

London Borough of Merton Audit results report

Year ended 31 March 2020

20 October 2020

Page 13

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 letters.

Building a better
working world



London Borough of Merton
Standards and General Purposes Committee

20 October 2020

Dear 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 audit conclusion in relation to the audit of the London Borough of Merton (the Authority) for 2019/20 and updates our preliminary Audit Results Report dated 10 September 2020. We will issue our final report soon after the Committee meeting.

Subject to concluding the outstanding matters listed in our report, we anticipate issuing an unqualified audit opinion on the financial statements in the form at Section 3 of this report. As set out on pages 5 to 8, as per our update to the Committee in July 2020, the Covid-19 pandemic has impacted the statements and our audit opinion. We 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 given the additional pressures they have faced responding to the pandemic and working remotely.

We welcome the opportunity to discuss the contents of this report with you at the Standards and General Purposes Committee meeting on 5 November 2020.

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	Independence	09	Appendices		

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 Audit Results Report is prepared in the context of the Statement of responsibilities / Terms and Conditions of Engagement. 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 planning report tabled at the 12 March 2020 Standards and General Purposes 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 which we reported to the Committee in July 2020.

Changes to reporting timescales

As a result of COVID-19, new regulations, the Accounts and Audit (Coronavirus) (Amendment) Regulations 2020 No. 404, have been published and came into force on 30 April 2020. This announced a change to publication date for final, audited accounts from 31 July to 30 November 2020 for all relevant authorities.

Changes to our risk assessment as a result of Covid-19

- Valuation of Property Plant and Equipment - The Royal Institute of Chartered Surveyors (RICS), the body setting the standards for property valuations, issued guidance to valuers highlighting that the uncertain impact of Covid-19 on markets might cause a valuer to conclude that there is a material uncertainty. Caveats around this material uncertainty were included in the year-end valuation reports produced by the Authority's external valuer. We considered that the material uncertainties disclosed by the valuer gave rise to an additional risk relating to disclosures on the valuation of property, plant and equipment. We had already identified valuation of the Authority's fixed assets as a significant risk.
- Disclosures on Going Concern - The pandemic has had a significant impact on the Authority's finances and as a result there was a need for the Authority to revisit and update financial plans for 2020/21 and the medium term financial plan. We determined that the unpredictability of the current environment gave rise to a risk that the Authority would not appropriately disclose the key factors relating to going concern, underpinned by management's assessment with particular reference to Covid-19 and the Authority's actual year end financial position and performance.
- Events after the balance sheet date - We identified an increased risk that further events after the balance sheet date concerning the Covid-19 pandemic would need to be disclosed. The amount of detail required in the disclosure needs to reflect the specific circumstances of the Authority.
- New accounting standard on leases (IFRS16) - The planned implementation of IFRS16 for the 2019/20 accounts has been deferred to 2021/22. As a result, we removed this areas of audit focus from the audit.

Executive Summary

Scope update

Changes in materiality - We updated our planning materiality assessment using the draft financial statements and have also reconsidered our risk assessment. Based on our planning materiality measure of 1.8% of gross expenditure on provision of services and performance materiality at 75% of planning materiality:

Materiality	Group (£m)		Authority (£m)	
	Audit Plan	Final	Audit Plan	Final
Planning	9.9	9.8	9.7	9.6
Performance	7.4	7.3	7.3	7.2
Reporting	0.494	0.488	0.487	0.480

P Information Produced by the Entity (IPE): We identified an increased risk around the completeness, accuracy, and appropriateness of information produced by the entity due to the inability of the audit team to verify original documents or re-run reports on-site from the Authority's systems. We **U**ndertook the following to address this risk:

- Used the screen sharing function of Microsoft Teams to evidence re-running of reports used to generate the IPE we audited; and
- Agree IPE to scanned documents or other system screenshots.

Additional EY consultation requirements concerning the impact on auditor reports because of Covid-19.

The continued impact of the Covid-19 pandemic increases the risks to the material accuracy of financial statements and disclosures. To ensure we are providing the right assurances to the Authority and its stakeholders the firm has introduced a rigorous consultation process for all auditor reports to ensure that they include the appropriate narrative.

The changes to audit risks, audit approach and auditor reporting requirements changed the level of work we needed to perform. We have set out the impact on our audit fee on page 39.

Executive Summary

Status of the audit

We have substantially completed our audit of the London Borough of Merton's financial statements for the year 31 March 2020 and have performed 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:

- Consideration of post balance sheet events up to the date of issuing the opinion.
- Receipt and review of the management representation letter.

We do not expect to issue the audit certificate at the same time as the audit opinion because of changes in the Whole of Government Accounts timetable. In our preliminary Audit Results Report presented to the 22 September 2020 meeting of the Standard and General Purposes Committee we indicated that our audit opinion may include two emphasis of matter paragraphs relating to the material uncertainty disclosure on the valuation of Property, plant and equipment assets, and going concern and the impact of the Covid-19 pandemic. We have now completed our internal consultation process on the form of the audit opinion and determined that the two specific disclosures are not fundamental to the reader's understanding of the accounts and therefore we do not need to emphasise the disclosures in our audit opinion.

Audit differences

There are three adjusted audit differences which we wish to bring to your attention and are included in Section 04. None of the adjustments made impact the general fund balance.

There is one unadjusted difference relating to industrial sites accounted for as Property, Plant and Equipment in the financial statements where we have disagreed with the approach taken by the Authority's valuer. Based on the work of our valuation specialist we have concluded that the value of industrial sites is understated by approximately £6.3m in the financial statements. We consider this to be a judgemental difference involving estimation which relate to facts or circumstances that are uncertain or open to interpretation. Management considers this to be a difference in professional opinion between two sets of valuers and therefore that no adjustment should be made. Further narrative disclosure has been added to Note 43, Assumptions Made About the Future and Other Sources of Estimation Uncertainty, to explain Management's view.

