially misstated due to fraud
- process for identifying and responding to risks of fraud, including any identified specific risks
- communication with the Joint Committee regarding its processes for identifying and responding to risks of fraud
- communication to employees regarding business practices and ethical behaviour.

We need to understand how the Joint Committee oversees the above processes. We are also required to make inquiries of both management and the Joint Committee as to their knowledge of any actual, suspected or alleged fraud. These areas have been set out in the fraud risk assessment questions below together with responses from the West Mercia Energy management.

# Fraud risk assessment

Question	Management response
<p>Has the Joint Committee assessed the risk of material misstatement in the financial statements due to fraud? What are the results of this process?</p>	<p>Yes – By the establishment of control systems to reduce the risk through financial regulations, standing orders and scheme of delegation. By employing staff within the finance function with the appropriate professional qualifications. By the regular production of management accounts and comparison to annual budgets.</p>
<p>How is the Joint Committee satisfied that the overall control environment is robust? In particular, what processes does the Joint Committee have in place to identify and respond to risks of fraud?</p>	<p>Fraud risks are identified by Internal Audit in their audit planning process; in identifying key controls to be assessed as part of an audit; in targeted fraud prevention work and by raising awareness of the potential for fraud with staff, members and people working and involved with WME. This is done through the Anti-Fraud and Corruption Strategy and speaking up about Wrongdoing Policy.</p>
<p>Are there any areas where there is a potential for override of controls or inappropriate influence over the financial reporting process (for example because of undue pressure to achieve financial targets)?</p>	<p>No areas considered to be high risk.</p>
<p>Have any specific fraud risks, or areas with a high risk of fraud, been identified and what has been done to mitigate these risks?</p>	<p>No areas with a high risk of fraud have been identified. If any risks are identified, recommendations for mitigation are made to managers who then implement as necessary.</p>
<p>Are internal controls, including segregation of duties, in place and operating effectively? If not, where are the risk areas and what mitigating actions have been taken?</p>	<p>Yes</p>

# Fraud risk assessment

Question	Management response
<p>How does the Joint Committee exercise oversight over management's processes for identifying and responding to risks of fraud and breaches of internal control? What arrangements are in place to report fraud issues and risks to the Joint Committee?</p>	<p>Reliance is taken from the annual work performed by Internal Audit who regularly report on their findings to the Joint Committee. The Internal Audit plan is approved by Joint Committee at regular intervals.</p> <p>In addition the Joint Committee receives updates on governance arrangements to provide assurance that the intended controls are working e.g. Risk management updates and the Annual Governance Statement. Collaboration between the Director, Internal Audit and the Treasurer. A Staff Whistleblowing Policy is in place.</p>
<p>How does the Joint Committee communicate and encourage ethical behaviour of its staff and contractors?</p>	<p>Staff are encouraged to report their concerns about fraud as set out in the Speaking up about wrongdoing (whistleblowing) policy and the Joint Committee's Anti-Corruption Strategy.</p>
<p>How do you encourage staff to report their concerns about fraud? Have any significant issues been reported?</p>	<p>The Joint Committee has a Whistleblowing Policy in place to enable staff to raise concerns regarding malpractice.</p> <p>No issues have been reported.</p>
<p>Are you aware of any related party relationships or transactions that could give rise to risks of fraud?</p>	<p>No</p>
<p>Are you aware of any instances of actual, suspected, or alleged fraud either within the Joint Committee as a whole or within specific departments since 1 April 2018?</p>	<p>No specific frauds identified.</p>
<p>Are you aware of any whistleblower reports or reports under the Bribery Act since 1 April 2018? If so how does the Joint Committee respond to these?</p>	<p>No</p>

# Laws and regulations

## Matters in relation to laws and regulations

ISA(UK&I)250 requires us to consider the impact of laws and regulations in an audit of the financial statements.

Management, with the oversight of the Joint Committee, is responsible for ensuring that the West Mercia Energy's operations are conducted in accordance with laws and regulations including those that determine amounts in the financial statements.

As auditor, we are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement due to fraud or error, taking into account the appropriate legal and regulatory framework. As part of our risk assessment procedures we are required to make inquiries of management and the Joint Committee as to whether the entity is in compliance with laws and regulations. Where we become aware of information of non-compliance or suspected non-compliance we need to gain an understanding of the noncompliance and the possible effect on the financial statements.

