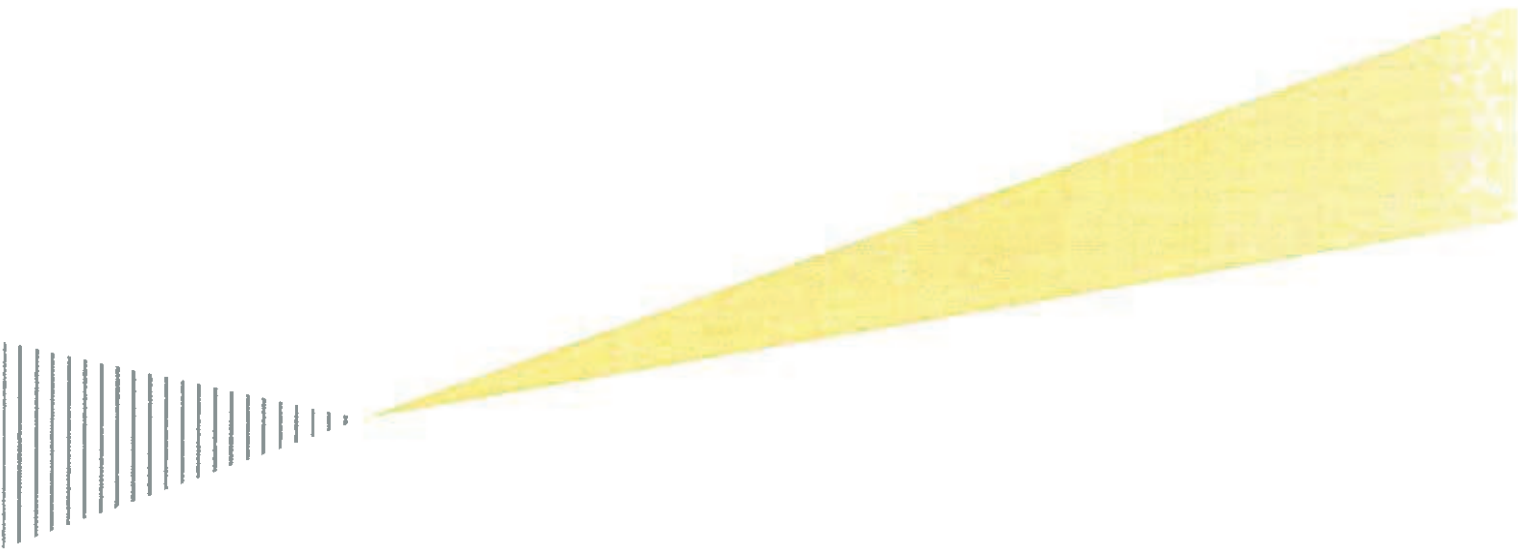


Merton Council Annual Audit Letter

Year ending 31 March 2013

October 2013

Ernst & Young LLP



Private and confidential
Members of Merton Council
Merton Civic Centre
London Road
Morden
SM4 5DX

4 October 2013

Dear Members,

Annual Audit Letter

The purpose of this Annual Audit Letter is to communicate to the Members of Merton Council and external stakeholders, including members of the public, the key issues arising from our work which we consider should be brought to their attention.

We have already reported the detailed findings from our audit work to those charged with the governance of Merton Council in the following reports:

2012/13 Audit results report for Merton Council Issued 18 September 2013

2012/13 Audit results report for Merton Pension Fund Issued 18 September 2013

The matters reported here are the most significant for the Council.

I would like to take this opportunity to thank the officers of Merton Council for their friendliness, cooperation and assistance during the course of our work.

Yours faithfully



David Wilkinson
For and behalf of Ernst & Young LLP
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In March 2010 the Audit Commission issued a revised version of the 'Statement of responsibilities of auditors and audited bodies' ('Statement of responsibilities'). It is available from the Chief Executive of each audited body and via the [Audit Commission's website](#).

The Statement of responsibilities serves as the formal terms of engagement between the Audit Commission's 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 Standing Guidance serves as our terms of appointment as auditors appointed by the Audit Commission. The Standing Guidance sets out additional requirements that auditors must comply with, over and above those set out in the Code of Audit Practice 2010 (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

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

1. Executive summary

Our 2012/13 audit work has been undertaken in accordance with the Council Audit Plan issued on 4 March 2013 and the Pension Fund Audit Plan issued on 12 April 2013. Our work was conducted in accordance with the Audit Commission's Code of Audit Practice, International Standards on Auditing (UK and Ireland) and other guidance issued by the Audit Commission.

