

London Borough of
Merton
Audit planning report
Year ended 31 March 2018

2 March 2018

2 March 2018



London Borough of Merton
Civic Centre,
London Road,
Morden,
SM4 5DQ

Dear Standards and General Purposes Committee Members

We are pleased to attach our Audit Plan which sets out how we intend to carry out our responsibilities as auditor. Its purpose is to provide the Standards and General Purposes Committee with a basis to review our proposed audit approach and scope for the 2017/18 audit in accordance with the requirements of the Local Audit and Accountability Act 2014, the National Audit Office's 2015 Code of Audit Practice, the Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA) Ltd, auditing standards and other professional requirements. It is also to ensure that our audit is aligned with the Committee's service expectations.

This plan summarises our initial assessment of the key risks driving the development of an effective audit for the Council, and outlines our planned audit strategy in response to those risks.

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 15 March 2018 as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully

Suresh Patel

For and on behalf of Ernst & Young LLP
Enc

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In April 2015 Public Sector Audit Appointments Ltd (PSAA) issued "Statement of responsibilities of auditors and audited bodies". It is available from the via the PSAA website (www.PSAA.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 (updated February 2017)" issued by the 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 in legislation, and covers matters of practice and procedure which are of a recurring nature. This report is made solely to the Standards and General Purposes Committee and management of the London Borough of Merton in accordance with the statement of responsibilities. Our work has been undertaken so that we might state to the Standards and General Purposes Committee and management of the London Borough of Merton 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 Standards and General Purposes Committee and management of the London Borough of Merton for this report or for the opinions we have formed. It should not be provided to any third-party without our prior written consent.



01

Overview of our 2017/18 audit strategy



Overview of our 2017/18 audit strategy

The following 'dashboard' summarises the significant accounting and auditing matters outlined in this report. It seeks to provide the Standards and General Purposes Committee with an overview of our initial risk identification for the upcoming audit and any changes in risks identified in the current year.

Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from PY	Details
Misstatements due to fraud or error	Fraud risk	No change in risk or focus	As identified in ISA 240, 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 would otherwise appear to be operating effectively.
Recognition of revenue by CHAS 2013 Ltd	Fraud risk	New risk	2017/18 will be the first year that the Council consolidates CHAS Ltd and prepares group accounts. The revenue of CHAS Ltd is material to the group accounts and its recognition represents a significant risk.
Valuation of Property, Plant and Equipment	Inherent risk	No change in risk or focus	These represent significant balances in the Council's accounts and will be subject to valuation changes. Management is required to provide material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.
Valuation of Pension Liability	Inherent risk	No change in risk or focus	The Council operates a defined benefits pension scheme. The valuation of this liability is based on an actuarial report and on work that involves significant estimation uncertainty.
PFI Accounting	Inherent risk	No change in risk	The Council has a material PFI arrangement. PFI accounting is a complex area, and we carried out a detailed review of arrangements in 2016/17. We will review the accounting entries and disclosures in relation to PFI in detail in 2017/18, with a focus on any significant changes.

Overview of our 2017/18 audit strategy (continued)

Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from PY	Details
Earlier accounts deadline and preparation of group accounts	Inherent risk	Increase in risk	<p>The Accounts and Audit Regulations 2015 introduced a significant change in statutory deadlines from the 2017/18 financial year. The timetable for the preparation and approval of accounts will be brought forward with draft accounts needing to be prepared by 31 May and the publication of the accounts by 31 July.</p> <p>For 2017/18 group accounts will be produced at year end due to growth in revenue of the Council's wholly owned subsidiary CHAS 2013 Ltd. This is the first time the Council will produce group accounts.</p>

Materiality

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Planning materiality
£10.6mn

Materiality has been set at £10.6mn, which represents 2% of the prior years gross Council and CHAS 2013 Limited revenue expenditure. This comprises of gross expenditure on the provision of services, levies expenditure and interest payable. We have not changed the basis for calculation of materiality from the previous period.

Performance materiality
£7.98mn

We have set performance materiality at £7.98mn, which represents 75% of materiality. We determine component performance materiality as a percentage of Group performance materiality based on risk and relative size to the Group. We consider the wholly owned subsidiary, CHAS 2013 Limited, to be a significant component with a performance materiality level of £1.59mn.

Audit differences
£0.5mn

We will report all uncorrected misstatements relating to the primary statements (comprehensive income and expenditure statement, balance sheet, movement in reserves statement and cash flow statement) greater than £0.5mn. Other misstatements identified will be communicated to the extent that they merit the attention of the Standards and General Purposes Committee.

Overview of our 2017/18 audit strategy (continued)

Audit scope

This Audit Plan covers the work that we plan to perform to provide you with:

- § Our audit opinion on whether the financial statements of the London Borough of Merton give a true and fair view of the financial position as at 31 March 2018 and of the income and expenditure for the year then ended; and
- § Our conclusion on the Council's arrangements to secure economy, efficiency and effectiveness.

We will also review and report to the NAO, to the extent and in the form required by them, on the Council's Whole of Government Accounts return.

Our audit will also include the mandatory procedures that we are required to perform in accordance with applicable laws and auditing standards.

When planning the audit we take into account several key inputs:

- § Strategic, operational and financial risks relevant to the financial statements;
- § Developments in financial reporting and auditing standards;
- § The quality of systems and processes;
- § Changes in the business and regulatory environment; and,
- § Management's views on all of the above.

