London Borough of Merton

Audit results report

Year ended 31 March 2019

22 July 2019

Page 205

22 July 2019

Dear Audit Committee Members

We are pleased to attach our audit results report for the forthcoming meeting of the Standards and General Purposes Committee. This report summarises our preliminary audit conclusion in relation to the audit of the London Borough of Merton for 2018/19. We will issue our final report following the Standards and General Purposes Committee meeting on 25 July 2019.

At the date of drafting this report our audit of the Authority for the year ended 31 March 2019 is in progress. Whilst the majority of our audit procedures are in progress, there is a possibility that we will not be in a position to issue our auditor's report by the 31 July. However, subject to concluding the outstanding matters listed in our report, we confirm that we expect to issue an unqualified audit opinion on the financial statements in the form at Section 4 of this report. We will also have no matters to report on your arrangements to secure economy, efficiency and effectiveness in your use of resources

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.

We would like to thank your staff for their help during the engagement.

We welcome the opportunity to discuss the contents of this report with you at the Standards and General Purposes Committee meeting on 25 July 2019.

Yours faithfully

Suresh Patel

Associate Partner

For and on behalf of Ernst & Young LLP

Encl

Contents

01 Executive Summary

02 Areas of Audit Focus

03 Audit Report

04 Audit Differences

05 Value for Money

06 Other reporting issues

07 Assessment of Control Environment

08 Data Analytics

09 Independence

10 Appendices

Page 207

Public Sector Audit Appointments Ltd (PSAA) have issued a ‘Statement of responsibilities of auditors and audited bodies’. It is available from the Chief Executive of each audited body and via the PSAA website (www.psaa.co.uk). This 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 April 2018)’ issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

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

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

01 Executive Summary

Executive Summary

Scope update

In our audit plan presented to the 14 March 2019 Audit Committee meeting, we provided you with an overview of our audit scope and approach for the audit of the financial statements. We carried out our audit in accordance with this plan, with the following exceptions:

- Changes in materiality - We updated our planning materiality assessment using the draft statement of accounts. Based on our materiality measure of 1.8% of gross expenditure on provision of services, we have updated our overall materiality assessment to £9.9m for the single entity financial statements and £10.0m for the group (audit plan – £9.4m for the single entity financial statements and £9.5m for the group). This results in updated performance materiality, at 50% of overall materiality, of £4.95 million for the single entity financial statements and £5m for the group. Our updated threshold for reporting misstatements of £495,000 for the single entity financial statements and £501,000 for the group.

We include a summary of our approach to the audit of the balance sheet including any changes to that approach from the prior year audit in Appendix A.

Status of the audit

Our audit of the Authority's financial statements for the year ended 31 March 2019 is in progress and we are performing the procedures outlined in our audit plan. Subject to satisfactory completion of the following outstanding items we expect to issue an unqualified opinion on the Authority's financial statements in the form which appears at Section 3. However until work is complete, further amendments may arise. The table below outlines the main procedures that are outstanding at the date of this report. We will provide a verbal update of progress to the Committee meeting.

Procedures significantly completed:			
• Income & expenditure (final review)	• Debtors & Creditors	• Journals testing	• CHAS revenue
• PFI (invoice testing to complete)	• Collection Fund (I&E procedures)	• IAS 19 (final checks on McCloud changes)	
Procedures in progress:			
• Grants (receipts in advance)	• Other disclosures	• Related party transactions	
• NDR appeals provision			

Following completion of the above procedures, we will need to review and check the final version of the statement of accounts, carry out a subsequent events review, review management representations and complete our final internal review procedures.

The deadline for audit submission of WGA has recently been revised to 13 September 2019. In light of this we will complete the work to the revised deadline and therefore will not issue the audit certificate at the same time as the audit opinion.

Executive Summary

Audit differences

At the date of this report there is one unadjusted audit difference arising from our audit. At the financial year-end Dedicated Schools Grant (DSG) funded services overspent by £3.5m and the year-end earmarked DSG reserve ended in a deficit position of £2.9m. We have concluded, based on the relevant guidance from CIPFA and the Department for Education, that it is not allowable for a voluntary earmarked balance to be presented in a deficit position. We have therefore concluded that the year-end deficit should either have been reflected in the Authority's reported financial performance for the year or charged to available funds in a usable revenue reserve. Management disagrees with our view.

There are two adjusted misstatements that we wish to bring to your attention as at the date of this report.

Firstly, the Authority has made material amendments to its disclosure of PFI assets at Notes 19 and 27 to the financial statements. We are satisfied that revised disclosures meet the requirements of the Code of Practice on Local Authority Accounting.

The second change relates to a national legal ruling regarding age discrimination arising from public sector pension scheme transitional arrangements, commonly described as the McCloud ruling. The draft accounts recognised this matter as a contingent liability consistent with the information the Authority knew at the time. However, since the year-end there has been additional evidence, including the legal ruling by the Supreme Court on 27th June 2019 which rejected the Government's appeal, which suggested that the amounts should in fact be able to be fully calculated and so included in the IAS19 liability disclosed within the financial statements. The Authority has since obtained updated information from its actuary and has revised the statements by increasing the net defined benefit pension liability reported in Balance Sheet and Note 23 of the financial statements by approximately £6.6m.

We consider audit differences further in Section 4 of this report.

Executive Summary

Areas of audit focus

Our audit plan identified key areas of focus for our audit of the Authority's financial statements. We summarise below our latest findings.

Significant risk	Findings & conclusions
Inappropriate capitalisation of revenue expenditure.	Our work is well progressed but we have not yet fully completed our work to test journals. To date we have found no indication that revenue expenditure has been inappropriately charged to capital.
Misstatements due to fraud or error	Our work is well progressed but we have not yet completed our work to test journals. We have identified no evidence of management manipulation of either accounting records or the financial statements to misreport the financial position and performance of the Authority.
Valuation of property, plant and equipment assets under depreciated replacement cost model	Our EY Real Estates (EYRE) specialist has completed their review of a sample of valuations. We have not identified any adjustments needed to the financial statements, but EYRE have identified the need for some further refinement of the Authority's valuation approach which we have recently shared with officers.

Page 211

Area of audit focus	Findings & conclusions
PFI accounting	We have largely completed our procedures including review by our EY PFI specialist and have no issues to report. The Authority has made adjustments to its accounting model which we are satisfied correctly adjust for the unadjusted misstatements reported as part of our 2017/18 audit.
Pension liabilities	We are completing our review including final adjustments made as a result of the McCloud issue before concluding.
Implementation of new accounting standards	We have considered management's impact assessment and are satisfied that the Authority has implemented the new standards appropriately.

