

London Borough of Merton

Audit planning report

Year ending 31 March 2020

27 February 2020

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27 February 2020



Dear Committee Members

London Borough of Merton, 2019/20 Audit planning report

We are pleased to attach our audit planning report for the forthcoming meeting of the Standards and General Purposes Committee. The purpose of this report is provide the Committee with a basis to review our proposed audit approach and scope for the 2019-20 audit, in accordance with the requirements of the auditing standards and other professional requirements, but also to ensure that our audit is aligned with the Committee's service expectations.

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

This report is intended solely for the information and use of the Standards and General Purposes Committee and management, and is not intended to be and should not be used by anyone other than these specified parties.

We welcome the opportunity to discuss this report with you on 12 March 2020 as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully

A handwritten signature in black ink, appearing to read 'S Patel', written in a cursive style.

Suresh Patel

Associate Partner

For and on behalf of Ernst & Young

Contents



Public Sector Audit Appointments Ltd (PSAA) issued the "Statement of responsibilities of auditors and audited bodies". It is available from the PSAA website (<https://www.psa.co.uk/audit-quality/statement-of-responsibilities/>). The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The "Terms of Appointment and further guidance (updated April 2018)" issued by the PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and in legislation, and covers matters of practice and procedure which are of a recurring nature.

This report is made solely to the Standards and General Purposes Committee and management of the London Borough of Merton in accordance with the statement of responsibilities. Our work has been undertaken so that we might state to the Standards and General Purposes Committee, and management of the London Borough of Merton those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the Standards and General Purposes Committee, and management of the London Borough of Merton for this report or for the opinions we have formed. It should not be provided to any third-party without our prior written consent.



01

Overview of our 2019-20 audit strategy



Overview of our 2019-20 audit strategy

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

Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from PY	Details
Misstatements due to fraud or error	Fraud risk	No change in risk or focus	As identified in ISA 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that would otherwise appear to be operating effectively.
Inappropriate capitalisation of revenue expenditure	Fraud risk	No change in risk or focus	Linking to our fraud risk identified above, we have determined that the way in which management could override controls is through the inappropriate capitalisation of revenue expenditure to understate revenue expenditure reported in the financial statements.
Valuation of Land and Buildings	Significant Risk	No change in risk or focus.	<p>The fair value of Property, Plant and Equipment (PPE) represents a significant balance in the Council's accounts and is subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.</p> <p>In 2017-18 we identified significant weaknesses in the approach taken by management to the valuation of assets carried at depreciated replacement cost (DRC). Our findings led to the carrying value of PPE being increased by approximately £163 million. We considered the weaknesses in arrangements for the valuation of land and buildings assets to be a significant deficiency in internal control at the Council.</p> <p>In 2018-19 we did not identified any material misstatements. We did, however identify some further improvements required to the Council's methodology for valuing assets carried at Existing Use Value (EUV). We have therefore continued to deem the valuation of land & buildings to be a significant risk as part of our 2019/20 audit.</p>
Data Migration of PPE Fixed Asset Register (FAR)	Significant Risk	New risk identified this year	During 2019/20 the Council is changing it's fixed asset register (FAR) to use the CIPFA accounting module. Given output from the system is material and the risk we outline above we have concluded this represents a significant audit risk for the 2019-20 audit.

Overview of our 2019-20 audit strategy

Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from PY	Details
Incorrect classification of Dedicated Schools Grant (DSG) deficit	Significant Risk	New risk identified this year	At the end of 2018/19 the Council had incurred a cumulative deficit of £2.9 million against DSG funded activities. This was accounted for as a negative, or debit balance, earmarked reserve. We concluded it was not permissible under extant accounting rules to have a negative earmarked reserve, and therefore considered this to be an uncorrected misstatement in the 2018/19 statements. The forecast level of cumulative DSG overspend in 2019/20 is £13m and is therefore material to the financial statements.
Pension Liability and Asset Valuation	Inherent Risk	No change in risk or focus.	The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme which it administers. Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.
Private Finance Initiative (PFI)	Inherent Risk	No change in risk or focus.	The Council has a material PFI arrangement. PFI accounting is a complex area, and a detailed review of these arrangements was undertaken by our internal expert in 2016-17 and followed-up in 2017-18 and 2018-19. We will review the accounting entries and disclosures in relation to PFI in detail in 2019-20, with a focus on any significant changes since the previous year.
New Accounting Standard - IFRS 16 Leases	Inherent risk	New risk identified this year	IFRS 16 (leases) applies from 1 April 2020. The Council needs to put in place arrangements to implement the new standard for the 2020-21 financial year, and to make necessary disclosures for forthcoming changes in accounting standards in its 2019-20 Statement of Accounts. Given the extent of operating leases and contracts potentially containing embedded lease held by the Council, this represents an inherent risk.

