London Borough of Merton
Audit planning report
Year ended 31 March 2019

February 2019

Building a better working world

28 February 2019

Dear Committee Members

Audit planning report

We are pleased to attach our audit planning report for the forthcoming meeting of the Standards and General Purposes Committee. The purpose of this report is provide the Committee with a basis to review our proposed audit approach and scope for the 2018-19 audit, in accordance with the requirements of the auditing standards and other professional requirements, but also to ensure that our audit is aligned with the Committee's service expectations.

This report summarises our assessment of the key issues which drive the development of an effective audit for the London Borough of Merton. We have aligned our audit approach and scope with these.

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 14 March 2019 as well as understand whether there are other matters which you consider may influence our audit.

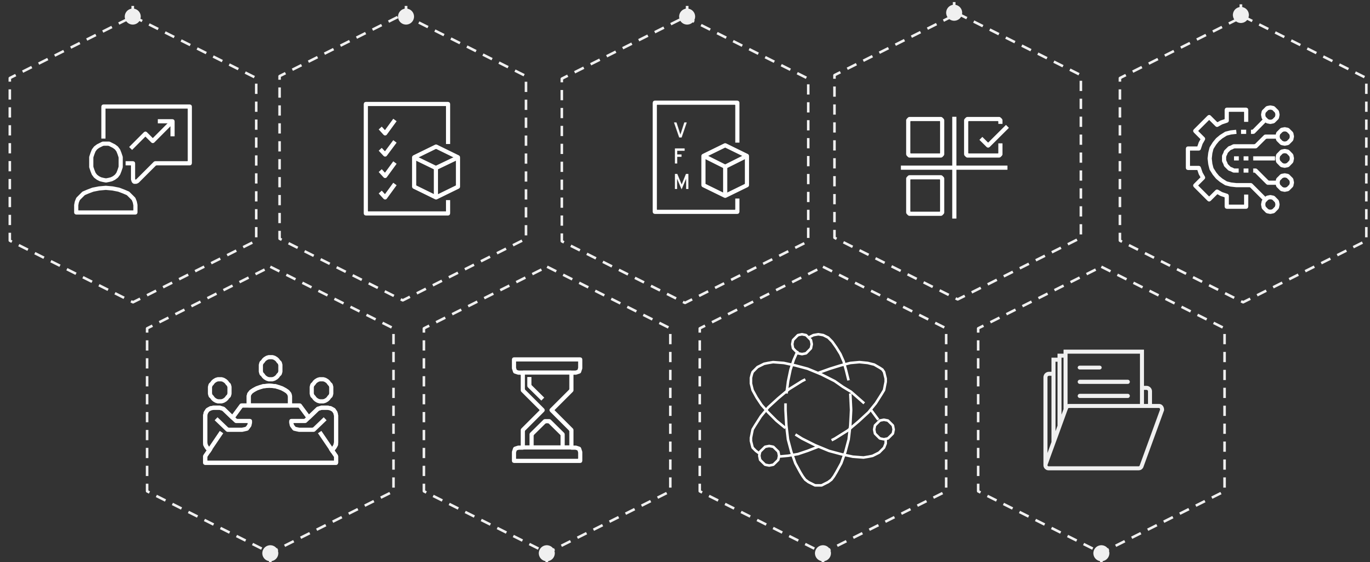
Yours faithfully

Suresh Patel

Associate Partner

For and on behalf of Ernst & Young

Contents



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 (April 2018)" 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 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 2018-19 audit strategy

Overview of our 2018-19 audit strategy

The following 'dashboard' summarises the significant accounting and auditing matters outlined in this report. It seeks to provide the Audit 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.
Inappropriate capitalisation of revenue expenditure	Fraud risk	A more clearly defined risk for 2018/19.	Linking to our fraud risk identified above, we have determined that the way in which management could override controls is through the in appropriate capitalisation of revenue expenditure to understate revenue expenditure reported in the financial statements.
Valuation of Land and Buildings	Significant Risk	No change in risk or focus.	The fair value of Property, Plant and Equipment (PPE) represents a significant balance in the Council's accounts and is 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. In 2017/18 we identified significant weaknesses in the approach taken by management to the valuation of assets carried at depreciated replacement cost (DRC). Our findings led to the carrying value of PPE being increased by approximately £163 million. We considered the weaknesses in arrangements for the valuation of land and buildings assets to be a significant deficiency in internal control at the Council.
Pension Liability and Asset Valuation	Inherent Risk	No change in risk or focus.	The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme which it administers. 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.

