

Merton Council

Standards and General Purposes Committee

5 March 2024

Supplementary agenda

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London Borough of Merton
Council
Audit Update Report
Year ended 31 Month 2023
1 March 2024

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Building a Better
working world

Agenda Item 6



London Borough of Merton
Standards and General Purposes Committee
Civic Centre
Morden
SM4 5DX

1 March 2024

Dear Standards and General Purposes Committee Members

We are pleased to attach our Audit Update Report which summarises the work we have undertaken to date for the 2022/23 Council audit.

The report also considers the likely impact of Government proposals to clear the backlog in local audit and put the local audit system on a sustainable footing. The joint statement on the update to proposals to clear the backlog and embed timely audit recognises that timely, high-quality financial reporting and audit of local bodies is a vital part of our democratic system. Not only does it support good decision making by local bodies, by enabling them to plan effectively, make informed decisions and manage their services, it ensures transparency and accountability to local taxpayers. All stakeholders have a critical role to play in addressing the audit backlog.

The Standards and General Purposes Committee, as the Council's body charged with governance, has an essential role in ensuring that it has assurance over both the quality of the draft financial statements prepared by management and the Council's wider arrangements to support the delivery of a timely and efficient audit. Where this is not done it will impact the level of resource needed to discharge our responsibilities. We will consider and report on the adequacy of the Council's external financial reporting arrangements and the effectiveness of the audit committee in fulfilling its role in those arrangements as part of our assessment of Value for Money arrangements, and consider the use of other statutory reporting powers to draw attention to weaknesses in those arrangements where we consider it necessary to do so.

This report is intended solely for the information and use of the Standards and General Purposes Committee, and management, and is not intended to be and should not be used by anyone other than these specified parties. We welcome the opportunity to discuss this report with you on 6 March 2024 as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully


ELIZABETH JACKSON

Partner, For and on behalf of Ernst & Young LLP

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Public Sector Audit Appointments Ltd (PSAA) issued the "Statement of responsibilities of auditors and audited bodies". It is available from the PSAA website (<https://www.psa.co.uk/managing-audit-quality/statement-of-responsibilities-of-auditors-and-audited-bodies/>). The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The "Terms of Appointment and further guidance (updated July 2021)" issued by the PSAA (<https://www.psa.co.uk/managing-audit-quality/terms-of-appointment/terms-of-appointment-and-further-guidance-1-july-2021/>) sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and in legislation, and covers matters of practice and procedure which are of a recurring nature.

This report is made solely to the Audit Committee and management of Suffolk County Council in accordance with our engagement letter. Our work has been undertaken so that we might state to the Audit Committee and management of Suffolk County Council those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the Audit Committee and management of Suffolk County Council for this report or for the opinions we have formed. It should not be provided to any third-party without our prior written consent.



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Context for the audit

Context for 2022/23 and 2023/24

Context for the 2022/23 and 2023/24 audits - Department for Levelling-up, Housing and Communities (DLUHC) and Financial Reporting Council (FRC) measures to address local audit delays

Timely, high-quality financial reporting and audit of local bodies is a vital part of our democratic system. It supports good decision making by local bodies and ensures transparency and accountability to local taxpayers. There is general agreement that the backlog in the publication of audited financial statements by local bodies has grown to an unacceptable level and there is a clear recognition that all stakeholders in the sector will need to work together to address this. DLUHC has worked collaboratively with the FRC, as incoming shadow system leader, and other system partners, to develop measures to clear the backlog. The proposals, which have been developed to maintain auditor independence and enable compliance with International Standards on Auditing (UK) (ISAs (UK)), consist of three phases:


- ▶ Phase 1: Reset involving clearing the backlog of historic audit opinions up to and including financial year 2022/23 by 30 September 2024.
- ▶ Phase 2: Recovery from Phase 1 in a way that does not cause a recurrence of the backlog by using backstop dates to allow assurance to be rebuilt over multiple audit cycles.
- ▶ Phase 3: Reform involving addressing systemic challenges in the local audit system and embedding timely financial reporting and audit.

