London Borough of Merton

Audit results report

Year ended 31 March 2018

30 October 2018

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EY

Building a better working world

30 October 2018

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 Merton Council's statement of accounts for 2017/18 further to the progress reports we have issued to you on 25 July and 28 August 2018.

We have substantially completed our audit of the Council's accounts for the year ended 31 March 2018. Subject to concluding the outstanding matters listed in our report, we confirm that we expect to issue an unqualified audit opinion on the statement of accounts in the form at Section 3. We also have no matters to report on your arrangements to secure economy, efficiency and effectiveness in your use of resources.

As explained in our progress report of 25 July it was not possible to conclude our work and issue our report by the statutory deadline of 31 July 2018. We include details in this report of the significant issues we identified during the audit and summarise some significant changes to the Council's accounts, particular in relation to property, plant and equipment (PPE). None of the PPE issues impact on the Council's level of general fund balances. We have made 3 recommendations for the Council to improve its arrangements for determining the valuation of its PPE and for preparing its accounts and have obtained management response. We also include in Section 9, the proposed additional fees associated with the additional work we have been required to undertake to complete the audit. This report is intended solely for the use of the Standards and General Purposes Committee, other members of the Council, and senior management. It should not be used for any other purpose or given to any other party without obtaining our written consent.

We would like to thank your staff for their help during the engagement. We welcome the opportunity to discuss the contents of this report with you at the Standards and General Purposes Committee meeting on 8 November 2018.

Yours faithfully

Associate Partner,

For and on behalf of Ernst & Young LLP

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In April 2015 Public Sector Audit Appointments Ltd (PSAA) issued “Statement of responsibilities of auditors and audited bodies”. It is available from the via the PSAA website (www.PSAA.co.uk).
The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.
The “Terms of Appointment (updated February 2017)” issued by the PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and in legislation, and covers matters of practice and procedure which are of a recurring nature.
This report is made solely to the Standards and General Purposes Committee of the London Borough of Merton in accordance with the statement of responsibilities. Our work has been undertaken so that we might state to the Standards and General Purposes Committee, and management of the London Borough of Merton those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the Standards and General Purposes Committee, and management of the London Borough of Merton for this report or for the opinions we have formed. It should not be provided to any third-party without our prior written consent.

01 Executive Summary

Executive Summary

Scope update

In our Audit Plan presented to the 15 March Standards and General Purposes Committee (the Committee) meeting, we provided you with an overview of our audit scope and approach for the audit of the Council's statement of accounts. We then communicated a number of changes in the scope of our audit in our Year-End Progress Report presented to the 30 July 2018 meeting. For completion we repeat the original scope and the changes we made:

- We revisited the significant risk we reported in respect of management override of controls. We determined that our specific response does not need to address as an element of the significant risk the following areas as we do not consider they present a risk of material fraud:
  - Changes made to accounting policies.
  - The completeness and valuation of provisions
  - Inappropriate capitalisation of expenditure.

  We still undertook procedures on these aspects of the Council's accounts but not as part of responding to the significant risk relating to management override of controls. This reduces our work in these areas by a small amount and negates the need for specific reporting on completion. Our response to the significant risk of management overriding controls still included testing the appropriateness of journal entries, reviewing accounting estimates and evaluating the business rationale for significant unusual transactions. We also undertook work on the Council's approach to calculating its minimum revenue provision which we considered relevant to the risk of management override of controls and have therefore undertook appropriate procedures to respond to the risk of fraud. We consider this further in Section 2 of this report.

  Given the scale of errors detected relating to the valuation of property, plant and equipment (PPE), which are set out in more detail in Sections 2 and 4 of this report, we revised our audit approach to consider the valuation of PPE, and land and buildings specifically, to be a significant risk. We also involved our own expert, EY Real Estate (EYRE), in light of our initial findings to ensure we gained sufficient and appropriate audit assurance.
- In our Audit Plan we identified the earlier accounts deadline and preparation of group accounts in 2017/18 as an inherent risk impacting on the audit of the financial statements. Although these issues clearly created business and delivery risks for the Council we have revised our approach to be clear that they do not generate risks at the financial statements level.
- We communicated that our audit procedures would be performed using a materiality of £10.6m. We updated this assessment using the draft financial statements and we also reconsidered our risk assessment. Based on our materiality measure of gross expenditure on net cost of services we have updated our overall materiality assessment to £11.2m for the single entity financial statements and £11.4m for the group. In the Audit Plan we also informed you that we had set performance materiality at 75% of overall materiality on the basis that at that stage we did not expect to identify material misstatements in the accounts. We set our performance materiality at an appropriately low level to reduce the probability that the aggregate of any uncorrected and undetected misstatements in the financial statements exceeds materiality for the financial statements as a whole. In light of the errors identified across a number of aspects of the accounts, but particularly in relation to the valuation of PPE, we revisited the determination of performance materiality and reduced it to 50% of overall materiality. This reduced performance materiality from the initial £8.4m to £5.6m for the single entity financial statements and from £8.5m to £5.7m for the group. As a consequence we needed to revisit the initial testing performed at the execution phase of the audit, increase sample sizes where required and undertake audit procedures on balances previously below the initial performance materiality.

Executive Summary

Scope update (contd)

- Our Audit Plan included as a significant risk the risk of fraud in recognising revenue relating to CHAS Ltd. Although 2017/18 outturn CHAS revenue is above our performance materiality level for the group and we believe there is a risk of fraud in revenue recognition relating to CHAS revenue, we consider it highly unlikely that any misstatement could exceed performance materiality, so that risk is not material to the group audit. Outturn CHAS revenue is also below our overall materiality level for the group audit of £11.4 m. We therefore concluded there is no significant risk of material misstatement. Although it will remain subject to some testing this reduced the level of testing required of CHAS revenue.
- We had also determined that CHAS Ltd was a significant component in the group financial statements due to its risks and financial size. We would like to clarify that CHAS Ltd is a significant component to the 2017/18 financial statements based on risk only. We determined our approach should be to apply a specific scope to our work on CHAS Ltd based on the nature of the transactions between the Council and the company.

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

Status of the audit

We have substantially completed our audit of Merton Council's statement of accounts for the year ended 31 March 2018 and have performed the procedures outlined in our Audit Plan and updated further during the course of the audit. Subject to satisfactory completion of the following outstanding items we expect to issue an unqualified opinion on the Council's statement of accounts in the form which appears at Section 4. However until work is complete, further amendments may arise:

- Receipt of one outstanding bank confirmation for a school balance
- Final agreement of all amendments made to the revised financial statements
- Final agreement of group consolidation
- Final completion of internal file review and any work to address points raised
- Completion of subsequent events review
- Receipt of the signed management representation letter
- Full completion of procedures required by the National Audit Office (NAO) regarding the Whole of Government Accounts submission.

We expect to issue the audit certificate at the same time as the audit opinion.

Executive Summary

Audit differences

Our audit of the Council's accounts had resulted in management making significant adjustments to the accounts:

- Significant changes have been made to the carrying value of property, plant and equipment in the financial statements in the current and comparative years as a result of our work. At the end of 2017/18 the total net book value of PPE increased by approximately £163 million from £561 million to £724 million as a result of the adjustments made.
- Service level income and expenditure in Comprehensive Income and Expenditure Statement (CIES) was grossed up by approximately £31.5 million for inter-departmental recharges. Service level income and expenditure in the Group CIES was grossed up by a further £10 million. These errors were highlighted by management early in the audit process but should have been detected as part of closedown.
- IAS 19 entries in the financial statements were originally based on an inaccurate IAS 19 report resulting in overstatement of the Council's pension liability and understatements of the pensions reserve by approximately £6.7 million. This error was again identified by management but should have been fully corrected prior to the draft financial statements being produced.

The Council has made all the above significant adjustments in the revised accounts. We include specific details in Section 4 Audit Differences. There were also a relatively large number of lower value and disclosure adjustments made as a result of our work which have also been corrected in the revised accounts.

We identified two unadjusted audit differences in the draft statement of accounts which management has chosen not to adjust. We ask that they be corrected or a rationale as to why they are not corrected be approved by the Standards and General Purposes Committee and included in the Letter of Representation. The value of the unadjusted audit differences is £3.7 million. We agree with management's assessment that the impact is not material.

Areas of audit focus

Our Audit Plan and Scope Update section of this report identified key areas of focus for our audit of Council's statement of accounts. This report sets out our observations and conclusions, including our views on areas which might be conservative, and where there is potential risk and exposure. We summarise our consideration of these matters, and any others identified, in the "Key Audit Issues" 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
- You agree with the resolution of the issue
- 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 the attention of the Standards and General Purposes Committee.

