London Borough of Merton

Audit Progress Report

Year-ended 31 March 2018

28 August 2018

Building a better working world

Dear Standards and General Purposes Committee Members

28 August 2018

Audit Progress Report

We are pleased to attach our report for the forthcoming meeting of the Committee. This report provides an update in relation to the audit of the London Borough of Merton (the Authority) for 2017/18 following our 25 July progress report.

As at the date of this report our audit remains in progress. Since the last Committee meeting we have worked closely with the Authority in addressing the issues we reported previously in relation to the valuation of the Authority's property, plant and equipment (PPE). The Authority has determined that it needs to commission an external valuer to provide it with the assurance it needs over the material accuracy of the valuation of its specialised assets. The work we engaged our own experts, EY Real Estates, is also still in progress. Whilst we have progressed some of the non-PPE aspects of the audit there remains work to complete. Progress has been slower than anticipated due largely to the challenges of undertaking the audit during a period when finance staff and auditors have had scheduled holiday.

We will provide a verbal update of the audit at the 6 September Committee meeting including an outline of the timeline we have determined to complete the audit and issue the auditor's report. We also include in this report our narrative reporting on our work to provide a value for money conclusion and an outline of the additional fees we have agreed to date with the Director of Corporate Services.

This report is intended solely for the use of the Standards and General Purposes Committee, other members of the Authority, and senior management. It should not be used for any other purpose or given to any other party without obtaining our written consent.

Yours faithfully

Suresh Patel

For and on behalf of Ernst & Young LLP

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01 Audit progress

Status of the audit

Update - As at the date of this report our audit remains in progress

PPE valuation.

In our July report we highlighted significant issues with the Authority's valuation of its PPE and our decision to engage our own valuation expert – EY Real Estates (EYRE). Following continued work in this area by the audit team and EYRE, the Authority has decided it will engage an external valuer to carry out some focused work on its approach to the valuation of its specialised assets (such as schools). The external valuer is scheduled to report back to the Authority later in September. In addition our work on the Authority's valuation of its non-specialist assets (such as other land and buildings) has identified some issues which we have now engaged EYRE to review.

As a consequence of the above, the PPE valuation matters remain unresolved and a work in progress and is unlikely to be resolved until the end of September subject to agreeing the reworked PPE disclosures and identifying any further PPE related matters.

Non-PPE audit procedures

These remain in progress and have progressed slower than anticipated due to the impact of the holiday commitments of the audit and finance teams. This has impacted on both the Authority's and the audit teams ability to complete the necessary work.

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Completion

We will have continuing challenges in resourcing the audit from now on as team members have been scheduled to work on other audits as part of our resourcing plan for the late summer and autumn. We are working hard to ensure we have the appropriate resource to deliver the audit as quickly as possible. At this stage we do not anticipate completing the audit until October.

Value for money (VFM) conclusion

In our Audit Plan we reported a significant risk to the VFM conclusion in relation to the extent of savings the Authority has identified in its medium term financial strategy. We have completed the procedures we planned to undertake in response. We do not expect to have any matters to include in the auditor's report in respect of the VFM conclusion. We provide details of our work in the next section.

Value for Money Risks

We are only required to determine whether there are any risks that we consider significant within the Code of Audit Practice, where risk is defined 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 enough work to deliver a safe conclusion on your arrangements to secure value for money, and enables us to determine the nature and extent of any further work needed. If we do not identify a significant risk we do not need to carry out further work.

The table below presents the risk areas in our Audit Planning.

What was the significant value for money risk?	What arrangements did the risk affect?	What was our planned response?
The Authority 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 Authority's Business Plan for 2018 to 2022 shows a cumulative budget gap including the use of reserves of £37.7 million. As at the end of November 2017, there was a forecast shortfall of £2.6 million or 31% in delivery of the Authority's current year savings target.	• Taking informed decisions • Deploying resources in a sustainable manner	Our approach will focus on reviewing the robustness of the Authority'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 Authority's future financial plans.

In our planning work we also considered the weaknesses identified by the Authority 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 did not consider the risk to be significant we have considered how the Authority has developed its arrangements during the year to address the weaknesses identified. We have also followed up the recommendations we made in the previous year's VFM reporting.