By considering these inputs, our audit is focused on the areas that matter and our feedback is more likely to be relevant to the Council.

Audit team changes

There are no significant changes to our team.



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02 Audit risks

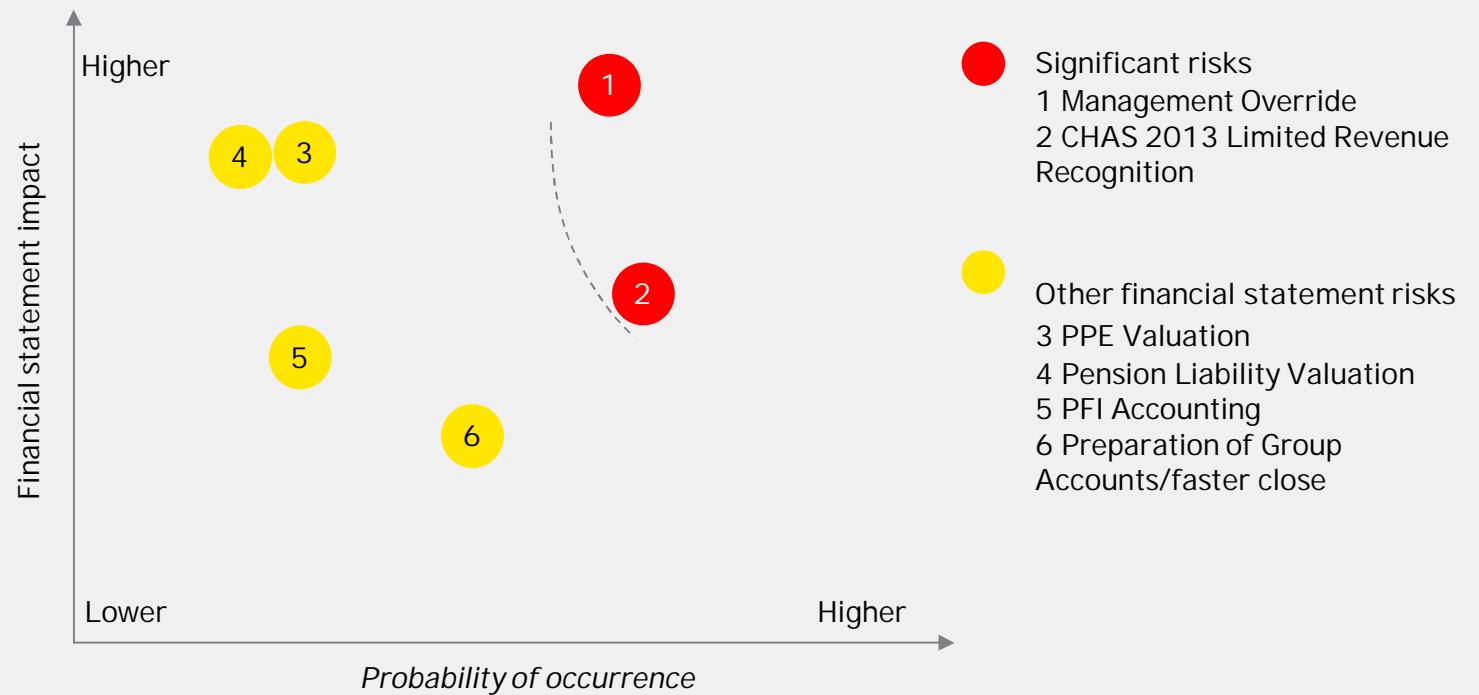


Risk assessment

Risk assessment

We have obtained an understanding of your strategy, reviewed your principal risks as identified in your 2017 Statement of Accounts and combined it with our understanding of the sector to identify key risks that impact our audit.

The following 'dashboard' summarises the significant matters that are relevant for planning our year-end audit:



Our response to significant risks

Management override of control

Financial statement impact

Misstatements that occur in relation to the risk of fraud by management override could affect the income and expenditure accounts, alongside significant balance sheet accounts where key estimates are processed.

What is the risk?

As identified in ISA (UK and Ireland) 240, 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. We identify and respond to this fraud risk on every audit engagement.

Minimum Revenue Provision (MRP)

The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 require the Council to make a prudent annual provision for the repayment of borrowing. This is known as the Minimum Revenue Provision (MRP). MRP is a real charge that impacts on the general fund and therefore the council tax financing requirement. From 2017/18 the Council has decided to make changes to its future approach to calculating MRP. Given the real impact of the charge on the reported financial position and performance of the Council we consider this change in approach to be relevant to the risk of management override.

What will we do?

- Review any changes made to accounting policies and consider the impact of changes to the general fund.
- Test the completeness and valuation of provisions, being areas that are most susceptible to manipulation to achieve desired expenditure levels.
- Test expenditure has been correctly capitalised. There is the incentive for the Council to inappropriately capitalize revenue expenditure to allow utilization of the healthy reserves over the general fund.
- Review accounting estimates for evidence of management bias specifically those with a higher level of inherent risk - PPE, pension liability and PFI.
- Test the appropriateness of journal entries recorded in the ledger and other adjustments made in the preparation of the financial statements.
- Evaluate the business rationale for significant unusual transactions.