Executive Summary

Control observations

We have adopted a fully substantive approach, so have not tested the operation of controls. Through undertaking the audit we have not identified a significant deficiency in the design or operation of an internal control that might result in a material misstatement in your statement of accounts and which is unknown to you. However, we have identified, and report further in Sections 2 & 7, deficiencies in the arrangements the Council has in place to ensure the valuation of its PPE is reflected materially correctly in its accounts.
As part of our work we have, however, identified some weaknesses in the Council's control environment whish we wish to draw to your attention. These are set out in more detail in Section 7 together with management comments on our observations.

Value for money

We have considered your arrangements to take informed decisions; deploy resources in a sustainable manner; and work with partners and other third parties. In our Audit Plan we identified one significant risk around the challenging financial outlook the Council continues to face and the impact of this on its arrangements to deploy resources in a sustainable manner. Our detailed work and conclusions in relation to this are set out in Section 5.

We also received correspondence from a member of the public asking us to investigate the Council in relation to its actions to secure a site for a new secondary school. We considered the correspondence against our responsibilities as external auditor and determined that there were matters raised that were relevant to our value for money conclusion. We undertook additional work to gain assurance in relation to those matters and concluded that the approach taken by the Council was not unreasonable.

We have no matters to report about your arrangements to secure economy efficiency and effectiveness in your use of resources.

Other reporting issues

We have reviewed the information presented in the Annual Governance Statement for consistency with our knowledge of the Council. An amendment was made to the Statement as a result of our work to include issues relating to the valuation of PPE detected as a result of our work and the Council's plan to address them. We have no other matters to report as a result of this work.

As at 30 October 2018 delivery of the procedures required by the National Audit Office (NAO) on the Whole of Government Accounts submission remains ongoing. Some amendments will be made to the consolidation template produced by the Council as a result of our work.

We have also concluded there is scope to improve the Council's arrangements to closedown its financial ledger, produce materially correct draft financial statements and support those financial statements with adequate working papers and included an associated recommendation as part of this report.

Independence

Please refer to Section 10 for our update on Independence where we conclude that there are no matters to report.

Executive Summary

Recommendations and management responses

We have made three recommendations to management relating to the findings to the audit of the accounts. Management have provided a response to each.

Recommendation 1

Consider the adequacy of the arrangements put in place to derive materially accurate fair values for PPE in advance of the closedown process for the 2018/19 statement of accounts.

Recommendation 2

Improve the process of supervision and review over the calculations, assumptions and judgements underpinning the valuation of PPE.

Management response to recommendations 1 & 2

We will be conducting an extensive post closure review, in line with previous years, once the Accounts are signed off. This will major on a route and branch review of our valuation processes and will introduce a greater degree of supervision together with sample testing to ensure accurate reporting is this important area. We will also consider the need to bring in some external validation of the process, particularly for the 2018/19 accounts..

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Recommendation 3

Improve arrangements to closedown the financial ledger, produce materially correct draft financial statements and support those financial statements with adequate working papers.

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Management response to recommendation 3

The Council will undertake an extensive review of the closure process both internally and with EY, in line with previous years. This will include a commitment to:

- An even greater focus on upstream work that can be undertaken prior to the commencement of the audit.
- Where practical, to build up greater resilience in our closure team.
- Improving protocols and continuity plans for operating the EY portal which proved to be problematic at key times during the audit.
- The recognition that both sides need to improve communications and importantly the logging of key decisions and discussions throughout the audit process.
- Improving closure task lists and robust signoff processes.
- Closer liaison and scrutiny of the valuation process by managers within Environment and Regeneration and Corporate Services.

02 Areas of Audit Focus

Significant risk – Misstatements due to fraud or error

What is the risk?

As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.

Significant Risk

Minimum Revenue Provision (MRP)
The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 require the Council to make a prudent annual provision for the repayment of borrowing. This is known as the Minimum Revenue Provision (MRP).
MRP is a real charge that impacts on the general fund and therefore the council tax financing requirement. From 2017/18 the Council has decided to make changes to its future approach to calculating MRP.
Given the real impact of the charge on the reported financial position and performance of the Council we consider this change in approach to be relevant to the risk of management override.

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What did we do?

In response to the identified risk we:

- Tested the appropriateness of journal entries recorded in the general ledger and other adjustments made in preparing the financial statements;
- Reviewed accounting estimates for evidence of management bias; and
- Evaluated the business rationale for any significant unusual transactions.

Minimum Revenue Provision (MRP)

We commissioned an EY expert to review the changes made by the Council in this area. Our approach focused on:

- Considering the prudence of the revised policy and approach.
- Assessing the accuracy of the calculation of the revised charge.
- Ensuring transparent disclosures are included in the financial statements to explain the change in policy.

We utilised our data analytics capabilities to assist with our work, including carrying out journal entry testing.

Significant risk – Misstatements due to fraud or error

Our conclusions

We have not identified any evidence of material management override. We have not identified any instances of inappropriate judgements being applied. We did not identify any other transactions during our audit which appeared unusual or outside the Council's normal course of business.

Minimum Revenue Provision (MRP)

Based on our consideration of the work undertaken by the EY Expert and the audit team's procedures on MRP we are satisfied that:

- The revised MRP charged for the current and previous years has been calculated correctly, is in accordance with extant regulations and is consistent with the planned approach reported to members and approved by the Council. The approach taken is not unusual, and a number of other councils have sought to alleviate short to medium financial pressures by re-profiling MRP.

- The paper describing the approach that was presented to members was clear, particularly in noting that the approach is a deferral of revenue costs rather than recurrent saving and that the overall charge over the revised 50 year repayment period will be greater.

- A prudent approach has been taken by the Council. Under the Council's previous policy, although allowable under the regulations, the amount outstanding would never have been fully paid down whereas under the new policy full repayment will occur over a 50 year period. The new policy relates to pre-2008 and subsequent supported borrowing only, and there has been no backdating of the policy.

The Council's MRP charge is based, in part, on its Capital Financing Requirement (CFR). When our work on this area was undertaken by our specialist at the interim stage of the audit we recommended to the Council that it should undertake a three-way reconciliation between its CFR calculated by reference to its balance sheet, to the CFR note in its Statement of Accounts and then to the items on which MRP is calculated. The work of our specialist to undertake this reconciliation at the interim stage of the audit identified a small difference that was not material to our responsibilities. The reconciliation was re-performed at year end. The difference between MRP calculated by reference to its balance sheet and MRP based on the items on which MRP is calculated is trivial. We are also satisfied that MRP reported in the financial statements and actually charged during the year is based on the higher amount.

Significant risk – Valuation of Land and Buildings

What is the risk?

Valuation of Land and Buildings

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

We originally considered the risk of materially inaccurate valuation of Council land and buildings to be an area of audit focus rather than significant risk in our Audit Plan. Given the scale of errors detected by our initial testing relating to the valuation of land and buildings we revised our audit approach and concluded that the valuation of land and buildings was a significant risk. In particular given the different methods applied, assumptions used and judgements made by the Council when determining the value of assets at depreciated replacement cost (DRC) and existing use value (EUV). We have been required to design special audit procedures to obtain sufficient assurance that the accounting disclosures are materially correct.

Significant Risk

What did we do and what did we find?

Our approach to the audit of the property, plant and equipment (PPE) balance appearing in the Council's 2017/18 financial statements included detailed testing of a sample of specialised land and building assets carried at depreciated replacement cost (DRC), the bulk of which are local authority controlled schools. Our approach was to agree key data used in the valuation to supporting evidence, including publically available market data and other third-party information sources, and challenge key assumptions made by the Council's valuer in determining the carrying value of assets at the balance sheet date. The composition by net book value (£) of the Council's total PPE balance disclosed in its draft financial statements split by valuation basis as is set out below:

		Net book value **31/03/2018** **£**
EUV	Existing Use Value	98,519,720.46
DRC	Depreciated replacement cost	321,965,740.38
	Others	147,118,271.92
		567,603,732.76

Our work to test land and buildings assets valued identified a number of errors and other inaccuracies in the valuation process which are summarised in the table over-page.