The Authority is responsible for preparing and publishing its Statement of Accounts, accompanied by the Annual Governance Statement, in which it reports publicly on the extent to which it complies with its own code of governance. This includes how it has monitored and evaluated the effectiveness of its governance arrangements in the year, and on any planned changes in the coming period. It is also responsible for having proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

As auditors we are responsible for:

- ▶ forming an opinion on the financial statements;
- ▶ reviewing the Annual Governance Statement;
- ▶ forming a conclusion on the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources; and
- ▶ undertaking any other work specified by the Audit Commission.

Summarised below are the conclusions from all elements of our work:

Audit the financial statements of Merton Council and its Pension Fund for the financial year ended 31 March 2013 in accordance with International Standards on Auditing (UK & Ireland)	On 27 September 2013 we issued an unqualified audit opinion for the Council.
	On 27 September 2013 we issued an unqualified audit opinion for the Pension Fund.
Form a conclusion on the arrangements the Authority has made for securing economy, efficiency and effectiveness in its use of resources.	On 27 September 2013 we issued an unqualified value for money conclusion.
Issue a report to those charged with the governance of the Authority (the Audit Committee) communicating significant findings from our audit.	On 18 September 2013 we issued our report for the Authority.
	On 18 September 2013 we issued our report for the Pension Fund.
Report to the National Audit Office on the accuracy of the consolidation pack the Authority is required to prepare for the Whole of Government Accounts.	We reported our findings to the National Audit Office on 27 September 2013.
Consider the completeness of disclosures in the Annual Governance Statement, identify any inconsistencies with other information of which we are aware from our work, and consider whether it complies with CIPFA / SOLACE guidance.	No issues to report.

Consider whether, in the public interest, we should make a report on any matter coming to our notice during the audit.

No issues to report.

Determine whether any other action should be taken in relation to our responsibilities under the Audit Commission Act.

No issues to report.

Issue a certificate that we have completed the audit in accordance with the requirements of the Audit Commission Act 1998 and the Code of Practice issued by the Audit Commission.

On 27 September 2013 we issued our audit completion certificate.

Issue a report to those charged with the governance of the Authority summarising our certification (grant claims and returns) work.

We will issue our annual certification report for 2012/13 to those charged with governance in December 2013 on completion of the housing and council tax subsidy claim.

2. Key findings

2.1 Financial statement audit

We audited the Authority's Statement of Accounts in line with the Audit Commission's Code of Audit Practice, International Standards on Auditing (UK and Ireland) and other guidance issued by the Audit Commission. We issued an unqualified audit report on 27 September 2013.

In our view, the quality of the process for producing the accounts, including the supporting working papers was good. We have held very constructive discussions with the Finance team to secure further improvements in the quality of working papers and arrangements for managing the audit process for the 2013/14 audit.

The main issues identified as part of our audit were:

Significant risk 1: Property, plant and equipment

- ▶ Errors in PPE valuation can lead to material misstatements. The valuation of PPE is a specialist area requiring complex estimation techniques. It is also highly material to the financial statements. We are aware of some areas for improvement identified in the 2010/11 audit with the Council's valuation process and documentation procedures.

Findings

- ▶ The Council carried out a prior period adjustment to account for investment properties not previously identified of £4.4million, and additional finance leases for properties of £3.97million. We reviewed and agreed these adjustments.
-

Significant risk 2: Pension Fund liability

- ▶ Errors on pension fund valuations can lead to material misstatement. Pension fund valuation is highly material to the financial statements. During the inter-valuation period the funding level fell from 91% as at March 2007 to 84% at the last valuation date of 2010, resulting in a deficit of £67 million. The Pension Fund deficit, on an IAS19 basis, rose from £103 million to £190 million.

Findings

- ▶ Our review of the Council's pension liability did not identify any issues. The above position reflected the economic conditions in 2010; the Fund's next actuarial valuation will be based on the position in April 2013.
-

Significant risk 3: Private Finance Initiative (PFI) schemes

- ▶ The London Borough has a net book value of £63.7 million of PFI assets disclosed in its accounts as at 31 March 2012. It also has a range of liabilities associated with its PFI schemes. These amounts are material and are based on a number of important assumptions. Small changes in these assumptions can lead to material changes in the values disclosed.

Findings

- ▶ The Council needed to remove Bishopsford School from its property, plant and equipment assets following the school becoming an academy during 2012/13, an adjustment of £11.74 million.
-

Other key findings:

Transfer of a PFI school to academy status

- ▶ Bishopsford School which is a PFI scheme school will become an academy during 2012/13. The transfer will require expert advice in order to agree valuation and accounting treatments.

Findings

- ▶ The financial statements presented for audit included Bishopsford School as an asset within property, plant and equipment in the balance sheet. We questioned this accounting treatment and

the Council subsequently removed the school from the balance sheet. The adjustment was £11.74 million, and we were content with the revised accounting treatment in the core financial statements and notes to the accounts.