Overview of our 2018-19 audit strategy

Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from PY	Details
New Accounting Standards	Inherent risk	New risk identified this year.	IFRS 9 (Financial Instruments) and IFRS 15 (Revenue from contracts) apply from 1 April 2018. We will assess the impact of these new standards to determine whether they have been appropriately implemented by the Council.
Private Finance Initiative (PFI)	Inherent Risk	No change in risk, but the focus of our work has been updated to reflect issues relevant to the year of account.	The Council has a material PFI arrangement. PFI accounting is a complex area, and a detailed review of these arrangements was undertaken by our internal expert in 2016/17 and followed-up in 2017/18. We will review the accounting entries and disclosures in relation to PFI in detail in 2018/19, with a focus on any significant changes since the previous year.

Materiality

Planning materiality
£9.5m

We have set materiality at £9.537 million for the group financial statements which represents 1.8% of the prior years gross revenue expenditure of the Council and CHAS 2013 Ltd. Materiality for the single entity Council financial statements is £9,426 million. In the prior year we calculated materiality by applying the maximum threshold possible, 2% of gross expenditure. We have reduced the maximum threshold for all local authorities to 1.8%, reflecting the higher profile of local government financial resilience and financial reporting.

Performance materiality
£4.7m

We have set performance materiality at £4.768 million for the group financial statements and £4,713 million for the single entity Council financial statements. This represents 50% of materiality reflecting the high level of error detected in our 2017/18 financial statements audit. 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 £1.91 million.

Audit differences
£476k

We will report all uncorrected misstatements relating to the group financial statements over £476,000. We will communicate other misstatements identified to the extent that they merit the attention of the Standards and General Purposes Committee.

Overview of our 2017/18 audit strategy

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 2019 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 National Audit Office (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.

02 Audit risks

Our response to significant risks

We have set out the significant risks (including fraud risks denoted by*) identified for the current year audit along with the rationale and expected audit approach. The risks identified below may change to reflect any significant findings or subsequent issues we identify during the audit.

	What is the risk?	What will we do?
Misstatements due to fraud or error *	The financial statements as a whole are not free of material misstatements whether caused by fraud or error. 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.	We will undertake our standard procedures to address fraud risk, which include: ➢ Identifying fraud risks during the planning stages. ➢ Inquiring of management about risks of fraud and the controls put in place to address those risks. ➢ Understanding the oversight given by those charged with governance of management's processes over fraud. ➢ Considering the effectiveness of management's controls designed to address the risk of fraud. ➢ Determining an appropriate strategy to address those identified risks of fraud. ➢ Performing mandatory procedures regardless of specifically identified fraud risks, including testing of journal entries and other adjustments in the preparation of the financial statements. We undertake similar procedures on all of our audit engagements.

Our response to significant risks (continued)

Inappropriate capitalisation of revenue expenditure*

Financial statement impact

We have assessed that the risk of misreporting revenue outturn in the financial statements is most likely to be achieved through:

► Revenue expenditure being inappropriately recognised as capital expenditure at the point it is posted to the general ledger.

► Expenditure being inappropriately transferred by journal from revenue to capital codes on the general ledger at the end of the year.

If this were to happen it would have the impact of understating revenue expenditure and overstating PPE additions and/or Revenue Expenditure Financed as Capital Under Statute (REFCUS) in the financial statements.

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 Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.

We have identified an opportunity and incentive to capitalise expenditure under the accounting framework, to remove it from the general fund. In arriving at this conclusion we have considered the continuing pressure on the revenue budget and the financial value of its annual capital programme which is many times out materiality level.

This could then result in funding of that expenditure, that should properly be defined as revenue, through inappropriate sources such as capital receipts, capital grants, or borrowing.

What will we do?

We will:

► Test PPE additions to ensure that the expenditure incurred and capitalised is clearly capital in nature.

► Seek to identify and understand the basis for any significant journals transferring expenditure from revenue to capital codes on the general ledger at the end of the year.

We will utilise our data analytics capabilities to assist with our work, including journal entry testing. We will assess journal entries more generally for evidence of management bias and evaluate for business rationale.

Our response to significant risks

Valuation of land and buildings

Financial statement impact

The net book value of other land and buildings in the 2017/18 audited accounts was £582.8 million.

What is the risk?

The fair value of land and buildings represents a significant balance in the Council's accounts and is 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.

In 2017/18 we identified significant weaknesses in the approach taken by management to the valuation of assets carried at depreciated replacement cost (DRC) and issues with assets valued using the Existing Use Valuation (EUV) approach.