Overview of our 2019-20 audit strategy

Materiality

Planning
materiality

£9.9m

We have set materiality at £9.9 million for the group financial statements which represents 1.8% of the prior years gross revenue expenditure of the Council, and the 2019-20 forecast GRE of CHAS 2013 Ltd and Merantun Development Ltd. Materiality for the single entity Council financial statements is £9.7 million. This is in line with the prior year where we have reduced the maximum threshold for local authorities to 1.8%, reflecting the higher profile of local government financial resilience and financial reporting.

Performance
materiality

£7.4m

We have set performance materiality at £7.4 million for the group financial statements and £7.3m for the single entity Council financial statements. This represents 75% of materiality reflecting the lower level of errors we detected in the 2018-19 financial statements. We determine component performance materiality as a percentage of Group performance materiality based on risk and relative size to the Group. We consider the wholly owned subsidiary, CHAS 2013 Limited, to be a significant component with a performance materiality level of £1.5 million. We do not consider the financial activity for Merantun Development Limited in the period will be material to the Group.

Audit
differences

£494k

We will report all uncorrected misstatements relating to the group financial statements over £494,000. We will communicate other misstatements identified to the extent that they merit the attention of the Standards and General Purposes Committee.

Overview of our 2019-20 audit strategy

Audit scope

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

- Our audit opinion on whether the financial statements of the London Borough of Merton to give a true and fair view of the financial position as at 31 March 2020 and of the income and expenditure for the year then ended; and
- Our conclusion on the Council's arrangements to secure economy, efficiency and effectiveness.

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

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

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

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

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

Taking the above into account, and as articulated in this audit plan, our professional responsibilities require us to independently assess the risks associated with providing an audit opinion and undertake appropriate procedures in response to that. Our Terms of Appointment with PSAA allow them to vary the fee dependent on "the auditors assessment of risk and the work needed to meet their professional responsibilities". PSAA are aware that the setting of scale fees has not kept pace with the changing requirements of external audit with increased focus on, for example, the valuations of land and buildings, the auditing of groups, the valuation of pension obligations, the introduction of new accounting standards such as IFRS 9, 15 and 16 in recent years as well as the expansion of factors impacting the value for money conclusion. Therefore to the extent any of these are relevant in the context of London Borough of Merton's audit, we will discuss these with management as to the impact on the scale fee. To increase the transparency of our fees we have included in the fees table in Appendix 8 a range of fees for the additional work we are planning to carry out to address the risks we have identified.



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02 Audit risks



Our response to significant risks

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

Misstatements due to fraud or error *

Page

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.

What will we do?

- ▶ Inquire of management about risks of fraud and the controls put in place to address those risks.
 - ▶ Understand the oversight given by those charged with governance of management's processes over fraud.
 - ▶ Consider of the effectiveness of management's controls designed to address the risk of fraud.
- Perform mandatory procedures regardless of specifically identified fraud risks, including:
- ▶ Testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements
 - ▶ Assessing accounting estimates for evidence of management bias, and
 - ▶ Evaluating the business rationale for significant unusual transactions.

We will utilise our data analytics capabilities to assist with our work.

Having evaluated this risk we have considered whether we need to perform other audit procedures not referred to above. We concluded that only those procedures included under 'Inappropriate capitalisation of revenue expenditure' are required.

Our response to significant risks

Inappropriate capitalisation of revenue expenditure*

Financial statement impact

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

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

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

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

What is the risk?

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

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

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

What will we do?

We will:

- ▶ Test PPE additions to ensure that the expenditure incurred and capitalised is clearly capital in nature.
- ▶ Seek to identify and understand the basis for any significant journals transferring expenditure from revenue to capital codes on the general ledger at the end of the year.

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

Our response to significant risks

Valuation of land and buildings

Financial statement impact

The net book value of other land and buildings in the 2018-19 audited accounts was £561.5 million.

