

# London Borough of Merton

Annual Audit Letter for the year  
ended 31 March 2019

September 2019

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The EY logo consists of the letters 'EY' in a bold, white, sans-serif font. A yellow triangle is positioned above the 'Y', pointing downwards towards the letter.

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Agenda Item 4

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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](http://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 set out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

This Annual Audit Letter is prepared in the context of the Statement of responsibilities and Terms of Appointment. 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

We are required to issue an annual audit letter to the London Borough of Merton (the Council) following completion of our audit procedures for the year ended 31 March 2019.

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

Area of Work	Conclusion
<b>Opinion on the Council and Pension Fund's:</b>	Unqualified - the financial statements give a true and fair view of the financial position of the Council and Pension Fund as at 31 March 2019 and of its expenditure and income for the year then ended.
▶ Financial statements	
▶ Consistency of other information published with the financial statements	Other information published with the financial statements was consistent with the Annual Accounts.
<b>Concluding on the Council's arrangements for securing economy, efficiency and effectiveness</b>	We concluded that you have put in place proper arrangements to secure value for money in your use of resources.

Area of Work	Conclusion
<b>Reports by exception:</b>	
▶ Consistency of Governance Statement	The Governance Statement was consistent with our understanding of the Council.
▶ Public interest report	We had no matters to report in the public interest.
▶ Written recommendations to the Council, which should be copied to the Secretary of State	We had no matters to report.
▶ Other actions taken in relation to our responsibilities under the Local Audit and Accountability Act 2014	We had no matters to report.

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

## Executive Summary (cont'd)

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As a result of the above we have also:

Area of Work	Conclusion
Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit.	We issued our Audit Results Report for the main Council on 22 July 2019 and the Pension Fund report on 9 July 2019.
Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.	We issued our certificate on 30 August 2019.

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We would like to take this opportunity to thank the Council and Pension Fund's staff for their assistance during the course of our work.

Suresh Patel

Associate Partner

For and on behalf of Ernst & Young LLP





# 02

## Purpose and Responsibilities

# Purpose and Responsibilities

## The Purpose of this Letter

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

We have already reported the detailed findings from our audit work in our 2018/19 Audit Results Report to the 25 July 2019 Standards and General Purposes Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council.

## Responsibilities of the Appointed Auditor

Our 2018/19 audit work has been undertaken in accordance with the Audit Plans that we issued on 14 March 2019 for both the main Council and Pension Fund and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK), and other guidance issued by the National Audit Office. As auditors we are responsible for:

Expressing an opinion:

- ▶ On the 2018/19 financial statements, including the pension fund; and
- ▶ On the consistency of other information published with the financial statements.

Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.

Reporting by exception:

- ▶ If the annual governance statement is misleading or not consistent with our understanding of the Council;
- ▶ Any significant matters that are in the public interest;
- ▶ Any written recommendations to the Council, which should be copied to the Secretary of State; and
- ▶ If we have discharged our duties and responsibilities as established by the Local Audit and Accountability Act 2014 and Code of Audit Practice.

Alongside our work on the financial statements, we also review and report to the National Audit Office (NAO) on your Whole of Government Accounts return.

## Responsibilities of the Council

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

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



03

# Financial Statement Audit



# Financial Statement Audit

## Key Issues

The Council's Statement of Accounts is an important tool for it to show how it has used public money and how it can demonstrate its financial management and financial health. We audited the Council's Statement of Accounts in line with the NAO's 2015 Code of Audit Practice, International Standards on Auditing (UK), and other guidance issued by the NAO and issued a qualified audit report on 31 July 2019.

Our detailed findings were reported to the 25 July 2019 Standards and General Purposes Committee.

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

Significant Risk	Our focus	Conclusion
Misstatements due to fraud or error	Testing key areas that are susceptible to management bias, for example, areas of the accounts subject to estimation.	We have not identified any instances of inappropriate judgements being applied.
Misstatements due to fraud or error Inappropriate capitalisation of revenue	Testing capital 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. We also 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 did not identify instances of the inappropriate capitalisation of revenue expenditure.
Property, Plant & Equipment (PPE) Asset Valuation	The reasonableness of the methodologies adopted by the valuer in undertaking their valuations in 2018/19 and of the key assumptions input into these valuations.	As a result of the Authority's ongoing work to improve PPE valuation processes and asset management records it made further amendments to asset valuations at 31 March 2018, reflected in the 2018/19 draft financial statements presented for audit.  We found the Council's valuation methodologies and assumptions reasonable.
Pension Fund Risk of Management Override: Year end investment journals	We reviewed the year end manual journals in relation to the valuation of investments and the recognition of investment income.	We did not identify any misstatements or issues.