Our findings led to the carrying value of PPE being increased by approximately £163 million. We considered the weaknesses in arrangements for the valuation of land and buildings assets to be a significant deficiency in internal control at the Council.

There is a risk that the value of land and buildings in the Council's accounts is materially misstated for 2018/19.

What will we do?

We will disaggregate the Council's other land and buildings and adopt different testing strategies for specialised assets the Council values using DRC and non-specialist assets valued using EUV.

► For DRC we will confirm that the Council has used the methodology it revised in the prior year following our audit which include the work of our expert. We will also test a sample of valuations, challenging the Council on key assumptions and base data such as agreeing floor areas back to original documentation.

► For EUV, due to the extent of subjectivity and professional judgement that management's expert applies we will engage our own expert to enable us to audit a sample of valuations, challenging management on key assumptions and judgements.

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.

What is the risk/area of focus?	What will we do?
<u>Pension Liability Valuation</u> The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by the Council. The Council's pension fund deficit is a material estimated balance and the Code requires that this liability be disclosed on the Council's balance sheet. At 31 March 2018 this totalled £350.1 million. The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the Pension Fund. 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 London Borough of Merton. ▶ 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 the National Audit Office for all Local Government sector 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. We will consider outturn information available at the time we undertake our work after production of the Council's draft financial statements, for example the year-end actual valuation of pension fund assets. We will use this to inform our assessment of the accuracy of estimated information included in the financial statements and whether any adjustments are required.
<u>PFI</u> The Council has a material PFI arrangement in relation to schools. PFI accounting is a complex area, and a detailed review of these arrangements was undertaken by our internal expert in 2016/17 and followed-up in 2017/18.	We will review the accounting entries and disclosures in relation to PFI in detail in 2018/19, with a focus on any significant changes since the expert's follow-up review in the previous year. Specifically, the Council is making changes to the detailed accounting model for its PFI in light of our points raised in the previous year and the unadjusted misstatement identified late in our 2017/18 audit and reported in the Audit Results Report. These amendments are currently being considered by our internal expert in discussion with the Council. We will also undertake testing of in-year inputs to the accounting models and agree relevant entries in the financial statements to year-end output from the accounting model.

Other areas of audit focus (continued)

What is the risk/area of focus?	What will we do?
IFRS 9 Financial instruments This new accounting standard will change: ▸ How financial assets are classified and measured; ▸ How the impairment of financial assets are calculated; and ▸ The disclosure requirements for financial instruments. There are transitional arrangements within the standard; and the 2018/19 CIPFA Code of Practice on Local Authority Accounting provides guidance on the application of IFRS 9. A statutory override is available for certain classes of financial assets. The Council is yet to undertake and document its assessment of the impact of IFRS9.	We will: ▸ Assess the Council's implementation arrangements that should include an impact assessment paper setting out the application of the new standard, transitional adjustments and planned accounting for 2018/19. ▸ Consider the classification and valuation of financial instrument assets. ▸ Review the implementation of the new expected credit loss model impairment calculations for assets. ▸ Check additional disclosure requirements for compliance with the CIPFA Code.
IFRS 15 Revenue from contracts with customers The key requirements of the standard cover the identification of performance obligations under customer contracts and the linking of income to the meeting of those performance obligations. The 2018/19 CIPFA Code of practice on local authority accounting provides guidance on the application of IFRS 15 and includes a useful flow diagram and commentary on the main sources of LG revenue and how they should be recognised. The impact on local authority accounting is likely to be limited as large revenue streams like council tax, non domestic rates and government grants will be outside the scope of IFRS 15. However where that standard is relevant, the recognition of revenue may change and new disclosure requirements introduced. The Council is yet to undertake and document its assessment of the impact of IFRS15.	We will: ▸ Assess the authority's implementation arrangements that should include an impact assessment paper setting out the application of the new standard, transitional adjustments and planned accounting for 2018/19. ▸ Consider application to the authority's revenue streams, and where the standard is relevant test to ensure revenue is recognised when (or as) it satisfies a performance obligation; and ▸ Check additional disclosure requirements.

