Audit Findings

Year ending 31 March 2020

West Mercia Energy
29 September 2020

Contents

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Appendices

The contents of this report relate only to those matters which came to our attention during the conduct of our normal audit procedures which are designed for the purpose of expressing our opinion on the financial statements. Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify control weaknesses, we will report these to you. In consequence, our work cannot be relied upon to disclose all defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

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Headlines

This table summarises the key issues arising from the audit of West Mercia Energy (‘the Joint Committee’) and the preparation of the Joint Committee's financial statements for the year ended 31 March 2019 for those charged with governance.

Financial Statements

Under the International Standards of Auditing (UK) (ISAs), we report whether, in our opinion:

- the Joint Committee's financial statements give a true and fair view of the Joint Committee’s financial position and Joint Committee’s expenditure and income for the year, and
- have been properly prepared in accordance with the CIPFA/LASAAC code of practice on local authority accounting and prepared in accordance with the Local Audit and Accountability Act 2014.

We also report whether other information published together with the audited financial statements (including the Statement of Accounts, Annual Governance Statement (AGS) and Narrative Report), is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

Our audit work was completed remotely in August and September and is substantially complete (see page 5). We have not identified any adjustments to the financial statements that have resulted in an impact on the Statement of Comprehensive Income and Expenditure. We anticipate issuing an unqualified audit opinion following the Joint Committee meeting on 29 September 2020, and receipt of the management representation letter.

We have concluded that the other information published with the financial statements, which includes the Statement of Accounts, Annual Governance Statement and Narrative Report, are consistent our knowledge of your organisation and with the financial statements we have audited.

Covid-19

The outbreak of the Covid-19 coronavirus pandemic has had a significant impact on the normal operations of the Joint Committee, principally around the requirements to work remotely in addition to significant changes to the profile of energy use by WME’s clients and related additional forecasting.

Both finance and the audit team also faced difficulties around access to systems and planning for the possibility of reduced capacity due to staff sickness.

We updated our audit risk assessment to consider the impact of the pandemic on our audit, resulting in an additional financial statements level significant risk being designated in respect of Covid 19. Further detail is set out on page 6.

Draft financial statements were provided to the audit team on 27 July 2020 as agreed.

Restrictions for non-essential travel and social distancing meant both WME staff and the audit team had to adapt to working entirely remotely. There were particular challenges this year in areas such as physical verification of assets, completion of ‘walkthrough’ testing and observation of the production of reports such as the Trial Balance and Journals report. WME staff and the audit team used video calling and screen sharing technology to overcome these challenges.

Acknowledgements

We would like to take this opportunity to record our appreciation for the assistance provided by the finance team and other staff during our audit and in particular the positive way they have supported us working remotely.

Summary

Overview of the scope of our audit

This Audit Findings presents the observations arising from the audit that are significant to the responsibility of those charged with governance to oversee the financial reporting process, as required by International Standard on Auditing (UK) 260 and the Code of Audit Practice ('the Code'). Its contents have been discussed with management.

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

Audit approach

Our audit approach was based on a thorough understanding of the Joint Committee's business and is risk based. It included:

- An evaluation of the Joint Committee's internal controls environment including its IT systems and controls
- Substantive testing on significant transactions and material account balances, including the procedures outlined in this report in relation to the key audit risks
- An additional Financial Statement level significant risk in relation to the impact of the pandemic.

Conclusion

We have substantially completed our audit of your financial statements and subject to outstanding queries being resolved (outlined at the Status of the Audit slide overleaf), we anticipate issuing an unqualified audit opinion following the Joint Committee meeting on 29 September 2020.

Our approach to materiality

The concept of materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to the monetary misstatements but also to disclosure requirements and adherence to acceptable accounting practice and applicable law.

Our assessment of the value of materiality has been adjusted on receipt of the 2019/20 draft accounts. We detail in the table below our assessment of materiality for West Mercia Energy.

	Joint Committee Amount (£)	Qualitative factors considered
Materiality for the financial statements	1,400k	2% of turnover (approximately) • User expectation, prior year measures, entity concept of materiality, risk
Performance materiality	1,050k	75% of headline materiality • Experience of misstatement, business activities, accounting systems, people, controls, fraud risks
Trivial matters	70k	5% of headline materiality in line with ISAs
Materiality for specific transactions, balances or disclosures	50k	Remuneration disclosures • Materiality has been reduced due to sensitive nature and public interest in these disclosures

Status of the audit and audit opinion

Our work is substantially complete and there are currently no matters of which we are aware that would require modification of our audit opinion, subject to the outstanding matters detailed below.