What is the risk?

The fair value of land and buildings represents a significant balance in the Council's accounts and is subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.

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

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

In 2018-19 we did not identify any material misstatements. However our EY Real Estates team (EYRE) identified some areas for improvement in the Council's approach to valuing assets carried at Existing Use Value (EUV). We have therefore continued to associate a significant risk to the valuation of land & buildings in the 2019-20 audit.

What will we do?

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

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

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

Audit risks

Our response to significant risks

Data Migration of PPE Fixed Asset Register (FAR)

Financial statement impact

The net book value of plant, property & equipment in the 2018-19 audited accounts was £701.3 million.

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What is the risk?

We are aware of a planned change to the Council's fixed asset register (FAR) from the current system to the CIPFA accounting module during the year. Given output from the system is material and there have been significant issues relating to PPE in prior years we have concluded this should be treated as a significant risk in our 2019-20 audit.

What will we do?

We will:

- ▶ review the Council's reconciliation of the prior year 2018-19 closing balance to the 2019-20 opening balance in the old FAR on Excel.
- ▶ review the Council's reconciliation between the old FAR on Excel to the new CIPFA accounting system to confirm that data transfer is complete and accurate.
- ▶ consider the Council's investigation into any variances between the two systems.
- ▶ assess the accuracy of data held on the new FAR through substantive testing of a sample of PPE.

Audit risks

Our response to significant risks

Incorrect classification of Dedicated Schools Grant (DSG) deficit

Financial statement impact

The forecast level of cumulative DSG overspend is £13 million for 2019-20. If the DSG deficit were to create a debit balance on the DSG reserve as opposed to debited into usable reserves, this will lead to an overstatement of usable reserves based on current accounting guidance.

What is the risk?

At the end of 2018/19 the Council had incurred a cumulative deficit of £2.9 million against DSG funded activities, This was accounted for as a negative, or debit balance, earmarked reserve. We concluded it was not permissible under extant accounting rules to have a negative earmarked reserve, and therefore considered this to be an uncorrected misstatement in the 2018/19 audit. The forecast level of cumulative DSG overspend in 2019/20 at £13m million is material and therefore potentially impacts the material accuracy of the 2019/20 financial statements.

The Department for Education (DfE) released some further guidance on DSG funding at the end of January 2020. We are liaising with the Council as to the impact that this guidance has on the accounting treatment of the DSG deficit.

What will we do?

DSG income: we will reconcile DSG income reported to the DSG funding schedule for the Council on the DfE website.

DSG expenditure: we will perform a year on year analytical review and substantive testing of relevant expenditure.

We will continue to consider the accounting decisions taken by the Council and relevant regulation and guidance, which are currently subject to change, to determine the acceptability of the accounting approach taken and any impact on the financial statements.

Audit risks

Other areas of audit focus

We have identified other areas of the audit, that have not been classified as significant risks, but are still important when considering the risks of material misstatement to the financial statements and disclosures.

What is the risk/area of focus?

Pension Liability Valuation

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

The Council's pension fund deficit is a material estimated balance and the Code requires that this liability be disclosed on the Council's balance sheet. At 31 March 2019 this totalled £342.7 million.

The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the Pension Fund.

Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.

Private Finance Initiative (PFI)

The Council has a material PFI arrangement in relation to schools. PFI accounting is a complex area, and a detailed review of these arrangements was undertaken by our internal expert in 2016-17 and followed-up in 2017-18 and 2018-19.

What will we do?

We will:

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

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

We will review the accounting entries and disclosures in relation to PFI in detail in 2019-20, with a focus on any significant changes since the expert's follow-up review in the previous year. At the planning stage we not aware of any contractual changes to the Council's PFI arrangements and therefore do not anticipate any significant changes.

We will also undertake testing of in-year inputs to the accounting models and agree relevant entries in the financial statements to year-end output from the accounting model.

Audit risks

Other areas of audit focus (Continued)

What is the risk/area of focus?

IFRS 16 Leases

This new accounting standard is applicable for local authority accounts from the 2020-21 financial year and will change:

- ▶ How operating leases are recognised (as lessee); and
- ▶ The disclosure requirements for operating leases (as lessee).