Minimum Revenue Provision (MRP)

We have commissioned an EY expert to review the changes made by the Council in this area. Our approach will focus on:

- Considering the prudence of the revised policy and approach.
- Assessing the accuracy of the calculation of the revised charge.
- Ensuring transparent disclosures are included in the financial statements to explain the change in policy.

We will utilise our data analytics capabilities to assist with our work, including carrying out testing on the Income and Expenditure accounts, and journal entry testing. We will assess journal entries for evidence of management bias and evaluate for business rationale.

Our response to significant risks (continued)

Risk of fraud in revenue and recognition for CHAS 2013 Limited

Financial statement impact

Misstatements that occur in relation to the risk of fraud in revenue recognition could affect the income accounts for CHAS 2013 Limited. The 2016/17 audited accounts show a turnover of £5.8mn.

What is the risk?

Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition. In the public sector, this requirement is modified by Practice Note 10 issued by the FRC, to also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.

As per prior years we have been able to rebut the presumption of fraud in revenue and expenditure recognition for the main council, however, we are not able to rebut the risk for CHAS 2013 Limited.

What will we do?

We will:

- Perform substantive testing over CHAS 2013 Limited turnover using data analytics.
- Inquiry of management about risk of revenue recognition fraud and the controls put in place to address those risks.

Other areas of audit focus

We have identified other areas of the audit, that have not been classified as significant risks, but are still important when considering the risks of material misstatement to the financial statements and disclosures and therefore may be key audit matters we will include in our audit report.

What is the risk/area of focus?	What will we do?
<p>Earlier accounts deadline and preparation of group accounts</p> <p>For 2017/18 the Council needs to prepare draft accounts by 31 May and the publish audited accounts by 31 July a challenge and risk for both preparers and auditors.</p> <p>Following prior year issues, there are risks to the Council including the late preparation of working papers and the impact of changes to the finance team. In addition, this will be the first time the Council prepares group accounts.</p> <p>As your auditor, we have a more significant peak in our audit work and a shorter period to complete the audit. Risks for auditors relate to delivery of all audits within the same compressed timetable. Slippage at one client could put delivery of others at risk.</p> <p>To mitigate this risk we will require:</p> <ul style="list-style-type: none"> • good quality draft accounts and supporting working papers by the agreed deadline; • appropriate Council staff to be available throughout the agreed audit period; and • complete and prompt responses to audit questions. <p>If the Council is unable to meet key dates within our agreed timetable, we will notify the Director of Corporate Services of the impact on the timing of your audit, which may be that we postpone the audit until later in the summer and redeploy the team to other work to meet deadlines elsewhere.</p> <p>Where we require additional work to complete your audit, due to new risks, scope changes, or poor audit evidence, we will notify the Director of Corporate Services of the impact on the timing of the audit and fees. Such circumstances may result in a delay to your audit while we complete other work elsewhere.</p>	<p>We will:</p> <ul style="list-style-type: none"> • Gain assurance over group accounting and related disclosures in the Council's group financial statements. • Work with the Council to engage early to facilitate early substantive testing where appropriate. • Provide an early review on the Council's streamlining of the Statement of Accounts where non-material disclosure notes are removed. • Facilitate faster close workshops to provide a forum for Local Authority accountants and auditors to share good practice and ideas to enable us all to achieve a successful faster closure of accounts for 2017/18. • Work with the Council to implement EY Client Portal, this will: <ul style="list-style-type: none"> • Streamline audit requests through a reduction of emails and improve communication; • Provide on-demand visibility into the status of audit requests and the overall audit status; • Reduce risk of duplicate requests; and • Provide better security of sensitive data. • Agree the team and timing of each element of our work with you. • Agree the supporting working papers that we require to complete our audit and provide coaching to your team on what constitutes good quality working papers.

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Other areas of audit focus (continued)

What is the risk/area of focus?

Valuation of Land and Buildings

The fair value of Property, Plant and Equipment (PPE) represent significant balances in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.

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What will we do?

We will:

- Consider and challenge the work performed by the Council's in-house valuers, including the adequacy of the scope of the work performed, their professional capabilities and the results of their work;
- Sample test key asset information used by the valuers;
- Consider the annual cycle of valuations to ensure that assets have been valued within a 5 year rolling programme as required by the Code for PPE. We also consider if there are any specific changes to assets that have occurred and that these have been communicated to the valuer;
- Review assets not subject to valuation in 2017/18 to confirm that the remaining asset base is not materially misstated;
- Consider changes to useful economic lives as a result of the most recent valuation; and
- Test accounting entries have been correctly processed in the financial statements.

Pension Liability Valuation

The Council makes extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme. The pension fund deficit is a material estimated balance and disclosed on the balance sheet. At 31 March 2017 this totalled £368 mn.

The information disclosed is based on the IAS 19 report issued to the Council by the actuary. Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.

We will:

- Liaise with the auditors of Merton Pension Fund, to obtain assurances over the information supplied to the actuary in relation to the Council;
- Assess the work of the Pension Fund actuary (Barnett Waddingham) including the assumptions they have used by relying on the work of PWC - Consulting Actuaries commissioned by Public Sector Auditor Appointments for all Local Government auditors, and considering any relevant reviews by the EY actuarial team; and
- Review and test the accounting entries and disclosures made within the Council's financial statements in relation to IAS19.