## Financial Statement Audit (cont'd)

### Our application of materiality

When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole.

Item	Thresholds applied
Planning materiality	<p>For the main Council we determined planning materiality to be £9.9m for the single entity financial statements and £10m for the group, which are 1.8% of gross revenue expenditure reported in the accounts. We consider the gross spending of the Council and Group to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.</p> <p>For the Pension Fund we determined planning materiality to be £7.2m, which is 1% of net assets reported in the accounts. We consider the net assets of the Pension Fund to be one of the principal considerations for stakeholders in assessing the financial performance of the Fund.</p>
Reporting threshold	<p>We agreed with the Standards and General Purposes Committee that we would report to the Committee all audit differences in excess of £495,000 for the single entity Council accounts and £501,000 for the group.</p> <p>We also agreed a reporting threshold of £360,000 for the Pension Fund financial statements.</p>

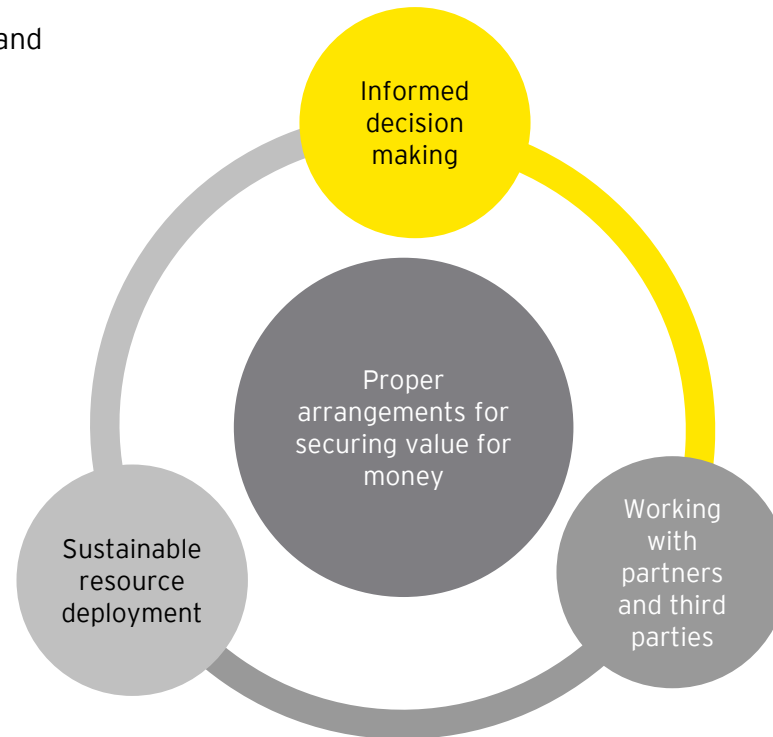


# 04 Value for Money

We are required to consider whether the Authority has put in place 'proper arrangements' to secure economy, efficiency and effectiveness in its use of resources. This is known as our value for money conclusion.

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

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



We identified one significant risk in relation to challenging financial outlook the Council faces and its arrangements for deploying resources in a sustainable way.

We have performed the procedures outlined in our audit plan and we included details of our findings in the Audit Results Report. We did not identify any significant weaknesses in the Authority's arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

We therefore had no matters to include in the auditor's report on the value for money conclusion.





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## Other Reporting Issues



## Other Reporting Issues

### Whole of Government Accounts

We are required to perform the procedures specified by the National Audit Office on the accuracy of the consolidation pack prepared by the **Authority** for Whole of Government Accounts purposes.

We have completed our work in this area and have no issues to report.

### Annual Governance Statement

We are required to consider the completeness of disclosures in the Authority's annual governance statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it is misleading.

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

### Report in the Public Interest

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

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

### Written Recommendations

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

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

### Objections Received

We did not receive any objections to the 2018/19 financial statements from members of the public.

### Other Powers and Duties

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

## Other Reporting Issues (cont'd)

### Independence

We communicated our assessment of independence in our Audit Results Report to the Audit Committee on 19 July 2019. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning regulatory and professional requirements.

### Control Themes and Observations

As part of our work, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Although our audit was not designed to express an opinion on the effectiveness of internal control, we are required to communicate to you significant deficiencies in internal control identified during our audit.