Classification of revenue and capital expenditure

- ▶ The Council has undertaken a review of the appropriateness of the classification of its capital and revenue expenditure and identified some errors and scope for improved awareness in this area.

Findings

- ▶ Our review identified £0.66million of expenditure funded by Transport for London incorrectly treated as revenue expenditure charged to capital when it was merely revenue expenditure. The Council adjusted the notes to the financial statements to reflect this. There was no effect on the expenditure disclosed in the income and expenditure statement.

Overprovision for non-domestic rates and council tax bad and doubtful debts

The Council over-provided for bad debt provisions in 2012/13 by £2 million on non-domestic rates (NDR) and £1.2million on council tax. The Council adjusted for council tax in the revised financial statements. Given the uncertainty of the new non-domestic rating regime and the lack of clarity in accounting guidance, no NDR adjustment is planned until 2013/14 when the position on collection rates and bad debts will become clearer.

The Council set out its position in its letter of representation and we accepted this approach. We will review the outturn position as part of our 2013/14 audit work.

2.2 Value for money conclusion

We are required to carry out enough work to conclude whether the Authority has proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

In accordance with guidance issued by the Audit Commission, in 2012/13 our conclusion was based on two criteria:

- ▶ The organisation has proper arrangements for securing financial resilience; and
- ▶ It has proper arrangements for challenging how it secures economy, efficiency and effectiveness.

We issued an unqualified value for money conclusion on 27 September 2013.

We noted the following improvement areas that the Council is addressing in 2013/14:

- ▶ Keep core budgets under review and ensure there is a process of internal challenge as part of budget setting that challenges assumptions and supports robust revised in-year forecasting
- ▶ Ensure in-year review of budgets identifies early changes that are reported to management and those charged with governance
- ▶ Re-profile the capital programme in the light of consistent slippage on individual schemes and build realistic expectations into the medium term financial strategy and other shorter-term spending plans.

2.3 Objections received

We received no objections to the 2012/13 accounts from members of the public.

We considered, and responded to, questions raised by one member of the public during 2012/13.

2.4 Whole of government accounts

The Authority is required to prepare a consolidation pack for the whole of government accounts. On 27 September 2013 we reported to the National Audit office the results of our work on its accuracy and identified no issues.

2.5 Annual governance statement

We are required to consider the completeness of disclosures in the Authority's Annual Governance Statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it complies with CIPFA/SOLACE guidance. We completed this work and did not identify any areas of concern.

2.6 Certification of grants claims and returns

We will present our Annual Certification Report for 2012/13 to those charged with governance. We are required to certify three claims and returns with a combined value in excess of £200million. We certified the Council's National Non-Domestic Rates Return on 25 September 2013; there were no issues arising. We will issue the Annual Certification Report for 2012/13 in December 2013 as our work on the housing and council tax benefit subsidy claim is due for completion in late November.

3. Control themes and observations

As part of our audit of the financial statements, we obtained sufficient understanding of internal control to plan our audit and determine the nature, timing and extent of testing. Although our audit was not designed to express an opinion on the effectiveness of internal control, we communicated significant deficiencies to those charged with governance at the Authority as required.

The matters reported are shown below and are limited to those we identified during the audit and that we concluded are important enough to report.

Description	Impact
<p>Our work identified that, due to the large number of financial systems currently operated by the Council, monthly or quarterly reconciliations between many of the Council's main financial systems are not carried out.</p> <p>These include accounts receivable, accounts payable, Carefirst and a full reconciliation of bank and cash to the general ledger. These are reconciled instead at the financial year end only.</p>	<p>Problems with reconciliations place additional pressure on the financial closedown process. The Council's Finance team are carrying out monthly reconciliations and formal quarterly reviews of major financial systems in 2013/14.</p> <p>A more integrated suite of financial systems would reduce the number of reconciliations required.</p>
<p>There is a complex reconciliation required from the Cabinet Report on budget to outturn to the Note 29 subjective analysis in the financial statements.</p>	<p>The reconciliation of the financial position shown in the financial statements to Cabinet reports is not straightforward. The Council should develop the presentation of reports to make clearer the financial movements from internal reporting to that disclosed in the Financial Statements (Income and Expenditure Statement and Note 29) and review presentation of service analysis.</p>
<p>We identified errors in bank reconciliations in six of 17 school bank reconciliations sampled.</p>	<p>Refresher training is required for those who prepare and review the school bank reconciliations to ensure accurate reconciliations.</p>
<p>We were unable to place reliance on the controls operating in your payroll system. This was due to issues identified by Internal Audit in a review of the implementation of the new payroll system introduced in April 2012.</p>	<p>We carried out a programme of substantive testing to obtain assurance over the disclosure of payroll costs in your financial statements. There were no issues arising from our work.</p>

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Ernst & Young LLP, 1 More London Place, London, SE1 2AF

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