Grant Thornton

Annual Audit Letter

Year ending 31 March 2018

Merseyside Waste Disposal Authority

29 August 2018

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Executive Summary

Purpose

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at Merseyside Waste Disposal Authority (the Authority) and its subsidiaries (the Group) for the year ended 31 March 2018.

This Letter is intended to provide a commentary on the results of our work to the Authority and external stakeholders, and to highlight issues that we wish to draw to the attention of the public. In preparing this Letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'. We reported the detailed findings from our audit work to the Authority's Audit Committee as those charged with governance in our Audit Findings Report on 27 July 2018.

Respective responsibilities

We have carried out our audit in accordance with the NAO's Code of Audit Practice, which reflects the requirements of the Local Audit and Accountability Act 2014 (the Act). Our key responsibilities are to:

- give an opinion on the Authority and group's financial statements (section two)
- assess the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources (the value for money conclusion) (section three).

In our audit of the Authority and group's financial statements, we comply with International Standards on Auditing (UK) (ISAs) and other guidance issued by the NAO.

Our work

Materiality	We determined materiality for the audit of the Authority's financial statements to be £1,136,000 (Group £1,145,000), which is 1.7% of the Authority's (and Group's) gross revenue expenditure.
Financial Statements opinion	We gave an unqualified opinion on the Authority and Group's financial statements on 31 July 2018.
Use of statutory powers	We did not identify any matters which required us to exercise our additional statutory powers.
Value for Money arrangements	We were satisfied that the Authority put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources. We reflected this in our audit report to the Authority on 31 July 2018.
Certificate	We certify that we have completed the audit of the accounts of Merseyside Waste Disposal Authority in accordance with the requirements of the Code of Audit Practice.

Audit of the Accounts

Materiality

In our audit of the Authority's financial statements, we use the concept of materiality to determine the nature, timing and extent of our work, and in evaluating the results of our work. We define materiality as the size of the misstatement in the financial statements that would lead a reasonably knowledgeable person to change or influence their economic decisions.

We determined materiality for the audit of the Authority's accounts to be £1,136,000 (Group £1,145,000), which is 1.7% of the Authority's (and Group’s) gross revenue expenditure. We used this benchmark as, in our view, users of the Authority’s and group’s financial statements are most interested in where the Authority and group has spent its revenue in the year.

We also set a lower level of specific materiality for senior officer remuneration of £20,000 due to its sensitive nature.

We set a lower threshold of £57,000 (Group £57,000), above which we reported errors to the Audit Committee in our Audit Findings Report.

The scope of our audit

Our audit involves obtaining sufficient evidence about the amounts and disclosures in the financial statements to give reasonable assurance that they are free from material misstatement, whether caused by fraud or error. This includes assessing whether:

- the accounting policies are appropriate, have been consistently applied and adequately disclosed
- the significant accounting estimates made by management are reasonable
- the overall presentation of the financial statements gives a true and fair view.

We also read the remainder of the statement of accounts, the narrative report and the annual governance statement to check that they are consistent with our understanding of the Authority, and with the financial statements included in the statement of accounts on which we gave our opinion.

We carry out our audit in accordance with ISAs (UK) and the NAO Code of Audit Practice. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our audit approach is based on a thorough understanding of the Authority’s business and is risk based.

We identified key risks and set out overleaf the work we performed in response to these risks and the results of this work.

Audit of the Accounts

Significant Audit Risks

These are the significant risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Improper revenue recognition Under ISA 240 (UK) there is a presumed risk that revenue may be misstated due to the improper recognition of revenue. This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.	Having considered the risk factors set out in ISA240 and the nature of the revenue streams at the Authority, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because: • there is little incentive to manipulate revenue recognition • opportunities to manipulate revenue recognition are very limited • the culture and ethical frameworks of local authorities, including Merseyside Waste Disposal Authority, mean that all forms of fraud are seen as unacceptable Therefore, we did not consider this to be a significant risk for Merseyside Waste Disposal Authority.	Whilst we rebutted this risk, our other work on the Authority's income including levy income did not identify any issues.
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 have: • gained an understanding of the accounting estimates, judgements applied and decisions made by management and considered their reasonableness • obtained a full listing of journal entries, identified and tested any unusual risk journal entries for appropriateness • evaluated the rationale for any changes in accounting policies or significant unusual transactions • reviewed significant related party transactions.	Our audit work has not identified any issues in respect of management override of controls.