To support the further development and testing of the measures, consultations are taking place to receive further feedback and inform the decision on how to proceed. Specifically:

- ▶ DLUHC has launched a consultation on changes to the Accounts and Audit Regulations 2015 to insert statutory backstop dates for historic financial statements and for the financial years 2023/24 to 2027/28.
- ▶ The National Audit Office (NAO) has launched a consultation on amending the Code of Audit Practice to :
 - ▶ Require auditors to issue audit opinions according to statutory backstop data for historic audits, and place specific duties on auditors to co-operate during the handover period for the new PSAA contract for the appointment of local authority auditors covering the years 2023/24 to 2027/28.
 - ▶ Allow auditors to produce a single value for money commentary for the period up to 2022/23 and use statutory reporting powers to draw significant matters to the attention of councils and residents.
- ▶ The Chartered Institute of Public Finance and Accountancy (CIPFA) is expected to launch a consultation on temporary changes to the accounting code for preparation of the financial statements. The proposed temporary changes to the financial reporting framework have an impact on both how the financial statements are prepared and our audit procedures necessary to gain assurance.

As a result of the system wide implementation of backstop dates, we will likely disclaim the opinion on the Council's 2022/23 accounts. The proposed disclaimer of the Council's 2022/23 accounts will impact both the audit procedures we need to undertake to gain assurance on the 2023/24 financial statements and the form of our audit report in 2023/24 and subsequent years during the recovery phase.

The changes proposed by the consultations therefore will have a significant impact on both the scope of the 2023/24 audit and our assessment of risk. We will continue to provide updates to the Committee as required. We will highlight those areas where we consider it most likely that the proposed measures will impact our audit approach and scope as part of the Audit Planning Reports to the June 2024 Standards and General Purposes Committee and Pensions Committee.



Context for 2022/23 and 2023/24

Responsibilities of Council/Authority management and those charged with governance

For the planned measures to be successful and the current backlog to be addressed it is vital that all stakeholders properly discharge their responsibilities.

The Council's Section 151 Officer is responsible for preparing the statement of accounts in accordance with proper practices and confirming they give a true and fair view of the financial position at the reporting date and of its expenditure and income for the year ended 31 March 2024. To allow the audit to be completed on a timely and efficient basis it is essential that the financial statements are supported by high quality working papers and audit evidence and that Council resources are readily available to support the audit process, within agreed deadlines. The Audit Committee, as the Council's body charged with governance, has an essential role in ensuring that it has assurance over both the quality of the draft financial statements prepared by management and the Council's wider arrangements to support the delivery of a timely and efficient audit. Where this is not done, we will:

- ▶ Consider and report on the adequacy of the Council's external financial reporting arrangements as part of our assessment of Value for Money arrangements.
 - ▶ Consider the use of other statutory reporting powers to draw attention to weaknesses in Council financial reporting arrangements where we consider it necessary to do so.
- Seek a fee variation for the cost of additional resources needed to discharge our responsibilities.
- Impact the availability of audit resource available to complete the audit work in advance of any applicable backstop dates.



02 2022/23 Council audit

Audit Progress - Council

Approach for 2022/23 Council audit

As set out in section 01 of this report, there are two current consultations on the proposals to develop measures to clear the backlog. In December 2023, Stephen Reid, UK Head of Public Sector Audit, issued a letter to Section 151 Officer's setting out EY's approach and how we are prioritising our delivery to best prepare for implementation of the expected legislation.

Extract from the December 2023 letter:

Following the ministerial statement in July and the continuing expectation of a 31 March 2024 backstop date for the completion of all outstanding audits to 2022/23, we have taken a number of steps to support the delivery of consistent high-quality audits and prepare for implementation of the proposals. These include:

- Maximising the completion of historic audits - working to close open audits where audit work is substantially complete and with a high likelihood of issuing an opinion in a short period of time. Currently, the delivery of these audits is likely to be phased through to early 2024.
- Pension fund audits - These audits are not subject to the reset of the system; we continue to prioritise completion of all these audits to 2022/23.
- Value for Money reporting - As there are no anticipated changes to value for money reporting requirements, auditors' exception reporting responsibilities and statutory powers we continue to prioritise the completion of our reporting up to the 2022/23 financial year. Given the increasing focus on the financial sustainability of the local government sector, as well as a focus on those authorities who are seen to be at greater risk of not achieving value for money, this is an important priority in providing necessary assurances to stakeholders.
- Planning for 2023/24 audits - Where capacity allows, we will seek to commence planning for 2023/24; focusing on the most recent set of financial statements and supporting the reset.