Executive Summary

Areas of audit focus

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

Significant risk	Findings & conclusions
Management Override: Misstatements due to fraud or error	We have completed our testing and found no indications of management override of controls.
Incorrect capitalisation of revenue expenditure	We have completed our testing, subject to review, and have nothing to report
Valuation of land and buildings	We have completed our work and have reported an unadjusted audit difference on page 7 and one adjustment in Section 04. Management's disclosure of the material uncertainty related to the valuation of its land and buildings is reasonable.
Data migration of property, plant and equipment for the new fixed asset register	We have completed our review of the reconciliations carried out by the Authority and have not identified any issues to report.
Incorrect classification of the Dedicated Schools Grant (DSG)	We have reviewed the Authority's accounting treatment of the DSG deficit and can confirm that it meets the requirements of the Code.

Other area of audit focus	Findings & conclusions
Pension liability	We have agreed the Authority's pension liability disclosures to the actuarial report. An amendment has been made to the financial statements to increase the pensions liability accounted for on the Authority's balance sheet to account for the difference between the Authority's share of Pension Fund assets used to inform the actuarial assessment of the pensions liability and the final value of Pension Fund assets accounted for in the Pension Fund's financial statements.
Private finance initiative	We have completed our review and have nothing to report.
Going concern	The draft accounts did not include a detailed disclosure on going concern. Officers have used the assessment of the impact of Covid-19 on the Authority's finances, as reported to Cabinet, to draft a new going concern disclosure note. We have scrutinised the financial assessment, cashflow, liquidity forecasts, known outcomes, sensitivities, mitigating actions and key assumptions. We reviewed and further amended the revised going concern disclosure and are satisfied that it is an adequate reflection of Management's assessment that it remains appropriate to prepare the financial statements on a going concern basis.



Executive Summary

Areas of audit focus

This report sets out our latest 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.

Control observations

We have adopted a fully substantive approach, so have not tested the operation of controls.

We have not identified any key control deficiencies as part of the audit process. Please refer to Section 7 for details.

Page 21

Value for money

We identified one significant risk relating to sustainable resource deployment and in particular the Authority's arrangements to manage the financial challenges outlined in the Medium Term Financial Strategy. We are satisfied that the Authority has proper arrangements in place around the MTFs. As such we have no matters to report in the audit opinion. We include further details in Section 05 of this report.

Other reporting issues

We have reviewed the information presented in the Annual Governance Statement for consistency with our knowledge of the Authority. We have no matters to report as a result of this work.

We have not yet performed the procedures required by the National Audit Office (NAO) on the Whole of Government Accounts (WGA) submission. However Treasury has extended the reporting timetable for WGA so we may not certify completion of the audit at the same time as issuing the audit opinion.

Independence

Please refer to Section 8 for our update on Independence. There are no relationships from 1 April 2019 to the date of this report, which we consider may reasonably be thought to bear on our independence and objectivity.



02 Areas of Audit Focus



Significant risk

Management Override:
Misstatements due to
fraud or error
(Fraud risk)

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.

For the Authority, we have assessed that this risk could manifest in:

- Inappropriate journal entries; specifically manual journals posted by management in the preparation of the financial statements.
- Significantly unusual transactions entered into by management that are outside of the normal scope of business of the Authority.
- Management bias in key accounting estimates and judgements.

Page 23

What judgements are we focused on?

We have considered the risk of management override in respect of the Authority's judgements over capitalisation of revenue expenditure (see over).

What did we do?

- Identified fraud risks during the planning stages.
- Asked management about risks of fraud and the controls put in place to address those risks.
- Understood the oversight given by those charged with governance of management's processes over fraud.
- Considered the effectiveness of management's controls designed to address the risk of fraud.
- Determined an appropriate strategy to address those identified risks of fraud.
- Performed mandatory procedures in relation to journal entries and other adjustments
- Assessed the nature of significantly unusual transactions
- Considered if management bias was present in key accounting estimates and judgments in the financial statements

What are our conclusions?

Our testing is complete. We did not identify any:

- material weaknesses in controls or evidence of material management override;
- instances of inappropriate judgements being applied; or
- any other transactions during our audit which appear unusual or outside the Authority's normal course of business.



Areas of Audit Focus

Significant risk

Incorrect capitalisation of revenue expenditure
(Fraud risk)

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) 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.

Misstatements that occur in relation to the risk of fraud in revenue and expenditure recognition could affect the income and expenditure accounts.

Page 24

What judgements are we focused on?

We have identified a risk of expenditure misstatement due to fraud or error that could affect the income and expenditure accounts. We have focused on the Authority's judgement that an item is capital expenditure in nature. If this were to happen it would have the impact of understating revenue expenditure and overstating property, plant and equipment additions and/or Revenue Expenditure Financed as Capital Under Statute (REFCUS) in the financial statements.

What did we do?

Our approach focused on:

- Sample testing additions to property, plant and equipment to ensure that they had been correctly classified as capital and included at the correct value in order to identify any revenue items that have been inappropriately capitalised; and
- Using our data analytics tool to identify and test journal entries that moved expenditure into capital codes.

What are our conclusions?

Our sample testing of additions to property, plant and equipment:

- Found they had been correctly classified as capital and included at the correct value.
- Did not identify any revenue items that were incorrectly classified as capital.

Our data analytical procedures did not identify any journal entries that incorrectly moved expenditure into capital codes.