This report sets out our observations and conclusions on the above matters, and any others identified, in the "Areas of Audit Focus" section of this report. We ask you to review these and any other matters in this report to ensure:

- There are no other considerations or matters that could have an impact on these issues; and
- You agree with the resolution of the issues; and there are no other significant issues to be considered.

There are no matters, apart from those reported by management or disclosed in this report, which we believe should be brought to your attention.

Executive Summary

Control observations

We have adopted a fully substantive approach, so have not tested the operation of controls. We are satisfied that the Authority has made reasonable progress to improve PPE valuation processes and asset management records, and we have identified no further errors in current year valuations. EYRE have identified the need for some further refinement of the Authority's valuation approach in relation to assets carried at existing use value which we have recently reported to officers. We consider this further in Section 2 of the report.

We have also considered progress made in relation to a number of internal control issues raised in our 2017/18 work as part of work to inform the 2018/19 Value for Money Conclusion. We consider these further in Sections 5 and 7 of this report.

Value for money

We have considered your arrangements to take informed decisions; deploy resources in a sustainable manner; and work with partners and other third parties. In our audit plan we identified a significant risk relating to the challenging financial outlook faced by the Authority and its arrangements to deploy the resources available to it in a sustainable way.

We have included in Section 5 the detailed work we carried out in response to this risk. Based on the results of our work we are satisfied that the Authority has proper arrangements in place in respect for taking informed decisions, deploying resources in a sustainable manner and working with partners and other third parties. We have, however, continued to highlight some areas where further improvements are required.

Other reporting issues

We have reviewed the information presented in the draft Annual Governance Statement for consistency with our knowledge of the Authority. We have no matters to report as a result of this work.
The deadline for audit submission of WGA has recently been revised to 13 September 2019. In light of this we will complete the work to the revised deadline and therefore will not issue the audit certificate at the same time as the audit opinion.

Independence

We have no matters relating to our Independence to bring to your attention. Section 10 includes our update.

02 Areas of Audit Focus

Significant risk

Misstatements due to fraud or error

What is the risk?

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.

Significant Risk

What did we do?

We focused our testing on the inherent risk that management could override controls through making inappropriate journal entries. As a result we:

- Identified specific fraud risks including postings made outside of normal business hours, journals posted by infrequent users, one-sided journals and journals which include the description correction.
- Tested journal entries which showed the fraud risk characteristics we outline above
- Tested a sample of journals used by the Authority to make other adjustments in the preparation of the financial statements.

We undertake similar procedures on all of our audit engagements.

What are our conclusions?

Subject to full completion of our work to test journals we have not identified any evidence of management manipulation of accounting records or the financial statements.

Significant risk

Inappropriate capitalisation of revenue expenditure

Page 215

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.

Significant Risk

What did we do?

We:

- Tested PPE additions and Revenue Expenditure Financed from Capital Under Statute (REFCUS) to a higher level of risk to ensure that the expenditure incurred and capitalised is clearly capital in nature.
- Sought 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 utilised our data analytics capabilities to assist with our work, including journal entry testing. We will also assessed journal entries more generally for evidence of management bias and evaluate for business rationale.

What are our conclusions?

- Our sample testing of additions to property, plant and equipment found that they had been correctly classified as capital and included at the correct value.
- Our sample testing of additions to property, plant and equipment did not identify any revenue items that were incorrectly classified.
- Our sample testing of REFCUS transactions found that they had been correctly classified and the expenditure met the definition of allowable expenditure.

As at the date of this report we have yet to fully complete our testing of journals.

Significant risk

Valuation of land and buildings

What is the risk?

The fair value of land and buildings represents a significant balance in the Authority'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 Authority.

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

Significant Risk

What did we do?

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

- For DRC we sought to confirm that the Authority has used the methodology it revised in the prior year following our audit which include the work of our expert. We also tested a sample of valuations, challenging the Authority 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 also engaged our own expert to enable us to audit a sample of valuations, challenging management on key assumptions and judgements.

What are our conclusions?

- Based on our work we are satisfied that the methodology established by the Authority in the prior year has been correctly applied in the current year to assets carried at DRC but we have identified some scope for improving the methodology, which we have recently shared with officers.
- Our valuation experts have completed their work on assets carried at EUV and we are satisfied that the Authority's valuations fall with an acceptable range.

As a result of the Authority's ongoing work to improve Property, Plant and Equipment (PPE) valuation processes and asset management records it made further amendments to asset valuations at 31 March 2018. These changes, which in aggregate are greater than our overall materiality level, were made by management in the 2018/19 draft financial statements presented for audit. The Authority has determined that there is no requirement for a prior year adjustment because the net value of the changes made to 2017/18 prior year audited figures is not material.

Area of audit focus

Pension liability valuation

What is the issue?

The Local Authority Accounting Code of Practice and IAS19 require the Authority to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by the Authority.

The Authority's pension fund deficit is a material estimated balance and the Code requires that this liability be disclosed on the Authority'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 Authority 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.

What did we do?

- Liaised with the auditors of Merton Pension Fund, to obtain assurances over the information supplied to the actuary in relation to the Authority.
- Assessed 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.
- Reviewed and tested the accounting entries and disclosures made within the Authority's financial statements in relation to IAS19.

We also considered outturn information available at the time of the audit after production of the Authority's draft financial statements, for example the year-end actual valuation of pension fund assets. We use this to inform our assessment of the accuracy of estimated information included in the financial statements and whether any adjustments are required.

Finally, we liaised with officers to understand the implications of the McCloud ruling and reviewed the changes made to the statements.

What are our conclusions?

We concluded that we could rely on the work of the actuary and that the values and entries from the actuarial report were correctly reflected in the draft financial statements.

As considered more fully in Section 4 of this report the Authority re-engaged the actuary to estimate the impact of the McCloud ruling on the pensions liability. We reviewed the Authority's assessment of the impact of the McCloud ruling and confirmed that changes made to the accounts were reasonable.

We are satisfied there was no significant difference between the year-end actual value of pension fund assets and the estimate used to inform the actuary's assessment of the IAS 19 liability.

Area of audit focus

PFI accounting

What is the issue?

The Authority 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.

Page 218

What did we do?

We reviewed the accounting entries and disclosures in relation to PFI in detail, with a focus on any significant changes since the expert's follow-up review in the previous year. At the planning stage we noted that the Authority intended to make changes to the detailed accounting model for its PFI in light of our points raised in the previous year and the unadjusted misstatement reported as part of our 2017/18 Audit Results Report. Our PFI specialist considered these amendments as part of their work.

We also undertook 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.

What are our conclusions?

Based on our work we are satisfied that:

- Amendments have been correctly made to the accounting model to correct for the issues noted by the PFI specialist in the prior year.
- Disclosures in the financial statements correctly reflect the output from the accounting model at year end. We have yet to fully complete our testing of inputs to the model, but have identified no issues from the work done to date.