The 2020-21 CIPFA Code of Practice on Local Authority accounting has not yet been issued. However, the Code requires the disclosure of information relating to the impact of an accounting change that will be required by a new accounting standard, but one which has not yet been implemented.

The Council currently recognises operating leases as a lessee with future minimum lease payments of £10.4 million and £45 million as a lessor. The Council also incurs a significant value of expenditure under contracts which may contain embedded leases.

What will we do?

We will:

- ▶ Assess the authority's implementation arrangements that should include an impact assessment paper setting out the application of the new standard, transitional adjustments and planned accounting for 2019-20; and
- ▶ Review additional disclosure requirements.



03

Value for Money Risks





Background

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

For 2019-20 this is based on the overall evaluation criterion:

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

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

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

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

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

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

Our risk assessment supports the planning of sufficient work to enable us to deliver a safe conclusion on arrangements to secure value for money and enables us to determine the nature and extent of further work that may be required. If we do not identify any significant risks there is no requirement to carry out further work. We consider business and operational risks insofar as they relate to proper arrangements at both sector and organisation-specific level. In 2019-20 this has included consideration of the steps taken by London Borough of Merton to consider the impact of Brexit on its future service provision, medium-term financing and investment values. Although the precise impact cannot yet be modelled, we anticipate that Councils will be carrying out scenario planning and that Brexit and its impact will feature on operational risk registers.

Our risk assessment has therefore considered both the potential financial impact of the issues we have identified, and also the likelihood that the issue will be of interest to local taxpayers, the Government and other stakeholders. This has resulted in the identification of the significant risks noted on the following page which we view as relevant to our value for money conclusion.



Value for Money Risks

What is the significant value for money risk?

Like other local government bodies, the Council 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 £7.0 million with further savings of approximately £3.3 million needing to be found to fully balance the budget and avoid further dependence on its reserves.

As at January 2020, the current draft business plan 2020-24 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 2020-21.
- £4,239,000 in 2021-22.
- £8,052,000 in 2022-23.
- £10,541,000 in 2023-24.

These financial pressures are compounded by other activities. Firstly the Ofsted inspection of the Council's services for special educational needs and/or disabilities (SEND) in September 2019, which identified some significant weaknesses, particularly in leadership and partnership working with CCGs, and opportunities for improvement. Secondly the Council continues to overspend against its Dedicated Schools Grant (DSG) budget and forecasts a year-end cumulative overspend of approximately £13 million.

We consider all of the above to be relevant to the sustainable resource deployment VFM criterion and constitute a significant risk given the increasing financial pressures faced by the Council.

What arrangements does the risk affect?

Sustainable resource deployment

What will we do?

Our approach will focus on reviewing the robustness of the Council's plans and arrangements to:

1. Address budget pressures in Children, Schools and Families, and
2. Achieve its savings targets and address budget gaps to deliver sustainable financial balance over the medium term.

This will include follow-up of the issues we highlighted as part of our prior year 2018-19 programme of value for money work.

In doing this we will explicitly consider:

- Financial pressures created by the need to address the findings of the SEND inspection and whether these have been adequately considered in the Council's medium-term financial plans.
- The Council's financial recovery plan in respect of the cumulative DSG deficit and whether the pressure on the DSG budget has been adequately reflected in the Council's medium term financial planning.