Other areas of audit focus (continued)

What is the risk/area of focus?	What will we do?
<p>PFI accounting</p> <p>The Council has a material PFI arrangement. PFI accounting is a complex area. We undertook a detailed review of the arrangements in 2016/17 and concluded that the accounting disclosures were materially correct. We did also identify and report to management some non-material issues.</p>	<p>We will:</p> <ul style="list-style-type: none">• Review assurances brought forward from the prior year regarding the appropriateness of the PFI financial model;• Review the PFI financial model for any significant changes, and if identified consider engaging relevant experts to review the model to ensure they are still working as expected;• Ensure the PFI accounting models have been updated for any service or other agreed variations and confirm consistency of current year model with prior year brought forward assurances; and• Agree outputs of the model to the accounts, including balances and disclosures for Assets, Liabilities, and Expenditure, and review the completeness and accuracy of disclosures.



03

Value for Money Risks





Background

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.

For 2017/18 this is based on the overall evaluation criterion:

"In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people"

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.

When considering your proper arrangements, we will draw on the requirements of the CIPFA/SOLACE framework for local government to ensure that our assessment is made against a framework that you are already required to have in place and to report on through documents such as your annual governance statement.

We are only required to determine whether there are any risks that we consider significant, which the Code of Audit Practice defines as:

"A matter is significant if, in the auditor's professional view, it is reasonable to conclude that the matter would be of interest to the audited body or the wider public"

Our risk assessment supports the planning of sufficient work to enable us to deliver a safe conclusion on arrangements to secure value for money and enables us to determine the nature and extent of further work that may be required. If we do not identify any significant risks there is no requirement to carry out further work.

Our risk assessment has therefore considered both the potential financial impact of the issues we have identified, and also the likelihood that the issue will be of interest to local taxpayers, the Government and other stakeholders. This has resulted in the identification of the significant risk noted on the following page which we view as relevant to our value for money conclusion. In our planning work we have also considered the weaknesses identified by the Council in contract standing orders and related processes, notably in respect of the maintenance of a comprehensive contract register, and compliance with its own contract procedure rules. Although we do not consider the risk to be significant we will continue to consider how the Council develops its arrangements to address the weaknesses identified.



Value for Money Risks

What is the significant value for money risk?	What arrangements does the risk affect?	What will we do?
<p>The Council continues to have a challenging financial outlook. To balance the budget over the medium term it will need to deliver significant savings to not be dependent on its reserves. As at January 2018, the current draft of the Council's Business Plan for 2018 to 2022 shows a cumulative budget gap including the use of reserves of £37.7mn. As at the end of November 2017, there was a forecast shortfall of £2.6mn or 31% in delivery of the Council's current year savings target.</p>	<p>Deploy resources in a sustainable manner</p>	<p>Our approach will focus on reviewing the robustness of the Council's plans and arrangements to address budget pressures in Community and Housing, which includes adult social care, and Children, Schools and Families, and to achieve its savings targets and address budget gaps to deliver sustainable financial balance over the medium term. This will include follow-up of the issues we highlighted as part of our 2016-17 programme of VFM work. We will also consider the causes of the shortfall against current savings programme targets and any related impact on the Council's future financial plans.</p>



04

Audit materiality

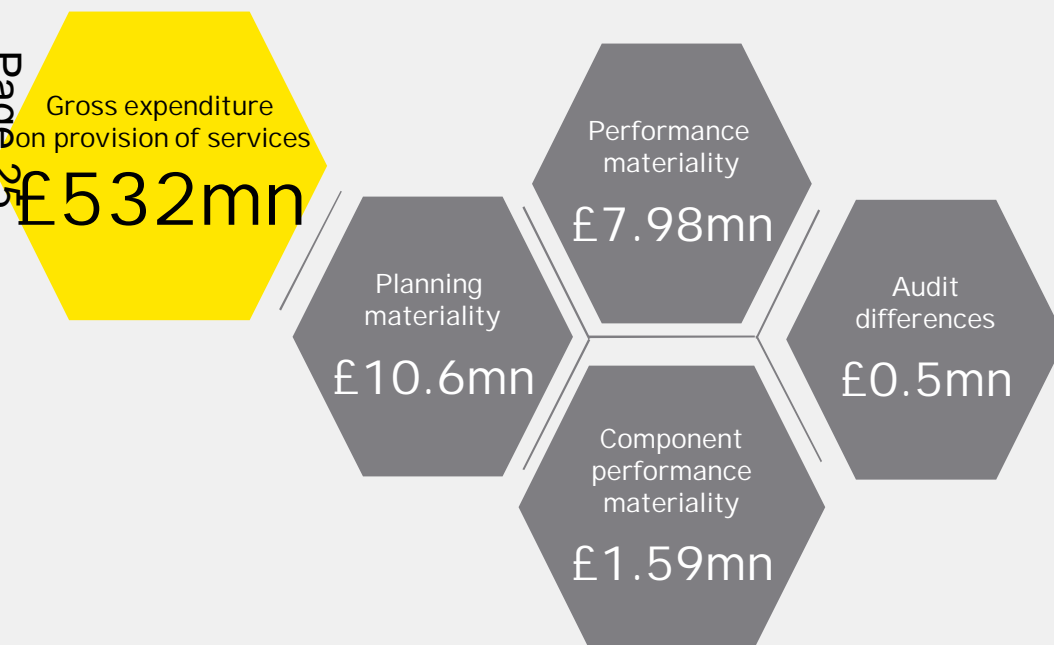


Materiality

Materiality

For planning purposes, materiality for 2017/18 has been set at £10.6mn. This represents 2% of the Council's prior year gross expenditure on provision of services plus the expenditure of CHAS 2013 Limited. It will be reassessed throughout the audit process. We consider that gross expenditure on the provision of services is the area of biggest interest to the users of the Council's accounts. We have provided supplemental information about audit materiality in Appendix C.

