

London Borough of Merton

Outline Audit Plan

Year ended 31 March 2022

24 February 2022



24 February 2022



Private and Confidential

London Borough of Merton
Standards and General Purposes Committee
Civic Centre
Morden
SM4 5DX

Dear Committee Members
Outline Audit Plan

We are pleased to attach our Outline Audit Plan. Its purpose is to provide the Standards and General Purposes Committee with an overview of our plans and fee for the 2021/22 audit before detailed work has commenced.

This report summarises our initial assessment of the key issues which drive the development of an effective audit for the London Borough of Merton. Due to the late completion of our 2020/21 audit, we have not yet completed our detailed planning procedures. We will provide a more detailed and comprehensive audit plan for the Committee at the next meeting, or circulate the plan separately if Members prefer. This report sets out the areas which we consider will be a focus for our 2021/22 plan.

Our audit is undertaken in accordance with the requirements of the Local Audit and Accountability Act 2014, the National Audit Office's 2020 Code of Audit Practice, the Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA) Ltd, auditing standards and other professional requirements.

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

Yours faithfully

E. Jackson.

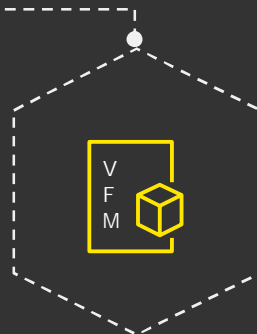
Elizabeth Jackson, Associate Partner
For and on behalf of Ernst & Young LLP
Encl

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

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

This report is made solely to the Standards and General Purposes Committee and management of the London Borough of Merton in accordance with the statement of responsibilities. Our work has been undertaken so that we might state to the Standards and General Purposes Committee, and management of the London Borough of Merton those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than to 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.



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01 2021/22 Audit



Wider public sector audit context

Recognising the increasing pressure on all auditors in the current climate the Department for Levelling Up, Housing and Communities (DLHUC) and CIPFA/LASAAC have both published papers relating to audit firms and timely completion of audits.

The DLHUC paper published in December 2021 sets out a range of measures agreed with key partners to support the timely completion of local government audits and the ongoing stability of the local audit market. It makes the following commitments:

1. FRC to publish updated Key Audit Partner (KAP) guidance by spring 2022, including new routes for an experienced Registered Individual to become a KAP;
2. Work with CIPFA to further develop the proposal for a new local audit training diploma in local government financial reporting and management aimed at different levels of auditor, and a new technical advisory service that could provide support to firms, and in particular new entrants;
3. DLHUC to provide further funding of £45 million over the course of next Spending Review period to support local bodies with the costs of strengthening their financial reporting, new burdens related to appointment of independent members and other Redmond recommendations and increased auditing requirements;
4. CIPFA to publish strengthened guidance on audit committees by April 2022. The guidance will emphasise the role that audit committees should have in ensuring accounts are prepared to a high standard, alongside broader changes including appointment of independent members. Following consultation, consider making the guidance, committees and the independent member statutory;
5. DLHUC to provide via the Local Government Association sector grant for a number of targeted training events for audit committee chairs;
6. NAO rolling over of amendments to 20/21 AGN 03 and 07 to allow for altering the timing of elements on the VfM arrangements work and enable more focus on fully delivering opinions on the financial statements;
7. CIPFA/LASAAC is undertaking a project to improve the presentation of local authority accounts to inform the development of the 2022/23 Accounting Code and comply with IFRS and statutory accounting principles HMT to undertake thematic review of financial reporting valuations for non-investment properties to inform development of the Accounting Code from 2022/23 onwards;
8. The government has asked CIPFA/LASAAC to consider the merits of a time-limited change to the Accounting Code for 2021/22;
9. Delaying implementation of standardised statements and associated audit requirements;
10. PSAA to progress their proposed procurement strategy for the next round of local audit contracts from 2023/24;
11. Extending the deadline for publishing audited local authority accounts to 30 November 2022 for 2021/22 accounts, then 30 September for 6 years, beginning with the 2022/23 accounts;
12. NAO to prepare for a re-laying of the Code of Audit Practice 2020 in parliament, so that it will apply for the whole of the next appointing period; and
13. Developing an industry-led workforce strategy, working with the system leader and audit firms, to consider the future pipeline of local audits, and associated questions related to training and qualifications.

2021/22 financial statements audit

Planning for 2021/22

We have met the Director of Corporate Services, the Assistant Director of Resources and members of the finance team regularly through December 2021 and January 2022 to discuss the conclusion of our 2020/21 audit.

We have commenced our initial planning work for the 2021/22 audit and have met with the Chief Executive, the Director of Corporate Services and Assistant Director of Resources. We have arranged regular liaison meetings throughout the year to inform our continuous audit planning and have held an initial planning meeting with officers to discuss key points from the prior year, incorporating the learning from the 2020/21 audit.