Area of audit focus

Implementation of new accounting standards

What is the issue?

IFRS 9 (Financial Instruments) and IFRS 15 (Revenue from contracts) apply from 1 April 2018. Based on our understanding at the planning stage we expected the impact of IFRS 15 to have limited impact on your accounts.

IFRS 9 changes 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. Central government has indicated following consultation that statutory overrides for certain classes of financial assets will be put in place. However, until these are confirmed there remains some uncertainty on the full accounting treatment

Page 219

What did we do?

For IFRS 9 we:

- Considered the classification and valuation of financial instrument assets.
- Reviewed the implementation of the new expected credit loss (ECL) model impairment calculations for assets.

For IFRS 15 we:

- Considered 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.

For both standards we:

- Assessed the Authority's implementation arrangements and planned accounting
- Checked additional disclosure requirements for compliance with the CIPFA Code

What are our conclusions?

The Authority was able to show that implementation of IFRS 15 had no material impact on its financial reporting arrangements. At the interim stage we fedback that a non-material consolidation adjustment was needed to CHAS review to ensure compliance with IFRS 15 in the group financial statements. An adjustment was made in the final group accounts.

For IFRS 9 we are satisfied that:

- Required changes to the classification and accounting for financial instruments were made correctly.
- An ECL model has been used to determine any impairment or provision for impairment necessary for financial assets.
- CIPFA Code disclosure requirements have been met.

03 Audit Report

Our draft opinion on the financial statements

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE LONDON BOROUGH OF MERTON

Opinion

We have audited the financial statements of the London Borough of Merton for the year ended 31 March 2019 under the Local Audit and Accountability Act 2014. The financial statements comprise the:

- Authority and Group Comprehensive Income and Expenditure Statement
- Authority and Group Movement in Reserves Statement,
- Authority and Group Balance Sheet,
- Authority and Group Cash Flow Statement and the related notes 1 to 43.
- Collection Fund and the related notes 1 to 5.

Page 221

The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2018/19.

In our opinion the financial statements:

- give a true and fair view of the financial position of the London Borough of Merton and Group as at 31 March 2019 and of its expenditure and income for the year then ended; and
- have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2018/19.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the Auditor's responsibilities for the audit of the financial statements section of our report below. We are independent of the Authority and Group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard and the Comptroller and Auditor General's (C&AG) AGN01, and we have fulfilled our other ethical responsibilities in accordance with these requirements.
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the Director of Corporate Services' use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the Director of Corporate Services has not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the Authority's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

Our draft opinion on the financial statements

Other information

The other information comprises the information included in the Statement of Accounts for the year ending 31 March 2019, other than the financial statements and our auditor's report thereon. The Director of Corporate Services is responsible for the other information.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in this report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of the other information, we are required to report that fact.

We have nothing to report in this regard.

Opinion on other matters prescribed by the Local Audit and Accountability Act 2014

Arrangements to secure economy, efficiency and effectiveness in the use of resources

In our opinion, based on the work undertaken in the course of the audit, having regard to the guidance issued by the Comptroller and Auditor General (C&AG) in November 2017, we are satisfied that, in all significant respects, the London Borough of Merton put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2019.

Matters on which we report by exception

We report to you if:

- in our opinion the annual governance statement is misleading or inconsistent with other information forthcoming from the audit or our knowledge of the Authority;
- we issue a report in the public interest under section 24 of the Local Audit and Accountability Act 2014;
- we make written recommendations to the audited body under Section 24 of the Local Audit and Accountability Act 2014;
- we make an application to the court for a declaration that an item of account is contrary to law under Section 28 of the Local Audit and Accountability Act 2014;
- we issue an advisory notice under Section 29 of the Local Audit and Accountability Act 2014; or
- we make an application for judicial review under Section 31 of the Local Audit and Accountability Act 2014.

We have nothing to report in these respects.

Our draft opinion on the financial statements

Responsibility of the Director of Corporate Services

As explained more fully in the Statement of the Director of Corporate Services' Responsibilities set out on page 170, the Director of Corporate Services is responsible for the preparation of the Statement of Accounts, which includes the financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2018/19, and for being satisfied that they give a true and fair view.

In preparing the financial statements, the Director of Corporate Services is responsible for assessing the Authority's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Authority either intends to cease operations, or have no realistic alternative but to do so.

The Authority is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to review regularly the adequacy and effectiveness of these arrangements.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.
A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at https://www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Scope of the review of arrangements for securing economy, efficiency and effectiveness in the use of resources

We have undertaken our review in accordance with the Code of Audit Practice, having regard to the guidance on the specified criterion issued by the Comptroller and Auditor General (C&AG) in November 2017, as to whether the London Borough of Merton had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. The Comptroller and Auditor General determined this criterion as that necessary for us to consider under the Code of Audit Practice in satisfying ourselves whether the London Borough of Merton put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2019.

Our draft opinion on the financial statements

We planned our work in accordance with the Code of Audit Practice. Based on our risk assessment, we undertook such work as we considered necessary to form a view on whether, in all significant respects, the [name of body] had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

We are required under Section 20(1)(c) of the Local Audit and Accountability Act 2014 to satisfy ourselves that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the National Audit Office (NAO) requires us to report to you our conclusion relating to proper arrangements.

We report if significant matters have come to our attention which prevent us from concluding that the Authority has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. We are not required to consider, nor have we considered, whether all aspects of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

Delay in certification of completion of the audit

We cannot formally conclude the audit and issue an audit certificate until we have completed the work necessary to issue our assurance statement in respect of the Authority's Whole of Government Accounts consolidation pack. We are satisfied that this work does not have a material effect on the financial statements or on our value for money conclusion.

Use of our report

This report is made solely to the members of the London Borough of Merton, as a body, in accordance with Part 5 of the Local Audit and Accountability Act 2014 and for no other purpose, as set out in paragraph 43 of the Statement of Responsibilities of Auditors and Audited Bodies published by Public Sector Audit Appointments Limited. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the London Borough of Merton and the Authority's members as a body, for our audit work, for this report, or for the opinions we have formed.

04 Audit Differences

Audit Differences

In the normal course of any audit, we identify misstatements between amounts we believe should be recorded in the financial statements and the disclosures and amounts actually recorded. These differences are classified as "known" or "judgemental". Known differences represent items that can be accurately quantified and relate to a definite set of facts or circumstances. Judgemental differences generally involve estimation and relate to facts or circumstances that are uncertain or open to interpretation.

Summary of unadjusted differences

We report to you any uncorrected misstatements greater than our nominal value of £495,000. There is one uncorrected misstatement at the date of this report to bring to your attention.