03 Value for Money Risks

Value for Money

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 2018/19 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:

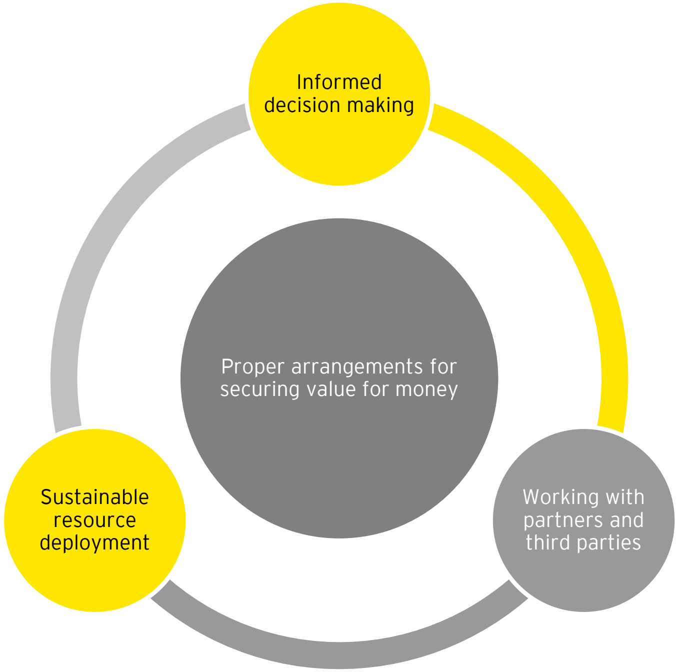
- Take informed decisions;
- Deploy resources in a sustainable manner; and
- Work with partners and other third parties.

In 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.



Value for Money Risks

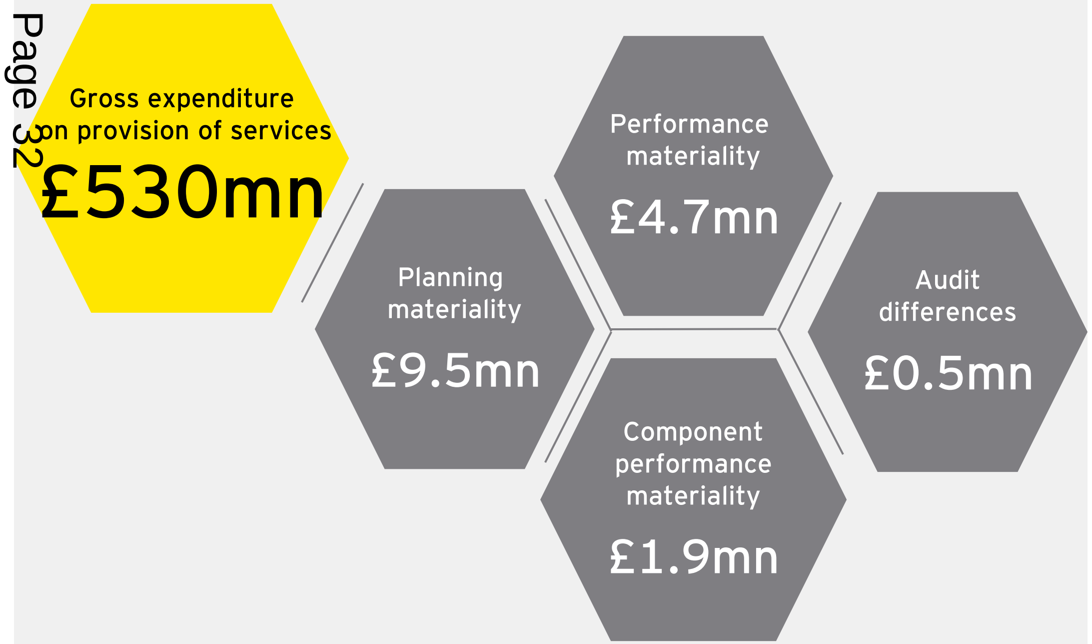
What is the significant value for money risk?	What arrangements does the risk affect?	What will we do?
The Council continues to have a challenging financial outlook. Based on the February Cabinet report, to balance the budget over the next four years it is planning to deliver cumulative agreed savings of approximately £9.5 million with further savings of approximately £10.3 million needing to be found to fully balance the budget and avoid further dependence on its reserves. As at 18 February, the current draft business plan 2019-23 shows a cumulative budget gap, including the use of reserves, and assuming no Adult Social Care grant but that Council Tax hypothecation can be used, as follows over the next four years: • No budget gap in 2019/20. • £1,112,000 in 2020/21. • £5,411,000 in 2021/22. • £6,078,000 in 2022/23.	Sustainable resource deployment	Our approach will focus on reviewing the robustness of the Council's plans and arrangements to address budget pressures in 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 2017-18 programme of value for money work.