This clarity in approach has enabled us to successfully close out a higher proportion of historic audits over the last few months, seeking to maximise the level of assurance provided.

Approach for Merton Council

Our approach for your 2022/23 Council audit has been to carry out the detailed value for money work, which includes a number of audit procedures to ensure robust financial reporting arrangements are in place to prepare the 2022/23 draft financial statements.

We have continued to have regular liaison meetings with senior finance officers.

Our work on the value for money is substantially complete. We identified one area of focus in relation to the sale of the Council's wholly owned subsidiary, CHAS Ltd, during the 2022/23 financial year. We plan to issue the VFM Interim report to the Standards and General Purposes Committee in June 2024.

Value for Money

Council's responsibilities for value for money

The Council is required to maintain an effective system of internal control that supports the achievement of its policies, aims and objectives while safeguarding and securing value for money from the public funds and other resources at its disposal.

As part of the material published with the financial statements, the Council is required to bring together commentary on the governance framework and how this has operated during the period in a governance statement. In preparing the governance statement, the Council tailors the content to reflect its own individual circumstances, consistent with the requirements of the relevant accounting and reporting framework and having regard to any guidance issued in support of that framework. This includes a requirement to provide commentary on arrangements for securing value for money from the use of resources.

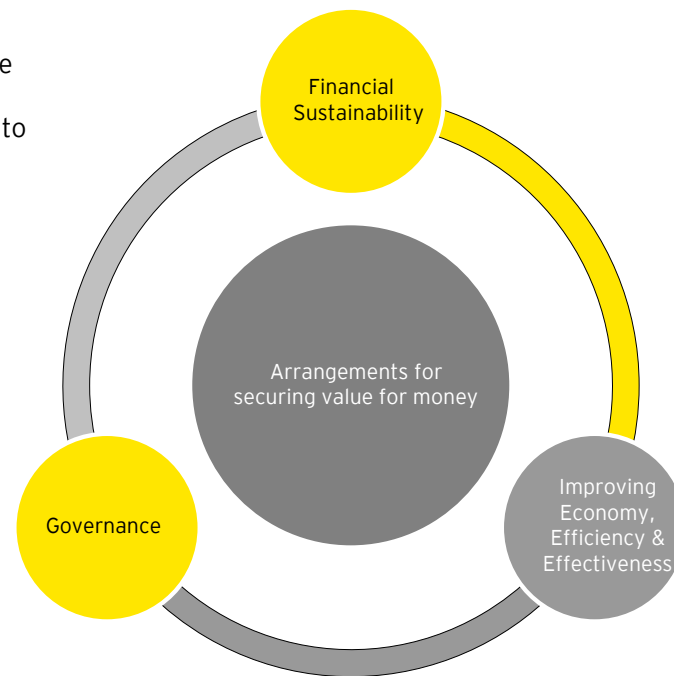
Auditor Responsibilities

Under the NAO Code of Audit Practice 2020 we are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. The Code requires the auditor to design their work to provide them with sufficient assurance to enable them to report to the Council a commentary against specified reporting criteria (see below) on the arrangements the Council has in place to secure value for money through economic, efficient and effective use of its resources for the relevant period.

The specified reporting criteria are:

- ▶ Financial sustainability - How the Council plans and manages its resources to ensure it can continue to deliver its services.
- ▶ Governance - How the Council ensures that it makes informed decisions and properly manages its risks.
- ▶ Improving economy, efficiency and effectiveness - How the Council uses information about its costs and performance to improve the way it manages and delivers its services.

Note: As set out in section 01 of this report, there is a live consultation from the NAO which closes on 7 March 2024 about the value for money approach in years up to and including 2022/23 and then from 2023/24. At this stage, we have not changed our approach to the value for money work as set out in the current Code.