Audit of the Accounts

Significant Audit Risks *(continued)*

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Accounting for changes in the Authority's operations The Resource Recovery Contract (RRC), a Public Private Partnership (PPP) scheme became fully operational on 1 September 2017. The Authority fully accounted for its contractual arrangement with Merseyside Energy Recovery Limited (MERL) – which is a consortium formed by SUEZ recycling and recovery UK, Sembcorp Utilities UK and I-Environment Investments Ltd - in its 2017/18 financial statements and will do for future years. Given the significant size of the contract and the complex nature of the accounting requirements, we have identified the accounting model to be used, the associated accounting entries and disclosures to be made in the financial statements as a risk requiring special consideration in this first year.	We have: • examined and tested the accuracy of the accounting entries and disclosures made ▪ reviewed management's processes and assumptions for the calculation of the valuation of the RRC assets, the instructions issued to valuation experts and the scope of their work ▪ considered the competence, specialist expertise and objectivity of the valuer, especially given the specialised nature of the assets under this scheme ▪ discussed with the valuer the basis on which the valuation has been carried ▪ reviewed whether impairments have been considered in accordance with IAS36. ▪ gained an understanding of the operations and accounting position proposed in discussion with management and the Authority's consultant • reviewed the accounting model developed and the entries proposed for reasonableness against our understanding of the RRC. Following discussions with the valuer, we identified that the land and buildings at the Knowsley site, where the Rail Transfer Loading Station is located, were acquired via a lease. During construction, some of these buildings were developed for use in providing the service concession arrangement. Management has confirmed that the lease is part of the service concession arrangement and its costs are included in the MERL's financial close model. At the end of the 30 year arrangement, MWDA has the option to extend the contract for a period of five years, after which the lease reverts to the Authority.	Our audit work has not identified any issues in respect of the RRC although our work identified a number of amendments to the draft accounts to correctly record and account for this complex transaction and the associated disclosure notes within the financial statements including: • the valuation of the Resource Recovery Contract in the draft accounts was understated being based on an initial estimate. The final valuation was £40.8m higher and increased total assets and net current liabilities by the same amount • a reduction of £1.97m to interest charges as the model used was not updated correctly. This reduced the charge to the Comprehensive Income and Expenditure Statement and was reversed out through the Capital Adjustment Account, with no overall impact on the outturn financial position for the year. The reduction in interest charges also reduced current assets and net current liabilities by the same amount in the balance sheet • disclosure amendments to the table in Note 28 to correctly analyse payments due within 1 year and long term liabilities. Payments due within one year were understated by £7.97m with a corresponding overstatement of long term liabilities. Management processed all of the amendments identified during our audit work.

Audit of the Accounts

Significant Audit Risks *(continued)*

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Operating expenses Non-pay expenses on other goods and services represents a significant percentage of the Authority's operating expenses. Management uses judgement to estimate accruals of un-invoiced costs. We have identified completeness of non-pay expenses as a risk requiring particular audit attention.	We have: • evaluated the Authority's accounting policy for recognition of non-pay expenditure for appropriateness • gained an understanding of the Authority's system for accounting for non-pay expenditure and documented our understanding of processes and key controls over the transaction cycle • undertaken a walkthrough of the key controls to assess whether those controls were in line with our documented understanding • tested a sample of operating expenses covering the full financial year • agreed the year-end creditor balance to system balances and control account reconciliations • tested a sample of year-end accruals and creditor balances. • performed cut-off testing to obtain assurance that creditors have been accounted for in the correct financial year.	Our audit work did not identify any issues in respect of operating expenses except for some differences in the year end creditor accruals and actual expenditure. Whilst not material, we recommended management should consider ways to further strengthen its arrangements to estimate accruals. We recognise the finance resources at the Authority are limited to a team of two.
Valuation of property, plant and equipment The Authority completed a revaluation of its asset base on 31 March 2016. This valuation informed the basis of valuation of assets recorded in the 2017-18 financial statements after taking into account any impairments, fixed asset additions and disposals and any other circumstances that have significantly affected the valuation of assets since this last revaluation. This represents a significant estimate by management in the financial statements and a possibly complex valuation assessment.	We have: • reviewed management's processes and assumptions for the calculation of the estimate • considered the competence, expertise and objectivity of the management experts used • reviewed the instructions issued to valuation experts and the scope of their work • reviewed and challenged the information used by the valuer to ensure it was robust and consistent with our understanding • tested revaluations made during the year to ensure they were input correctly into the Authority's accounts • evaluated the assumptions made by management for those assets not revalued during the year and how management satisfied themselves that these were not materially different to current value.	No issues have been identified from our work in respect of the valuation of property, plant and equipment, except for the valuation for the Resource Recovery Contract that was used to compile the accounts submitted for audit which was initially based on an estimate. The final expert valuation reported a higher asset valuation requiring an increase to the asset value of £40.8m. This amendment was processed by management.