At the financial year-end Dedicated Schools Grant (DSG) funded services overspent by £3.5m and the year-end earmarked DSG reserve ended in a deficit position of £2.9m. We have concluded, based on relevant guidance from CIPFA and the Department for Education, that it is not allowable for a voluntary earmarked balance to be presented in a deficit position. We have therefore concluded that the year-end deficit should either have been reflected in the Authority's reported financial performance for the year or charged to a usable revenue reserve. Management disagrees with our view.

Summary of adjusted differences

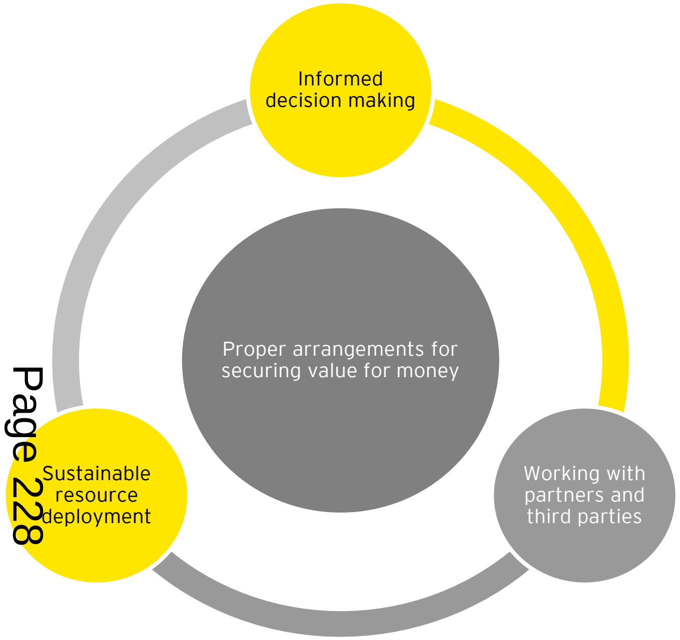
We highlight adjusted misstatements greater than £4.95 million which have been corrected by management that were identified during the course of our audit. There is one adjustment which we wish to draw to your attention.
The Council has made material amendments to its disclosure of PFI assets at Notes 19 and 27 to the financial statements. We are satisfied that revised disclosures meet the requirements of the Code of Practice on Local Authority Accounting.

McCloud ruling

As noted in the Executive Summary a national issue has resulted in a relatively late change to the accounts and IAS19 liability disclosure. It relates to legal rulings regarding age discrimination arising from public sector pension scheme transitional arrangements, commonly described as the McCloud ruling. The draft accounts recognised this matter as a contingent liability consistent with the information the Authority had at the time. However, since the year-end there has been additional evidence, including the legal ruling by the Supreme Court on 27th June 2019 which rejected the Government's appeal, which suggested that the amounts should in fact be able to be fully calculated and so included in the IAS19 liability disclosed within the financial statements. The actuary has now estimated the impact of the McCloud ruling for the Authority.
We are currently considering the work of the actuary but adjustments made to the financial statements in respect are likely to have the impact of increasing the net defined benefit pension liability reported in Balance Sheet and Note 23 of the financial statements by approximately £6.6m. Some other elated disclosures changes, including changes to the disclosure of sources of estimation uncertainty and post balance sheet events, will also been made.

05 Value for Money Risks

Value for Money



Page 228

Background

We are required to consider whether the Authority 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.

Overall conclusion

We identified one significant risk around these arrangements and assessed progress against issues we had raised in the prior year audit. The tables below present our findings in response to the risk in our audit plan.

We have no matters to include in the auditor's report about your arrangements to secure economy, efficiency and effectiveness in your use of resources. We have, however, continued to highlight some areas where further improvements are required.

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.

We present below the findings of our work in response to the risks areas in our audit plan as well as the additional risk identified since then.

What is the significant value for money risk?	What arrangements did the risk affect?	What did we do and what our findings?
Financial resilience and sustainable resource deployment The Authority continues to have a challenging financial outlook. To balance the budget over the next four years it is planning to deliver cumulative agreed savings of approximately £9.7 million with further savings of approximately £10.1 million needing to be found to fully balance the budget and avoid further dependence on its reserves. The current 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 • £1,108m in 2020/21 • £5,409m in 2021/22 • £6,076m in 2022/23	Sustainable resource deployment	Our approach focused on reviewing the robustness of the Authority'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 included follow-up of the issues we highlighted as part of our 2017-18 programme of value for money work. Our detailed findings are set out below. **Year-end financial performance** At the end of the financial year 2018/19 the overall underspend was £7.7m or approximately 1.4% of the gross general fund budget. Net service expenditure was underspent by £2m with the remainder of the underspend being realised from higher than anticipated savings in Corporate provisions. Although there was an overall underspend, the Children's, Schools and Families department outturn position was an overspend of £2.3m. This was mainly due to placements costs as the demand for these services remains high and these pressures are expected to continue. The level of underspending against budget has allowed the Authority to increase the level of earmarked and general fund reserves available to finance revenue expenditure by approximately £5m or 8%. Some of this increase has been taken to the General Fund Reserve, Spending Review Reserve and Balancing the Budget reserve and therefore is available to support the continued pressure on the revenue budget faced by the Authority over the medium term.

Value for Money Risks (continued)

What are our findings?

Total Capital Expenditure for 2018/19 was £31.4m. The Capital Programme for 2018/19 as approved in March 2016 was £61.3 m. Subsequently, slippage from 2017/18 of £7.1 million was added, and new funding of £16.8 million giving an effective opening programme of £72.4 million. However, during the financial year there was a net reduction in the overall programme mainly from budget being re-profiled into subsequent financial years. This resulted in a final revised capital budget of £35.3m. Final capital outturn was therefore 11% lower than the final revised budget. Of the approximate £3.1m underspend against the revised capital programme, £219,000 has been carried forward in approved schemes to 2019/20. The Authority itself recognizes that the forecasting trend during 2018/19 followed the pattern of previous years and there was a continuing problem with the quality of forecasting around November when the Medium Term Financial Strategy is being prepared. Although this is not uncommon for local authorities the Authority has spent considerable time with budget managers to improve the accuracy of capital budgeting and forecasting. This work will continue in 2019-20.

The robustness of the MTFS and savings plans

The current iteration of the MTFS was presented to the Authority on the 6th March 2019 as part of the 2019/23 Business Plan. The MTFS forecasts an adjusted cumulative budget gap of £6 million by 2022/23 after considering the impact of 2019/20 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 and challenged management where an assumption has been made.

When the Authority agreed the pay deal with unions it was estimated that the average cost of the deal was 2.7% in 2018/19 and 2.8% in 2019/20. In the budget/MTFS the Authority provided for 2.7% and 2.8% on the total estimated pay budget. The Authority's actual staffing profile means that most staff received 2% and the few staff at the lower pay grades received the higher increases.