04

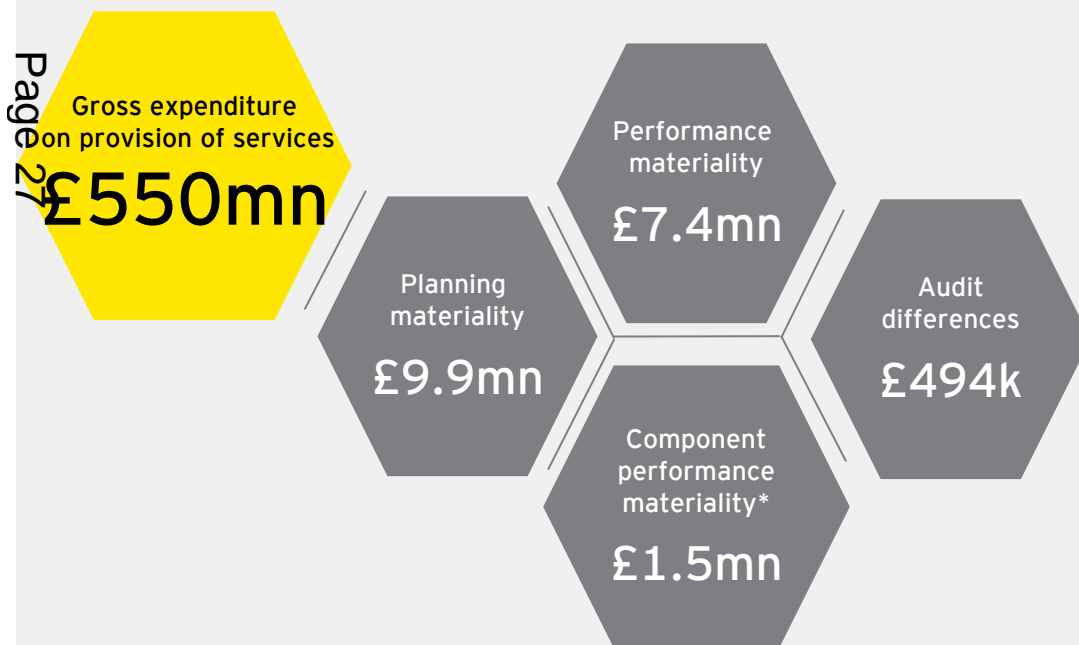
Audit materiality



Materiality

Materiality

For planning purposes, planning materiality for 2019-20 has been set at £9.9 million for the group financial statements. This represents 1.8% of the Council's prior year gross revenue expenditure (GRE) on provision of services, plus the 2019-20 forecast GRE of CHAS 2013 Limited and Merantun Development Limited. It will be reassessed throughout the audit process. We consider that gross expenditure on the provision of services is the area of biggest interest to the users of the Council's accounts.



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

Key definitions

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

Performance materiality - the amount we use to determine the extent of our audit procedures. We have set performance materiality at £7.4mn for the group financial statements which represents 75% of planning materiality. This reflects the relatively lower level of error detected in our 2018-19 financial statements audit.

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

* Component performance materiality relates to CHAS 2013 Ltd only; Merantun Development Ltd is out of group scope.

Audit difference threshold - we propose that misstatements identified below this threshold of £494,000 are deemed clearly trivial. The same threshold for misstatements is used for component reporting. We will report to you all uncorrected misstatements over this amount relating to the comprehensive income and expenditure statement, balance sheet and collection fund that have an effect on income or that relate to other comprehensive income.

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



05

Scope of our audit



Our Audit Process and Strategy

Objective and Scope of our Audit scoping

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

We issue an audit report that covers:

1. Financial statement audit

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

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

Procedures required by standards

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

Procedures required by the Code

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

2. Arrangements for securing economy, efficiency and effectiveness (value for money)

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources.

Our Audit Process and Strategy (continued)

Audit Process Overview

Our audit involves:

- ▶ Identifying and understanding the key processes and internal controls; and
- ▶ Substantive tests of detail of transactions and amounts.

For 2019-20 we plan to follow a substantive approach to the audit as we have concluded this is the most efficient way to obtain the level of audit assurance required to conclude that the financial statements are not materially misstated.

Analytics:

We will use our computer-based analytics tools to enable us to capture whole populations of your financial data, in particular journal entries. These tools:

- ▶ Help identify specific exceptions and anomalies which can then be subject to more traditional substantive audit tests; and
- ▶ Give greater likelihood of identifying errors than random sampling techniques.

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

Internal audit:

We will review internal audit plans and the results of their work and meet with the Head of Internal Audit as necessary. We will reflect the findings from these reports, together with reports from any other work completed in the year, in our detailed audit plan, where they raise issues that could have an impact on the financial statements, the Narrative Statement and the Annual Governance Statement.

Scope of our audit

Group scoping

For 2019-20 the Council has determined that it should consolidate CHAS 2013 Ltd and Merantun Development Ltd to prepare group accounts. Our audit strategy for performing an audit of an entity components is risk based. We identify components as:

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

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

We have determined that CHAS 2013 Ltd is a significant component due to risk. We have also determined our approach will be to apply a specific scope to our work on CHAS 2013 Ltd based on the nature of the transactions between the Council and the company. We are the auditors of CHAS 2013 Ltd but will not undertake the audit until later in the year. We have also considered the Council's other wholly owned subsidiary, Merantun Development Limited, as part of our group scoping assessment but based on information available at the planning stage of the audit do not consider its financial activity in the period will be material to the Group.

