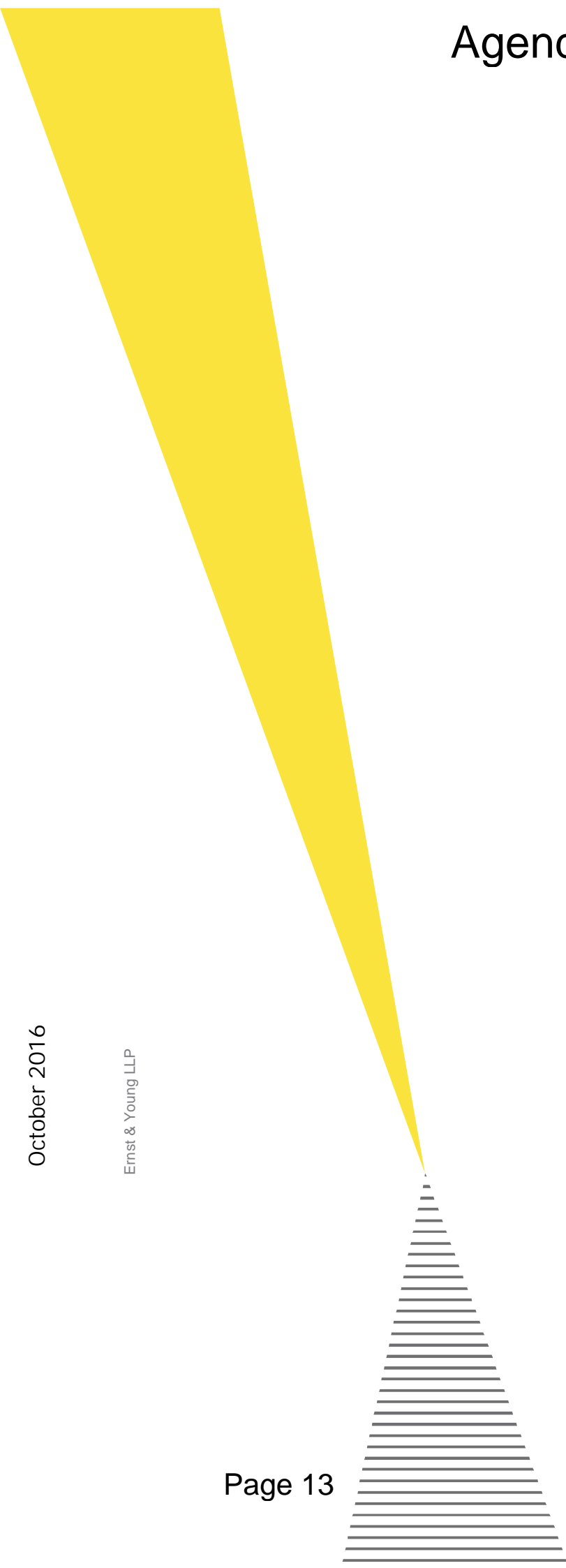


# Merton Council

Annual Audit Letter for the year ended 31 March 2016

October 2016

Ernst & Young LLP



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In April 2015 Public Sector Audit Appointments Ltd (PSAA) issued "Statement of responsibilities of auditors and audited bodies 2015-16". It is available from the Chief Executive of each audited body and via the PSAA website ([www.psa.co.uk](http://www.psa.co.uk))

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 from 1 April 2015' issued by PSAA 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 statute, and covers matters of practice and procedure which are of a recurring nature.

This Annual Audit Letter is prepared in the context of the Statement of responsibilities. It is addressed to the Members of the audited body, and is prepared for their sole use. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure – If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

A close-up photograph of a person's hands writing on a document. The person is holding a blue pen in their right hand and a pen cap in their left hand. The document is white with some text and a red line. A yellow rectangular overlay is positioned over the lower part of the image, containing the text 'Executive Summary'.

## Executive Summary

## Executive Summary

We are required to issue an annual audit letter to Merton Council (the Council) following completion of our audit procedures for the year ended 31 March 2016.

Below are the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on the Council's and Pension Fund's: ▶ Financial statements	Unqualified – the financial statements give a true and fair view of the financial position of the Council and Pension Fund as at 31 March 2016 and of its expenditure and income for the year then ended
▶ Consistency of other information published with the financial statements	Other information published with the financial statements was consistent with the Annual Accounts.
Concluding on the Council's arrangements for securing economy, efficiency and effectiveness	We concluded that you have put in place proper arrangements to secure value for money in your use of resources
Area of Work	Conclusion
Reports by exception:	
▶ Consistency of Governance Statement	The Governance Statement was consistent with our understanding of the Council.
▶ Public interest report	We had no matters to report in the public interest.
▶ Written recommendations to the Council, which should be copied to the Secretary of State	We had no matters to report.
▶ Other actions taken in relation to our responsibilities under the Local Audit and Accountability Act 2014	We had no matters to report.