04 Audit materiality

Materiality

Materiality

For planning purposes, materiality for 2017/18 has been set at £9.536 million for the group financial statements. This represents 1.8% 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 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 £4.768mn for the group financial statements which represents 50% of planning materiality. This reflects the relatively high level of error detected in our 2017/18 financial statements audit.

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 of £476,000 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

Our Audit Process and Strategy

Objective and Scope of our Audit scoping

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.

Our Audit Process and Strategy (continued)

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 2018/19, 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 Audit Committee.

Internal audit:

We will review internal audit plans and the results of their work and meet with the Head of Internal Audit as necessary. 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, the Narrative Statement and the Annual Governance Statement.

Scope of our audit

Group scoping

For 2018/19 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 risk. 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. We have also considered the Council's other wholly owned subsidiary, Merantun Development Limited, as part of our group scoping assessment but based on information available at the planning stage of the audit do not consider its financial activity in the period will be material to the Group.

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
Simon Luk Senior
Adam Le-Huray Baker Senior

EY Real Estates (EYRE)	PFI Specialist	PwC (consulting actuary) and EY Actuaries

Working together with the Council

We are working together with officers to identify continuing improvements in communication and processes for the 2018-19 audit.

We will continue to keep our audit approach under review to streamline it where possible.

Page 38

Use of specialists

When auditing key judgements, we are often required to use the input and advice provided by specialists who have qualifications and expertise not possessed by the core audit team. The areas where specialists are expected to provide input for the current year audit are:

Area	Specialists
Pensions disclosure	EY Actuaries Barnett Waddingham – Actuary to Merton Pension Fund
PPE	The Council's own internal valuer is engaged by the Council for valuation of its PPE. EY Real Estates
PFI	EY Internal PFI 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

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 2018-19.

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 Committee Chair as appropriate. We will also provide updates on corporate governance and regulatory matters as necessary.

Audit phase	Timetable	Standards and General Purposes Committee Meeting timetable	Deliverables
Initial Planning: Risk assessment and setting of scopes and walkthrough of key systems and processes	November		
	December		
Completion of initial planning	January		
	February		
Interim audit testing and completion of walkthroughs	March	Standards and General Purposes Committee Meeting	Audit Planning Report and verbal update on interim work.
Interim audit testing and completion of walkthroughs	April		
	May		
	June		
Year end audit Audit Completion procedures	July	Standards and General Purposes Committee Meeting	Audit Results Report Audit opinions and completion certificates
	August		Annual Audit Letter

Page 41

08 Independence

Independence

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
▸ 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; ▸ The safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality review; ▸ The overall assessment of threats and safeguards; ▸ Information about the general policies and process within EY to maintain objectivity and independence. ▸ Where EY has determined it is appropriate to apply more restrictive independence rules than permitted under the Ethical Standard	▸ 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; ▸ Details of non-audit services provided and the fees charged in relation thereto; ▸ Written confirmation that the firm is independent; ▸ Written confirmation that all covered persons are independent; ▸ 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; ▸ Details of any contingent fee arrangements for non-audit services provided by us or our network firms; and ▸ An opportunity to discuss auditor independence issues.

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

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%.

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.

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

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.

Relationships, services and related threats and safeguards

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 2018

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 2018 and can be found here:

http://www.ey.com/uk/en/about-us/ey-uk-transparency-report-2018

09 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 2018/19 (£)	Final Fee 2017/18 (£)
Scale Fee – Code work	110,493	143,498
Additional fees		
- Additional work on PPE	5,000-15,000*	20,000**
- MRP review	-	4,500
- Letter from member of the public	-	9,000
- Additional work arising from change in materiality and clearance of audit queries	15,000-25,000*	52,000**
Total audit	130,493-150,493	228,998
Non-audit services - Housing Benefits	TBC	51,227***
Non-audit services – Teachers' Pensions limited assurance	TBC	8,500
Total other non-audit services	TBC	59,727
Total fees	TBC	288,725

The agreed fee presented is based on the following assumptions:

- ► Officers meeting the agreed timetable of deliverables;
- ► Our accounts opinion 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 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.

All fees exclude VAT

Notes:
* We include a range of additional fees to reflect the additional work we will need to undertake in respect of the risks we have reported in this plan. We will confirm the exact additional fees as the audit progresses and seek agreement with management and PSAA.
** This remains subject to approval by PSAA.
*** The 2017/18 Housing Benefit certification work includes a proposed scale fee variation of £9,985 for additional testing. This fee has been agreed by management but remains subject to approval by PSAA.