The price inflation assumptions incorporated into the MTFS are cash limited but at a corporate level an ‘excess inflation provision’ is incorporated into the Council’s financial plans. 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.

Value for Money Risks (continued)

What are our findings?

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.
- Collection Fund surplus / deficit and the impact of a reduction in retention for Business Rates from 100% to 75% from 2019/20.
- A general contingency for unforeseen cost and demand pressures.
- 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.

As part of our work we have also 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 four years 2019/20 to 2022/23 a cumulative total of approximately £9.4 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 £10.2 million of savings by 2022/23. To gain assurance on the robustness of projected savings proposals already built into the 2019/20 budget we selected one agreed proposal from the following three council directorates;

- Corporate Services.
- Children, Schools and Families.
- Community and Housing directorates.

We reviewed support for the estimated saving built into the budget and details on progress made on delivery of the saving to date in 2019/20. In all cases we are satisfied that reasonable support exists for the proposed savings.

Overall, we are satisfied 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, not unrealistically optimistic, and there is some support available for savings plans and associated actions. The Authority remains financially resilient and in-year performance has been better than budgeted for. However, significant financial challenges remain over the medium term. This is particularly true for demand-led services such as Children's and Adult Social care which have experienced over-spending in the year and where the Council expects cost pressures to continue.

Value for Money Risks (continued)

What are our findings?

Dedicated Schools Grant (DSG)

At the financial year-end DSG funded services overspent by £3.5m and the year-end earmarked DSG reserve ended in a deficit position of £2.9 million. The Authority has produced a deficit recovery plan as required by DfE outlining both the actions it has taken to date and plans to take in the future to reduce the recurrent deficit. Actions taken to date include:

- The provision of extra state school placements.
- Efforts to minimise the use of residential placements.
- A reduction in independent provision placements inflation increases through joint working with South London Consortium including use of a Dynamic Purchasing System.
- Additional Resourced Provision and Education Health and Care Plan funding allocations only being inflated once since 2013/14.

Future planned actions specifically focused on addressing growing demand and funding pressure on children with high needs include:

- Expanding state school provision of special schools and additionally resourced provision for high needs children. Working collaboratively with state schools to provide support and encourage inclusive practice, hence reducing specialist placements.
- Improving the consistency of identification of children with Special Educational Needs across schools in the Borough.
- More intervention and support for the age 14-25 cohort.

Despite the planned further actions the Authority forecasts that without additional funding the cumulative deficit will continue to grow to approximately £22.4m by the end of 2021-22. This deficit is not integrated into the Authority's medium term financial plans. If the forecast is accurate and the deficit is not addressed through the receipt of additional funding from Government this will reduce the net level of earmarked revenue reserves available to the Authority to support its general revenue spending and increase the budget gap.

Value for Money Risks (continued)

What are our findings?

Follow-up of prior year recommendations

As part of our 2017/18 VFM conclusion work at the Authority we raised the following issues in our Audit Results Report. We concluded the Authority should:

- Continue to review its corporate procurement and contract management arrangements given the known weaknesses in arrangements in those areas.
- Address weaknesses in its CM2000 system raised by Internal Audit in a 'limited assurance' rated review.
- Continue to undertake a control's review following implementation of E5 which remained a work in progress at the end of 2017/18.

We consider each of these areas further below.

Procurement and contract management arrangements

As part of our year-end update of our VFM risk assessment we noted that two limited assurance Internal Audit reviews have been issued in 2018/19 relating to the area of procurement. Those reviews are 'Corporate Procurement' and 'Contract Monitoring of Commissioned Places'. We are aware from our cumulative audit knowledge and work at the planning stage of the existence of some weaknesses in the Authority's corporate procurement and contract management processes. We do not consider these to be a significant risk to our VFM conclusion responsibilities of themselves but, as part of our year-end work, have sought to gain an understanding of the work being done by the Authority to improve its arrangements.

Consistent with our wider knowledge the Authority has been working has been ongoing for the past two years to centralise, standardise, modernise and improve its the Authority's procurement and contract management arrangements. The Authority has identified that these changes are necessary to both improve internal control and identify and deliver cost efficiencies and other value for money improvements from the significant value of goods and services the Authority commissions and procures from external suppliers. Progress is being made, although the speed of change is not at the rate the Authority would ideally like. Many of the changes require significant revisions in custom and practice and the culture of the organisation, particularly where arrangements are devolved, and this is not quick to achieve. Like many other Authority's Merton has also faced challenges in recruiting to key vacancies within its procurement function in what is a highly competitive labour market.

We have concluded the weaknesses in arrangements highlighted by Internal Audit in its reviews in the period are not indicative of an absence of proper arrangements. Based on available performance monitoring information, which has not been formally subject to audit, revisions made to the Authority's arrangements are improving the level of standardisation and control. The number and value of contracts not fully following or partially exempted from the requirements of contract standing orders has significantly decreased, and the completeness of information held on the Authority's corporate contract register has significantly increased. It is, however, vital that the Authority maintains a continued focus is maintained on continuing to developing and embedding the revised arrangements to further improve internal control and secure the value for money improvements potentially realisable from effective procurement and contract management arrangements.

Value for Money Risks (continued)

What are our findings?

CM 2000 system

An Internal Audit review undertaken in 2017/18 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.

As at the end of 2018/19 Internal Audit reported two priority 1 actions arising from its review, which remain in progress. A follow up audit has been included in the 2019/20 Internal Audit Plan to provide assurance on improvements in this area. The two outstanding actions relate to contract extension and ensuring that contracts are in place for all off-contract providers using CM2000. Based on the work of Internal Audit we have concluded that some progress has been made in the year but note that two priority 1 actions have not yet been addressed. As for 2017/18 we have concluded that the weaknesses are not indicative of an absence of proper arrangements, but that a focus addressing the outstanding Internal Audit recommendations needs to be maintained.

E5 controls review

We have reviewed progress on the ongoing work to review controls following implementation of the Authority's E5 general ledger system. The aim of the Authority's review is to capture full process documentation and review and improve system controls. The aim of the review is to ensure systems operate as efficiently as possible and minimise the administrative burden on systems users, while maintaining sufficient controls and adequate separation of duties. Reasonable progress has been made in addressing internal and external audit recommendations and associated actions, although overall progress has not been as quick as the Authority would ideally like. This is consistent with the findings of relevant Internal Audit work and our own review. For example, we have considered the work the Authority has done to improve its Property Plant and Equipment valuation processes and to update and cleanse its asset management records. We also note that Internal Audit has issued 'substantial assurance' conclusions in respect of all financial system assurance audits undertaken in the year, including a review of the general ledger. The Authority accepts, however, that the work remains ongoing and the need to fully complete the review continues to feature as part of the 2018/19 Annual Governance Statement action plan. Overall we have concluded that reasonable progress has been made overall in addressing prior year issues and recommendations but further work is required in all of the areas considered and progress has not been as fast as the Authority ideally would have liked.