Significant risk – Valuation of Land and Buildings

What did we do and what did we find? (Contd)	
Issue	**Finding and resulting actions by Management**
Building Cost Information Service (BCIS) rebuild cost per square metre.	BCIS cost had been incorrectly indexed backwards when this was not required to derive the value of specialised assets (e.g. schools) at the balance sheet date. There were further arithmetic errors in the calculation of indexation. Values have been updated using a current index and we have audited both the revised approach and resulting restatement. Correction of the error has resulted in the carrying value of assets at the balance sheet date increasing by approximately £31.5 million.
Asset lives and calculation of depreciation factor.	The asset life to date used in the calculation of the depreciation factor applied to the valuations had been incorrectly determined resulting in an error in the calculation. There was also inconsistency in the assumptions made on the assumed total and residual useful life of buildings. The valuer and management re-considered their approach in light of our challenge. Errors in life to date were corrected and target and residual life assumptions were amended to ensure they were both reasonable and consistently applied. The changes to the Council's approach resulted in the carrying value of assets at the balance sheet date reducing by approximately £30 million.
Valuation of built on land	There was no consistency on the assumed valuation rates per acre for built on land. The source data was not fully specified in all cases. The Council had applied a value which has been derived from property valuation consultants who were commissioned to provide market values in 2006. The values were subsequently indexed up each year to the balance sheet date. The indexed land values at the balance sheet date were close to current industrial land values for South West London based on available market data. Based on current guidance on the valuation of schools, we challenged on the basis that a residential value would be more appropriate and noted that the indexed valuation was significantly below current residential values for South West London based on available market data. We also identified arithmetic errors in the indexation calculation. The valuer and management accepted that current residential values should be used. The Council commissioned the District Valuer as a management expert to provide current residential values for six geographic sub-divisions of the Borough at the balance sheet date for each of the last three accounting periods. Application of these land values increased the carrying value of affected assets at the balance sheet date by approximately £161 million.

The above adjustments impact the balance sheet valuation of land and buildings with the opposite entry being largely the revaluation reserve (part of unusable reserves).

Significant risk – Valuation of Land and Buildings

What did we do and what did we find? (Contd)

As part of our work we engaged our own experts, EY Real Estates (EYRE), in the assessment and challenge of key judgements made by the Council's valuer in determining DRC valuations – for example the reasonableness of the valuation basis (industrial vs residential) for built on land for schools, and the reasonableness of target and residual lives used in the calculation of DRC.

Given the significant and pervasive errors detected in DRC valuations we also commissioned EYRE to consider the approach taken by the Council to the valuation of non-specialised PPE carried at existing use value (EUV). This work was undertaken through a detailed review of the valuation of a sample of assets carried at EUV and resulted in a detailed report being produced by EYRE for the audit team. We directed EYRE to concentrate on assets carried at EUV given there is also a high degree of subjectivity and judgement that needs to be applied by the valuer under this approach, particularly around assumptions made on yield rates used to capitalise income used to inform the valuation. This is different to the remaining PPE where assets are not valued at either DRC or EUV and are either short-life or otherwise valued at depreciated historic cost or nominal value, with far less subjectivity and judgement applied in the valuation approach.

The results of the EYRE work highlighted some values that were considered to be outside of a reasonable range, although the magnitude of error was far smaller than for assets carried at DRC. We include the table below to show the assets which were outside of the range, our challenge to management and the outcome. The Council has made further amendments to the financial statements in light of the findings and further work has been undertaken by the audit team to gain assurance that the potential wider impact of the findings was not material.

Asset tested	Management valuation £	EY range £	EY challenge	Outcome
A	1,498k	1,670 – 2,040k	The valuation disregards the hire income for the first 9 months of the cash flow	Agreed - Management have revised the valuation to £1,894k
B	1,547k	2,480 -3,500k	Management have an unsupported assumption related to the net Income used for 2017-18 and could use more recent information on car parking income	Agreed - Management have revised the valuation to £2,807k
C	8,500k	6,000 – 7,330k	Should the void period be greater than management's 12 months?	No change - We accept management's assertion that they have yet to try and let the property so the void period is sufficient.
D	71k	115-165k	Assumptions on ground rent are too low having regard to the current market.	No change - We accept management's assertion that the ground rent charge is prescribed by the lease.
E	224k	330-580k		

Significant risk – Valuation of Land and Buildings

Conclusions and way forward

In determining the adjustments required to the financial statements as a result of the identified errors we asked the Council to consider the requirements of IAS 8 and the CIPFA Code of Practice on Local Authority Accounting (the Code) as to whether prior period adjustments were required to be made in respect of the error identified. The adjustments required are caused by errors in the valuation approach which have resulted in material errors in the carrying value of PPE and other associated entries in the financial statements and therefore meet the criteria for prior year adjustments set out in IAS 8 which is adopted by the Code. The errors in the Council's valuation approach leading to the misstatements existed prior to the start of the comparative year disclosed in the accounts. The Council has determined, and we agree, that it needs to restate and disclose corrected opening balances at the start of the comparative year i.e. prepare a 'third balance sheet' showing the restated financial position of the Council as at 1/4/2016.

The required re-statement is more pervasive in its impact than being limited only to PPE balances and disclosures in the balance sheet, with the following disclosures being effected and requiring restatement:

- The carrying value of property plant and equipment in the Balance Sheet and associated disclosure note.
- Current year and prior year depreciation charges to the Comprehensive Income and Expenditure Account (CIES) and accumulated depreciation in the Balance Sheet and associated disclosure notes.
- Impairment charges and the reversal of prior year impairments in the CIES.
- The calculation and disclosure of profit and loss on disposal in the CIES.
- The reversal of depreciation and impairment from the CIES and associated entries in the Expenditure and Funding Analysis and Adjustments between Accounting Basis and Funding Basis disclosure notes.
- The balance on the Revaluation Reserve and Capital Adjustment Accounts in Balance Sheet unusable reserves and associated disclosure notes.

The full details of the adjustments made are set out in the prior period adjustments disclosure at Note 19 of the Council's revised financial statements.

We have also considered the underlying cause of the deficiencies in the valuation approach we identified which we consider to be a significant deficiency in internal control at the Council. In our view based on the findings of our work and engagement of our own expert, there were deficiencies in the arrangements adopted by the Council to derive and disclose a fair value for its assets. These deficiencies not only relate to the valuation process itself but also to the adequacy and effectiveness of supervision and review of the valuation calculations, assumptions and judgements. We note that the Council has now recognized weaknesses in the valuation process as a significant governance issue in it's 2017/18 Annual Governance Statement and as a result management have stated that they will undertake an internal review to ensure that future valuation work is both accurate and timely.

Recommendation 1 - Consider the adequacy of the arrangements put in place to derive materially accurate fair values for PPE in advance of the closedown process for the 2018/19 statement of accounts.

Recommendation 2 - Improve the process of supervision and review over the calculations, assumptions and judgements underpinning the valuation of PPE.

Areas of Audit Focus

Other areas of audit focus

What is the risk/area of focus?	What did we do?	What are our findings?
Pension Asset/Liability Valuation The Council makes extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme. The pension fund deficit is a material estimated balance and disclosed on the balance sheet. At 31 March 2017, our assessment at the planning stage of the audit, this totalled £368 million. The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the Council. 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.	The procedures we undertook were to: • Liaise with the auditors of Merton Pension Fund, to obtain assurances over the information supplied to the actuary in relation to the Council; • Assess the work of the Pension Fund actuary (Barnett Waddingham) including the assumptions they have used by relying on the work of PWC - Consulting Actuaries commissioned by Public Sector Auditor Appointments for all Local Government auditors, and considering any relevant reviews by the EY actuarial team; and • Review and test the accounting entries and disclosures made within the Council's financial statements in relation to IAS19.	There was an error in pensions asset data provided by Merton Pension Fund (the Fund) to the actuary that was used to produce the IAS 19 report. This was detected by the Fund in May and communicated to the Council. To correct the error details of outturn pensions assets data were provided by the Fund to the actuary and a revised IAS 19 report produced in May prior to the draft financial statements being submitted for audit. However IAS 19 entries in the draft financial statements were made based on the original erroneous IAS 19 report. This was detected as a result of the audit and adjustments made so that IAS 19 entries in the revised financial statements are now based on the corrected IAS 19 report. We did not identify any other material issues with regard to the valuation of pension assets and liabilities