Audit of the Accounts

Audit opinion

We gave an unqualified opinion on the Authority and Group's financial statements on 31 July 2018

Preparation of the accounts

The Authority presented us with draft accounts in accordance with the national deadline.

As in previous years, our audit work identified a number of amendments to the draft financial statements resulting from misclassification and disclosure changes, differences in year end creditor accruals and actual expenditure, and differences in the consolidation of the group accounts. We recognise the finance resources at the Authority are limited but recommended management consider any additional ways to further strengthen its arrangements for accounts preparation and review to further reduce any amendments required to the draft accounts in future years.

Issues arising from the audit of the accounts

We reported the key issues from our audit to the Authority's Audit Committee on 27 July 2018.

We identified one adjustment affecting the group and Authority's reported financial position relating to the valuation for the Resource Recovery Contract which was understated being based on an initial estimate which needed updating . The final expert valuation reported a higher asset valuation requiring an increase to the asset value of £40.8m which the Authority processed in its accounts.

A number of amendments were also made to the financial statements following our audit in respect of disclosure and misclassification changes. These had no impact on the group and Authority's reported financial position for 2017/18.

Certificate of closure of the audit

We are also required to certify that we have completed the audit of the accounts of Merseyside Waste Disposal Authority in accordance with the requirements of the Code of Audit Practice. We issued our certificate on the closure of the audit on 31 July 2018.

Annual Governance Statement and Narrative Report

We are required to review the Authority's Annual Governance Statement and Narrative Report. It published them on its website in the Statement of Accounts in line with the national deadlines.

Our review of the Narrative Report identified a few areas where disclosures could be further developed, for example in respect performance reporting. Management has updated the Narrative Report to reflect the findings from our review.

Both documents were prepared in line with the CIPFA Code and relevant supporting guidance. We confirmed that both documents were consistent with the financial statements prepared by the Authority and with our knowledge of the Authority.

Value for Money conclusion

Background

We carried out our review in accordance with the NAO Code of Audit Practice, following the guidance issued by the NAO in November 2017 which specified the criterion for auditors to evaluate:

In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.

Key findings

Our first step in carrying out our work was to perform a risk assessment and identify the key risks where we concentrated our work.

The key risks we identified and the work we performed are set out overleaf.

Overall Value for Money conclusion

We are satisfied that in all significant respects the Authority put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2018.

Value for Money conclusion

Key Value for Money risks

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Authority reserves and levy increases The Authority continues to operate under significant financial pressures but has continued to manage its finances to deliver a balanced outturn position. However, to avoid levy increases over a number of years, continued use has been made of the Authority's reserves to achieve a balanced budget. This has resulted in general reserves falling to £11.64 million at the end of 2016/17. The planned use of general reserves during 2017/18 is expected to reduce the Authority's available reserves to £2.84m at 31 March 2018. We understand the Authority meeting in February will consider future levy increases for the three years 2018/19 to 2020/21.	As part of our audit we: • reviewed the Authority's financial position, in particular the level of general reserves • reviewed the proposals for levy increases over the medium term.	We found: • for 2017/18, the Authority's actual outturn position was an underspend of £2.066m against its revised budget, reducing the total call on reserves during the year. The revised budget expected the use of reserves of £9.169m, the actual call on reserves was £7.102m. The underspend arose in a number of areas but the main savings were due to the delayed start of the RRC (£1.266m), recycling credits (£0.23m), savings on the behavioural change programme resulting from the delay in the City Region review (£0.236m) and, lower interest costs (£0.169m) • to avoid levy increases over a number of years, continued use has been made of the Authority's reserves to achieve a balanced budget. This has resulted in general reserves falling to £11.6 million at 31 March 2017. The reduced call on reserves during 2017/18 has meant general fund reserves at the end of 2017/18 amounted to £4.5m, which is an improved position • the budget report to the Authority in February 2018 set out clearly the need for a levy increase given the on-going depletion of the Authority's reserves. The Authority meeting approved a levy increase of 9% for 2018/19 with possible increases of 7% in 2019/20 and 2.8% in 2020/21 being noted. The 2018/19 budget still plans a modest use of reserves of £1.255m in 2018/19. The Authority needs to continue to carefully consider the adequacy of current reserves to cater for unforeseen events, and whether they should be increased. **Conclusion** • The Authority has a history of effective financial management and control and delivering a surplus outturn position. • Whilst a levy increase has been agreed for 2018/19, there is a need for the Authority to continue to consider levy increases for the medium term to allow officers to plan for future operations. In addition, there is also a need for the Authority to carefully consider the adequacy of current reserves to cater for unforeseen events, and whether they should be increased.