We report our findings on our VFM conclusion work on the next few pages.

Value for Money

What are our findings?

2017/18 financial position and performance

At the end of the financial year the overall underspend was £266,000 compared to a £5.4 million overspend or 1 per cent of the gross budget in 2016/17, and a 2017/18 forecast overspend of approximately £600,000 as at month 9. Despite the small surplus delivered services have continued to overspend, with total service overspending in the year of £1.15 million. Service overspending has again primarily been incurred in the more volatile demand led areas of Children, Families and Schools and Community and Housing, although the main area of overspending has shifted from adult social care to children's and in particular social care and youth inclusion budgets. The level of service level of overspending has reduced significantly from 2016/17 (£10.1 million) and is at its lowest level for four years, but the overall underspend was only achieved through service expenditure growth built into to the 2017/18 budget and continued underspending on corporate services budgets and corporate provisions.

The level of usable reserves has decreased in the period. Although the overall General Fund balance has remained unchanged at approximately £12.8 million, usable earmarked revenue reserves (excluding balances held by schools) have decreased by approximately £1 million or 2.4% of total usable earmarked reserves of £41m. There has also been a decrease of £4.2 million in usable reserves available to support capital spending as planned.

Total Capital Expenditure for 2017/18 was £32.2 million compared to an original capital programme budget of £39.5 million. Significant changes were made to the capital programme and budget across the year and, in common with previous years, the forecast of capital outturn made at the end of month 9 (£39.4 million) was significantly over-stated. The relatively high level of slippage in delivery of the programme is also consistent with prior years.

Prior year overspending in Community and Housing related to adult social care, and primarily the access and enablement budget. This has been largely addressed in 2017/18 although there remains some residual overspending at a level of 1 per cent of the budget in this area. The Authority reports that there has been a noticeable reduction in committed expenditure on placements in the latter part of the financial year which is due to the introduction of an outcomes forum, weekly monitoring of variations and increased scrutiny of care packages. It should be noted, however, that Adult Social Care received £9.3 million budget growth in 2017/18 to support identifiable pressures in the placements budget. The changes in arrangements and work practices made in the period have therefore stabilised spending in 2017/18 at broadly 2016/17 levels rather than generating savings. It is essential that this level of control against the budget is maintained as continued budget growth at this level cannot be maintained and is not planned for in the medium term financial strategy (MTFS).

The main driver of overall service level overspending in 2017/18 was overspending in Children Schools and Families. The main area of overspending within the service is social care and youth inclusion costs, although there was also significant overspending against the Special Education Needs (SEN) transport cost budget. The Authority also notes that the service identified underspends to offset cost pressures that are not sustainable on an on-going basis or one-off windfalls which are not guaranteed to reoccur in future years. This means that the demographic and new burdens cost pressures will continue into the new financial year with budgetary pressures being primarily driven by the complexity rather than the volume of cases. Both placement and SEN transport budgets are considered by the Authority to be particularly volatile areas and due to the increasing volume of children's social care activity and Education Health and Care Plan (EHCP) requests the service is concentrating on demand management balancing its education and social care statutory duties with careful and considered oversight of spend.

What are our findings?

Future Financial Planning and the MTFS

The current iteration of the MTFS was presented to Authority in February 2018 as part of the 2018/22 Business Plan. The MTFS forecasts a cumulative budget gap of £17.4 million by 2021/22 after considering the impact of 2018/19 savings and income proposals and transfers from departmental and the Balancing the Budget reserves.

We have considered the reasonableness of pay and price increases built into the MTFS projections. Uplifts for pay inflation are based on the two-year pay increase offered to all council employees from 1 April 2018. The majority of employees will receive an uplift of 2 per cent on 1 April 2018 and a further 2 per cent on 1 April 2019, with those on lower salaries receiving higher increases. The offer also includes the introduction of a new national pay spine on 1 April 2019. In determining uplifts for price inflation the Authority has considered Consumer Price Index (CPI), Retail Price Index (RPI) and bank base rate forecasts over its MTFS planning horizon. Although lower than both CPI and RPI the Authority's estimate of price inflation is higher than the forecast base rate changes. The price inflation assumptions incorporated into the MTFS are cash limited but at a corporate level an 'excess inflation provision' is incorporated into the MTFS. This is intended to assist services that experience price increases greatly in excess of the provision built into the budget. Based on our review we are satisfied that price and pay inflation assumptions built into the MTFS are reasonable. The MTFS also considers:

- Income – there is no assumption around inflation of income from fees and charges built into the MTFS. This is considered to be a prudent approach noting that service departments can treat forecast increases income as part of savings schemes.
- Forecast Collection Fund surplus / deficits and the impact of a move to a London Pilot business rate pool from 2018/19.
- A general contingency for unforeseen cost and demand pressures (£1.5 million).
- Bad debt provision, with no allowance for any increase being made over the period covered by the MTFS.
- Revenuisation – this is the cost of expenditure originally included in the capital programme that could not be justified as capital expenditure.
- Employer pension contributions.
- The cost of local elections.
- Other corporate and technical adjustments.

We have considered savings proposals over and above those already delivered in prior years and incorporated into the MTFS forecast. The scale of the challenge the Authority faces to identify and deliver the savings necessary to balance the budget continues to grow. For the three years 2019/20 to 2021/22 a cumulative total of approximately £3.7 million of savings have been proposed by directorates. To balance the budget without calling on reserves to a greater extent than planned directorates still need to identify and deliver a further £18.4 million of savings by 2021/22. To gain assurance on the robustness of projected savings proposals already built into the 2018/19 budget we selected one agreed proposal from each of the Children, Schools and Families and Community and Housing directorates, and asked to see support for the estimated saving built into the budget and details on progress made on delivery of the saving to date in 2018/19. The savings proposal for Children's, Families and Schools is reported as being fully delivered in the current year giving reasonable assurance the saving proposal was valid and supportable. The Community and Housing saving proposal, which related to Adult Social Care, was not considered to be achievable as a result of changes in circumstances outside of the Authority's control. As a result it was withdrawn and replaced by alternative savings proposal which are currently being reported as partially delivered in the current year. This provides some assurance that planned savings are actively reviewed and replacement schemes identified where original schemes are no longer considered viable.

What are our findings?

Future Financial Planning and the MTFS (continued)

We note that significant growth was built into the adult social care budget for 2017/18 in response to demand pressures and overspending in the prior period noted as part of our work on the 2016/17 VFM conclusion. Given the level of assumed growth is reduced significantly across all services from 2018/19 it is essential that planned recurrent savings are realised for the Authority to be financially sustainable.

Overall we have concluded that the MTFS is comprehensive and the reporting of it, and detailed assumptions underpinning it, are clear. The assumptions built into the MTFS are reasonable based on external evidence, comprehensive and not unrealistically optimistic, and there is some support available for savings plans and associated actions. The Authority remains financially resilient over the medium term but financial challenges are continuing to grow. Although reduced in 2017/18 the current level of service overspending is not sustainable. Reserves still offer the Authority some flexibility but it is increasingly important that service level savings are identified and delivered as planned.

Weaknesses in contract standing orders and related processes

As part of our planning assessment we consider Internal Audit work undertaken in the period. At the planning stage we reported that Internal Audit had identified some instances of non-compliance with procurement rules and contract standing orders together with some instances of non-compliance with contract register processes based on its work undertaken at that point in time. Although we did not consider these to be significant risks we identified them as relevant to our value for money conclusion responsibilities and undertook to follow-up progress at the execution phase of the audit drawing on planned 2017/18 Internal Audit reviews of corporate procurement and contract monitoring of commissioned services which had not been delivered at the planning stage.

We have liaised with the Head of Internal Audit who has confirmed that both the corporate procurement and contract monitoring of commissioned services reviews were deferred to 2018/19, with the corporate procurement review currently being undertaken as at July 2018. Based on a discussion with Internal Audit progress made during the year and subsequent to year-end in addressing the previously identified weaknesses in arrangements has been mixed. Some improvements have been identified in the current audit review of procurement in relation to contract standing order updates, the issue of guidance for staff on the intranet, overall strategy and the development and function of Operational Procurement Groups. We are pleased to note these issues have been addressed and are included in the revised Contract Standing Orders issued November 2017. We have concluded that the residual weaknesses are not indicative of an absence of adequate arrangements, but that this is an area where continued focus is needed to improve arrangements.