Other areas of audit focus

What is the risk/area of focus?	What did we do?	What are our findings?
PFI accounting The Council has a material PFI arrangement. PFI accounting is a complex area. We undertook a detailed review of the arrangements in 2016/17 and concluded that the accounting disclosures were materially correct. We did also identify and report to management some non-material issues.	In response to the risk we: • Reviewed assurances brought forward from the prior year regarding the appropriateness of the PFI financial model; • Reviewed the PFI financial model for any significant changes, and if identified consider engaging relevant experts to review the model to ensure they are still working as expected; • Ensured the PFI accounting models have been updated for any service or other agreed variations and confirm consistency of current year model with prior year brought forward assurances; and • Agreed outputs of the model to the accounts, including balances and disclosures for Assets, Liabilities, and Expenditure, and review the completeness and accuracy of disclosures.	Our work in this area is complete, and there are no issues arising from work done in the year that we wish to bring to your attention. We did, however, re-engage our internal expert to consider whether any remaining adjustments were required to the PFI model based on our prior year findings. Our expert's approach is to populate a 'parallel' accounting model developed by EY with the same contractual and other information used by the Council's accounting model. The outputs of the EY and Council models are compared to determine whether outputs from the Council model used to populate the financial statements accord with our expectation. We undertook this approach to ascertain whether residual differences between the output of the Council's model and the findings of our 2016/17 review could become cumulatively material over time. Based on the work of our expert we are content that the total difference between the Council's model and our parallel model does not exceed £3.2 million over the life of the project agreement. These differences arise because the Council accounting model treats an annual reduction made in respect of a previous partial termination of the agreement as a real terms (uninflated) value, whereas it is constant in cash terms. This means that the amount it allocates to the minimum lease rental is less than in the parallel model, in turn reducing the implicit lease interest rate. This results in an earlier amortisation of the lease liability in the Council's model compared to our parallel model. The actual difference at the end of 2017/18 was to understate the PFI liability by £3.1 million and understate net cumulative service costs by £3.1 million. The adjustment needed to increase net service costs would be offset by a reduction in cumulative MRP and would therefore have no overall impact on the reported financial position or performance of the Council. Neither the difference at the end of the year or the full difference are material based on our 2017/18 materiality. We are, however, required to report the difference as an unadjusted misstatement, and have included this in Section 4 of this report. The findings to identify these residual adjustments were only made available late in the audit process. It has therefore not been practicable for the Council to make the necessary adjustments to the accounting models and related disclosures in the financial statements prior to conclusion of the 2017/18 audit. The Council has agreed to make the required adjustments to the accounting models in 2018/19.

03 Audit Report

Draft audit report

Our opinion on the financial statements

INDEPENDENT AUDITOR’S REPORT TO THE MEMBERS OF THE LONDON BROOUGH OF MERTON

Opinion

We have audited the financial statements of The London Borough of Merton for the year ended 31 March 2018 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 5.

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 2017/18.

In our opinion the financial statements:

- give a true and fair view of the financial position of the London Borough of Merton and Group as at 31 March 2018 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 2017/18.

Basis for opinion

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

Conclusions relating to going concern

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

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

Audit Report

Our opinion on the financial statements

Other information

The other information comprises the information included in the Statement of Accounts For the year end 2017/18, other than the financial statements and our auditor's report thereon. The Director of Corporate Services is responsible for the other information.

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

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

We have nothing to report in this regard.

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

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

In our opinion, based on the work undertaken in the course of the audit, having regard to the guidance issued by the Comptroller and Auditor General (C&AG) in November 2017, we are satisfied that, in all significant respects, the London Borough of Merton put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2018.

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.

Audit Report

Our opinion on the financial statements

Responsibility of the Director of Corporate Services

As explained more fully in the Statement of Responsibilities set out on page 163 the Director of Corporate Services is responsible for the preparation of the Statement of Accounts, which includes the financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18, and for being satisfied that they give a true and fair view.

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

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

Auditor's responsibilities for the audit of the financial statements

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

Scope of the review of arrangements for securing economy, efficiency and effectiveness in the use of resources
We have undertaken our review in accordance with the Code of Audit Practice, having regard to the guidance on the specified criterion issued by the Comptroller and Auditor General (C&AG) in November 2017, as to whether the London Borough of Merton had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people. The Comptroller and Auditor General determined this criterion as that necessary for us to consider under the Code of Audit Practice in satisfying ourselves whether the [name of body] put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2018.

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

Audit Report

Our opinion on the financial statements

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.

Certificate

We certify that we have completed the audit of the accounts of the London Borough of Merton in accordance with the requirements of the Local Audit and Accountability Act 2014 and the Code of Audit Practice issued by the National Audit Office.

Use of our report

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

04 Audit Differences

Audit Differences

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

Summary of differences

We highlight misstatements greater than £5.6 million which have been corrected by management that were identified during the course of our audit.

- Significant changes have been made to the carrying value of property, plant and equipment in the financial statements in the current and comparative years as a result of our work:
    - At the end of 2017/18 the total net book value of PPE increased by approximately £163 million from £561 million to £724 million
    - At the end of 2016/17 the total net book value of PPE increased by approximately £174 million from £513 million to £687 million
    - At the start of 2015/16 the total net book value of PPE increased by approximately £220 million from £461 million to £681 million

- Service level income and expenditure in Comprehensive Income and Expenditure Statement (CIES) was grossed up by approximately £31.5 million for inter-departmental recharges. Service level income and expenditure in the Group CIES was grossed up by a further £10 million. This was as a result of the incorrect posting of a journal to eliminate inter-departmental recharges being incorrectly posted as part of closedown. This was detected and corrected in the single entity accounts, but not the group financial statements.

- IAS 19 entries in the financial statements were originally based on an inaccurate IAS 19 report resulting in overstatement of the Council’s pension liability and understatements of the pensions reserve by approximately £6.7 million. This also impacted on IAS 19 entries taken to the CIES and disclosure of adjustments between accounting basis and funding basis.

There are two unadjusted differences arising from our audit which we wish to draw to your attention:

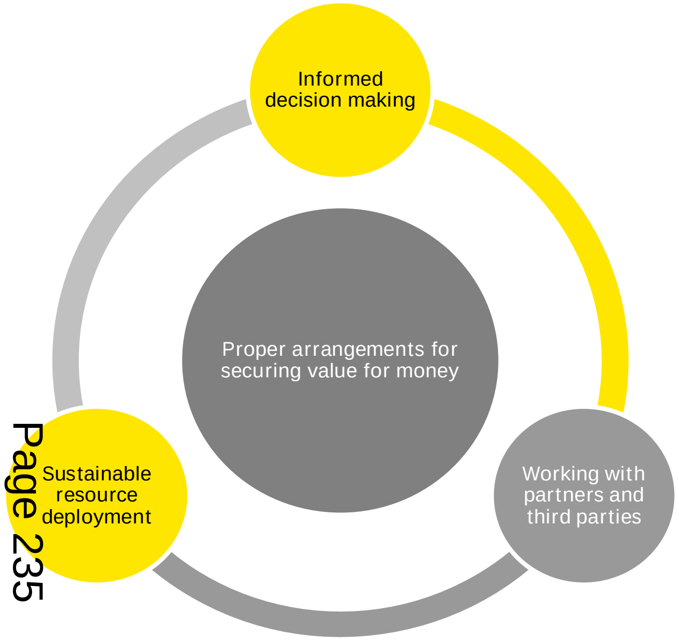
- The closing liability for PFI carried on the Council’s balance sheet is understated by £3.1 million with corresponding adjustments required to cumulative service income expenditure, MRP and the capital adjustment account in unusable reserves of approximately the same amount.

- As part of our work to test creditors in the financial statements we identified a balance of approximately £624,000 relating to balances brought forward from the exercise to migrate to the e5 general ledger that occurred in February 2017. The Council has not yet been able to fully determine what the balance relates to but believe a proportion of the creditors will not need to be repaid but that it is prudent to continue to account for these balances as liabilities while they are investigated. Given the Council’s assertion that a proportion of the creditors will not need to be repaid we are not able to conclude the balance is correctly classified as a creditor and have treated it as an unadjusted misstatement.

There were also a relatively large number of lower value and disclosure adjustments made as a result of our work.

05 Value for Money Risks

Value for Money



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Background

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. This is known as our value for money (VFM) conclusion. For 2017/18 this is based on the overall evaluation criterion:

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

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

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

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

Overall conclusion

We identified one significant risk around these arrangements. We also responded to information provided by a member of the public during the course of the audit that we deemed relevant to our VFM conclusion responsibilities. The tables below present our findings in response to the risks in our Audit Plan and the information received during the course of the audit.

On the basis of the work we performed we consider the Council has in place proper arrangements to secure economy, efficiency and effectiveness in it's 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.

The table below presents the risk areas in our Audit Planning.

What was the significant value for money risk?	What arrangements did the risk affect?	What was our planned response?
The Authority continues to have a challenging financial outlook. To balance the budget over the medium term it will need to deliver significant savings to not be dependent on its reserves. As at January 2018, the current draft of the Authority's Business Plan for 2018 to 2022 shows a cumulative budget gap including the use of reserves of £37.7 million. As at the end of November 2017, there was a forecast shortfall of £2.6 million or 31% in delivery of the Authority's current year savings target.	• Taking informed decisions • Deploying resources in a sustainable manner	Our approach will focus on reviewing the robustness of the Authority's plans and arrangements to address budget pressures in Community and Housing, which includes adult social care, and Children, Schools and Families, and to achieve its savings targets and address budget gaps to deliver sustainable financial balance over the medium term. This will include follow-up of the issues we highlighted as part of our 2016/17 programme of VFM work. We will also consider the causes of the shortfall against current savings programme targets and any related impact on the Authority's future financial plans.