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We request that the Standards and General Purposes Committee confirm its understanding of, and agreement to, these materiality and reporting levels.

Key definitions

Planning materiality – the amount over which we anticipate misstatements would influence the economic decisions of a user of the financial statements.

Performance materiality – the amount we use to determine the extent of our audit procedures. We have set performance materiality at £7.98mn which represents 75% of planning materiality. This reflects our experience that draft accounts have in previous years been of a reasonable quality.

Component performance materiality range – we determine component performance materiality as a percentage of Group performance materiality based on risk and relative size to the Group.

Audit difference threshold – we propose that misstatements identified below this threshold are deemed clearly trivial. The same threshold for misstatements is used for component reporting. We will report to you all uncorrected misstatements over this amount relating to the comprehensive income and expenditure statement, balance sheet and collection fund that have an effect on income or that relate to other comprehensive income.

Other uncorrected misstatements, such as reclassifications and misstatements in the cashflow statement and movement in reserves statement or disclosures, and corrected misstatements will be communicated to the extent that they merit the attention of the Standards and General Purposes committee, or are important from a qualitative perspective.



05

Scope of our audit



Scope of our audit

Objective and Scope of our Audit

Under the Code of Audit Practice our principal objectives are to review and report on the Council's financial statements and arrangements for securing economy, efficiency and effectiveness in its use of resources to the extent required by the relevant legislation and the requirements of the Code. We issue an audit report that covers:

1. Financial statement audit

Our objective is to form an opinion on the financial statements under International Standards on Auditing (UK and Ireland).

We also perform other procedures as required by auditing, ethical and independence standards, the Code and other regulations. We outline below the procedures we will undertake during the course of our audit.

Procedures required by standards

- Addressing the risk of fraud and error; Significant disclosures included in the financial statements; Entity-wide controls;
- Reading other information contained in the financial statements and reporting whether it is inconsistent with our understanding and the financial statements; and Auditor independence.

Procedures required by the Code

- Reviewing, and reporting on as appropriate, other information published with the financial statements, including the Annual Governance; and
- Reviewing and reporting on the Whole of Government Accounts return, in line with the instructions issued by the NAO.

2. Arrangements for securing economy, efficiency and effectiveness (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.

Audit Process Overview

Our audit involves identifying and understanding the key processes and internal controls and substantive tests of detail of transactions and amounts. For 2017/18 we plan to follow a substantive approach to the audit as we have concluded this is the most efficient way to obtain the level of audit assurance required to conclude that the financial statements are not materially misstated.

Analytics - We will use our computer-based analytics tools to enable us to capture whole populations of your financial data, in particular journal entries. These tools help identify specific exceptions and anomalies which can then be subject to more traditional substantive audit tests; and give greater likelihood of identifying errors than random sampling techniques.

We will report the findings from our process and analytics work, including any significant weaknesses or inefficiencies identified and recommendations for improvement, to management and the Standards and General Purposes Committee.

Internal audit - We will regularly review internal audit plans and the results of their work. We will reflect the findings from these reports, together with reports from any other work completed in the year, in our detailed audit plan, where they raise issues that could have an impact on the financial statements.

Scope of our audit

Group scoping

For 2017/18 the Council has determined that it should consolidate CHAS 2013 Ltd and prepare group accounts. Our audit strategy for performing an audit of an entity components is risk based. We identify components as:

1. Significant components: A component is significant when it is likely to include risks of material misstatement of the group financial statements, either because of its relative financial size to the group (quantitative criteria), or because of its specific nature or circumstances (qualitative criteria). We generally assign significant components a full or specific scope given their importance to the financial statements.
2. Not significant components: The number of additional components and extent of procedures performed depended primarily on: evidence from significant components, the effectiveness of group wide controls and the results of analytical procedures.

For all other components we perform other procedures to confirm that there is no risk of material misstatement within those locations. These procedures are detailed below.

We have determined that CHAS 2013 Ltd is a significant component due to its risks and financial size. We have also determined our approach will be to apply a specific scope to our work on CHAS 2013 Ltd based on the nature of the transactions between the Council and the company. We are the auditors of CHAS 2013 Ltd but will not undertake the audit until later in the year.

Scoping by Entity

Our preliminary audit scopes by number of locations we have adopted are set out below. We provide scope details for the component within Appendix D.

0	A	Full scope audits
1	B	Specific scope audits
0	C	Review scope audits
0	D	Specified procedures
0	E	Other procedures

Scope definitions

Full scope: where a full audit is performed to the materiality levels assigned by the Group audit team for purposes of the consolidated audit.

Specific scope: where the audit is limited to specific accounts or disclosures identified by the Group audit team based on the size and/or risk profile of those accounts.

Review scope: where procedures primarily consist of analytical procedures and inquiries of management. On-site or desk top reviews may be performed, according to our assessment of risk and the availability of information centrally.

Specified Procedures: where the component team performs procedures specified by the Group audit team in order to respond to a risk identified.