Scoping by Entity

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

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

Scope definitions

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

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

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

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

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



06

Audit team



Audit team

Audit team structure:

Suresh Patel
Associate Partner

Simon Mathers
Senior Manager

Simon Luk
Senior

Sejal Patel
Senior

Working together with the Council

We are working together with officers to identify continuing improvements in communication and processes for the 2019-20 audit.

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

EY Real
Estates (EYRE)

PwC (consulting
actuary) and EY
Actuaries

Use of specialists

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

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

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

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

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



07 Audit timeline





Audit timeline

Timetable of communication and planned deliverables

Timeline

Below is a timetable showing the key stages of the audit and the planned deliverables we have agreed to provide to you through the audit cycle in 2019-20. Please note that we will communicate any changes to this plan to officers and members as soon as we can. From time to time matters may arise that require immediate communication with the Standards and General Purposes Committee and we will discuss them with the Committee Chair as appropriate. We will also provide updates on corporate governance and regulatory matters as necessary.

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



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08

Independence



Introduction

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

Required communications

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

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

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

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

Relationships, services and related threats and safeguards

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

Overall Assessment

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

Self interest threats

A self interest threat arises when EY has financial or other interests in the Council. Examples include where we receive significant fees in respect of non-audit services; where we need to recover long outstanding fees; or where we enter into a business relationship with you. At the time of writing, there are no long outstanding fees. At the time of producing this plan EY advisory are responding to the Council's invitation to tender for a review of Air Quality Behavioural Insights. We do not believe there to be any perceived or actual independence matters that this engagement would create for the external audit, including consideration of the NAO's list of prohibited non-audit services. The proposed fee is also well below the NAOs fee cap for non-audit services of 70% of the scale audit fee. We will continue to keep you updated on whether this work proceeds.

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

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

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

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

Self review threats

Self review threats arise when the results of a non-audit service performed by EY or others within the EY network are reflected in the amounts included or disclosed in the financial statements. There are no self review threats at the date of this report.

Management threats

Partners and employees of EY are prohibited from taking decisions on behalf of management of the Council. Management threats may also arise during the provision of a non-audit service in relation to which management is required to make judgements or decision based on that work. There are no management threats at the date of this report.

Relationships, services and related threats and safeguards

Other threats

Other threats, such as advocacy, familiarity or intimidation, may arise. There are no other threats at the date of this report.

Other communications

EY Transparency Report 2019

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

Details of the key policies and processes in place within EY for maintaining objectivity and independence can be found in our annual Transparency Report which the firm is required to publish by law. The most recent version of this Report is for the year end 30 June 2019:

[https://www.ey.com/Publication/vwLUAssets/ey-uk-2019-transparency-report/\\$FILE/ey-uk-2019-transparency-report.pdf](https://www.ey.com/Publication/vwLUAssets/ey-uk-2019-transparency-report/$FILE/ey-uk-2019-transparency-report.pdf)

New UK Independence Standards

The Financial Reporting Council (FRC) published the Revised Ethical Standard 2019 in December and it will apply to accounting periods starting on or after 15 March 2020. A key change in the new Ethical Standard will be a general prohibition on the provision of non-audit services by the auditor (and its network) which will apply to UK Public Interest Entities (PIEs). A narrow list of permitted services will continue to be allowed.

Summary of key changes

- Extraterritorial application of the FRC Ethical Standard to UK PIE and its worldwide affiliates
 - A general prohibition on the provision of non-audit services by the auditor (or its network) to a UK PIE, its UK parent and worldwide subsidiaries
 - A narrow list of permitted services where closely related to the audit and/or required by law or regulation
 - Absolute prohibition on the following relationships applicable to UK PIE and its affiliates including material significant investees/investors:
 - Tax advocacy services
 - Remuneration advisory services
 - Internal audit services
 - Secondment/loan staff arrangements
- An absolute prohibition on contingent fees.
- Requirement to meet the higher standard for business relationships i.e. business relationships between the audit firm and the audit client will only be permitted if it is inconsequential.
- Permitted services required by law or regulation will not be subject to the 70% fee cap.
- Grandfathering will apply for otherwise prohibited non-audit services that are open at 15 March 2020 such that the engagement may continue until completed in accordance with the original engagement terms.
 - A requirement for the auditor to notify the Audit Committee where the audit fee might compromise perceived independence and the appropriate safeguards.
 - A requirement to report to the audit committee details of any breaches of the Ethical Standard and any actions taken by the firm to address any threats to independence. A requirement for non-network component firm whose work is used in the group audit engagement to comply with the same independence standard as the group auditor. Our current understanding is that the requirement to follow UK independence rules is limited to the component firm issuing the audit report and not to its network. This is subject to clarification with the FRC.