Areas of Audit Focus

Significant risk

Valuation of other land & buildings



What is the risk?

as an area of audit focus. The Royal Institute of Chartered Surveyors (RICS), the body setting the standards for property valuations, has issued guidance to valuers highlighting that the uncertain impact of COVID-19 on markets might cause a valuer to conclude that there is a material uncertainty, which the valuer would then disclose in their report. RICS has explained this is not a 'disclaimer' in the valuation: valuers are continuing to apply their professional judgement, this is disclosing the additional uncertainty attached to current valuations. This is particularly relevant for Fair Value / Market Value based assets because of the paucity of market information available at 31 March upon which to give those valuations. The Authority's valuation report includes this reference. [our work](#)

What judgements are we focused on?

Page 25
The reasonableness of the methodologies adopted by the valuer in undertaking their valuations in 2019/20 and of the key assumptions input into these valuations. In particular assets with reference to fair value/ market value. Additionally, we considered assets not revalued in the current year for the potential of material misstatement in valuation as of 31 March 2020.

What did we do?

- Considered the work performed by the Authority's valuers, including the adequacy of the scope of the work performed, their professional capabilities and the results of their work.
- Disaggregated the Authority's other land and buildings and adopted different testing strategies for specialised assets the Authority values using depreciated replacement cost (DRC) and non-specialist assets valued using existing use value (EUV):
 - For DRC we checked that the Authority had used the methodology it revised in the prior year following our audit which included 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 and the impact of Covid-19 on aspects of these valuations we engaged our own expert (EY Real Estates) to enable us to audit a sample of valuations, challenging management on key assumptions and judgements.
- Reviewed assets not subject to valuation in 2019/20 to confirm that the valuation remaining asset base was not materially misstated.
- Checked that the material uncertainty reported by the Authority's valuer was appropriately disclosed in the financial statements.



Areas of Audit Focus

Significant risk

Valuation of other land & buildings

What are our conclusions?

- We completed our work in response to this risk, including the work carried out by our EY Real Estates.
- We have reviewed the disclosure in the financial statements relating to the material valuation uncertainty paragraph included by the valuer in their valuation report, and consider the disclosure appropriate.

Page 26

We have concluded that the assessment of fair values performed by the valuer and the directors are within an acceptable range and the carrying values of assets are fairly stated at 31 March 2020 within material parameters. There is, however, one area relating to the valuation of industrial sites accounted for as Property, Plant and Equipment in the financial statements where we disagreed with the approach taken by the Council's valuer. Based on the work of our valuation specialist we have concluded that the value of industrial sites is understated by approximately £6.3m in the financial statements. We consider this to be a judgemental difference involving estimation which relate to facts or circumstances that are uncertain or open to interpretation. Management considers this to be a difference in professional opinion between two sets of valuers and therefore that no adjustment should be made. Further narrative disclosure has been added to Note 43, Assumptions Made About the Future and Other Sources of Estimation Uncertainty, to explain Management's view.

- The Authority undertook a desktop review to estimate the change in value for land and buildings not actually subject to revaluation by a valuer in 2019/20. However, this estimate was not reflected in the draft accounts. We reviewed the exercise and concluded that the estimate made was reasonable, being based on the results of the actual revaluation exercise undertaken in the year. We recommended that the Authority adjust the carrying value of land and buildings assets in the financial statements to account for the estimate. This had the impact of reducing the carrying value of property, plant and equipment assets by approximately £2.9m.



Areas of Audit Focus

Significant risk

Data Migration of the property, plant and equipment Fixed Asset Register (FAR)



What is the risk?

During 2019/20, the Authority has changed its fixed asset register (FAR) from the current system to the CIPFA accounting module. Given output from the system is material and there have been significant issues relating to property valuations in prior years we have concluded this should be treated as a significant risk in our 2019-20 audit.

our work.

What judgements are we focused on?

The adequacy of the reconciliations undertaken by the Authority and accuracy of data held on the new FAR.

What did we do?

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

What are our conclusions?

We found that:

- The prior year 2018-19 closing balance fully reconciled to the new year 2019-20 opening balance in the old FAR.
- Property, plant and equipment data had been completely and accurately transferred between the old FAR and new CIPFA accounting system in 2019/20.
- All variances between the two systems were adequately explained.
- Some immaterial adjustments were made to improve the accuracy of data on the new CIPFA accounting system.



Areas of Audit Focus

Significant risk

Incorrect classification of Dedicated Schools Grant (DSG) deficit



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 Authority was forecasting a cumulative DSG overspend in 2019/20 of £13 million.

In January 2020 the Department for Education (DfE) released some further guidance on the accounting treatment of the DSG deficit.

our work.

What judgements are we focused on?

The decision made by the Authority on how it would account for its DSG deficit.

What did we do?

- DSG income: we reconciled DSG income reported to the DSG funding schedule for the Authority on the DfE website.
- DSG expenditure: we performed a year on year analytical review and substantive testing of relevant expenditure.
- We considered the accounting decisions taken by the Authority to determine the acceptability of the accounting approach taken and any impact on the financial statements.

What are our conclusions?

Our procedures on DSG income and expenditure identified no significant issues.

The Authority has followed the guidance issued by CIPFA following clarification of the DfE guidance which allows the Authority to disclose a negative DSG deficit without this being charged to the General Fund.

A statutory instrument is currently being prepared by the Ministry of Housing, Communities and Local Government which would allow cumulative DSG deficits to be accounted for as an unusable reserve. The statutory instrument will apply prospectively from 1 April 2020 and therefore has no impact on the Council's 2019/20 financial statements.



Areas of Audit Focus



Pension Liability Valuation

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. 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 2020 this totalled £279 million (£343 million at 31 March 2019).