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In our planning work we also considered the weaknesses identified by the Authority in contract standing orders and related processes, notably in respect of the maintenance of a comprehensive contract register, and compliance with its own contract procedure rules. Although we did not consider the risk to be significant we have considered how the Authority has developed its arrangements during the year to address the weaknesses identified. We have also followed up the recommendations we made in the previous year's VFM reporting.

We report our findings on our VFM conclusion work over the remainder of this section of the report.

Value for Money

What are our findings?

2017/18 financial position and performance

At the end of the financial year the overall underspend was £266,000 compared to a £5.4 million overspend or 1 per cent of the gross budget in 2016/17, and a 2017/18 forecast overspend of approximately £600,000 as at month 9. Despite the small surplus delivered services have continued to overspend, with total service overspending in the year of £1.15 million. Service overspending has again primarily been incurred in the more volatile demand led areas of Children, Families and Schools and Community and Housing, although the main area of overspending has shifted from adult social care to children's and in particular social care and youth inclusion budgets. The level of service level of overspending has reduced significantly from 2016/17 (£10.1 million) and is at its lowest level for four years, but the overall underspend was only achieved through service expenditure growth built into to the 2017/18 budget and continued underspending on corporate services budgets and corporate provisions.

The level of usable reserves has decreased in the period. Although the overall General Fund balance has remained unchanged at approximately £12.8 million, usable earmarked revenue reserves (excluding balances held by schools) have decreased by approximately £1 million or 2.4% of total usable earmarked reserves of £41m. There has also been a decrease of £4.2 million in usable reserves available to support capital spending as planned.

Total Capital Expenditure for 2017/18 was £32.2 million compared to an original capital programme budget of £39.5 million. Significant changes were made to the capital programme and budget across the year and, in common with previous years, the forecast of capital outturn made at the end of month 9 (£39.4 million) was significantly over-stated. The relatively high level of slippage in delivery of the programme is also consistent with prior years.

Prior year overspending in Community and Housing related to adult social care, and primarily the access and enablement budget. This has been largely addressed in 2017/18 although there remains some residual overspending at a level of 1 per cent of the budget in this area. The Authority reports that there has been a noticeable reduction in committed expenditure on placements in the latter part of the financial year which is due to the introduction of an outcomes forum, weekly monitoring of variations and increased scrutiny of care packages. It should be noted, however, that Adult Social Care received £9.3 million budget growth in 2017/18 to support identifiable pressures in the placements budget. The changes in arrangements and work practices made in the period have therefore stabilised spending in 2017/18 at broadly 2016/17 levels rather than generating savings. It is essential that this level of control against the budget is maintained as continued budget growth at this level cannot be maintained and is not planned for in the medium term financial strategy (MTFS).

The main driver of overall service level overspending in 2017/18 was overspending in Children Schools and Families. The main area of overspending within the service is social care and youth inclusion costs, although there was also significant overspending against the Special Education Needs (SEN) transport cost budget. The Authority also notes that the service identified underspends to offset cost pressures that are not sustainable on an on-going basis or one-off windfalls which are not guaranteed to reoccur in future years. This means that the demographic and new burdens cost pressures will continue into the new financial year with budgetary pressures being primarily driven by the complexity rather than the volume of cases. Both placement and SEN transport budgets are considered by the Authority to be particularly volatile areas and due to the increasing volume of children's social care activity and Education Health and Care Plan (EHCP) requests the service is concentrating on demand management balancing its education and social care statutory duties with careful and considered oversight of spend.

Value for Money

What are our findings?

Future Financial Planning and the MTFS

The current iteration of the MTFS was presented to Authority in February 2018 as part of the 2018/22 Business Plan. The MTFS forecasts a cumulative budget gap of £17.4 million by 2021/22 after considering the impact of 2018/19 savings and income proposals and transfers from departmental and the Balancing the Budget reserves.

We have considered the reasonableness of pay and price increases built into the MTFS projections. Uplifts for pay inflation are based on the two-year pay increase offered to all council employees from 1 April 2018. The majority of employees will receive an uplift of 2 per cent on 1 April 2018 and a further 2 per cent on 1 April 2019, with those on lower salaries receiving higher increases. The offer also includes the introduction of a new national pay spine on 1 April 2019. In determining uplifts for price inflation the Authority has considered Consumer Price Index (CPI), Retail Price Index (RPI) and bank base rate forecasts over its MTFS planning horizon. Although lower than both CPI and RPI the Authority's estimate of price inflation is higher than the forecast base rate changes. The price inflation assumptions incorporated into the MTFS are cash limited but at a corporate level an 'excess inflation provision' is incorporated into the MTFS. This is intended to assist services that experience price increases greatly in excess of the provision built into the budget. Based on our review we are satisfied that price and pay inflation assumptions built into the MTFS are reasonable. The MTFS also considers:

- Income – there is no assumption around inflation of income from fees and charges built into the MTFS. This is considered to be a prudent approach noting that service departments can treat forecast increases income as part of savings schemes.
- Forecast Collection Fund surplus / deficits and the impact of a move to a London Pilot business rate pool from 2018/19.
- A general contingency for unforeseen cost and demand pressures (£1.5 million).
- Bad debt provision, with no allowance for any increase being made over the period covered by the MTFS.
- Revenuisation – this is the cost of expenditure originally included in the capital programme that could not be justified as capital expenditure.
- Employer pension contributions.
- The cost of local elections.
- Other corporate and technical adjustments.

We have considered savings proposals over and above those already delivered in prior years and incorporated into the MTFS forecast. The scale of the challenge the Authority faces to identify and deliver the savings necessary to balance the budget continues to grow. For the three years 2019/20 to 2021/22 a cumulative total of approximately £3.7 million of savings have been proposed by directorates. To balance the budget without calling on reserves to a greater extent than planned directorates still need to identify and deliver a further £18.4 million of savings by 2021/22. To gain assurance on the robustness of projected savings proposals already built into the 2018/19 budget we selected one agreed proposal from each of the Children, Schools and Families and Community and Housing directorates, and asked to see support for the estimated saving built into the budget and details on progress made on delivery of the saving to date in 2018/19. The savings proposal for Children's, Families and Schools is reported as being fully delivered in the current year giving reasonable assurance the saving proposal was valid and supportable. The Community and Housing saving proposal, which related to Adult Social Care, was not considered to be achievable as a result of changes in circumstances outside of the Authority's control. As a result it was withdrawn and replaced by an alternative savings proposal of similar value which is currently being reported as partially delivered in the current year. This provides some assurance that planned savings are actively reviewed and replacement schemes identified where original schemes are no longer considered viable.

Value for Money

What are our findings?

Future Financial Planning and the MTFS (continued)

We note that significant growth was built into the adult social care budget for 2017/18 in response to demand pressures and overspending in the prior period noted as part of our work on the 2016/17 VFM conclusion. Given the level of assumed growth is reduced significantly across all services from 2018/19 it is essential that planned recurrent savings are realised for the Authority to be financially sustainable.

Overall we have concluded that the MTFS is comprehensive and the reporting of it, and detailed assumptions underpinning it, are clear. The assumptions built into the MTFS are reasonable based on external evidence, comprehensive and not unrealistically optimistic, and there is some support available for savings plans and associated actions. The Authority remains financially resilient over the medium term but financial challenges are continuing to grow. Although reduced in 2017/18 the current level of service overspending is not sustainable. Reserves still offer the Authority some flexibility but it is increasingly important that service level savings are identified and delivered as planned.

Weaknesses in contract standing orders and related processes

As part of our planning assessment we consider Internal Audit work undertaken in the period. At the planning stage we reported that Internal Audit had identified some instances of non-compliance with procurement rules and contract standing orders together with some instances of non-compliance with contract register processes based on its work undertaken at that point in time. Although we did not consider these to be significant risks we identified them as relevant to our value for money conclusion responsibilities and undertook to follow-up progress at the execution phase of the audit drawing on planned 2017/18 Internal Audit reviews of corporate procurement and contract monitoring of commissioned services which had not been delivered at the planning stage.

We have liaised with the Head of Internal Audit who has confirmed that both the corporate procurement and contract monitoring of commissioned services reviews were deferred to 2018/19, with the corporate procurement review currently being undertaken as at July 2018. Based on a discussion with Internal Audit progress made during the year and subsequent to year-end in addressing the previously identified weaknesses in arrangements has been mixed. Some improvements have been identified in the current audit review of procurement in relation to contract standing order updates, the issue of guidance for staff on the intranet, overall strategy and the development and function of Operational Procurement Groups. We are pleased to note these issues have been addressed and are included in the revised Contract Standing Orders issued November 2017. We have concluded that the residual weaknesses are not indicative of an absence of adequate arrangements, but that this is an area where continued focus is needed to improve arrangements.