Next Steps

We will continue to monitor and assess all ongoing and proposed non-audit services and relationships to ensure they are permitted under FRC Revised Ethical Standard 2016 which will continue to apply until 31st March 2020 as well as the recently released FRC Revised Ethical Standard 2019 which will be effective from 01st April 2020. We will work with you to ensure orderly completion of the services or where required, transition to another service provider within mutually agreed timescales.

We do not provide any non-audit services which would be prohibited under the new standard.



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Appendices



Appendix A

Fees

The duty to prescribe fees is a statutory function delegated to Public Sector Audit Appointments Ltd (PSAA) by the Secretary of State for Communities and Local Government. PSAA has published a scale fee for all relevant bodies. This is defined as the fee required by auditors to meet statutory responsibilities under the Local Audit and Accountability Act 2014 in accordance with the requirements of the Code of Audit Practice and supporting guidance published by the National Audit Office, the financial reporting requirements set out in the Code of Practice on Local Authority Accounting published by CIPFA/LASAAC, and the professional standards applicable to auditors' work.

	Planned fee 2019/20 (£)	Final Fee 2018/19 (£)
Scale Fee - Code work	110,493	110,493
Additional fees		
- Additional work on PPE	5,000-15,000*	14,560**
- Additional work arising from change in materiality and clearance of audit queries	-	23,500**
- Additional work arising from McCloud query	-	850
- VFMC significant risk	2,000-7,000	-
- Data migration for the new FAR	1,500-7,500	-
Total audit	118,993-139,993	149,403
Non-audit services:		
Housing Benefits 1819	TBC	TBC
Housing Benefits 1718 Module X (further work on the 1718 claim)	n/a	39,600
Teachers' Pensions limited assurance	TBC	9,000
Contract for Air Quality Behavioural Insights project	TBC	-
Total other non-audit services	TBC	TBC
Total fees	TBC	TBC

The agreed fee presented is based on the following assumptions:

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

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

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

All fees exclude VAT

Notes:





* We include a range of additional fees to reflect the additional work we will need to undertake in respect of the risks we have reported in this plan. We will confirm the exact additional fees as the audit progresses and seek agreement with management and PSAA.

** This remains subject to approval by PSAA.


Appendix B



Required communications with the Standards and General Purposes Committee

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

		 Our Reporting to you
Required communications	 What is reported?	  When and where
Terms of engagement	Confirmation by the Standards and General Purposes Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Our responsibilities	Reminder of our responsibilities as set out in the engagement letter	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Planning and audit approach	<p>Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.</p> <p>When communicating key audit matters this includes the most significant risks of material misstatement (whether or not due to fraud) including those that have the greatest effect on the overall audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team</p>	Audit Planning Report, 12 March 2020 meeting of the Standards and General Purposes Committee.
Significant findings from the audit	<ul style="list-style-type: none"> ▶ Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures ▶ Significant difficulties, if any, encountered during the audit ▶ Significant matters, if any, arising from the audit that were discussed with management ▶ Written representations that we are seeking ▶ Expected modifications to the audit report ▶ Other matters if any, significant to the oversight of the financial reporting process 	Audit Results Report, 23 July 2020 meeting of the Standards and General Purposes Committee.