Other procedures: Where we do not consider it material to the Group financial statements in terms of size relative to the Group and risk, we perform other procedures to confirm that there is no risk of material misstatement within those locations.



06

Audit team



Audit team

Audit team structure:

Suresh Patel
Associate Partner

Simon Mathers
Senior Manager

Sejal Patel
Senior

Daniel West
Senior

PFI Model
Specialist

Peter Dymoke
(Senior Manager)

MRP Specialist

Neil Gibson
(Senior Manager)

Use of specialists

When auditing key judgements, we are often required to rely on the input and advice provided by specialists who have qualifications and expertise not possessed by the core audit team. The areas where either EY or third party specialists provide input for the current year audit are:

Area	Specialists
Valuation of Land and Buildings	EY Valuations Team
Pensions disclosure	EY Actuaries
PFI	EY Internal PFI Specialist
MRP	EY Internal MRP Specialist

In accordance with Auditing Standards, we will evaluate each specialist's professional competence and objectivity, considering their qualifications, experience and available resources, together with the independence of the individuals performing the work.

We also consider the work performed by the specialist in light of our knowledge of the Council's business and processes and our assessment of audit risk in the particular area. For example, we would typically perform the following procedures:

- Analyse source data and make inquiries as to the procedures used by the specialist to establish whether the source data is relevant and reliable;
- Assess the reasonableness of the assumptions and methods used;
- Consider the appropriateness of the timing of when the specialist carried out the work; and
- Assess whether the substance of the specialist's findings are properly reflected in the financial statements.



07 Audit timeline





Audit timeline

Timetable of communication and deliverables

Timeline

Below is a timetable showing the key stages of the audit and the deliverables we have agreed to provide to you through the audit cycle in 2017/18. From time to time matters may arise that require immediate communication with the Standards and General Purposes Committee and we will discuss them with the Standards and General Purposes Committee Chair as appropriate. We will also provide updates on corporate governance and regulatory matters as necessary.

Audit phase	Timetable	Audit committee timetable	Deliverables
Planning:	October		
Risk assessment and setting of scopes	November	Standards and General Purposes Committee	
Walkthrough of key systems and processes	December		
	January	Standards and General Purposes Committee	
Interim audit testing	February		
	March	Standards and General Purposes Committee	Audit Planning Report and interim audit update
Year end audit	April		
Quality Report/Account testing	May		
	June		
Year end audit Audit completion procedures	July	Standards and General Purposes Committee	Audit Results Report Audit opinions and completion certificates Annual Audit Letter



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08

Independence



Introduction

The FRC Ethical Standard and ISA (UK) 260 “Communication of audit matters with those charged with governance”, requires us to communicate with you on a timely basis on all significant facts and matters that bear upon our integrity, objectivity and independence. The Ethical Standard, as revised in June 2016, requires that we communicate formally both at the planning stage and at the conclusion of the audit, as well as during the course of the audit if appropriate. The aim of these communications is to ensure full and fair disclosure by us to those charged with your governance on matters in which you have an interest.

Required communications

Planning stage	Final stage
<p>▶ The principal threats, if any, to objectivity and independence identified by Ernst & Young (EY) including consideration of all relationships between the you, your affiliates and directors and us;</p> <p>▶ The safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality review;</p> <p>▶ The overall assessment of threats and safeguards;</p> <p>▶ Information about the general policies and process within EY to maintain objectivity and independence.</p> <p>▶ Where EY has determined it is appropriate to apply more restrictive independence rules than permitted under the Ethical Standard</p>	<p>▶ In order for you to assess the integrity, objectivity and independence of the firm and each covered person, we are required to provide a written disclosure of relationships (including the provision of non-audit services) that may bear on our integrity, objectivity and independence. This is required to have regard to relationships with the entity, its directors and senior management, its affiliates, and its connected parties and the threats to integrity or objectivity, including those that could compromise independence that these create. We are also required to disclose any safeguards that we have put in place and why they address such threats, together with any other information necessary to enable our objectivity and independence to be assessed;</p> <p>▶ Details of non-audit services provided and the fees charged in relation thereto;</p> <p>▶ Written confirmation that the firm and each covered person is independent and, if applicable, that any non-EY firms used in the group audit or external experts used have confirmed their independence to us;</p> <p>▶ Written confirmation that all covered persons are independent;</p> <p>▶ Details of any inconsistencies between FRC Ethical Standard and your policy for the supply of non-audit services by EY and any apparent breach of that policy;</p> <p>▶ Details of any contingent fee arrangements for non-audit services provided by us or our network firms; and</p> <p>▶ An opportunity to discuss auditor independence issues.</p>

In addition, during the course of the audit, we are required to communicate with you whenever any significant judgements are made about threats to objectivity and independence and the appropriateness of safeguards put in place, for example, when accepting an engagement to provide non-audit services.

We also provide information on any contingent fee arrangements, the amounts of any future services that have been contracted, and details of any written proposal to provide non-audit services that has been submitted;

We ensure that the total amount of fees that EY and our network firms have charged to you and your affiliates for the provision of services during the reporting period, analysed in appropriate categories, are disclosed.

Relationships, services and related threats and safeguards

We highlight the following significant facts and matters that may be reasonably considered to bear upon our objectivity and independence, including the principal threats, if any. We have adopted the safeguards noted below to mitigate these threats along with the reasons why they are considered to be effective. However we will only perform non-audit services if the service has been pre-approved in accordance with your policy.