- ● Receipt of assurance from the auditors of Shropshire County Pension Fund in relation to the IAS 19 disclosures.
- ● Completion of audit testing including receipt of bank confirmations requested and documentation of debtor and creditor sample testing .
- ● Receipt of signed management representation letter.
- ● Review of final set of draft financial statements and resolution of review points following engagement lead final review.

Status

- 🔴 Likely to result in material adjustment or significant change to disclosures within the financial statements
- 🟠 Potential to result in material adjustment or significant change to disclosures within the financial statements
- 🟢 Not considered likely to result in material adjustment or change to disclosures within the financial statements

Our anticipated audit report opinion will be unmodified

Significant audit risks

	Risks identified in our Audit Plan	Auditor commentary
①	**Improper revenue recognition** Under ISA 240 (UK) there is a presumed risk that revenue may be misstated due to the improper recognition of revenue. For West Mercia Energy, we have concluded that the greatest risk of material misstatement relates to the occurrence of utility income	We have undertaken the following work in relation to this risk: – reviewed and tested revenue recognition policies; – evaluated design and tested operating effectiveness of controls around revenue recognition; and – analytical review and substantive testing of income transactions. As a result of audit procedures performed, we have not identified any issues in relation to improper revenue recognition
②	**Management override of controls** Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities. We identified management override of controls as a risk requiring special audit consideration.	We have undertaken the following work in relation to this risk: – evaluated design effectiveness of management controls over journals; – analysed the journals listing and determined the criteria for selecting high risk, unusual journals; – tested unusual journals recorded during the year and after the draft accounts stage for appropriateness and corroboration; and – gained an understanding of the accounting estimates and critical judgments applied made by management and considered their reasonableness with regard to corroborative evidence. As a result of audit procedures performed, we have not identified any issues in relation to management override of controls.
③	**Covid– 19** Following the outbreak of Covid 19 and subsequent lockdown restrictions in March 2020, we designated an additional financial statement level significant risk in respect of the pandemic and its impact on global market conditions (in particular in relation to the LGPS liability calculation) and control and governance issues associated with remote working.	We have undertaken the following work in relation to this risk : – worked with management to understand the implications the response to the Covid-19 pandemic had on the organisation's ability to prepare the financial statements and update financial forecasts and assessed the implications for our materiality calculations (no changes were made to materiality levels previously reported); – evaluated the adequacy of the disclosures in the financial statements that arose in light of the Covid-19 pandemic; – evaluated whether sufficient audit evidence could be obtained through remote technology; – evaluated whether sufficient audit evidence could be obtained to corroborate significant management estimates such as assets and the pension fund liability valuations; and – evaluated management's assumptions that underpin the revised financial forecasts and the impact on management's going concern assessment We have not identified any material uncertainties in relation to Covid-19 that would result in a material misstatement in the financial statements.

Significant audit risks (continued)

Risks identified in our Audit Plan	Auditor commentary
④ **Valuation of pension fund net liability** The Joint Committee's pension fund asset and liability as reflected in its balance sheet represent a significant estimate in the financial statements. We identified the valuation of the pension fund net liability as a risk requiring special audit consideration	We have undertaken the following work in relation to this risk: – updated our understanding of the processes and controls in place to ensure that the pension fund net liability is not materially misstated and evaluated the design of associated controls; – evaluated the instructions issued by management of the information provided to the actuary to estimate the net pension liability; – assessed the competence, capabilities and objectivity of the actuary; – assessed the accuracy and completeness of the information provided to the actuary to estimate the net pension liability; – tested the consistency of the pension fund assets and liabilities and disclosures in the financial statements with the actuarial report; and – undertaken procedures to confirm the reasonableness of the actuarial assumptions made by reviewing the report of the consulting actuary and performing any additional procedures suggested within the report; As a result of audit procedures performed, we have not identified any issues in relation to the valuation of the pension fund net liability. Our conclusion is subject to assurances from the auditor of Shropshire County Pension Fund as to the control surrounding the validity and accuracy of membership data, contributions data and the benefits data sent to the actuary by the pension fund, and the assets valuation in the pension fund financial statements.
Going concern disclosures WME is dependent on being able to trade on favourable terms within the existing energy market. There are heightened risks for trading die to Brexit outcomes uncertainties. We therefore identified the adequacy of disclosures relating to going concern in the financial statements as a significant risk at the planning stage.	We have undertaken the following work in relation to this risk: During the planning stage of the audit we were concerned about the potential impact of on access to energy markets and currency fluctuations of a ‘no deal’ Brexit. Following this, the Covid19 pandemic created additional pressures in relation to reduced energy usage at client sites following the imposition of lockdown restrictions and the possibility of a worsening economic outlook leading to an unwillingness to continue the arrangement on the part of the owners. The results of our work in this area are set out overleaf. We have no concerns to report about the Joint Committee adopting the going concern concept for its 2019/20 financial statements.