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

 Our Reporting to you

Required communications	 What is reported?	 When and where
Public Interest Entities	<p>For the audits of financial statements of public interest entities our written communications to the Audit Committee include:</p> <ul style="list-style-type: none"> ▶ A declaration of independence ▶ The identity of each key audit partner ▶ The use of non-member firms or external specialists and confirmation of their independence ▶ The nature and frequency of communications ▶ A description of the scope and timing of the audit ▶ Which categories of the balance sheet have been tested substantively or controls based and explanations for significant changes to the prior year, including first year audits ▶ Materiality ▶ Any going concern issues identified ▶ Any significant deficiencies in internal control identified and whether they have been resolved by management ▶ Actual or suspected non-compliance with laws and regulations identified relevant to the Audit Committee ▶ The valuation methods used and any changes to these including first year audits ▶ The scope of consolidation and exclusion criteria if any and whether in accordance with the reporting framework ▶ The identification of any non-EY component teams used in the group audit ▶ The completeness of documentation and explanations received ▶ Any significant difficulties encountered in the course of the audit ▶ Any significant matters discussed with management ▶ Any other matters considered significant 	<p>Audit Planning Report, 12 March 2020 meeting of the Standards and General Purposes Committee.</p> <p>and</p> <p>Audit Results Report, 23 July 2020 meeting of the Standards and General Purposes Committee.</p>



Appendix B

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

 Our Reporting to you		
Required communications	 What is reported?	  When and where
Page 46	Going concern	Audit Results Report, 23 July 2020 meeting of the Standards and General Purposes Committee.
	Financial statements	Audit Results Report, 23 July 2020 meeting of the Standards and General Purposes Committee.
Fraud		Audit Results Report, 23 July 2020 meeting of the Standards and General Purposes Committee.
Related parties		Audit Results Report, 23 July 2020 meeting of the Standards and General Purposes Committee.

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

 Our Reporting to you



Required communications	 What is reported?	 When and where
<p>Independence</p>	<p>Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence</p> <p>Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as:</p> <ul style="list-style-type: none"> ▶ The principal threats ▶ Safeguards adopted and their effectiveness ▶ An overall assessment of threats and safeguards ▶ Information about the general policies and process within the firm to maintain objectivity and independence <p>For public interest entities and listed companies, communication of minimum requirements as detailed in the FRC Revised Ethical Standard 2016:</p> <ul style="list-style-type: none"> ▶ Relationships between EY, the Council and senior management, its affiliates and its connected parties ▶ Services provided by EY that may reasonably bear on the auditors' objectivity and independence and related safeguards ▶ Fees charged by EY analysed into appropriate categories such as statutory audit fees, tax advisory fees, other non-audit service fees ▶ A statement of compliance with the Ethical Standard, including any non-EY firms or external experts used in the audit ▶ Details of any inconsistencies between the Ethical Standard and Group's policy for the provision of non-audit services, and any apparent breach of that policy ▶ Details of any contingent fee arrangements for non-audit services ▶ Where EY has determined it is appropriate to apply more restrictive rules than permitted under the Ethical Standard ▶ The Audit Committee should also be provided an opportunity to discuss matters affecting auditor independence 	<p>Audit planning report, March 2020 and Audit results report, July 2020</p>

Appendix B

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



Our Reporting to you

Required communications	 What is reported?	 When and where
External confirmations	<ul style="list-style-type: none"> ▶ Management's refusal for us to request confirmations ▶ Inability to obtain relevant and reliable audit evidence from other procedures 	Audit Results Report, 23 July 2020 meeting of the Standards and General Purposes Committee.
Consideration of laws and regulations	<ul style="list-style-type: none"> ▶ Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off ▶ Enquiry of the Audit Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Committee may be aware of 	Audit Results Report, 23 July 2020 meeting of the Standards and General Purposes Committee.
Internal controls	<ul style="list-style-type: none"> ▶ Significant deficiencies in internal controls identified during the audit 	Audit Results Report, 23 July 2020 meeting of the Standards and General Purposes Committee.
Representations	<ul style="list-style-type: none"> ▶ Written representations we are requesting from management and/or those charged with governance 	Assurance Letter to be received shortly after year-end.
Material inconsistencies and misstatements	<ul style="list-style-type: none"> ▶ Material inconsistencies or misstatements of fact identified in other information which management has refused to revise 	Audit Results Report, 23 July 2020 meeting of the Standards and General Purposes Committee.
Auditors report	<ul style="list-style-type: none"> ▶ Key audit matters that we will include in our auditor's report ▶ Any circumstances identified that affect the form and content of our auditor's report 	Audit Results Report, 23 July 2020 meeting of the Standards and General Purposes Committee.

Additional audit information

Other required procedures during the course of the audit

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

Our responsibilities required by auditing standards

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

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Purpose and evaluation of materiality

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

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

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

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