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.

Our approach has focused on:

- Liaising with the auditors of the Merton Pension Fund to obtain assurances over the information supplied to the actuary in relation to the Authority;
- Assessing 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 NAO for all Local Government sector auditors, and considering any relevant reviews by the EY actuarial team; and
- Reviewing and testing the accounting entries and disclosures made within the Authority's financial statements in relation to IAS19.

Findings and conclusions

We have agreed the Authority's pension liability disclosures to the IAS19 report provided by the actuary. We have now also received the assurances requested from the auditor of the Pension Fund. Following the receipts of that assurance an amendment has been made to the financial statements to increase the pensions liability accounted for on the Authority's balance sheet to account for the difference between the Authority's share of Pension Fund assets used to inform the actuarial assessment of the pensions liability and the final value of Pension Fund assets accounted for in the Pension Fund's financial statements.



Areas of Audit Focus



Going concern disclosure

There is presumption that the Authority will continue as a going concern. However, the current and future uncertainty over government funding and other sources of Authority revenue as a result of Covid-19 increases the need for the Authority to undertake a detailed going concern assessment to support its assertion. From an audit perspective, the auditor’s report going concern concept is a 12-month outlook from the audit opinion date, rather than the balance sheet date. So, this year, for example, we will need to see evidence of the going concern assessment up to and including around September / October 2021.

Findings and conclusions

The draft accounts did not include a going concern disclosure but officers had carried out assessment of the impact of the Covid-19 pandemic on the Authority’s income, expenditure, balances and reserves to inform reporting to Cabinet. Officers have used these assessments, and working in collaboration with the audit team, drafted a new going concern disclosure note for inclusion in the final version of the statements.

We have reviewed the assessment, focusing on the reasonableness of the financial impact assessment, cashflow and liquidity forecasts, known outcomes, sensitivities, mitigating actions and key assumptions, particular around reductions in fees and charges. We have also considered the adequacy of management’s new disclosure note and its agreement with the financial assessment.

The Authority is forecasting that as at July 2020 it will incur an overspend in 2020/21 of £23m which is predominantly Covid-19 related. Whilst the Authority continues to review all service areas revenue and capital budgets to identify options for delivering efficiency savings and / or generating income with the aim of setting a balanced budget in 2021/22 and reducing the overspend in 2020/21, The Authority has the following reserves to call on in delivering its services:

General Fund	£13.8m	Earmarked	£59.6m
Capital grants	£21.9m	Capital receipts	£2.1m

If required the Authority is prepared to ‘un-earmark’ certain reserves to meet its Covid-19 related commitments.

We therefore note that the Authority has headroom within the General Fund to absorb the estimated financial impact of the Covid-19 pandemic in the short to medium-term.

In terms of cash, at the end of June the Authority had a cash balance of £13.4m, with a further £35m in money market funds which are instantly callable, £65m in short term deposits maturing between one month and eight months and £10m in longer term property related investments, also available within a few days.

We have now reviewed the new going concern disclosure which officers plan to include at Note 42 of the statements, and are satisfied that it adequately reflects the Authority’s assessment and informs the reader of the impact of the pandemic on the Authority’s finances.



Areas of Audit Focus



Private Finance Initiative (PFI) accounting

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 and 2018-19.

Our approach has focused on:

- Reviewing 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.
- Testing of in-year inputs to the accounting models and agreeing relevant entries in the financial statements to year-end output from the accounting model.

Findings and conclusions

Officers have affirmed that there have been no significant changes in the way the Authority accounts for PFI. We have completed our review and found that the accounting entries and disclosures are in line with the prior year arrangements and satisfactorily reported in the 2019/20 statements.



03 Audit Report



Audit Report

Draft audit report

Our 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 2020 under the Local Audit and Accountability Act 2014. The financial statements comprise the:

- Authority and Group Movement in Reserves Statement,
- Authority and Group Comprehensive Income and Expenditure 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 [x]

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 2019/20.

In our opinion the financial statements:

- give a true and fair view of the financial position of the London Borough of Merton as at 31 March 2020 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 2019/20.

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 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 Resources use of the going concern basis of accounting in the preparation of the financial statements is not appropriate; or
- the Director of Corporate Resources 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.

Other information

The other information comprises the information included in the Statement of Accounts 2019/20, other than the financial statements and our auditor's report thereon. The Director of Corporate Resources 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.



Audit Report

Draft audit report

Our opinion on the financial statements

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 April 2020, 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 2020.

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 Council;
- 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

Responsibility of the Director of Corporate Resources

As explained more fully in the Statement of the Responsibilities, the Director of Corporate Resources 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 2019/20, and for being satisfied that they give a true and fair view.

In preparing the financial statements, the Director of Corporate Resources 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.



Draft audit report

Our opinion on the financial statements

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 April 2020, 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 2020.

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 London Borough of Merton 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 the 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.

Until we have completed these procedures we are unable to certify that we have completed the audit of the accounts in accordance with the requirements of the Local Audit and Accountability Act 2014 and the Code of Audit Practice issued by the NAO.

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 Authority and the Authority's members as a body, for our audit work, for this report, or for the opinions we have formed.

Suresh Patel (Key Audit Partner)
Ernst & Young LLP (Local Auditor)
London Date



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 adjusted differences

Judgemental misstatement

The Authority undertook a desktop to estimate the change in value for land and buildings not actually subject to revaluation by a qualified valuer in 2019/20. We reviewed the exercise and concluded that the estimate made was reasonable as it was based on the results of the actual revaluation exercise undertaken in the year. We therefore recommended that the Authority adjust the carrying value of land and buildings assets in the financial statements to account for the estimate. This had the impact of reducing the carrying value of property, plant and equipment assets by approximately £2.9m.