Going concern

Our responsibility

As auditors, we are required to “obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern” (ISA (UK) 570).

Going concern commentary	Auditor commentary
Management's assessment process	
Management have undertaken the following process in order to determine the applicability of the going concern assumption: • Produced a detailed business plan for the 2020/21 period • Obtained joint agreements between owning authorities • Produced long term cash flow forecasts	Management have concluded that West Mercia Energy is a going concern and as such, the financial statements have been prepared on this basis.
Work performed • Consideration of factors and events which may be indicative of a going concern issue or cast significant doubt over an entity’s ability to continue as a going concern • Review of management’s supporting documents as stated above to understand whether assumptions used are reasonable • Inquiries of key management personnel	There are no factors that we are aware of which we consider would cast significant doubt over West Mercia Energy’s ability to continue as a going concern. We considered three key risks to the going concern assumption. - Maintaining cash liquidity for foreseeable future - The potential impact of a ‘no deal’ Brexit on energy markets and West Mercia Energy’s business model - The withdrawal of one or more member authorities from the Joint Committee Management assumptions in relation to cash flow, which is the key driver in ensuring solvency, appear reasonable. The assessment provided extends to 12 months following the date of anticipated audit opinion. The possibility of a ‘no deal’ Brexit does not appear to present a fundamental threat to West Mercia Energy’s financial viability. It is reasonable to conclude at this time that the major driver of the future success of West Mercia Energy will be the impact of supply and demand on market prices, with Brexit being one of a number of factors impacting that. To date West Mercia Energy has provided a net financial contribution to the Joint Committee member authorities. It appears unlikely that West Mercia Energy will become unprofitable due to the impact of Brexit or Covid19 and it has large contracts secured for 2022 and 2023. No member authorities have given notice of intention to leave to Joint Committee.
Concluding comments	Overall, we are satisfied that the preparation of the financial statements using the going concern principal is reasonable. Our conclusion is based on the assumption that the four member organisations of the Joint Committee will continue the current arrangement and to support WME for at least the next 12 months.

Significant findings – key judgements and estimates

	Summary of management's policy	Audit Comments	Assessment
Net pension liability – £6.809m	The Joint Committee's net pension liability at 31 March 2020 is £6.928m (PY £6.809mm) comprising the Shropshire County Pension Fund Local Government and unfunded defined benefit pension scheme obligations. The Joint Committee uses Mercer to provide actuarial valuations of the Joint Committee's assets and liabilities derived from this scheme. A full actuarial valuation is required every three years. The latest full actuarial valuation was completed in 2019. A roll forward approach is used in intervening periods, which utilises key assumptions such as life expectancy, discount rates, salary growth and investment returns. Given the significant value of the net pension fund liability, small changes in assumptions can result in significant valuation movements. As at the time of writing, we await receipt of assurance from the auditors of Shropshire Pension Fund in relation to information supplied to the Actuary for the purposes of the triennial valuation. Our opinion will be subject to receipt of this assurance.	See below	🟠 (subject to Pension Fund auditor response)

Audit Comments

We have

- Undertaken an assessment of management's expert
- Reviewed and assessed the actuary's roll forward approach taken,
- Used an auditors expert (PWC) to assess the actuary and assumptions made by the actuary

Assumption	Actuary Value	PwC range	Assessment
Discount rate	2.3%	2.3% – 2.4%	🟢
Pension increase rate	2.2%	2.1%	🟢
Salary growth	3.35%	Employer specific Long term: 3.35% - 3.6%	🟢
Life expectancy – Males currently aged 45 / 65	24.2/ 22.9	22.5 – 24.7 / 20.9 – 23.2	🟢
Life expectancy – Females currently aged 45 / 65	26.6 / 25	25.9 – 27.7/ 24 – 25.8	🟢

Reviewed

- the completeness and accuracy of the underlying information used to determine the estimate
- Impact of any changes to valuation method
- Reasonableness of the Authority's share of LPS pension assets.
- Reasonableness of increase/decrease in estimate
- Adequacy of disclosure of estimate in the financial statements

Assessment

🔴 We disagree with the estimation process or judgements that underpin the estimate and consider the estimate to be potentially materially misstated
🟠 We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider optimistic
🟡 We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider cautious
🟢 We consider management's process is appropriate and key assumptions are neither optimistic or cautious