06 Other reporting issues

Other reporting issues

Consistency of other information published with the financial statements, including the Annual Governance Statement

We must give an opinion on the consistency of the financial and non-financial information in the Statement of Accounts 2018/19 with the audited financial statements. We must also review the Annual Governance Statement for completeness of disclosures, consistency with other information from our work, and whether it complies with relevant guidance.

Financial information in the Statement of Accounts 2018/19 and published with the financial statements was consistent with the audited financial statements.

We have reviewed the latest version of the Annual Governance Statement (2 July) and can confirm it is consistent with other information from our audit of the financial statements and we have no other matters to report.

Whole of Government Accounts

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

We have not yet performed the procedures required by the National Audit Office (NAO) on the Whole of Government Accounts submission, as at the time of writing, we had only just received the Group Audit instructions from the NAO. We will complete this work in August ahead of the deadline of 13 September 2019.

Other powers and duties

We have a duty under the Local Audit and Accountability Act 2014 to consider whether to report on any matter that comes to our attention in the course of the audit, either for the Authority to consider it or to bring it to the attention of the public (i.e. “a report in the public interest”). We did not identify any issues which required us to issue a report in the public interest.

We also have a duty to make written recommendations to the Authority, copied to the Secretary of State, and take action in accordance with our responsibilities under the Local Audit and Accountability Act 2014. We did not identify any issues.

07 Assessment of Control Environment

Financial controls

It is the responsibility of the Authority to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. Our responsibility as your auditor is to consider whether the Authority has put adequate arrangements in place to satisfy itself that the systems of internal financial control are both adequate and effective in practice.

As part of our audit of the financial statements, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. As we have adopted a fully substantive approach, we have therefore not tested the operation of controls.

Although our audit was not designed to express an opinion on the effectiveness of internal control we are required to communicate to you significant deficiencies in internal control.

We have not identified any significant deficiencies in the design or operation of an internal control that might result in a material misstatement in your financial statements of which you are not aware. However we have identified some areas for improvement as a result of our 2018/19 VFM procedures:

- Although there is a positive direction of travel further work is required to continue to improve the completeness of the Authority’s corporate contract register and consistency of its procurement and contract management arrangements more generally.
- The Authority should seek to fully address the priority 1 recommendations raised by Internal Audit relating to its CM2000 electronic care monitoring system.
- The ongoing review of controls in the E5 General Ledger and associated systems should be fully completed.

08 Data Analytics

Data analytics – Journal Entry Analysis and Payroll Analysis

Analytics Driven Audit

Data analytics

We used our data analysers to enable us to capture entire populations of your financial data. These analysers:

- Help identify specific exceptions and anomalies which can then be the focus of our substantive audit tests; and
- Give greater likelihood of identifying errors than traditional, random sampling techniques.

In 2018/19, our use of these analysers in the Authority's audit included testing journal entries and employee expenses, to identify and focus our testing on those entries we deem to have the highest inherent risk to the audit.

We capture the data through our formal data requests and the data transfer takes place on a secured EY website. These are in line with our EY data protection policies which are designed to protect the confidentiality, integrity and availability of business and personal information.

Journal Entry Analysis
We obtain downloads of all the financial ledger transactions posted in the year. We perform completeness analysis over the data, reconciling the sum of transactions to the movement in the trial balances and financial statements to ensure we have captured all data. Our analysers then review and sort transactions, allowing us to more effectively identify and test journals that we consider to be higher risk, as identified in our audit plan.

Payroll Analysis
We also use our journal entry analyser in our payroll testing of the non-schools payroll. We obtain all payroll transactions posted in the year from the general ledger system and perform completeness analysis over the data, including reconciling the total amount to the payroll system. We then analyse the data against a number of specifically designed procedures. These include analysis of payroll costs by month to identify any variances from established expectations, as well as more detailed transactional interrogation.

09 Independence

Confirmation

We confirm that there are no changes in our assessment of independence since our confirmation in our audit plan dated March 2019.

We complied with the FRC Ethical Standards and the requirements of the PSAA's Terms of Appointment. **In** our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning of regulatory and professional requirements.

We consider that our independence in this context is a matter which you should review, as well as us. It is important that you and the Standards and General Purposes Committee consider the facts known to you and come to a view. If you would like to discuss any matters concerning our independence, we will be pleased to do this at the meeting of the Standards and General Purposes Committee on 25 July 2019.

We confirm we have not undertaken any non-audit work outside the NAO Code requirements in relation to our work.

Relationships, services and related threats and safeguards

The FRC Ethical Standard requires that we provide details of all relationships between Ernst & Young (EY) and your Authority, and its directors and senior management and its affiliates, including all services provided by us and our network to your Authority, its directors and senior management and its affiliates, and other services provided to other known connected parties that we consider may reasonably be thought to bear on the our integrity or objectivity, including those that could compromise independence and the related safeguards that are in place and why they address the threats.
There are no relationships from 1 April 2018 to the date of this report, which we consider may reasonably be thought to bear on our independence and objectivity.

Services provided by Ernst & Young

The table overleaf includes a summary of the fees that you have paid to us in the year ended 31 March 2019 in line with the disclosures set out in FRC Ethical Standard and in statute.

As at the date of this report, there are no future services which have been contracted and no written proposal to provide non-audit services has been submitted.

Fee analysis

As part of our reporting on our independence, we set out below a summary of the fees paid for the year ended 31 March 2019.

We confirm that we have not undertaken non-audit work outside the NAO Code requirements. We have adopted the necessary safeguards in completing this work and complied with Auditor Guidance Note 1 issued by the NAO.

	Final Fee 2018/19 (£)	Planned fee 2018/19 (£)	Final Fee 2017/18 (£)
Scale Fee – Code work	110,493	110,493	143,498
Additional fees			
- Additional work on PPE	TBC	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	TBC	15,000-25,000*	52,000
- Additional work arising from McCloud issue**	TBC	-	-
Total audit	TBC	130,493-150,493	228,998
Non-audit services - Housing Benefits	TBC	40,000	51,227
Non-audit services – Teachers' Pensions limited assurance	TBC	TBC	8,500
Total other non-audit services	TBC	TBC	59,727
Total fees	TBC	TBC	288,725

Notes:
* We include a range of additional fees to reflect the additional work we will need to undertake in respect of the risks we reported in our plan. We will confirm the exact additional fees on final completion of the audit and seek agreement with management and PSAA.
** At the time of writing we are quantifying the cost of the additional procedures we have been required to carry out in response to the McCloud issue.
All fees exclude VAT

10 Appendices

Audit approach update

We are required to summarise our approach to the audit of the balance sheet and any changes to this approach from the prior year audit.