Risk assessment questions have been set out below together with responses from management.

# Impact of laws and regulations

Question	Management response
<p>What arrangements does the Joint Committee have in place to prevent and detect non-compliance with laws and regulations?</p>	<p>The Joint Committee has appointed a Monitoring Officer and a Treasurer, both of whom are responsible for ensuring all applicable statutes and regulations are complied with. The Monitoring Officer will report to the Joint Committee if he/she considers any proposal or decision to be unlawful.</p> <p>The Treasurer is required to report to the Joint Committee if a decision has been made or is about to be made that involves incurring unlawful expenditure or any unlawful action in relation to the financial accounts.</p> <p>The Treasurer and the Director are professionally qualified in finance with appropriate levels of experience. The Treasurer reports directly to the Joint Committee.</p> <p>Assurance also gained from Internal Audit work for 2018-19.</p> <p>The Joint Committee has a Whistleblowing Policy in place to enable staff to raise concerns regarding malpractice. In addition, the Joint Committee's constitution incorporates Financial Regulations, Standing Orders, and Scheme of Delegation to ensure business is conducted in compliance with existing law and regulations.</p>



# Impact of laws and regulations

Question	Management response
<p>How does management gain assurance that all relevant laws and regulations have been complied with?</p>	<p>The Joint Committee has aN Annual Governance Statement which highlights the scope of responsibility which determines sound system of internal controls and management of risk. A risk register is kept and in the event of any incident, risks are reviewed to ensure controls, mitigation measures and scores are appropriate.</p> <p>The Monitoring Officer and Treasurer provide advice to the Director on compliance with relevant laws and regulations.</p> <p>Internal Audit examine, evaluate and report on arrangements to ensure compliance with legislation and regulations, recommending to management any arrangements to address weaknesses, as necessary.</p>
<p>How is the Joint Committee provided with assurance that all relevant laws and regulations have been complied with?</p>	<p>The Monitoring Officer and Treasurer provide advice to the Joint Committee on compliance with relevant laws and regulations.</p> <p>The Joint Committee is responsible for the approval of the Annual Governance Statement and the review of the related assurances which set out the system of internal control and detail the policies and procedures in place. This provides the assurance that management arrangements are in place for identifying and responding to changes in law and regulations and highlights any significant governance issues arising as a result of such changes.</p> <p>Internal Auditors' reports to the Joint Committee incorporate issues relating to compliance with legislation and regulations, where appropriate.</p>

# Impact of laws and regulations

Question	Management response
<p>Have there been any instances of non-compliance or suspected non-compliance with law and regulations since 1 April 2018, or earlier with an on-going impact on the 2018/19 financial statements?</p>	<p>We are aware that a Customer has a query in respect of WME's compliance with or exemption from the need to be a licensed supplier of electricity under the Electricity Act 1989, therefore are on notice that a Customer is querying a possible non-compliance given their interpretation of the Act and WME's arrangements.</p> <p>The Customer is being supplied with energy by TOTAL Gas &amp; Power (who is a licensed supplier) and as such WME does not consider that it is the supplier of electricity to the Customer requiring a licence.</p> <p>WME is currently consulting an external legal advisor to review its contractual arrangements to ensure that they clearly address any application of the Electricity Act 1989 to WME or confirm its non-application, and to ensure that there is no ambiguity as to the relationship between the Customer, WME and the energy supplier.</p>
<p>What arrangements does the Joint Committee have in place to identify, evaluate and account for litigation or claims?</p>	<p>The Treasurer has responsibility to account for litigation or claims in the annual accounts that are considered by Joint Committee and subject to external audit.</p> <p>Given the relatively small size of the organisation, the Director would be aware of or be made aware of by his team of any issues.</p>
<p>Is there any actual or potential litigation or claims that would affect the financial statements?</p>	<p>No</p>
<p>Have there been any reports from other regulatory bodies, such as HM Revenues and Customs which indicate non-compliance?</p>	<p>No</p>

# Going concern

## Matters in relation to laws and regulations

ISA(UK&I)570 covers auditor responsibilities in the audit of financial statements relating to management's use of the going concern assumption in the financial statements.

Going concern is a fundamental principle in the preparation of financial statements. Under the going concern assumption, West Mercia Energy is viewed as continuing in operation for the foreseeable future with no necessity of liquidation or ceasing trading. Accordingly, the Joint Committee's assets and liabilities are recorded on the basis that assets will be realised and liabilities discharged in the normal course of business.