We have adopted a fully substantive audit approach and have therefore not tested the operation of controls.

Our audit did not identify any significant deficiencies in internal control. However we did identify some areas for improvement as a result of our 2018/19 CFM 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.



**06**

**Focused on your future**





## Focused on your future

The Code of Practice on Local Authority Accounting in the United Kingdom introduces the application of new accounting standards in future years. The impact on the Council is summarised in the table below.

Standard	Issue	Impact
<b>IFRS 16 Leases</b>	<p>It is currently proposed that IFRS 16 will be applicable for local authority accounts from the 2020/21 financial year.</p> <p>Whilst the definition of a lease remains similar to the current leasing standard; IAS 17, for local authorities who lease a large number of assets the new standard will have a significant impact, with nearly all current leases being included on the balance sheet.</p> <p>There are transitional arrangements within the standard and although the 2020/21 Accounting Code of Practice for Local Authorities has yet to be issued, CIPFA have issued some limited provisional information which begins to clarify what the impact on local authority accounting will be. Whether any accounting statutory overrides will be introduced to mitigate any impact remains an outstanding issue.</p>	<p>Until the 2020/21 Accounting Code is issued and any statutory overrides are confirmed there remains some uncertainty in this area.</p> <p>However, what is clear is that the Council will need to undertake a detailed exercise to identify all of its leases and capture the relevant information for them. The Council must therefore ensure that all lease arrangements are fully documented.</p>
<b>IASB Conceptual Framework</b>	<p>The revised IASB Conceptual Framework for Financial Reporting (Conceptual Framework) will be applicable for local authority accounts from the 2019/20 financial year.</p> <p>This introduces;</p> <ul style="list-style-type: none"> <li>- new definitions of assets, liabilities, income and expenses</li> <li>- updates for the inclusion of the recognition process and criteria and new provisions on derecognition</li> <li>- enhanced guidance on accounting measurement bases</li> <li>- enhanced objectives for financial reporting and the qualitative aspects of financial information.</li> </ul> <p>The conceptual frameworks is not in itself an accounting standard and as such it cannot be used to override or disapply the requirements of any applicable accounting standards.</p> <p>However, an understanding of concepts and principles can be helpful to preparers of local authority financial statements when considering the treatment of transactions or events where standards do not provide specific guidance, or where a choice of accounting policies is available.</p>	<p>It is not anticipated that this change to the Code will have a material impact on Local Authority financial statements.</p> <p>However, Authorities will need to undertake a review to determine whether current classifications and accounting remains valid under the revised definitions.</p>



**07**

**Audit Fees**

## Audit Fees

### Main Council

For the main Council our proposed fee for 2018/19 reported in our Audit Results Results Report. We have agreed the additional fees with the Corporate Director Resources.

	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	14,560	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 audit queries	23,500	15,000-25,000*	52,000
- Additional work arising from McCloud issue	850	-	-
<b>Total audit</b>	<b>149,403</b>	<b>130,493-150,493</b>	<b>228,998</b>
Non-audit services - Housing Benefits		40,000	51,227
Non-audit services - Teachers' Pensions limited assurance	TBC	TBC	8,500
<b>Total other non-audit services</b>	<b>TBC</b>	<b>TBC</b>	<b>59,727</b>
<b>Total fees</b>	<b>TBC</b>	<b>TBC</b>	<b>288,725</b>

#### Notes:

\* We included a range of additional fees to reflect the additional work we estimated we needed to undertake in respect of the risks we reported in our plan. We have agreed the actual final additional fees with the Council and are seeking agreement with Public Sector Audit Appointments Limited (PSAA).

All fees exclude VAT

## Audit Fees

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### Pension Fund

For the Pension Fund our proposed fee for 2018/19 reported in our Audit Results Results Report.

	Final Fee 2018/19 £	Planned Fee 2018/19 £	Scale Fee 2018/19 £	Final Fee 2017/18 £
<b>Total Audit Fee - Code work</b>	<b>18,170*</b>	<b>16,170</b>	<b>16,170</b>	<b>21,000</b>

\* Includes a proposed fee of £2,000 for additional work arising from the significant changes made to the Fund's investment holdings during the year, movement of funds into LCIV and the resulting in changes in fund manager and custodian arrangements. We have agreed the additional fee with management but it remains subject to approval by PSAA.

All fees exclude VAT



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