Known misstatements

Debtors on the main Authority balance sheet have been reduced by a total of approximately £1.34m, with a corresponding adjustment made to receipts in advance. The adjustment is as a result of two issues:

- The write back of historic council tax and NNDR receipts in advance to the general fund totalling approximately £860k had been incorrectly debited to debtors rather than to receipts in advance.
- Approximately £480k of income relating to 2020/21 had been reversed from the year account by adjustment of receipts in advance rather than debtors. This has the impact of grossing up debtors and receipts in advance.

Both of these adjustments had no impact on the general fund balance.

Following receipt IAS19 assurances from the auditor of the Pension Fund an amendment has been made to the financial statements to increase the pensions liability accounted for on the Authority's balance sheet by £4.5m to account for the difference between the Authority's share of Pension Fund assets used to inform the actuarial assessment of the pensions liability and the final value of Pension Fund assets accounted for in the Pension Fund's financial statements.

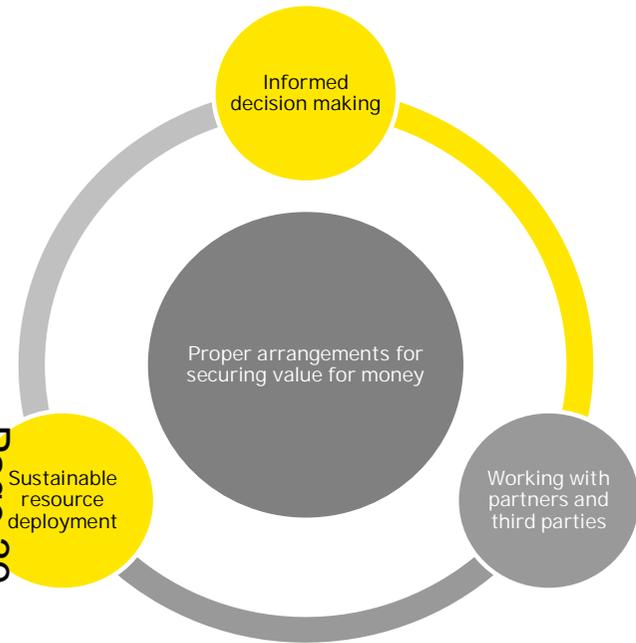
Unadjusted difference

There is one unadjusted misstatement we wish to bring to your attention. Based on the work of our valuation professionals we have concluded that the value of industrial sites accounted for as Property, Plant and Equipment in the financial statements is understated by approximately £6.3m. We consider this to be a judgemental difference. Management considers this to be a difference in professional opinion between two sets of valuers and therefore that no adjustment should be made. Further narrative disclosure has been added to Note 43, Assumptions Made About the Future and Other Sources of Estimation Uncertainty, to explain Management's view.



05

Value for Money



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 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.

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.

Impact of covid-19 on our Value for Money assessment

On 16 April 2020 the National Audit Office published an update to auditor guidance in relation to the 2019/20 Value for Money assessment in the light of Covid-19. This clarified that in undertaking the 2019/20 Value for Money assessment auditors should consider Local Authorities' response to Covid-19 only as far as it relates to the 2019-20 financial year; only where clear evidence comes to the auditor's attention of a significant failure in arrangements as a result of Covid-19 during the financial year, would it be appropriate to recognise a significant risk in relation to the 2019-20 VFM arrangements conclusion.

Overall conclusion

We identified one significant risk around these arrangements. The tables below present our findings in response to the risks in our Audit Planning Report and any other significant weaknesses or issues we want to bring to your attention.

We have not identified any new significant risks around these arrangements.

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.



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 risk area in our audit plan.

What is the significant value for money risk?

Sustainable resource deployment

In the March 2020 Audit Plan we reported that like other local government bodies, the Authority continued to have a challenging financial outlook. To balance the budget over the next four years it was 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 draft business plan 2020-24 showed 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 were compounded by other activities. Firstly the Ofsted inspection of the Authority’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 Authority’s overspending against its Dedicated Schools Grant (DSG) budget.

We consider all of the above to be relevant to the sustainable resource deployment VFM criterion and as a result it constituted a significant risk.

Since the March 2020 Audit Plan, we have clarified with the NAO that the overspend relating to the DSG budget should not be a consideration for our VFM conclusion work around sustainable resource deployment because the revised DfE regulations make it clear that local authorities are not required to fund the DSG deficit with general fund monies. However, there remains an expectation that authorities will put in place arrangements to manage DSG related spending.



Value for Money Risks (continued)

What did we do?

Our approach focused on reviewing the robustness of the Authority's plans and arrangements to:

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

We also followed up the issues we highlighted as part of our prior year 2018-19 programme of value for money work.

In doing this we explicitly considered the:

- 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 Authority's deficit recovery plan in respect of the cumulative DSG deficit.

What did find?

Overall 2019/20 financial performance including financial performance in Children, Schools and Families

The Council delivered a 2019/20 overall revenue underspend of £1.7m or approximately 0.3% of its gross general fund budget. Total capital expenditure for 2019/20 was £23.2 million. The Council made a number of amendments to the capital budget during the year reflecting slippage from the prior year brought forward and significant re-profiling of activity into subsequent financial years. This resulted in a final revised capital budget of £27.0m compared to an opening planned capital programme of £53.9m. Final capital outturn was therefore 13% lower than the final revised budget.

The level of underspending against budget allowed the Council to increase the level of earmarked and general fund reserves available to finance revenue expenditure by approximately £4m or 6%. Some of this increase was taken to the General Fund Reserve, Spending Review Reserve and Balancing the Budget Reserve and therefore is available to support the continuing pressures on the revenue budget faced by the Council over the medium term.