Accounting policies

Accounting area	Summary of policy	Comments	Assessment
Revenue recognition	• Revenue and capital transactions are accounted for on an accruals basis. This means that all revenue income is recorded when the debt has been established rather than when money has been received.	• The policy is appropriate under the relevant accounting framework, IFRS. • Extent of judgement involved is low, and the range of possible outcomes and potential financial statement impact of different accounting policy choices would be minimal • Disclosure of the accounting policy in the notes to the financial statements is adequate • Accounting policy is reasonable when compared to peers and industry practice	● Green
Judgements and estimates	• Key estimates and judgements include: – Accruals – Valuation of pension fund net liability	• The accounting policies for areas of key estimate and judgement are adequately disclosed and appropriate under the relevant accounting framework, IFRS. • Testing performed in relation to accruals has not identified any issues, we consider management procedures for calculation liabilities to be appropriate • The extent of management judgment involved in the calculation of the net defined benefit obligation associated with the LGPS is minimal. Reliance is placed on actuarial experts of which we have corroborated and found to be reasonable • Please note, we await responses from the auditors of Shropshire Pension Fund in relation to data supplied to the Actuary for the purposes of the triennial valuation prior to being able to issue assurance over the estimate and accounts.	● Amber (work in progress)
Other critical policies		• We have reviewed the Joint Committee's policies against the requirements of the CIPFA Code of Practice. The Joint Committee's accounting policies are appropriate and consistent with previous years.	● Green

Assessment

- 🟥 Marginal accounting policy which could potentially be open to challenge by regulators
- 🟧 Accounting policy appropriate but scope for improved disclosure
- 🟩 Accounting policy appropriate and disclosures sufficient

Other communication requirements

We set out below details of other matters which we, as auditors, are required by auditing standards and the Code to communicate to those charged with governance.

Issue	Commentary
Matters in relation to fraud	We have previously discussed the risk of fraud with the Joint Committee. We have not been made aware of any incidents of material fraud in the period and no other issues have been identified during the course of our audit procedures.
Matters in relation to related parties	We are not aware of any related parties or related party transactions which have not been disclosed.
Matters in relation to laws and regulations	You have not made us aware of any significant incidences of non-compliance with relevant laws and regulations and we have not identified any incidences from our audit work.
Written representations	A letter of representation has been requested from the Joint Committee, which is included in the Committee papers.
Confirmation requests from third parties	We requested from management permission to send confirmation requests to entities with which the Joint Committee holds cash. This permission was granted and the requests were sent and information obtained as required.
Disclosures	Our review found no material omissions in the financial statements.
Audit evidence and explanations/significant difficulties	All information and explanations requested from management was provided.

Other responsibilities under the Code

Issue	Commentary
Other information	We are required to give an opinion on whether the other information published together with the audited financial statements (including the Annual Governance Statement and Narrative Report) is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. No inconsistencies have been identified. We plan to issue an unmodified opinion in this respect.
Matters on which we report by exception	We are required to report on a number of matters by exception in a numbers of areas: • If the Annual Governance Statement does not meet the disclosure requirements set out in the CIPFA/SOLACE guidance or is misleading or inconsistent with the other information of which we are aware from our audit • If we have applied any of our statutory powers or duties We have nothing to report on these matters.
Certification of the closure of the audit	We intend to certify the closure of the 2019/20 audit of West Mercia Energy Joint Committee in the audit opinion.

Independence and ethics

Independence and ethics

- We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Financial Reporting Council's Ethical Standard and confirm that we, as a firm, and each covered person, are independent and are able to express an objective opinion on the financial statements

We confirm that we have implemented policies and procedures to meet the requirements of the Financial Reporting Council’s Ethical Standard and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements.

Further, we have complied with the requirements of the National Audit Office’s Auditor Guidance Note 01 issued in December 2017 which sets out supplementary guidance on ethical requirements for auditors of local public bodies.

Details of fees charged are detailed in Appendix B.

Audit and Non-audit services

No non-audit services have been provided to the Joint Committee.

Audit Adjustments

We are required to report all non trivial misstatements to those charged with governance, whether or not the accounts have been adjusted by management.

Impact of adjusted/ unadjusted misstatements

As a result of audit procedures undertaken, we have not identified any misstatements for adjustment.

Misclassification and disclosure changes

- The draft accounts included 30 years as the weighted average duration of the defined benefit obligation for scheme members. The assumption disclosed as adopted for WME is outside the range used by the actuary that PwC has concluded is reasonable. On undertaking further work to corroborate the duration stated, we identified that the 30 years reflects the workforce and profile after the transfer of WMS. The stated assumption was adjusted to 16 years, which is in keeping with the combined WME and WMS employer positions.

- We also noted a smaller number of trivial disclosure and clerical issues which were amended by the Finance team within the final set of financial statements.

Fees

We confirm below our final fees charged for the audit.

Audit Fees

	Proposed fee	Final fee
Joint Committee audit	£14,250	£14,250
Total audit fees (excluding VAT)	**£14,250**	**£14,250**

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