Value for Money

Follow up of prior year VFM recommendation

As part of our 2016/17 VFM conclusion work at the Authority we raised the following recommendations for improvement in our Audit Results Report. We recommended that the Authority should:

- Consider areas of adult social are related activity where it could further benefit from working in collaboration with its main CCG and other parties to the Sustainability and Transformation Plan, for example, joint procurement or commissioning.
- Ensure that teams are sufficiently supported and encouraged to make effective use of the new IT systems (Mosiac and the E5 general ledger) for producing timely and accurate financial and operational information.

Good progress has been made against the first recommendation. The significant prior year overspend on the access and assessment budget has been largely addressed although there remains some residual overspending. This offers some assurance that work started in 2016/17 and considered as part of our 2016/17 value for money conclusion work has had a positive impact on controlling the sharp increase in demand and unit cost experienced in 2016/17. Some of the arrangements we considered in 2016/17, such as holding weekly budget management meetings and the implementation of a management action plan, have operated throughout 2017/18 and appear to have had a positive impact. Throughout 2017/18 the Authority also reported on the Better Care Fund agreement with Merton CCG and its potential liability of a £474,000 risk share contribution, in addition to a £275,000 pressure from the previous year. At the end of the year there has been a reduction in the expected risk share allocation to £150,000, which the Authority attributes to continued effective working relationships between the Community and Housing management team and the CCG. It should be noted, however, Adult Social Care received £9.3 million growth in 2017/18 to support identifiable pressures in the placements budget. The changes in arrangements and work practices made in the period have therefore stabilised spending in 2017/18 at broadly 2016/17 levels rather than generating savings.

Progress made against the second prior year recommendation has been less strong. An Internal Audit review undertaken in the year of the Authority's CM2000 system received limited assurance. CM2000 is the Authority's electronic care monitoring system, which enables the logging and analysing of home care visits by care providers contracted to use the system. The CM2000 system interfaces with Mosaic, the Authority's main social care system, which in turn interfaces with the E5 general ledger. This process should enable payments to be made to providers automatically and subsequent billing of client invoices to be correct. However, due to problems with system implementation this was not always possible. Although several staff currently have access to CM2000, user-friendly monitoring reports are not readily available and there is a heavy reliance on the CM2000 Contract Monitoring officer to supply information required from the system. It was also not possible for the Authority to undertaken a complete reconciliation of Mosaic to the E5 general ledger throughout the 2017/18 year with a final reconciliation not being completed until April. The Authority's own 2017/18 Annual Governance Statement continues to disclose a governance issue around the need to fully review controls in light of the new E5 financial management system, with the ability to reconcile Mosaic income and expenditure to E5 is a key part of this.

Value for Money

Information provided by a member of the public during the course of the audit

In April this year we received correspondence from a member of the public asking us to investigate the Authority in relation to its actions to secure a site for a new secondary school. We considered the correspondence against our responsibilities as external auditor and determined that there were matters raised that were relevant to our responsibility to form a conclusion on the Authority's arrangements for ensuring the effective, economic and efficient use of its resources. Specifically we agreed to consider whether the Authority complied with its duty to obtain best consideration reasonably obtainable in determining the value of:

- Elim Church
- Domex warehouse.
- Merton Hall
- The specified works to convert Merton Hall.

In carrying out our procedures during May and June in response to the matters raised we sought and obtained a significant amount of relevant and appropriate information from the Authority, as well as verbal responses from officers to a series of follow up enquiries.

In late June we responded to the member of the public with details of our findings and conclusions which in summary stated that based on the procedures we performed, in our view the approach taken by the Authority in determining valuations (which included obtaining external valuations) for the four items specified above was not unreasonable. As a result, we will have no matters to include in the auditor's report in relation to VFM.

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 2017/18 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 2017/18 and published with the financial statements was consistent with the audited financial statements.

We have reviewed the Annual Governance Statement and the amendment officers have made to the Statement as a result of our work to include issues relating to the valuation of PPE detected as a result of our work and the Council's plan to address them. We have no other matters to report as a result of this work.

Whole of Government Accounts

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

As at 30 October 2018 delivery of the procedures required by the National Audit Office (NAO) on the Whole of Government Accounts submission remains ongoing. Some amendments will be made to the consolidation template produced by the Council as a result of our work. We will report progress and any matters arising to the 8 November meeting of the Standards and General Purposes Committee.

Other powers and duties

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

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

Other reporting issues

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 Council'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;
- Findings and issues around the opening balance on initial audits (if applicable);
- Related parties;
- External confirmations;
- Going concern;
- Consideration of laws and regulations; and
- Group audits

We were not able to issue our auditor's report by the 31 July deadline. This was due to a combination of material and complex accounting issues in particular in relation to the valuation of the Authority's property, plant and equipment and changes in materiality necessitating additional audit procedures. We also experienced some unexpected audit staff sickness which impacted on delivery.
There were also some errors and issues in the draft financial statements that should have been corrected through better closedown arrangements and quality review of the draft financial statements. These included:

- The grossing up of service level income and expenditure in the draft financial statements by approximately £31.5 million for inter-departmental recharges in the single entity financial statements and a further £10 million in the group financial statements. Although this was flagged by management relatively early in the audit this should have been detected and corrected as part of financial closedown.
- Processing of IAS 19 entries in the financial statements based on an inaccurate IAS 19 report resulting in overstatement of the Council's pension liability by approximately £6.7 million.
- Prior period adjustments being made in the draft financial statements which did not meet the criteria for prior year adjustments set out in IAS 8 and adopted by the Code.

Other reporting issues

Other matters (contd)
We have therefore concluded that there is scope to improve the Council's arrangements to closedown its financial ledger, produce materially correct draft financial statements and support those financial statements with adequate working papers. See recommendation 3. Recommendation 3 Improve arrangements to closedown the financial ledger, produce materially correct draft financial statements and support those financial statements with adequate working papers.

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07 Assessment of Control Environment

Assessment of Control Environment

Financial controls

It is the responsibility of the Council 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 Council 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 considered the deficiencies in the valuation approach for land and buildings carried at depreciated replacement cost, which we consider in more detail in Section 3 of this report, to be a significant deficiency in internal control at the Council. We have reported that the Council needs to consider the adequacy of its current arrangements for deriving materially accurate valuations of its PPE and improve the supervision and review of the valuation work. We have not identified any other significant deficiencies in the design or operation of an internal control that might result in a material misstatement in your financial statements of which you are not aware. However, there are four further points we wish to bring to your attention over the remainder of this section.

Assessment of Control Environment

Observation

As part of our work to test creditors in the financial statements we identified a balance of approximately £624,000 relating to balances brought forward from the exercise to migrate to the e5 general ledger that occurred in February 2017. The Council has not yet been able to fully determine what the balance relates to but believe a proportion of the creditors will not need to be repaid but that it is prudent to continue to account for these balances as liabilities while they are investigated.

The amount involved is not material to our responsibilities. Given the Council's assertion that a proportion of the creditors will not need to be repaid we are not able to conclude the balance is correctly classified as a creditor and have treated it as an unadjusted misstatement. It is important that the balance is fully investigated and cleared as quickly as possible in 2018/19.

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Management comment

The figure represents historic creditor balances that were transferred into the new e5 system at go live from legacy systems. The Council has undertaken extensive work during 2017/18 and during closing, to fully reconcile the ledger and this work highlighted a number of creditors that will not need to be paid and can therefore be written back to the ledger during 2018/19.
The work undertaken to check the historic creditor balance does indicate that creditors are overstated in the Balance Sheet as at 31st March 2018 but as this work was completed late in the closing process, we have not yet fully discussed our findings with you. Therefore, we consider that we have acted prudently by retaining the £624k creditor in the 1718 accounts. In addition, throughout this process we considered that the sum involved was not material to the accounts and that any adjustment to the balance could be left until 2018/19.

Observation

As part of our work to test creditors appearing in the financial statements we reviewed transactions on the housing benefit control account to which all entitlement and payment transactions relating to Housing Benefit are posted. This consists of entitlements, cash payments and overpayments.
As at the end of the year, the Council review the control account to identify which year balances relate to, whether they relate to under or overpayments of benefit and therefore how they should be accounted for and disclosed in the financial statements at the end of the year. At the end of the year a manual adjustment should have been be made to the code to ensure related creditors were disclosed in the financial statements. However, this year-end journal was not made.