Overall Assessment

Overall, we consider that the safeguards that have been adopted appropriately mitigate the principal threats identified and we therefore confirm that EY is independent and the objectivity and independence of Suresh Patel, your audit engagement partner and the audit engagement team have not been compromised.

Self interest threats

A self interest threat arises when EY has financial or other interests in the Council. Examples include where we receive significant fees in respect of non-audit services; where we need to recover long outstanding fees; or where we enter into a business relationship with you. At the time of writing, there are no long outstanding fees.

We believe that it is appropriate for us to undertake permissible non-audit services and we will comply with the policies that you have approved.

None of the services are prohibited under the FRC's ES or the National Audit Office's Auditor Guidance Note 01 and the services have been approved in accordance with your policy on pre-approval. The ratio of non audit fees to audits fees is not permitted to exceed 70%.

At the time of writing, no non-audit services are planned. No additional safeguards are required.

A self interest threat may also arise if members of our audit engagement team have objectives or are rewarded in relation to sales of non-audit services to you. We confirm that no member of our audit engagement team, including those from other service lines, has objectives or is rewarded in relation to sales to you, in compliance with Ethical Standard part 4.

Self review threats

Self review threats arise when the results of a non-audit service performed by EY or others within the EY network are reflected in the amounts included or disclosed in the financial statements.

There are no self review threats at the date of this report.

Management threats

Partners and employees of EY are prohibited from taking decisions on behalf of management of the Council. Management threats may also arise during the provision of a non-audit service in relation to which management is required to make judgements or decision based on that work.

There are no management threats at the date of this report.

Other threats

Other threats, such as advocacy, familiarity or intimidation, may arise.

There are no other threats at the date of this report.

Other communications

EY Transparency Report 2017

Ernst & Young (EY) has policies and procedures that instil professional values as part of firm culture and ensure that the highest standards of objectivity, independence and integrity are maintained.

Details of the key policies and processes in place within EY for maintaining objectivity and independence can be found in our annual Transparency Report which the firm is required to publish by law. The most recent version of this Report is for the year ended 1 July 2017 and can be found here:

<http://www.ey.com/uk/en/about-us/ey-uk-transparency-report-2017>



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Appendices



Fees

The duty to prescribe fees is a statutory function delegated to Public Sector Audit Appointments Ltd (PSAA) by the Secretary of State for Communities and Local Government. PSAA has published a scale fee for all relevant bodies. This is defined as the fee required by auditors to meet statutory responsibilities under the Local Audit and Accountability Act 2014 in accordance with the NAO Code.

	Planned fee 2017/18	Scale fee 2017/18	Final Fee 2016/17
	£	£	£
Total Fee - Code work	143,498	143,498	143,498
Additional code work	4,500**	-	12,000*
Total audit	147,598	143,498	155,498
Non-audit services - Housing Benefits claim certification	41,242	41,242	30,555
Non-audit services - Teachers' Pensions limited assurance	8,500***	N/A	8,500
Total other non-audit services	49,742	41,242	39,055
Total fees	197,240	184,740	194,553

- Includes £5,000 for work undertaken on ledger migration and £7,000 for extra work in respect of controls issues arising from ledger migration, all agreed with the Council. The additional fee remains subject to final agreement by PSAA.

** For additional work on the Council's MRP revision - agreed with the Director of Corporate Services and subject to approval by PSAA

***To be confirmed with the Director of Corporate Services

All fees exclude VAT

The agreed fee presented is based on the following assumptions:

- ▶ Officers meeting the agreed timetable of deliverables;
- ▶ Our accounts opinion and value for money conclusion being unqualified;
- ▶ Appropriate quality of documentation is provided by the Council; and
- ▶ The Council has an effective control environment.

If any of the above assumptions prove to be unfounded, we will seek a variation to the agreed fee. This will be discussed with the Council in advance.



Fees for the auditor's consideration of correspondence from the public and formal objections will be charged in addition to the scale fee.

Appendix B



Required communications with the Committee

We have detailed the communications that we must provide to the Standards and General Purposes Committee.



Our Reporting to you

Required communications	 What is reported?	 When and where
Terms of engagement	Confirmation by the Standards and General Purposes Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Our responsibilities	Reminder of our responsibilities as set out in the engagement letter	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Planning and audit approach	<p>Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.</p> <p>When communicating key audit matters this includes the most significant risks of material misstatement (whether or not due to fraud) including those that have the greatest effect on the overall audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team</p>	Audit planning report
Significant findings from the audit	<ul style="list-style-type: none"> • Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures • Significant difficulties, if any, encountered during the audit • Significant matters, if any, arising from the audit that were discussed with management • Written representations that we are seeking • Expected modifications to the audit report • Other matters if any, significant to the oversight of the financial reporting process 	Audit results report



Required communications with the Committee (continued)

Required communications	 What is reported?	 When and where
Going concern	<p>Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including:</p> <ul style="list-style-type: none"> • Whether the events or conditions constitute a material uncertainty • Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements • The adequacy of related disclosures in the financial statements 	Audit results report
Misstatements	<ul style="list-style-type: none"> • Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation • The effect of uncorrected misstatements related to prior periods • A request that any uncorrected misstatement be corrected • Corrected misstatements that are significant • Material misstatements corrected by management 	Audit results report
Fraud	<ul style="list-style-type: none"> • Enquiries of the Standards and General Purposes Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity • Any fraud that we have identified or information we have obtained that indicates that a fraud may exist • A discussion of any other matters related to fraud 	Audit results report
Related parties	<ul style="list-style-type: none"> • Significant matters arising during the audit in connection with the entity's related parties including, when applicable: • Non-disclosure by management • Inappropriate authorisation and approval of transactions • Disagreement over disclosures • Non-compliance with laws and regulations • Difficulty in identifying the party that ultimately controls the entity 	Audit results report