Our audit procedures are designed to be responsive to our assessed risk of material misstatement at the relevant assertion level. Assertions relevant to the balance sheet include:

- Existence: An asset, liability and equity interest exists at a given date
- Rights and Obligations: An asset, liability and equity interest pertains to the entity at a given date
- Completeness: There are no unrecorded assets, liabilities, and equity interests, transactions or events, or undisclosed items
- Valuation: An asset, liability and equity interest is recorded at an appropriate amount and any resulting valuation or allocation adjustments are appropriately recorded
- Presentation and Disclosure: Assets, liabilities and equity interests are appropriately aggregated or disaggregated, and classified, described and disclosed in accordance with the applicable financial reporting framework. Disclosures are relevant and understandable in the context of the applicable financial reporting framework

Our approach to gaining assurance over the Council's balance sheet in to substantively test all relevant assertions for all material balances. This remains unchanged from the previous period.

Appendix B

Summary of communications during 2018/19

Date	Nature	Summary
14 February 2019	Meeting	Suresh and Simon met with the Director of Corporate Services to agree timing of the audit
14 March 2019	Meeting	Suresh attended the Audit Committee to present the audit plan.
29 April 2019	Meeting	Suresh and Simon met with the Director of Corporate Services for an update on the audit
8 June 2019	Meeting	Suresh & Simon met with the Director of Corporate Resources to discuss audit progress
25 July 2019	Meeting	EY attended Audit Committee to present this Audit Results Report (ISA 260 report).

In addition to the above specific meetings and letters the audit team met with the management team multiple times throughout the audit to discuss audit findings.

We also attend all meetings of the Standards and General Purposes Committee.

Required communications with the Standards and General Purposes Committee

There are certain communications that we must provide to the Audit Committees of UK clients. We have detailed these here together with a reference of when and where they were covered:

Required communications	What is reported?	Our Reporting to you 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.	Audit Plan - March 2019
Planning and audit approach	Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.	Audit Plan - March 2019
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 - July 2019

Appendix C

Required communications	What is reported?	Our Reporting to you When and where
Major Local Authorities	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 ▸ Subject to compliance with regulations, any actual or suspected non-compliance with laws and regulations identified relevant to the audit committee ▸ Subject to compliance with regulations, any suspicions that irregularities, including fraud with regard to the financial statements, may occur or have occurred, and the implications thereof ▸ 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 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 Plan - March 2019 and Audit Results Report - July 2019

Page 248

Appendix C

		Our Reporting to you
Required communications	**What is reported?**	**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	No conditions or events were identified, either individually or together to raise any doubt about the London Borough of Merton's ability to continue for the 12 months from the date of our report
Misstatements	▸ Uncorrected misstatements and their effect on our audit opinion ▸ The effect of uncorrected misstatements related to prior periods ▸ A request that any uncorrected misstatement be corrected ▸ Material misstatements corrected by management	Audit Results Report - July 2019
Subsequent events	▸ Enquiry of the Standards and General Purposes Committee where appropriate regarding whether any subsequent events have occurred that might affect the	
Fraud	▸ Enquiries of the Standards and General Purposes Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the Authority ▸ Any fraud that we have identified or information we have obtained that indicates that a fraud may exist ▸ Unless all of those charged with governance are involved in managing the Authority, any identified or suspected fraud involving: a. Management; b. Employees who have significant roles in internal control; or c. Others where the fraud results in a material misstatement in the financial statements. ▸ The nature, timing and extent of audit procedures necessary to complete the audit when fraud involving management is suspected ▸ Any other matters related to fraud, relevant to Standards and General Purposes Committee responsibility.	Audit Results Report - July 2019

Appendix C

		Our Reporting to you
Required communications	**What is reported?**	**When and where**
Related parties	Significant matters arising during the audit in connection with the Authority'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 Authority	Audit Results Report - July 2019
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 Communications whenever significant judgments are made about threats to objectivity and independence and the appropriateness of safeguards put in place. For public interest entities and listed companies, communication of minimum requirements as detailed in the FRC Revised Ethical Standard 2016: ▸ Relationships between EY, the company and senior management, its affiliates and its connected parties ▸ Services provided by EY that may reasonably bear on the auditors' objectivity and independence ▸ 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	Audit Plan - March 2019 and Audit Results Report - July 2019

Appendix C

		Our Reporting to you
Required communications	**What is reported?**	**When and where**
	▸ Details of any inconsistencies between the Ethical Standard and Authority'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	
External confirmations	▸ Management's refusal for us to request confirmations ▸ Inability to obtain relevant and reliable audit evidence from other procedures.	We have received all requested confirmations
Consideration of laws and regulations	▸ Subject to compliance with applicable regulations, matters involving identified or suspected non-compliance with laws and regulations, other than those which are clearly inconsequential and the implications thereof. Instances of suspected non-compliance may also include those that are brought to our attention that are expected to occur imminently or for which there is reason to believe that they may occur ▸ 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	We have asked management and those charged with governance. We have not identified any material instances or non-compliance with laws and regulations
Significant deficiencies in internal controls identified during the audit	▸ Significant deficiencies in internal controls identified during the audit.	Audit Results Report – July 2019

Appendix C

Required communications	What is reported?	Our Reporting to you When and where
Written representations	► Written representations we are requesting from management and/or those charged with governance	Audit Results Report - July 2019
Material inconsistencies or misstatements	► Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	Audit Results Report - July 2019
Auditors report	► Any circumstances identified that affect the form and content of our auditor's report	Audit Results Report - July 2019
Fee Reporting	► 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 Plan - March 2019 and Audit Results Report - July 2019

Management representation letter

Management Rep Letter

Page 253

Ernst & Young LLP

Suresh Patel
Associate Partner
Ernst & Young LLP
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SE1 2AF

This letter of representations is provided in connection with your audit of the consolidated and Authority financial statements of the London Borough of Merton ("the Group and Authority") for the year ended 31 March 2019. We recognise that obtaining representations from us concerning the information contained in this letter is a significant procedure in enabling you to form an opinion as to whether the consolidated and Authority financial statements give a true and fair view of the Group and Authority financial position of the London Borough of Merton as of 31 March 2019 and of its financial performance (or operations) and its cash flows for the year then ended in accordance with, for the Group and Authority, the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2018/19.