Value for Money Risks (continued)

What did we find (continued)?

As part of the overall revenue underspend, net service expenditure was underspent by £147k with savings in Adult Social Care, Corporate Services and Children, Schools and Families (CSF). The CSF department outturn position underspent by £241k. The overall net underspend within the department was achieved by lower than planned redundancy costs, savings against the schools PFI budget and underspending within other cross-departmental budgets. There was also underspending on procurement & schools organisation, early years and education & inclusion budgets. Delivery of an overall underspend at service level represents a considerable achievement given the significant overspends incurred in both 2018/19 and 2017/18. However, areas of budget pressure experienced in recent years have continued into 2019/20, with Special Education Needs (SEN) transport spend in particular, being again significantly over budget. Costs in this area are inherently volatile and difficult for the Council to forecast and control, with small increases in the number of SEN children entitled to the provision of transport potentially having a significant impact on the level of expenditure incurred.

More broadly costs related to the implementation of Special Educational Needs and/or Disabilities (SEND) reforms have continued to grow significantly during the year. These costs are primarily funded from DSG, and at the end of the year the cumulative DSG deficit stood at £12.75 million with this being partly driven by SEND related costs. Although it is now clear, following the issue further guidance and planned regulation by the Department for Education (DfE), DSG deficits should not be covered from the general fund but over time be recovered from DSG income, the Council has a role in working with the DfE and other partners to control related spending. We consider this further below.

Achievement of savings targets and medium-term financial planning

The Medium-Term Financial Strategy was last updated in February 2020 as part of the Council's Business Plan. At that time the Council set a balanced budget for 2020/21 with residual gaps to be closed of £3.3m, £6.9m, and £9.0m in 2021/22, 2022/23 and 2023/24 respectively. Cumulative savings of £11.9m had been identified in 2020/21, rising to £16.3m by 2023/24. We have not tested individual schemes in detail as part of our work but based on the Council's own internal reporting note that a programme of named savings schemes had been established in support of this.

Despite delivering an overall revenue underspend the Council only succeeded in delivering 72% of the savings it planned for the year. This compared to 78% of planned savings being achieved in the prior year. The main shortfall was in the Environment and Regeneration Department where only 52% of planned savings were delivered. Given the recurrent nature of many of the planned savings the Council needs to improve the rate of savings delivery.

Although not directly relevant to our 2019/20 value for money conclusion responsibilities given its proximity to the end of the year, the emergence of the C-19 pandemic subsequent to the budget being set has fundamentally changed the Council's planned spending and income streams in 2020/21. At the end of month 4 of 2020/21 the Council forecast a full-year overspend of £23.7m which is being driven entirely by the adverse financial impact of C-19. The Council's reporting suggests that the underlying position discounting the impact of C-19 would be a forecast full-year surplus of £3.2m. The impact of C-19 on the Council's ability to deliver its planned programme of savings has been a contributory factor to the forecast level of 2020/21 overspending, and medium-term financial planning will require significant revision in due course as the extent and duration of net cost pressures become clearer. Work is currently ongoing in all service areas to review revenue and capital budgets during 2020 to identify options for delivering efficiency savings and/or income generation, with the aim of setting both a balanced budget in 2021/22 and reducing the overspend in 2020/21.

Value for Money Risks (continued)

What did we find (continued)?

SEND inspection response and DSG recovery planning

Ofsted inspection of the Council's SEND services in September 2019 identified some significant weaknesses, particularly in leadership and partnership working with Clinical Commissioning Groups (CCGs), and related opportunities for improvement.

A key requirement of the SEND reforms is for relevant authorities to work together to develop appropriate education, health and care plans (EHCP). EHCPs are for children and young people aged up to 25 with complex needs who need more support than is available through special educational needs support. EHCPs identify educational, health and social needs and set out the additional support to meet those needs. Elements of SEND generally, and EHCPs specifically, are funded by the DSG. The Council reports that the annual increase in the number of EHCPs significantly exceeds the number of additional special school places the Council is able to create in the borough. This is creating financial pressure and significantly contributing to the cumulative deficit of DSG related costs against available funding. Other adverse variances include £1.2m on EHCP allocations to Merton primary and secondary schools, £2m on EHCP allocations to out of borough maintained primary, secondary and special schools, and £1.1m on one-to-one support, therapies and alternative education. While the EHCP costs do not directly impact the Council's General Fund, the Council is required to produce a recovery plan in respect of the cumulative DSG deficit and the Council has a key role, working with the DfE and other partners, in shaping arrangements to deliver against this.

Although areas of good practice were identified, Ofsted raised a number of adverse findings covering:

- A lack of progress in implementing SEND reforms, including a need for more effective partnership arrangements with NHS commissioners.
- A lack of training for health and social care professionals on the EHCP process.
- Weaknesses in quality assurance arrangements around EHCPs.

Subsequent to the inspection the Council has produced a joint written statement with the South West London Clinical Commissioning Group providing an update on the progress made against each overarching objective and action point raised in the Inspection. Based on a review of relevant documentation the statement is underpinned by a detailed action plan and further supporting arrangements.

The Council also produced an updated DSG recovery plan in January 2020 focusing on actions required to address the funding pressures on the high needs block element of the DSG funding allocation. Specifically:

- Expanding state special school provision.
- Working collaboratively with the Council's state special schools to provide support and encourage inclusive practice, hence reducing specialist placements.
- Improving the consistency of identifying children with Special Educational Needs across borough schools.
- More intervention and support for the age 14-25 cohort.



Value for Money Risks (continued)

What did we find (continued)?