Required communications with the Committee (continued)

Required communications	 What is reported?	 When and where
Independence	<p>Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence</p> <p>Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as:</p> <ul style="list-style-type: none"> • The principal threats • Safeguards adopted and their effectiveness • An overall assessment of threats and safeguards • Information about the general policies and process within the firm to maintain objectivity and independence 	Audit Planning Report and Audit Results Report
External confirmations	<ul style="list-style-type: none"> • Management's refusal for us to request confirmations • Inability to obtain relevant and reliable audit evidence from other procedures 	Audit results report
Consideration of laws and regulations	<ul style="list-style-type: none"> • Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off • Enquiry of the Standards and General Purposes Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Standards and General Purposes Committee may be aware of 	Audit results report
Internal controls	<ul style="list-style-type: none"> • Significant deficiencies in internal controls identified during the audit 	Management letter/audit results report

Required communications with the Committee (continued)

Required communications	 What is reported?	 When and where
Group audits	<ul style="list-style-type: none"> • An overview of the type of work to be performed on the financial information of the components • An overview of the nature of the group audit team’s planned involvement in the work to be performed by the component auditors on the financial information of significant components • Instances where the group audit team’s evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor’s work • Any limitations on the group audit, for example, where the group engagement team’s access to information may have been restricted • Fraud or suspected fraud involving group management, component management, employees who have significant roles in group-wide controls or others where the fraud resulted in a material misstatement of the group financial statements 	Audit planning report Audit results report
Representations	Written representations we are requesting from management and/or those charged with governance	Audit results report
Material inconsistencies and misstatements	Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	Audit results report
Auditors report	<ul style="list-style-type: none"> • Key audit matters that we will include in our auditor’s report • Any circumstances identified that affect the form and content of our auditor’s report 	Audit results report
Fee Reporting	<ul style="list-style-type: none"> • Breakdown of fee information when the audit plan is agreed • Breakdown of fee information at the completion of the audit • Any non-audit work 	Audit planning report Audit results report
Certification work	Summary of certification work undertaken	Certification report

Additional audit information

Other required procedures during the course of the audit

In addition to the key areas of audit focus outlined in section 2, we have to perform other procedures as required by auditing, ethical and independence standards and other regulations. We outline the procedures below that we will undertake during the course of our audit.

Our responsibilities required by auditing standards

- Identifying and assessing the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.
- Obtaining an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Concluding on the appropriateness of management's use of the going concern basis of accounting.
- Evaluating the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtaining sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. Reading other information contained in the financial statements, including the board's statement that the annual report is fair, balanced and understandable, the Standards and General Purposes Committee reporting appropriately addresses matters communicated by us to the Standards and General Purposes Committee and reporting whether it is materially inconsistent with our understanding and the financial statements; and
- Maintaining auditor independence.

Additional audit information (continued)

Purpose and evaluation of materiality

For the purposes of determining whether the accounts are free from material error, we define materiality as the magnitude of an omission or misstatement that, individually or in the aggregate, in light of the surrounding circumstances, could reasonably be expected to influence the economic decisions of the users of the financial statements. Our evaluation of it requires professional judgement and necessarily takes into account qualitative as well as quantitative considerations implicit in the definition. We would be happy to discuss with you your expectations regarding our detection of misstatements in the financial statements.

Materiality determines:

- The locations at which we conduct audit procedures to support the opinion given on the Group financial statements; and
- The level of work performed on individual account balances and financial statement disclosures.

The amount we consider material at the end of the audit may differ from our initial determination. At this stage, however, it is not feasible to anticipate all of the circumstances that may ultimately influence our judgement about materiality. At the end of the audit we will form our final opinion by reference to all matters that could be significant to users of the accounts, including the total effect of the audit misstatements we identify, and our evaluation of materiality at that date.

Scoping the group audit

The below table sets out the scoping details. We set audit scopes for each reporting unit which, when taken together, enable us to form an opinion on the group accounts. We take into account the size, risk profile, changes in the business environment, and other factors when assessing the level of work to be performed at each reporting unit.

Detailed scoping							
In scope components	Scope	Statutory audit performed by EY	Coverage			Current year rationale for scoping	
			Gross Revenue Expenditure	Profit before tax	Total assets	Size	Risk
CHAS 2013 Limited	Specific	a	£4.52m	£1.27m	£2.63m	No	Yes

The expenditure of CHAS 2013 Limited represents 1% of the group Gross Revenue Expenditure. Therefore we consider CHAS 2013 Limited to be an in scope significant component based on risk and will require a specific scope audit. We would usually assign either full scope or a specific scope to components that are based on risk. As the wholly owned subsidiary is forecast to have a turnover of £7.8mn in 2017/18, this has a specific impact on the income account. We note that the presumed risk of fraud in respect of revenue recognition for CHAS cannot be rebutted in respect of income. Testing of CHAS Income will therefore address this significant risk in respect of the component account.

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

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