We understand that the purpose of your audit of our consolidated and Authority financial statements is to express an opinion thereon and that your audit was conducted in accordance with International Standards on Auditing, which involves an examination of the accounting system, internal control and related data to the extent you considered necessary in the circumstances, and is not designed to identify - nor necessarily be expected to disclose - all fraud, shortages, errors and other irregularities, should any exist.

Accordingly, we make the following representations, which are true to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves:

A. Financial Statements and Financial Records

1. We have fulfilled our responsibilities, under the relevant statutory authorities, for the preparation of the financial statements in accordance with, for the Group and Authority the Accounts and Audit Regulations 2015 and CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2018/19.

2. We acknowledge, as members of management of the Group and Authority, our responsibility for the fair presentation of the consolidated and Authority financial statements. We believe the consolidated and Authority financial statements referred to above give a true and fair view of the financial position, financial performance (or results of operations) and cash flows of the Group and Authority in accordance with the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2018/19.

3. The significant accounting policies adopted in the preparation of the Group and Authority financial statements are appropriately described in the Group and Authority financial statements.

4. As members of management of the Group and Authority, we believe that the Group and Authority have a system of internal controls adequate to enable the preparation of accurate financial statements in accordance with the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2018/19 for the Group and Authority that are free from material misstatement, whether due to fraud or error.

5. We believe that the effects of any unadjusted audit differences accumulated by you during the current audit and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the consolidated and Authority financial statements taken as a whole. We have not corrected the difference relating to the Dedicated Schools Grant Earmarked Reserve identified and brought to our attention by the auditor because [specify reasons for not correcting misstatement].

Management representation letter

Management Rep Letter

Page 254

B. Non-compliance with law and regulations, including fraud

1. We acknowledge that we are responsible for determining that the Group and Authority's activities are conducted in accordance with laws and regulations and that we are responsible for identifying and addressing any non-compliance with applicable laws and regulations, including fraud.

2. We acknowledge that we are responsible for the design, implementation and maintenance of internal controls to prevent and detect fraud.

3. We have disclosed to you the results of our assessment of the risk that the consolidated and Authority financial statements may be materially misstated as a result of fraud.

4. We have no knowledge of any identified or suspected non-compliance with laws or regulations, including fraud that may have affected the Group or Authority (regardless of the source or form and including without limitation, any allegations by "whistleblowers"), including non-compliance matters:

- involving financial statements;
- related to laws and regulations that have a direct effect on the determination of material amounts and disclosures in the consolidated or Authority's financial statements;
- related to laws and regulations that have an indirect effect on amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operations of the Group or Authority's activities, its ability to continue to operate, or to avoid material penalties;
- involving management, or employees who have significant roles in internal controls, or others; or
- in relation to any allegations of fraud, suspected fraud or other non-compliance with laws and regulations communicated by employees, former employees, analysts, regulators or others.

C. Information Provided and Completeness of Information and Transactions

1. We have provided you with:

- Access to all information of which we are aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
- Additional information that you have requested from us for the purpose of the audit; and
- Unrestricted access to persons within the entity from whom you determined it necessary to obtain audit evidence.

2. All material transactions have been recorded in the accounting records and are reflected in the consolidated and Authority financial statements.

3. We have made available to you all minutes of the meetings of the Group and Authority held through the year to the most recent meeting of the Standards and General Purposes Committee on 25 July 2019.

4. We confirm the completeness of information provided regarding the identification of related parties. We have disclosed to you the identity of the Group and Authority's related parties and all related party relationships and transactions of which we are aware, including sales, purchases, loans, transfers of assets, liabilities and services, leasing arrangements, guarantees, non-monetary transactions and transactions for no consideration for the year ended, as well as related balances due to or from such parties at the year end. These transactions have been appropriately accounted for and disclosed in the consolidated and Authority financial statements.

5. We believe that the significant assumptions we used in making accounting estimates, including those measured at fair value, are reasonable.

6. We have disclosed to you, and the Group and Authority has complied with, all aspects of contractual agreements that could have a material effect on the consolidated and Authority financial statements in the event of non-compliance, including all covenants, conditions or other requirements of all outstanding debt.

Management representation letter

Management Rep Letter

D. Liabilities and Contingencies

1. All liabilities and contingencies, including those associated with guarantees, whether written or oral, have been disclosed to you and are appropriately reflected in the consolidated and Authority financial statements.

2. We have informed you of all outstanding and possible litigation and claims, whether or not they have been discussed with legal counsel.

3. We have recorded and/or disclosed, as appropriate, all liabilities related litigation and claims, both actual and contingent, and have disclosed in Note 12 to the consolidated and Authority financial statements all guarantees that we have given to third parties.

E. Subsequent Events

1. Other than as described in Note 33 to the consolidated and Authority financial statements, there have been no events subsequent to year end which require adjustment of or disclosure in the consolidated and Authority financial statements or notes thereto.

F. Group audits

1. There are no significant restrictions on our ability to distribute the retained profits of the Group because of statutory, contractual, exchange control or other restrictions other than those indicated in the Group financial statements.

2. Necessary adjustments have been made to eliminate all material intra-group unrealised profits on transactions amongst Authority, subsidiary undertakings and associated undertakings.

G. Other information

1. We acknowledge our responsibility for the preparation of the other information. The other information comprises the Narrative Statement.

2. We confirm that the content contained within the other information is consistent with the financial statements.

H. Use of the Work of a Specialist

1. We agree with the findings of the specialists that we engaged to evaluate the valuation of Property, Plant and Equipment and Investment Property and have adequately considered the qualifications of the specialists in determining the amounts and disclosures included in the consolidated and Authority financial statements and the underlying accounting records. We did not give or cause any instructions to be given to the specialists with respect to the values or amounts derived in an attempt to bias their work, and we are not otherwise aware of any matters that have had an effect on the independence or objectivity of the specialists.

I. Estimates

Valuation of Property, Plant and Equipment

Valuation of Pension Fund assets and liabilities

Accounting entries relating to Private Finance Initiative schemes

1. We believe that the measurement processes, including related assumptions and models, used to determine the accounting estimates have been consistently applied and are appropriate in the context of the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18.

2. We confirm that the disclosures made in the financial statements with respect to the accounting estimate(s) are complete and made in accordance with CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18.

3. We confirm that no adjustments are required to the accounting estimates and disclosures in the financial statements due to subsequent events.

Management representation letter

Management Rep Letter

J, Retirement benefits

1. On the basis of the process established by us and having made appropriate enquiries, we are satisfied that the actuarial assumptions underlying the scheme liabilities are consistent with our knowledge of the business. All significant retirement benefits and all settlements and curtailments have been identified and properly accounted for.

Yours faithfully,

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Caroline Holland

Director of Corporate Services

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Cllr Peter McCabe

Chair of the Standards and General Purposes Committee

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