Although the impact of this was ultimately trivial to our responsibilities it is important that all year end closedown actions are properly undertaken.

Management comment

A closedown journal was missed off the work plan resulting in this small inaccuracy. Once it was discovered it was decided not to adjust the accounts given its non-material impact. However, we will tighten up our procedures and ensure a comprehensive checklist is further developed with effective signoff procedures.

Assessment of Control Environment

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Observation

As part of our 2016/17 work and Audit Results Report we noted some delays in the performance of key control reconciliations following migration to the e5 general ledger. As part of this we considered whether key control reconciliations were undertaken on a timely basis during the current year and level of any remaining differences in year-end reconciliations. We have concluded that accounts receivable, accounts payable and social services income and expenditure (recorded on the Mosaic system) were not undertaken on a timely basis during the year. Although not material to our responsibilities there were a number of reconciling items between the Mosaic system and general ledger at year-end with a total net difference of £4.9 million.

It is important that all key control reconciliations are undertaken on a timely basis during the year. Although monthly reconciliations between the general ledger and Mosaic systems have been produced in 2018/19, and the value of the difference between the Mosaic system and general ledger had reduced to approximately £1.3 million by July 2018, this difference needs to continue to be investigated and cleared.

Management comment

A full reconciliation was undertaken of the Mosaic system during 2017/18 and the differences identified. This reconciliation continues to be undertaken on a monthly basis so that all differences are identified and actioned where appropriate. It is important to acknowledge that our E5 system remains the primary source of the Council's transactions and the regular reconciliations we undertake provide a high level of confidence of that.

Observation

As part of our work to consider the Council's bad debt provision we noted that as a result of issues arising from the transfer to the Council's new e5 general ledger system the Council did not bring recoverability proceedings for any outstanding raised debt between Feb 2017 and August 2017. As the Council have 60 day payment terms for debtors, this meant that any debtors raised since December 2016 had not been chased until August 2017. The Council consider it unlikely that they will recover most of these debtors due to the significant drop in communication with debtors and the lack of recovery action due to a lack of available evidence to progress.

We are satisfied that an appropriate adjustment has been to the Council's bad debt provision to account for the potential loss of income but note that it is important that recovery actions for all debt outstanding should be commenced promptly.

Management comment

This was a by-product of the implementation of our new e5 system resulting in a lack of evidence to support these debts in order to be able to take the appropriate action to collect them. We are pleased to report this has now been resolved and prompt action is being taken on all outstanding debts.

08 Data Analytics

Data analytics – testing of General Ledger Journals, and Employee Costs

Analytics Driven Audit

Data analytics

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

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

In 2017/18, our use of these analysers in the Council's audit included testing journal entries and employee costs, to identify and focus our testing on those entries we deem to have the highest inherent risk to the audit.

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

Journal Entry Analysis

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

09 Independence

Confirmation

We confirm that there are no changes in our assessment of independence since our confirmation in [our audit planning board report dated 2 March 2018.

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

We consider that our independence in this context is a matter which you should review, as well as us. It is important that management and the Standards and General Purposes Committee consider the facts known to you and come to a view. If you would like to discuss any matters concerning our independence, we will be pleased to do this at the meeting of the Standards and General Purposes Committee on 8 November 2018.

We confirm we have undertaken non-audit work outside the PSAA Code requirements in relation to our work on the Teachers' Pensions limited assurance reviews. We have adopted the necessary safeguards in our completion of this work.

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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 Council, and its directors and senior management and its affiliates, including all services provided by us and our network to your Council, its directors and senior management and its affiliates, and other services provided to other known connected parties that we consider may reasonably be thought to bear on the our integrity or objectivity, including those that could compromise independence and the related safeguards that are in place and why they address the threats.

There are no relationships from 01 April 2017 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

Below includes a summary of the fees that you have paid to us in the year ended 31 March 2018 in line with the disclosures set out in FRC Ethical Standard and in statute. We confirm that none of the services listed in the below table has been provided on a contingent fee basis.

Fee analysis

We have reported to the Committee in July and September the impact of the issues included in this report on the audit fee. As part of our reporting on our independence, we set out below a summary of the fees paid/agreed for the year ended 31 March 2018.

	Proposed final fee 2017/18	Planned fee 2017/18	Scale fee 2017/18	Final Fee 2016/17
		£	£	£
Total Fee – Code work	143,498	143,498	143,498	143,498
Additional code work:			-	12,000
- MRP revision	4,500	4,500	-	-
- Responding to a member of the public	9,000	-	-	-
- Engagement of EY Real Estates	20,000	-	-	-
- Additional work arising from change in materiality and clearance of audit queries	52,000	-	-	-
Total audit	228,998	147,598	143,498	155,498
Non-audit services - Housing Benefits claim certification	Tbc	41,242	41,242	30,555
Non-audit services – Teachers' Pensions limited assurance	Tbc	8,500	N/A	8,500
Total other non-audit services	Tbc	49,742	41,242	39,055
Total fees	Tbc	197,240	184,740	194,553

* We have agreed additional fees with the Director of Corporate Services. They are subject to approval by PSAA.

10 Appendices

Audit approach update

There were no changes in our approach to the audit of the balance sheet compared to the prior year audit. In 2017/18 we have taken a wholly substantive approach to gaining audit assurance and have not sought to test controls. In the prior year we placed partial reliance on controls to gain assurance in respect of payroll expenditure. This does not have a direct impact on the Council's balance sheet.

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

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

Summary of communications

Date	Nature	Summary
Throughout the year	Meetings, calls and e-mails	The Associate Partner and Senior Manager have been in regular contact with the Chief Executive, Director of Corporate Services, Assistant Director of Resources and corporate finance team regularly throughout the year and up to the date of this report to discuss audit and Council matters, business and financial risks, accounts closedown and the audit approach.
• 9/5/2017 • 29/6/2017 • 7/9/2017 • 9/11/2017 • 31/1/2018 • 15/3/2018 • 30/7/2018 • 6/9/2018	Meetings and reports	The Associate Partner and/or Senior Manager have attended all meetings of the Standards & General Purposes Committee held during the year and through to the date of issue of this report, with reports on audit progress and other items presented to each meeting of the Committee. Specific reports issued and communications with the Standards and General Purposes Committee are detailed in Appendix C. Audit progress reports have been presented to each meeting apart from the 26 March meeting of the Committee when the Audit Plan was presented.

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

Required communications with the Standards and General Purposes Committee

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

Required communications	What is reported?	Our Reporting to you When and where
Terms of engagement	Confirmation by the Standards and General Purposes Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Our responsibilities	Reminder of our responsibilities as set out in the engagement letter.	Audit planning report, 15 March 2018 S&GPC
Planning and audit approach	Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.	Audit planning report, 15 March 2018 S&GPC Audit progress reports, 30 July and 6 September S&GPCs
Significant findings from the audit	• Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures • Significant difficulties, if any, encountered during the audit • Significant matters, if any, arising from the audit that were discussed with management • Written representations that we are seeking • Expected modifications to the audit report • Other matters if any, significant to the oversight of the financial reporting process • Findings and issues regarding the opening balance on initial audits (delete if not an initial audit)	Audit results report, 8 November S&GPC. Audit progress reports, 30 July and 6 September S&GPCs

Appendix C

Required communications	What is reported?	Our Reporting to you: When and where
Going concern	Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including: • Whether the events or conditions constitute a material uncertainty • Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements • The adequacy of related disclosures in the financial statements	No conditions or events were identified, either individually or together to raise any doubt about the London Borough of Merton's ability to continue for the 12 months from the date of our report.
Misstatements	• Uncorrected misstatements and their effect on our audit opinion • The effect of uncorrected misstatements related to prior periods • A request that any uncorrected misstatement be corrected • Material misstatements corrected by management	Audit results report, 8 November S&GPC.
Subsequent events	• Enquiry of the audit committee where appropriate regarding whether any subsequent events have occurred that might affect the financial statements.	We have enquired of management and those charged with governance. We have no matters to report.
Fraud	• Enquiries of the Standards and General Purposes Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the Authority • Any fraud that we have identified or information we have obtained that indicates that a fraud may exist • Unless all of those charged with governance are involved in managing the Authority, any identified or suspected fraud involving: a. Management; b. Employees who have significant roles in internal control; or c. Others where the fraud results in a material misstatement in the financial statements. • The nature, timing and extent of audit procedures necessary to complete the audit when fraud involving management is suspected • Any other matters related to fraud, relevant to Standards and General Purposes Committee responsibility.	We have enquired of management and those charged with governance. We have no matters to report. Audit results report, 8 November S&GPC.