Below are key questions on the going concern assumption which we would like the Audit & Governance Committee to consider.

# Going concern considerations

Question	Management response
Does the Joint Committee have procedures in place to assess the Joint Committee's ability to continue as a going concern?	A detailed Business Plan for the Joint Committee is approved in February each year, this looks forward two years. Regular management reporting is produced for the Joint Committee indicating the positive trading performance of the business.
Is management aware of the existence of other events or conditions that may cast doubt on the Joint Committee's ability to continue as a going concern?	No
Are arrangements in place to report the going concern assessment to the Joint Committee? How has the Joint Committee satisfied itself that it is appropriate to adopt the going concern basis in preparing the financial statements?	The WME Business Plan for 2019/20 contains financial projections for 2019/20 and the Business Plan constitutes a going concern assessment where factors affecting future profitability have been considered. The Joint Agreement has been extended to 31 <sup>st</sup> March 2020 and has recently been updated further. Management regularly report to the Flexible Energy Advisory Panel in terms of future trading performance and contractual positions.
Are the financial assumptions in that report (e.g., future levels of income and expenditure) consistent with the Joint Committee's Business Plan and the financial information provided to the Joint Committee throughout the year?	Yes
Are the implications of statutory or policy changes appropriately reflected in the Business Plan, financial forecasts and report on going concern?	Yes

# Going concern considerations

Question	Management response
Have there been any significant issues raised with the Joint Committee during the year which could cast doubts on the assumptions made? (Examples include adverse comments raised by internal and external audit regarding financial performance or significant weaknesses in systems of financial control).	No
Does a review of available financial information identify any adverse financial indicators including negative cash flow? If so, what action is being taken to improve financial performance?	No
Does the Joint Committee have sufficient staff in post, with the appropriate skills and experience, particularly at senior manager level, to ensure the delivery of the Joint Committee's objectives? If not, what action is being taken to obtain those skills?	Yes

# Related parties

## Matters in relation to Related Parties

Local Government bodies are required to comply with IAS 24 and disclose transactions with entities/individuals that would be classed as related parties. These may include:

- entities that directly, or indirectly through one or more intermediaries, control, or are controlled by the Joint Committee (i.e. subsidiaries);
- associates;
- joint ventures;
- an entity that has an interest in the Joint Committee that gives it significant influence over the Joint Committee;
- key management personnel, and close members of the family of key management personnel, and
- post-employment benefit plans (pension fund) for the benefit of employees of the Joint Committee, or of any entity that is a related party of the Joint Committee.

A disclosure is required if a transaction (or series of transactions) is material on either side, i.e. if a transaction is immaterial from the Joint Committee perspective but material from a related party viewpoint then the Joint Committee must disclose it.

ISA (UK&I) 550 requires us to review your procedures for identifying related party transactions and obtain an understanding of the controls that you have established to identify such transactions. We will also carry out testing to ensure the related party transaction disclosures you make in the financial statements are complete and accurate.

Related party considerations have been set out below and management has provided its response.

# Related parties

Question	Management response
What controls does the Joint Committee have in place to identify, account for, and disclose related party transactions and relationships?	Members and chief officers complete annually a Related Party Transactions Declaration Form. At the formal tender stage of contracts, the tenderer is required to complete a declaration of any connection with officers or elected members of WME.
Who have the Joint Committee identified as related parties?	See response as above. Also within the annual accounts transactions for the financial year between WME and each of the Member Authorities are disclosed.

# Accounting estimates

## Matters in relation to accounting estimates

Local Government bodies need to apply appropriate estimates in the preparation of their financial statements. ISA (UK&I) 540 sets out requirements for auditing accounting estimates. The objective is to gain evidence that the accounting estimates are reasonable and the related disclosures are adequate. Under this standard we have to identify and assess the risks of material misstatement for accounting estimates by understanding how the Joint Committee identifies the transactions, events and conditions that may give rise to the need for an accounting estimate.

Accounting estimates are used when it is not possible to measure precisely a figure in the accounts. We need to be aware of all material estimates that the CCG is using as part of its accounts preparation; these are detailed in Appendix A to this report. The audit procedures we conduct on the accounting estimate will demonstrate that:

- the estimate is reasonable; and
- estimates have been calculated consistently with other accounting estimates within the financial statements.