Value for Money conclusion

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Resource Recovery Contract The Resource Recovery Contract became operational on 1 September 2017. Given the significant size of the RRC and the operational impact on the Authority, there is a need for the Authority to ensure effective governance arrangements are in place to manage the contract, including contract variations, review key targets and outputs, monitor budgets and their achievement, as well as ensure effective reporting.	As part of our audit we: • reviewed the governance and contract management, monitoring and reporting arrangements put in place to effectively monitor and report on the RRC.	We found: • there was some slippage in the commissioning of the RRC due to issues outside the control of the Authority during the early part of 2017. However, the facility became fully operational on 1 September 2017. Early indications are that the RRC is working well and delivering the services expected and agreed • the Authority has a contract management team to manage the RRC who report to the Executive Management Team on a monthly basis in a number of areas including tonnages, recycling rates, inputs and a range of other information. This is routinely monitored with the aim of ensuring performance is adequate and if needed, action is taken. A number of quarterly monitoring reports are also prepared covering operational performance, contract performance and financial performance • in addition to the contract management team, there is also a data analysis team who check the tonnages and apply the appropriate charge rates to ensure that MWDA is paying the correct amount for the services received. The data analysis team monitor on a monthly, quarterly and annual basis. • there have been no significant operational of financial issues since the RRC went live in September 2017 and discussions with management indicate tonnages processed and performance are in accordance with budget and key performance expectations • the Authority has a Service Delivery Plan which includes clear objectives for the RRC which are routinely reported to the Authority • given the significant size of the RRC, there is an ongoing need for the Authority to continue to carefully monitor and manage the contract, including the delivery of key targets and outputs, routine monitoring of budgets, as well as regular reporting. **Conclusion** • The RRC became fully operational on 1 September 2017 and appears to be operating as planned. However, given the significant size of the RRC and the operational impact on the Authority, there is a need for the Authority to continue to carefully monitor and manage the contract, including the delivery of key targets and outputs, monitoring of budgets as well as ensuring effective reporting.

A. Reports issued and fees

We confirm below our final reports issued and fees charged for the audit and the provision of non-audit services.

Report issued	Date issued
Audit Plan	February 2018
Audit Findings Report	July 2018
Annual Audit Letter	August 2018

Fees issued	Planned	Actual fees	2016/17 fees
	£	£	£
Statutory Authority audit[1]	29,363	29,363	29,363
Audit of subsidiary company Mersey Waste Holdings Limited	10,200	10,200	10,900
Total fees	**39,563**	**39,563**	**40,263**

The planned fees for the year were in line with the scale fee set by Public Sector Audit Appointments Ltd (PSAA).

[1] We have undertaken additional work during the year on the Resource Recovery Contract. We have agreed an additional fee for this work of £7,500 with the Authority. This fee variation is subject to agreement by Public Sector Audit Appointments Ltd.

Non- audit services

No non-audit services were provided by Grant Thornton UK LLP to the Authority during the year ended 31 March 2018.

Working with the Authority

During the year we have delivered a number of successful outcomes with you:

- an efficient audit – we worked with officers during the year to ensure the earlier accounts preparation and audit deadlines were achieved
- improved financial processes – we worked with you to improve your processes including developing arrangements for reconciling your cash position with St Helens MBC
- providing training – we provided your teams with training on financial accounts and annual reporting.

We would like to record our appreciation for the assistance and co-operation provided to us during our audit by the Authority's staff.