Area of Work	Conclusion
Reporting to the National Audit Office (NAO) on our review of the Council's Whole of Government Accounts return (WGA).	We had no matters to report.

As a result of the above we have also:

Area of Work	Conclusion
Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit.	Our Audit Results Reports were issued on 31 August 2016 and presented to the 8 September 2016 meeting of the Standards and General Purposes Committee for both the main Council and Pension Fund audits.

Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.	Our certificate was issued on 19 September 2016.
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We would like to take this opportunity to thank the Council and Pension Fund's staff for their assistance during the course of our work.

Paul King  
Executive Director  
For and on behalf of Ernst & Young LLP

Purpose

Work

## Purpose

### The Purpose of this Letter

The purpose of this annual audit letter is to communicate to Members and external stakeholders, including members of the public, the key issues arising from our work, which we consider should be brought to the attention of the Council.

We have already reported the detailed findings from our audit work in our 2015/16 Audit Results Report to the 8 September meeting of the Standards and General Purposes Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council.



# Responsibilities



## Responsibilities

### Responsibilities of the Appointed Auditor

Our 2015/16 audit work has been undertaken in accordance with the Audit Plan that we issued on 19 February 2016 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- ▶ Expressing an opinion:
  - ▶ On the 2015/16 financial statements; and
  - ▶ On the consistency of other information published with the financial statements.
- ▶ Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.
- ▶ Reporting by exception:
  - ▶ If the annual governance statement is misleading or not consistent with our understanding of the Council;
  - ▶ Any significant matters that are in the public interest;
  - ▶ Any written recommendations to the Council, which should be copied to the Secretary of State; and
  - ▶ If we have discharged our duties and responsibilities as established by the Local Audit and Accountability Act 2014 and Code of Audit Practice.

Alongside our work on the financial statements, we also review and report to the National Audit Office (NAO) on you Whole of Government Accounts return. The extent of our review and the nature of our report are specified by the NAO.

## Responsibilities of the Council

The Council is responsible for preparing and publishing its statement of accounts accompanied by an Annual Governance Statement (AGS). In the AGS, the Council reports publicly each year on how far it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in year, and any changes planned in the coming period.

The Council is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.



# Financial Statement Audit

## Financial Statement Audit

### Key Issues

The Council's Statement of Accounts is an important tool for the Council to show how it has used public money and how it can demonstrate its financial management and financial health.

We audited the Council and Pension Fund's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office and issued unqualified audit reports on 9 September 2016.

Our detailed findings were included in our Audit Results Reports for both the main Council and Pension Fund audits presented to the 8 September meeting of the Standards and General Purposes Committee. In those reports, which were issued on 31 August 2016, we noted that there were some areas where our work was outstanding and was to be completed. We completed work in those areas and this enabled us to issue unqualified audit reports on the Council and Pension Fund financial statements.

The key issues identified as part of our audit were as follows:

Significant Risk	Conclusion
<p>Management override of controls</p> <p>A risk present on all audits is that management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly, and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.</p> <p>Auditing standards require us to respond to this risk by testing the appropriateness of journals, testing accounting estimates for possible management bias and obtaining an understanding of the business rationale for any significant unusual transactions.</p>	<p>We completed our testing in respect of the procedures set out in our Audit Plan and found no evidence of management override or bias. Specifically:</p> <ul style="list-style-type: none"><li>• Our detailed testing of journal entries recorded in the general ledger has found them to be appropriate.</li><li>• We were satisfied that the MRP charged by the Council for the period was been calculated in accordance with extant requirements and supported by accounting records. We also identified no evidence of manipulation or management override in respect of bad debt provisions included in the accounts.</li><li>• We identified no significant unusual transactions in the course of our work.</li></ul>

We also identified two non-significant audit risks during the planning phase of our audit, one in respect of payroll processing arrangements by bodies external to the Council and the other in respect of housing benefit overpayment debtors, which we also reported to you in our Audit Plan. We concluded we had material assurance in respect of both of these risks but that there remained further work to do to fully address recommendations raised by the service auditor of the shared HR and payroll service operated by the London Borough of Sutton.

We also reported one unadjusted misstatement on the Council's main accounts. This related to an overstatement of debtors and creditors of approximately £1.1 million. Given this had no impact on either the reported financial performance or position of the Council of the year management and those charged with governance decided to make no adjustment in respect of this misstatement.