This follows other actions in recent years to control spending:

- 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 the South London Consortium including use of a Dynamic Purchasing System.
- Additional Resourced Provision and Education Health and Care Plan banding allocations have only been inflated once since 2013/14.

Despite this, significant and continuing increases in ECHPs and other qualifying demand for SEN support are driving additional costs and mean that there remains a reliance on relatively expensive independent school provision that cannot be easily addressed in the short term. The Council therefore continues to forecast an increasing cumulative DSG overspend of approximately £65.9m by the end of 2023/24. This deficit was partly integrated into the Council's medium-term financial plans, which assumed that the Council's General Fund meets all the deficits until the end of 2020/21 and 50% of the deficit thereafter, but this remains under further consideration given that it has now been made clear that DSG deficits are not chargeable to the general fund. A further update of the DSG recovery plan and arrangements was planned for the summer but this has been delayed due to the impact of C-19, but it is clear that regular discussions with DfE and other partners have continued.

Based on all of the above we are satisfied that the Council 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.



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 2019/20 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 2019/20 and published with the financial statements was consistent with the audited financial statements.

We have reviewed the latest version of the Annual Governance Statement 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

The Treasury has extended the timetable for the Authority to make its WGA submission and for the auditor's assurance statement. As a result, we have yet to receive the submission.

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 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 have had no reason to exercise these duties.

Other matters

As required by ISA (UK&I) 260 and other ISAs specifying communication requirements, we must tell you significant findings from the audit and other matters if they are significant to your oversight of the Authority's financial reporting process. They include the following:

- Significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures;
- Any significant difficulties encountered during the audit; Any significant matters arising from the audit that were discussed with management;
- Written representations we have requested; Expected modifications to the audit report;
- Any other matters significant to overseeing the financial reporting process; Related parties; External confirmations; Going concern; and
- Consideration of laws and regulations.

We have nothing to report.



07

Assessment of Control Environment



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.



08

Independence

Independence

Confirmation

We confirm there are no changes in our assessment of independence since our confirmation in our audit planning report dated March 2020. We complied with the APB Ethical Standards. 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 your Audit 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 22 September 2020.

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

Page 15 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, senior management and its affiliates, including all services provided by us and our network to your Authority, 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 2019 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 2020 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.

Appendix A

Fees

As part of our reporting on our independence, we set out below a summary of the fees paid for the year ended 31 March 2020. We have included the fees paid by the Authority in engaging us as a reporting accountant on DWP's the housing benefits assurance programme. We have adopted the necessary safeguards in completing this work and complied with Auditor Guidance Note 1 issued by the NAO.

In our Audit Plan and subsequent reporting to the Standards and General Purposes Committee, we have communicated our proposal to increase the scale fee for 2019/20. This proposal is currently being considered by PSAA as part of their national consideration of EY's fee proposals. The table below does not reflect those proposals and includes items where we need to determine the final fee to present to the Director of Corporate Services.

	Final fee 2019/20 (£)	Planned fee 2019/20 (£)	Final Fee 2018/19 (£)
Scale Fee - Code work	110,493	110,493	110,493
Additional work:			
PPE including RICS related material uncertainty	14,250	5,000-15,000	14,560
Change in materiality and clearance of audit queries	-	-	23,500
McCloud query	-	-	850
• VFMC significant risk	6,800	2,000-7,000	-
• Data migration for the new FAR	6,900	1,500-7,500	-
• Going concern assessment and disclosure	2,750	-	-
• EY consultation on auditor's report on the statements involving EY professional practice directorate to ensure the auditor's report is appropriate.	5,600	-	-
Total audit	146,793	118,993-139,993	149,403
Non-audit services:			
Housing Benefits 1819	TBC	TBC	TBC
Housing Benefits 1718 Module X (further work on the 1718 claim)	-	n/a	39,600
Teachers' Pensions	TBC	TBC	9,000
Total other non-audit services	TBC	TBC	TBC
Total fees	TBC	TBC	TBC

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 Standards and General Purposes Committee where the audit fee might compromise perceived independence and the appropriate safeguards.
- A requirement to report to the Standards and General Purposes 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 do not provide any non-audit services which would be prohibited under the new standard.

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://assets.ey.com/content/dam/ey-sites/ey-com/en_uk/about-us/transparency-report-2019/ey-uk-2019-transparency-report.pdf



09 Appendices

Appendix A

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:

		 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.	Audit Plan – March 2020
Planning and audit approach	Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.	Audit Plan – March 2020
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 – November 2020

Appendix A

		Our Reporting to you
Required communications	What is reported?	When and where
Going concern	<p>Events or conditions identified that may cast significant doubt on the entity’s ability to continue as a going concern, including:</p> <ul style="list-style-type: none"> • 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 Merton Council’s ability to continue for the 12 months from the date of our report
Misstatements	<ul style="list-style-type: none"> • 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 – November 2020
Subsequent events	<ul style="list-style-type: none"> • Enquiry of the audit committee where appropriate regarding whether any subsequent events have occurred that might affect the financial statements. 	Audit Results Report – November 2020
Fraud	<ul style="list-style-type: none"> • 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: <ol style="list-style-type: none"> 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 – November 2020

Appendix A

		Our Reporting to you
Required communications	What is reported?	When and where
Related parties	<p>Significant matters arising during the audit in connection with the Authority's related parties including, when applicable:</p> <ul style="list-style-type: none"> • 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 - November 2020
Independence	<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>Communications whenever significant judgments are made about threats to objectivity and independence and the appropriateness of safeguards put in place.</p> <p>For public interest entities and listed companies, communication of minimum requirements as detailed in the FRC Revised Ethical Standard 2019:</p> <ul style="list-style-type: none"> • 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 2020 and Audit Results Report - November 2020