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Appendix C

		Our Reporting to you
Required communications	What is reported?	When and where
Related parties	Significant matters arising during the audit in connection with the Authority's related parties including, when applicable: • Non-disclosure by management • Inappropriate authorisation and approval of transactions • Disagreement over disclosures • Non-compliance with laws and regulations • Difficulty in identifying the party that ultimately controls the Authority	Audit results report, 8 November S&GPC. We have no matters to report.
Independence	Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence. Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as: • The principal threats • Safeguards adopted and their effectiveness • An overall assessment of threats and safeguards • Information about the general policies and process within the firm to maintain objectivity and independence Communications whenever significant judgments are made about threats to objectivity and independence and the appropriateness of safeguards put in place.	Audit planning report, 15 March 2018 S&GPC and Audit results report, 8 November S&GPC.

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Appendix C

		Our Reporting to you
Required communications	What is reported?	When and where
External confirmations	• Management's refusal for us to request confirmations • Inability to obtain relevant and reliable audit evidence from other procedures.	Audit results report, 8 November S&GPC. We have obtained all requested confirmations.
Consideration of laws and regulations	• Subject to compliance with applicable regulations, matters involving identified or suspected non-compliance with laws and regulations, other than those which are clearly inconsequential and the implications thereof. Instances of suspected non-compliance may also include those that are brought to our attention that are expected to occur imminently or for which there is reason to believe that they may occur • Enquiry of the audit committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the audit committee may be aware of	Audit results report, 8 November S&GPC. We have asked management and those charged with governance. We have not identified any material instances or non-compliance with laws and regulations.
Significant deficiencies in internal controls identified during the audit	• Significant deficiencies in internal controls identified during the audit.	Audit results report, 8 November S&GPC. We identified one significant deficiency in internal control relating to the approach to valuation of assets carried at DRC and have raised a number of other control observations as part of this report.
Certification work	• Summary of certification work	The audit of the Council's Housing Benefit claim and limited assurance review of its Teachers' Pensions return remain ongoing at October 2018. Findings of the Housing Benefit claim certification audit will be reported in our 2017/18 annual certification report. The results of our limited assurance review of the Teachers' Pensions return will be reported in a separate findings report.

Appendix C

		Our Reporting to you
Required communications	What is reported?	When and where
Group Audits	• An overview of the type of work to be performed on the financial information of the components • An overview of the nature of the group audit team's planned involvement in the work to be performed by the component auditors on the financial information of significant components • Instances where the group audit team's evaluation of the work of a component auditor gave rise to a concern about the quality of that auditor's work • Any limitations on the group audit, for example, where the group engagement team's access to information may have been restricted • Fraud or suspected fraud involving group management, component management, employees who have significant roles in group-wide controls or others where the fraud resulted in a material misstatement of the group financial statements.	Audit planning report, 15 March 2018 S&GPC and Audit results report, 8 November S&GPC.
Written representations we are requesting from management and/or those charged with governance	• Written representations we are requesting from management and/or those charged with governance	Audit results report, 8 November S&GPC.
Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	• Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	None identified.
Auditors report	• Any circumstances identified that affect the form and content of our auditor's report	Audit results report, 8 November S&GPC
Fee Reporting	• 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 planning report, 15 March 2018 S&GPC and Audit results report, 8 November S&GPC.

Management representation letter

Management Representation Letter

8 November 2018

Ernst & Young LLP
1 More London Riverside
London
SE1 2AF

Dear Sirs

This letter of representations is provided in connection with your audit of the consolidated and council financial statements of the London Borough of Merton ("the Group and Council") for the year ended 31 March 2018. We recognise that obtaining representations from us concerning the information contained in this letter is a significant procedure in enabling you to form an opinion as to whether the consolidated and council financial statements give a true and fair view of the Group and Council financial position of London Borough of Merton as of 31 March 2018 and of its financial performance (or operations) and its cash flows for the year then ended in accordance with, for the Group and Council, the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18. We understand that the purpose of your audit of our consolidated and council financial statements is to express an opinion thereon and that your audit was conducted in accordance with International Standards on Auditing, which involves an examination of the accounting system, internal control and related data to the extent you considered necessary in the circumstances, and is not designed to identify - nor necessarily be expected to disclose - all fraud, shortages, errors and other irregularities, should any exist.

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

A. Financial Statements and Financial Records

1. We have fulfilled our responsibilities, under the relevant statutory authorities, for the preparation of the financial statements in accordance with, for the Group and Council in accordance with the Accounts and Audit Regulations 2015 and CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18.
2. We acknowledge, as members of management of the Group and Council, our responsibility for the fair presentation of the consolidated and council financial statements. We believe the consolidated and council 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 2017/18 and are free of material misstatements, including omissions. We have approved the consolidated and council financial statements.
3. The significant accounting policies adopted in the preparation of the Group and Council financial statements are appropriately described in the Group and Council financial statements.

Management representation letter

Management Representation Letter

4. As members of management of the Group and Council, we believe that the Group and Council have a system of internal controls adequate to enable the preparation of accurate financial statements in accordance with the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18 for the Group and the Council that are free from material misstatement, whether due to fraud or error.
5. We believe that the effects of any unadjusted audit differences accumulated by you during the current audit and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the consolidated and council financial statements taken as a whole. We have not corrected the differences relating to the New Schools PFI scheme identified by and brought to the attention from the auditor because [specify reasons for not correcting misstatement].

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

1. We acknowledge that we are responsible to determine that the Group and Council's activities are conducted in accordance with laws and regulations and that we are responsible to identify and address any non-compliance with applicable laws and regulations, including fraud.
2. We acknowledge that we are responsible for the design, implementation and maintenance of internal controls to prevent and detect fraud.
3. We have disclosed to you the results of our assessment of the risk that the consolidated and Council financial statements may be materially misstated as a result of fraud.
4. We have no knowledge of any identified or suspected non-compliance with laws or regulations, including fraud that may have affected the Group or Council (regardless of the source or form and including without limitation, any allegations by "whistleblowers"), including non-compliance matters:

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

C. Information Provided and Completeness of Information and Transactions

1. We have provided you with:

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

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

Management representation letter

Management Representation Letter

3. We have made available to you all minutes of the meetings of the Council held through the year to the most recent meeting of the Standards and General Purposes Committee on 8 November 2018.
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 year ended, as well as related balances due to or from such parties at the year end. These transactions have been appropriately accounted for and disclosed in the consolidated and council 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 consolidated and council financial statements in the event of non-compliance, including all covenants, conditions or other requirements of all outstanding debt.

D. Liabilities and Contingencies

1. All liabilities and contingencies, including those associated with guarantees, whether written or oral, have been disclosed to you and are appropriately reflected in the consolidated and council financial statements.
2. We have informed you of all outstanding and possible litigation and claims, whether or not they have been discussed with legal counsel.
3. We have recorded and/or disclosed, as appropriate, all liabilities related litigation and claims, both actual and contingent, and have disclosed in Note 12 to the consolidated and council financial statements all guarantees that we have given to third parties.

E. Subsequent Events

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

F. Group audits

1. There are no significant restrictions on our ability to distribute the retained profits of the Group because of statutory, contractual, exchange control or other restrictions other than those indicated in the Group financial statements.
2. Necessary adjustments have been made to eliminate all material intra-group unrealised profits on transactions amongst council, subsidiary undertakings and associated undertakings.

G. Other information

1. We acknowledge our responsibility for the preparation of the other information. The other information comprises the Narrative Statement.
2. We confirm that the content contained within the other information is consistent with the financial statements.

Management representation letter

Management Representation Letter

Comparative information – corresponding financial information

1. As part of your audit significant errors were detected in the carrying value of land and buildings property, plant and equipment assets valued at depreciated replacement cost. The errors in our valuation approach led to misstatements which were present prior to the start of the comparative year. Restatement and disclosure of corrected opening balances at the start of the comparative year has also been required.
2. The comparative amounts have been correctly restated to reflect the above matter(s) and appropriate note disclosure of this these restatements has also been included in the current year's consolidated and council financial statements.

Estimates

Valuation of Property, Plant and Equipment
Valuation of Pension Fund assets and liabilities
Accounting entries relating to Private Finance Initiative schemes

1. We believe that the measurement processes, including related assumptions and models, used to determine the accounting estimates have been consistently applied and are appropriate in the context of the CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18.
2. We confirm that the disclosures made in the financial statements with respect to the accounting estimate(s) are complete and made in accordance with CIPFA LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18.
3. We confirm that no adjustments are required to the accounting estimates and disclosures in the financial statements due to subsequent events.

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.

Management representation letter

Management Representation Letter

Yours faithfully,

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Caroline Holland
Director of Corporate Services

____

Cllr Peter McCabe
Chair of the Standards and General Purposes Committee

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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.

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