Planning and identifying risks of significant weakness in VFM arrangements

The NAO's guidance notes requires us to carry out a risk assessment which gathers sufficient evidence to enable us to document our evaluation of the Council arrangements, in order to enable us to draft a commentary under the three reporting criteria. This includes identifying and reporting on any significant weaknesses in those arrangements and making appropriate recommendations.

In considering the Council arrangements, we are required to consider:


- ▶ The Council's governance statement;
- ▶ Evidence that the Council's arrangements were in place during the reporting period;
- ▶ Evidence obtained from our work on the accounts;
- ▶ The work of inspectorates and other bodies; and
- ▶ Any other evidence source that we regard as necessary to facilitate the performance of our statutory duties.

We then consider whether there is evidence to suggest that there are significant weaknesses in arrangements. The NAO's guidance is clear that the assessment of what constitutes a significant weakness and the amount of additional audit work required to adequately respond to the risk of a significant weakness in arrangements is a matter of professional judgement. However, the NAO states that a weakness may be said to be significant if it:

- ▶ Exposes - or could reasonably be expected to expose - the Council to significant financial loss or risk;
- ▶ Leads to - or could reasonably be expected to lead to - significant impact on the quality or effectiveness of service or on the Council's reputation;
- ▶ Leads to - or could reasonably be expected to lead to - unlawful actions; or

Identifies a failure to take action to address a previously identified significant weakness, such as failure to implement or achieve planned progress on action/improvement plans.

- ▶ We should also be informed by a consideration of:
- ▶ The magnitude of the issue in relation to the size of the Council;
- ▶ Financial consequences in comparison to, for example, levels of income or expenditure, levels of reserves (where applicable), or impact on budgets or cashflow forecasts;
- ▶ The impact of the weakness on the Council's reported performance;
- ▶ Whether the issue has been identified by the Council's own internal arrangements and what corrective action has been taken or planned;
- ▶ Whether any legal judgements have been made including judicial review;
- ▶ Whether there has been any intervention by a regulator or Secretary of State;
- ▶ Whether the weakness could be considered significant when assessed against the nature, visibility or sensitivity of the issue;
- ▶ The impact on delivery of services to local taxpayers; and
- ▶ The length of time the Council has had to respond to the issue.



Value for Money

Responding to identified risks of significant weakness

Where our planning work has identified a risk of significant weakness, the NAO's guidance requires us to consider what additional evidence is needed to determine whether there is a significant weakness in arrangements and undertake additional procedures as necessary, including where appropriate, challenge of management's assumptions. We are required to report our planned procedures to the audit committee.

Reporting on VFM

Where we are not satisfied that the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources the Code requires that we should refer to this by exception in the audit report on the financial statements.

In addition, the Code requires us to include the commentary on arrangements in the Auditor's Annual Report. The Code states that the commentary should be clear, readily understandable and highlight any issues we wish to draw to the Council's attention or the wider public. This should include details of any recommendations arising from the audit and follow-up of recommendations issued previously, along with our view as to whether they have been implemented satisfactorily.

Status of our 2022/23 VFM work

We have substantially completed our VFM procedures and will present the VFM Interim Report to the June 2024 committee meeting. At the date of this update report, our work so far has not identified any weaknesses in arrangements for any of the reporting criteria.

We are currently finalising our work on the area of focus for 2022/23 - sale of CHAS Ltd. The sale took place during the financial year and we have reviewed the governance arrangements in place for the sale. Our work to date has not identified any weaknesses in the arrangements followed by the Council.

Our value for money work in 2022/23 included procedures to determine if the financial reporting processes to underpin the preparation of the draft 2022/23 financial statements was robust. The Council published their draft 2022/23 financial statements for audit on the 31 May 2023, in line with the Audit and Accounts regulations, and advertised and held an inspection period for members of the public in line with these regulations. We confirm that the 2022/23 draft financial statements were arithmetically correct, agreed to the data in the general ledger, and prepared in line with the content required by the CIPFA Code. Bank reconciliations have been appropriately carried out and reviewed during the year. The finance team engaged well with the initial planning of the 2022/23 audit and during the VFM review. Therefore, appropriate arrangements for financial reporting were in place during 2022/23.

Independence

We have no issues we need to bring to your attention subject to completion of our audit procedures.

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