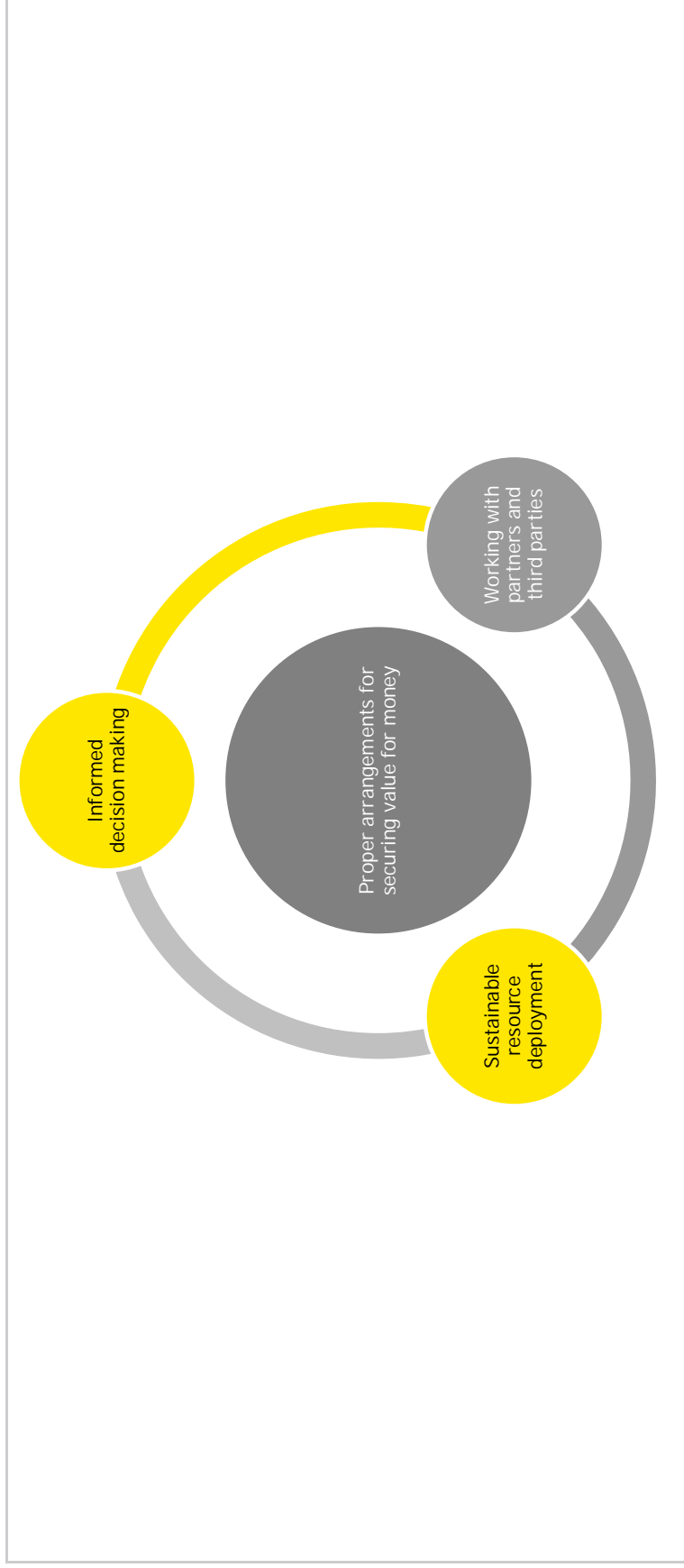
Value for Money

## Value for Money

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. This is known as our value for money conclusion.

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

- Take informed decisions;
- Deploy resources in a sustainable manner; and
- Work with partners and other third parties.



We issued an unqualified value for money conclusion on 9 September 2016.

We did not identify any significant risks in relation to the Council's arrangements.

We considered a variety of information sources at the planning stage and updated our understanding of your arrangements at the conclusion stage of the audit, including our understanding of your business and entity level controls, your own risk management arrangements, current and prior year Annual Governance Statements, budgetary control information and outturn performance against budget, your medium term financial planning, the work of internal audit and other regulators and VFM profile cost comparison data made available by PSAA.

We did not identify any significant weaknesses in the Council's arrangements.





## Other Reporting Issues

## Other Reporting Issues

### Whole of Government Accounts

We performed the procedures required by the National Audit Office on the accuracy of the consolidation pack prepared by the Council for Whole of Government Accounts purposes. We had no issues to report.

### Annual Governance Statement

We are required to consider the completeness of disclosures in the Council's Annual Governance Statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it is misleading.

We completed this work and did not identify any areas of concern.

### Report in the Public Interest

We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by the Council or brought to the attention of the public.

We did not identify any issues which required us to issue a report in the public interest.

### Written Recommendations

We have a duty under the Local Audit and Accountability Act 2014 to designate any audit recommendation as one that requires the Council to consider it at a public meeting and to decide what action to take in response.

We did not identify any issues which required us to issue a written recommendation.

### Objections Received

We did not receive any objections to the 2015/16 financial statements from members of the public.