Accounting estimates considerations have been set out below and management has provided its response.



# Accounting estimates

Question	Management response
Are management aware of transactions, events and conditions (or changes in these) that may give rise to recognition or disclosure of significant accounting estimates that require significant judgement?	No
Are the management arrangements for the accounting estimates, as detailed in Appendix A reasonable?	Yes
How is the Joint Committee provided with assurance that the arrangements for accounting estimates are adequate?	By obtaining the necessary input of the Treasurer, Director and Internal Audit as required.

# Appendix A - Accounting estimates

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Estimated remaining useful lives of Property Plant and Equipment and Motor Vehicles	Assets are assigned to asset categories with appropriate asset lives.	Consistent asset lives applied to each asset category.	No	The useful lives of equipment are recorded in accordance with the adopted accounting policy of the Joint Committee	No
Depreciation	Depreciation is provided for on property plant and equipment and motor vehicles with a finite useful life on a straight-line basis	Consistent application of depreciation method across assets	No	The length of the life is determined at the point of acquisition or revaluation.	No
Impairments	Assets are assessed at each year-end as to whether there is any indication that an asset may be impaired. Where indications exist and any possible differences are estimated to be material, the recoverable amount of the asset is estimated and, where this is less than the carrying amount of the asset, an impairment loss is recognised for the shortfall.	Assets are assessed at each year-end as to whether there is any indication that an asset may be impaired.	No	Valuations are made in-line with the CIPFA Code of Practice guidance.	No
Non adjusting events - events after the balance sheet date	The Joint Committee follows the requirements of the CIPFA Code of Practice.	The Treasurer is notified by the Director.	This would be considered on individual circumstances	This would be considered on individual circumstances	No

# Appendix A - Continued

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Measurement of Financial Instruments	Measurements are obtained from appropriate sources. The Joint Committee follows the requirements of the CIPFA Code of Practice.	The financial instruments are measured by the Director and the accounts reviewed by the Treasurer .	No	The measurements are based upon the best information held at the current time and are provided by experts in their field.	No
Creditor accruals	Accruals are estimated by reviewing goods and services received prior to the end of the financial year for which an invoice has not been received.	The date of receipt of the goods and services is used in the estimation of the accrual.	No	The use of actual dates of receipt of goods and services gives a low degree of uncertainty.	No
Pension Fund (LGPS) Actuarial gains/losses	The actuarial gains and losses figures are calculated by the actuarial expert Mercers. These figures are based on making % adjustments to the closing values of assets/liabilities.	The Joint Committee responds to queries raised by the administering Joint Committee Shropshire Council.	The Joint Committee are provided with an actuarial report by Mercers (LGPS).	The nature of these figures forecasting into the future are based upon the best information held at the current time and are developed by experts in their field.	No
Provisions for liabilities	Provisions are made where an event has taken place that gives the Joint Committee a legal or constructive obligation that probably requires settlement by a transfer of economic benefits or service potential, and a reliable estimate can be made of the amount of the obligation. Provisions are charged as an expense line in the CI&ES in the year that the Joint Committee becomes aware of the obligation, and are measured at the best estimate at the balance sheet date of the expenditure required to settle the obligation, taking into account relevant risks and uncertainties	Charged in the year that the Joint Committee becomes aware of the obligation	No	Estimated settlements are reviewed at the end of each financial year – where it becomes less than probable that a transfer of economic benefits will now be required (or a lower settlement than anticipated is made), the provision is reversed and credited back to the relevant service. Where some or all of the payment required to settle a provision is expected to be recovered from another party (e.g. from an insurance claim), this is only recognised as income if it is virtually certain that reimbursement will be received by the Joint Committee	No



[grantthornton.co.uk](http://grantthornton.co.uk)

© 2019 Grant Thornton UK LLP

'Grant Thornton' refers to the brand under which the Grant Thornton member firms provide assurance, tax and advisory services to their clients and/or refers to one or more member firms, as the context requires. Grant Thornton UK LLP is a member firm of Grant Thornton International Ltd (GTIL). GTIL and the member firms are not a worldwide partnership. GTIL and each member firm is a separate legal entity. Services are delivered by the member firms. GTIL does not provide services to clients. GTIL and its member firms are not agents of, and do not obligate, one another and are not liable for one another's acts or omissions.