Appendix A

		Our Reporting to you
Required communications	What is reported?	When and where
	<ul style="list-style-type: none"> • 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 	
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. 	We have received all requested confirmations
Consideration of laws and regulations	<ul style="list-style-type: none"> • 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 and that the audit committee may be aware of 	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	<ul style="list-style-type: none"> • Significant deficiencies in internal controls identified during the audit. 	Audit Results Report – November 2020

Appendix A

		 Our Reporting to you
Required communications	 What is reported?	  When and where
Written representations we are requesting from management and/or those charged with governance	<ul style="list-style-type: none"> Written representations we are requesting from management and/or those charged with governance 	Audit Results Report – November 2020
Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	<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 – November 2020
Auditors report	<ul style="list-style-type: none"> Any circumstances identified that affect the form and content of our auditor’s report 	Audit Results Report – November 2020
Fee Reporting	<ul style="list-style-type: none"> Breakdown of fee information when the audit planning report is agreed Breakdown of fee information at the completion of the audit Any non-audit work 	Audit Plan – March 2020 and Audit Results Report – November 2020

Page 58

Management representation letter – Illustrative draft

Management Rep Letter

[To be prepared on the entity's letterhead]

Date

Suresh Patel

Associate Partner

Ernst & Young LLP

This letter of representations is provided in connection with your audit of the financial statements of the London Borough of Merton (“the Group and Council”) for the year ended 31 March 2020. We recognize 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 financial statements give a true and fair view of the financial position of the London Borough of Merton as of 31 March 2020 and of its income and expenditure and its cash flows for the year then ended in accordance with CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2019/20.

We understand that the purpose of your audit of our 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 the Accounts and Audit Regulations 2015 and CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2019/20.

2. We acknowledge, as members of management of the Group and Council, our responsibility for the fair presentation of the financial statements. We believe the 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 Council in accordance with the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2019/20, and are free of material misstatements, including omissions. We have approved the financial statements.

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

4. As members of management of the Group and Council, we believe that the Group and Council has a system of internal controls adequate to enable the preparation of accurate financial statements in accordance with CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2019/20 that are free from material misstatement, whether due to fraud or error. We have disclosed to you any significant changes in our processes, controls, policies and procedures that we have made to address the effects of the COVID-19 pandemic on our system of internal controls.

5. We believe that the effects of any unadjusted audit differences, summarised in the accompanying schedule, 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 council financial statements taken as a whole. We have not corrected these differences identified and brought to our attention by the auditor because [specify reasons for not correcting misstatement].

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

1. We acknowledge that we are responsible to determine that the Group and Council's business activities are conducted in accordance with laws and regulations and that we are responsible to identify and address any non-compliance with applicable laws or 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 financial statements may be materially misstated as a result of fraud.

Management Rep Letter

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

- Involving financial improprieties
- Related to laws or regulations that have a direct effect on the determination of material amounts and disclosures in the Group and Council’s financial statements
- Related to laws or 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 and Council’s business, its ability to continue in business, or to avoid material penalties
- Involving management, or employees who have significant roles in internal control, or others

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 financial statements, including those related to the COVID-19 pandemic.

3. We have made available to you all minutes of the meetings of Group and Council and the Standards and General Purposes Committee held through the 1 April 2019 to the most recent meeting on the following date: 22 September 2020.

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 Council’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 period ended, as well as related balances due to or from such parties at the 31 March 2020 end. These transactions have been appropriately accounted for and disclosed in the 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 Council has complied with, all aspects of contractual agreements that could have a material effect on the financial statements in the event of non-compliance, including all covenants, conditions or other requirements of all outstanding debt.

7. From 1 April 2019 through the date of this letter we have disclosed to you any unauthorized access to our information technology systems that either occurred or to the best of our knowledge is reasonably likely to have occurred based on our investigation, including of reports submitted to us by third parties (including regulatory agencies, law enforcement agencies and security consultants), to the extent that such unauthorized access to our information technology systems is reasonably likely to have a material impact to the financial statements, in each case or in the aggregate.

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 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 to litigation and claims, both actual and contingent, and have disclosed in Note [X] to the financial statements all guarantees that we have given to third parties.

Management Rep Letter

E. Subsequent Events

1. There have been no events, including events related to the COVID-19 pandemic, subsequent to period end which require adjustment of or disclosure in the financial statements or notes thereto.

F. Other information

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

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

G. Going Concern

1. Note [X] to the financial statements discloses all the matters of which we are aware that are relevant to the Group and Council's ability to continue as a going concern, including significant conditions and events, our plans for future action, and the feasibility of those plans.

H. Estimates

When we have identified following estimates as significant or higher risk:

- i. Pension Liability
- ii. Property, Plant & Equipment / Investment Properties – Valuation and Impairment
- iii. Provision for impairment of receivables
- iv. NDR Appeals Provision

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 CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2019/20.

2. We confirm that the significant assumptions used in making the accounting estimates appropriately reflect our intent and ability to carry out the operations on behalf of the Group and Council.

3. We confirm that the disclosures made in the financial statements with respect to the accounting estimates are complete, including the effects of the COVID-19 pandemic on 31 March 2020 and made in accordance with CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2019/20.

4. We confirm that no adjustments are required to the accounting estimates and disclosures in the financial statements due to subsequent events, including due to the COVID-19 pandemic.

I. 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.

J. 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 Council, subsidiary undertakings and associated undertakings.

Yours faithfully,

Director of Corporate Services (Chief Financial Officer)

Chair of the Standards and General Purposes Committee

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

© 2020 EYGM Limited.
All Rights Reserved.

ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.