### Other Powers and Duties

We identified no issues during our audit that required us to use our additional powers under the Local Audit and Accountability Act 2014.

## Independence

We communicated our assessment of independence in our Audit Results Report to the Standards and General Purposes Committee meeting on 8 September 2016. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning regulatory and professional requirements.

## Control Themes and Observations

As part of our work, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Although our audit was not designed to express an opinion on the effectiveness of internal control, we are required to communicate to you significant deficiencies in internal control identified during our audit. We did not identify any significant deficiencies in the design or operation of an internal control that might result in a material misstatement in your financial statements of which you are not aware.

A close-up, slightly blurred photograph of a person's hands holding binoculars. The person's face is partially visible in the background, looking through the eyepieces. The binoculars are dark-colored, and the focus is on the objective lenses. A bright yellow rectangular graphic is overlaid on the lower-left portion of the image.

Focused on your  
future

## Focused on your future

Area	Issue	Impact
<p>Medium term financial challenges and budget pressures.</p>	<p>In common with many local authorities, the Council faces significant financial challenges over the medium term. In our 2015/16 Audit Results Report we specifically considered the Council's medium term financial strategy (MTFS) set out in its 2016/20 Business Plan. We noted that at the time the MTFS was set the Council forecast a budget gap of approximately £3.5 million by 2019/20.</p> <p>Subsequent to the issue of our audit results report an updated MTFS was presented to the 12 October meeting of the Cabinet as part of the 2017/21 Business Plan. Although the forecast budget gap by 2019/20 has now fallen to approximately £1.4 million, the Council predicts that further savings of approximately £16.6 million will be needed to balance the budget by 2020/21. The latest available revenue budget monitoring information for 2016/17 to the end of August continues to forecast a net outturn overspend for the year, now predicted to be approximately £5 million.</p>	<p>The Council will need to continue its work to identify additional efficiency and cost savings to help close the projected budget gap as part of regular updates through its business planning process.</p> <p>We will monitor the Council's response to the financial and budget pressures that it faces in the context of our value for money responsibilities.</p>
<p>EU referendum</p>	<p>Following the majority vote to end the UK's membership of the European Union (EU) in the EU Referendum held on 23 June 2016 there is a heightened level of volatility in the financial markets and increased macroeconomic uncertainty in the UK. All three major rating agencies (S&amp;P, Fitch and Moody's) took action on the UK Sovereign credit rating and, following the rating action on the UK Government. For entities in the public sector, there is likely to be an impact on investment property valuations if confidence in the wider UK property market falls; and the valuation of defined benefit pension obligations may also be affected. It is too early to estimate the quantum of any impact of these issues, but there is likely to be significant ongoing uncertainty for a number of months while the UK renegotiates its relationships with the EU and other nations.</p>	<p>Many of the issues and challenges that face the UK public sector will continue to exist, not least because continued pressure on public finances will need responding to. Additionally it may well be that the challenges are increased if the expected economic impacts of the referendum and loss of EU grants outweigh the benefits of not having to contribute to the EU and require even more innovative solutions.</p> <p>We are committed to supporting our clients through this period, and help identify the opportunities that will also arise. We will engage with you on the concerns and questions you may have, provide our insight at key points along the path, and provide any papers and analysis of the impact of the referendum on the Government and Public Sector market.</p>

Area	Issue	Impact
Highways Network Asset (HNA)	<p>The Code of Practice on Transport Infrastructure Assets (TIA Code) was first published in 2010 and updated in 2013. The key aim of this document was to improve the asset management of TIA. During 2016, this guidance has been renamed and updated, with the Highways Network Asset (HNA) Code, Guidance Notes and Accounting Guidance being published. Local Government has historically used depreciated historic cost (DHC) as the valuation approach for infrastructure assets. The introduction of the HNA Code will see this valuation basis change to depreciated replacement cost with effect from 1 April 2016. The change will be applied prospectively from that date, so Highways Authorities are not required to disclose comparative information. This is a fundamental change in approach which will require new accounting and estimation approaches as well as amendments to existing systems, or implementation of new systems.</p>	<p>The impact on the Council's Balance Sheet will be highly significant; with the recognition of a single highways network asset of approximately £5 billion. The impact on the audit will also be significant, as auditors will need to obtain sufficient assurance over the material accuracy of this asset. The Council has an established working group of highways engineers and accountants to ensure these accounting changes are appropriately implemented.</p> <p>We will work closely with the Council at both the local level, regarding system implementation, valuation procedures and accounting, and at the wider level through the continuation of our HNA Client Workshops.</p>



Appendix A

## Audit Fees

## Appendix A Audit Fees

Our fee for 2015/16 is in line with the scale fee set by the PSAA and reported in our Audit Plan and Audit Results Report.

We confirm we have not undertaken any non-audit work outside of the PSAA's requirements.



Ernst & Young LLP

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ED None

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