Required communications with the Standards and General Purposes 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	Communication of the planned scope and timing of the audit, any limitations and the significant risks identified. 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	Audit Planning Report, 14 March 2019 meeting of the Standards and General Purposes Committee.
Significant findings from the audit	▸ 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, 25 July 2019 meeting of the Standards and General Purposes Committee.

Appendix B

Required communications with the Standards and General Purposes Committee (continued)

		Our Reporting to you
Required communications	**What is reported?**	**When and where**
Public Interest Entities	For the audits of financial statements of public interest entities our written communications to the Audit Committee include: ▸ A declaration of independence ▸ The identity of each key audit partner ▸ The use of non-member firms or external specialists and confirmation of their independence ▸ The nature and frequency of communications ▸ A description of the scope and timing of the audit ▸ Which categories of the balance sheet have been tested substantively or controls based and explanations for significant changes to the prior year, including first year audits ▸ Materiality ▸ Any going concern issues identified ▸ Any significant deficiencies in internal control identified and whether they have been resolved by management ▸ Actual or suspected non-compliance with laws and regulations identified relevant to the Audit Committee ▸ The valuation methods used and any changes to these including first year audits ▸ The scope of consolidation and exclusion criteria if any and whether in accordance with the reporting framework ▸ The identification of any non-EY component teams used in the group audit ▸ The completeness of documentation and explanations received ▸ Any significant difficulties encountered in the course of the audit ▸ Any significant matters discussed with management ▸ Any other matters considered significant	Audit planning report, March 2019 and Audit results report, July 2019

Page 49

Required communications with the Standards and General Purposes Committee (continued)

Required communications	What is reported?	Our Reporting to you: When and where
Going concern	Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including: ▶ 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, 25 July 2019 meeting of the Standards and General Purposes Committee.
Misstatements	▶ 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, 25 July 2019 meeting of the Standards and General Purposes Committee.
Fraud	▶ Enquiries of the Audit 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, 25 July 2019 meeting of the Standards and General Purposes Committee.
Related parties	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, 25 July 2019 meeting of the Standards and General Purposes Committee.

Required communications with the General Purposes and Standards Committee (continued)

Our Reporting to you

Required communications	What is reported?	When and where
Independence	Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as: ▶ 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 For public interest entities and listed companies, communication of minimum requirements as detailed in the FRC Revised Ethical Standard 2016: ▶ Relationships between EY, the Council and senior management, its affiliates and its connected parties ▶ Services provided by EY that may reasonably bear on the auditors' objectivity and independence and related safeguards ▶ Fees charged by EY analysed into appropriate categories such as statutory audit fees, tax advisory fees, other non-audit service fees ▶ A statement of compliance with the Ethical Standard, including any non-EY firms or external experts used in the audit ▶ Details of any inconsistencies between the Ethical Standard and Group's policy for the provision of non-audit services, and any apparent breach of that policy ▶ Details of any contingent fee arrangements for non-audit services ▶ Where EY has determined it is appropriate to apply more restrictive rules than permitted under the Ethical Standard ▶ The Audit Committee should also be provided an opportunity to discuss matters affecting auditor independence	Audit planning report, March 2019 and Audit results report, July 2019

Page 51

Required communications with the Standards and General Purposes Committee (continued)

Required communications	What is reported?	Our Reporting to you: When and where
External confirmations	▶ Management's refusal for us to request confirmations ▶ Inability to obtain relevant and reliable audit evidence from other procedures	Audit Results Report, 25 July 2019 meeting of the Standards and General Purposes Committee.
Consideration of laws and regulations	▶ 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 Audit Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Committee may be aware of	Audit Results Report, 25 July 2019 meeting of the Standards and General Purposes Committee.
Internal controls	▶ Significant deficiencies in internal controls identified during the audit	Audit Results Report, 25 July 2019 meeting of the Standards and General Purposes Committee.
Representations	▶ Written representations we are requesting from management and/or those charged with governance	Assurance Letter to be received shortly after year-end.
Material inconsistencies and misstatements	▶ Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	Audit Results Report, 25 July 2019 meeting of the Standards and General Purposes Committee.
Auditors report	▶ 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, 25 July 2019 meeting of the Standards and General Purposes Committee.

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 Council'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 Council 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 Audit Committee reporting appropriately addresses matters communicated by us to the Committee and reporting whether it is materially inconsistent with our understanding and the financial statements; and Maintaining auditor independence.

Page 53

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 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.