Follow up of prior year VFM recommendation

As part of our 2016/17 VFM conclusion work at the Authority we raised the following recommendations for improvement in our Audit Results Report. We recommended that the Authority should:

- Consider areas of adult social are related activity where it could further benefit from working in collaboration with its main CCG and other parties to the Sustainability and Transformation Plan, for example, joint procurement or commissioning.
- Ensure that teams are sufficiently supported and encouraged to make effective use of the new IT systems (Mosiac and the E5 general ledger) for producing timely and accurate financial and operational information.

Good progress has been made against the first recommendation. The significant prior year overspend on the access and assessment budget has been largely addressed although there remains some residual overspending. This offers some assurance that work started in 2016/17 and considered as part of our 2016/17 value for money conclusion work has had a positive impact on controlling the sharp increase in demand and unit cost experienced in 2016/17. Some of the arrangements we considered in 2016/17, such as holding weekly budget management meetings and the implementation of a management action plan, have operated throughout 2017/18 and appear to have had a positive impact. Throughout 2017/18 the Authority also reported on the Better Care Fund agreement with Merton CCG and its potential liability of a £474,000 risk share contribution, in addition to a £275,000 pressure from the previous year. At the end of the year there has been a reduction in the expected risk share allocation to £150,000, which the Authority attributes to continued effective working relationships between the Community and Housing management team and the CCG. It should be noted, however, Adult Social Care received £9.3 million growth in 2017/18 to support identifiable pressures in the placements budget. The changes in arrangements and work practices made in the period have therefore stabilised spending in 2017/18 at broadly 2016/17 levels rather than generating savings.

Progress made against the second prior year recommendation has been less strong. An Internal Audit review undertaken in the year of the Authority's CM2000 system received limited assurance. CM2000 is the Authority's electronic care monitoring system, which enables the logging and analysing of home care visits by care providers contracted to use the system. The CM2000 system interfaces with Mosaic, the Authority's main social care system, which in turn interfaces with the E5 general ledger. This process should enable payments to be made to providers automatically and subsequent billing of client invoices to be correct. However, due to problems with system implementation this was not always possible. Although several staff currently have access to CM2000, user-friendly monitoring reports are not readily available and there is a heavy reliance on the CM2000 Contract Monitoring officer to supply information required from the system. It was also not possible for the Authority to undertaken a complete reconciliation of Mosaic to the E5 general ledger throughout the 2017/18 year with a final reconciliation not being completed until April. The Authority's own 2017/18 Annual Governance Statement continues to disclose a governance issue around the need to fully review controls in light of the new E5 financial management system, with the ability to reconcile Mosaic income and expenditure to E5 is a key part of this.

Fees

Update on fees

At the July Committee meeting we stated that as a result of the significant issues arising in the audit, including the need to respond to a member of the public, we would be seeking to agree additional fees with the Director of Corporate Services. To date we have outlined the fees included in the table. In estimating the proposed additional fees for the additional work we have made allowances for the additional time we have spent on the audit arising from our own resourcing challenges. We will seek to agree final fees with the Director of Corporate Services on completion of all the audit work. These fees are subject to approval by Public Sector Audit Appointments Ltd.

* These fees are as at the end of August so any further work will increase the proposed final fees.

Tbc fees will be finalised on completion of the relevant work.

	Proposed final fee 2017/18	Planned fee 2017/18	Scale fee 2017/18	Final Fee 2016/17
		£	£	£
Total Fee - Code work	143,498	143,498	143,498	143,498
Additional code work:			-	12,000
- MRP revision	4,500	4,500	-	-
- Responding to a member of the public	9,000	-	-	-
- Engagement of EY Real Estates	13,000*	-	-	-
- Additional work arising from change in materiality and clearance of audit queries	30,000*	-	-	-
Total audit	199,998	147,598	143,498	155,498
Non-audit services - Housing Benefits claim certification	Tbc	41,242	41,242	30,555
Non-audit services – Teachers' Pensions limited assurance	Tbc	8,500	N/A	8,500
Total other non-audit services	Tbc	49,742	41,242	39,055
Total fees	Tbc	197,240	184,740	194,553

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