For 2021/22, the timetable as published in the draft Accounts and Audit (Amendment) regulations 2021 extends the publication date for audited local authority accounts from 31 July to 30 November 2022.

Due to the ongoing impact of later deadlines and completion of audits from 2020/21, we have yet to start our planning for the 2021/22 audit. We set out in this report our initial considerations of the risks for the audit – these are broadly similar to those identified in 2020/21. We will update these risks as our planning progresses and take into account the risks suggested by the NAO in the Auditor Guidance Note 06 – Local Government Audit Planning, which has not yet been released for 2021/22.

2021/22 financial statements audit

The CIPFA/LASAAC paper explores proposals for change to the 2021/22 Code of Practice on Local Authority Accounting in the United Kingdom and the 2022/23 code that might serve to improve current issues around timeliness of the publication of audited financial statements. Two key proposals of this report include:

1. To allow local authorities to pause professional valuations for operational property, plant and equipment for a period of up to two years (though the initial proposal is for the 2021/22 financial year); this approach also explores the use of an index to be used to increase or reduce that valuation; and
2. To defer the implementation of IFRS 16 Leases (standard) for a further year and not make the planned changes to the 2022/23 code to implement that standard.

This paper is currently undergoing consultation.

Materiality

Our application of materiality

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

Gross expenditure on the provision of services

£557m

We consider gross revenue expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Authority.

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Planning materiality

£10.0m

Planning materiality is the amount over which we anticipate misstatements would influence the economic decisions of a user of the financial statements. For planning purposes, planning materiality for 2021/22 has been set at £10.0 million, which represents 1.8% of the prior years gross expenditure on provision of services plus the forecast GRE of CHAS 2013 Limited. The use of 1.8% of gross revenue expenditure in line with the prior year.

Planning materiality for the Authority has been set at £9.9 million.

Performance materiality

£7.5m

Performance materiality is the amount we use to determine the extent of our audit procedures. We have set performance materiality at £7.5 million for the group financial statements which represents 75% of planning materiality and is in line with the prior year.

Performance materiality for the Authority is £7.4 million.

Audit differences

£0.5m

We will report all uncorrected misstatements relating to the primary statements (comprehensive income and expenditure statement, balance sheet, movement in reserves statement, cash flow statement and collection fund) greater than £0.5 million. Other misstatements identified will be communicated to the extent that they merit the attention of the Standards and General Purposes Committee.

These figures will be updated upon receipt of the draft 2021/22 financial statements.

Overview of 2021/22 audit strategy

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

Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from PY	Details
Risk of fraud in revenue and expenditure recognition	Fraud risk / Significant risk	No change in risk or focus	<p>Under ISA 240, there is a presumed risk that revenue may be misstated due to improper revenue recognition. In the public sector, this requirement is modified by Practice Note 10 issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.</p> <p>We have identified the accounting for Covid-19 related grant income as a specific area where revenue may be inappropriately recognised.</p>
Misstatements due to fraud or error	Fraud risk / Significant risk	No change in risk or focus	<p>As identified in ISA 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that would otherwise appear to be operating effectively.</p> <p>In addition to our overall response, we consider where these risks may manifest themselves and identify separate fraud risks as necessary below.</p>
Inappropriate capitalisation of revenue expenditure	Fraud risk / Significant risk	No change in risk or focus	<p>As noted above, under ISA 240, management is in a unique position to perpetrate fraud through the override of controls. We have identified the inappropriate capitalisation of revenue expenditure on property, plant and equipment as an area of risk.</p>

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Audit risks and areas of focus

Risk / area of focus	Risk Identified	Change from PY	Details
Valuation of Land and Buildings – PPE valued under Depreciated Replacement Cost (DRC) and Existing Use Value (EUV)/Fair Value (FV)	Significant risk	No change in risk or focus	<p>The fair value of Property, Plant and Equipment (PPE) represents a significant balance in the Authority's accounts and is subject to valuation changes, impairment reviews and depreciation charges.</p> <p>The valuation of these assets is reliant upon expert valuations based on information provided by the Authority. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet. Errors within the judgements, assumptions or information provided to the valuer can have a material impact on the financial statements.</p> <p>As a result of our work last year we identified a number of errors which resulted in material amendments to the valuation of property, plant and equipment within the financial statements of the Authority. As such, the valuation of land and buildings remains a significant audit risk.</p> <p>The recognition of this risk is subject to the current CIPFA/LASAAC proposals currently under consultation (see page 5).</p>
National Non-Domestic Rates (NNDR) Appeals Provision	Inherent risk	No change in risk or focus	<p>Statistics compiled by the Ministry for Housing, Communities and Local Government, reveal that councils are forecasting net additions to appeal in the coming years. The reason behind the forecast increase is that, due to the impact of Covid-19, businesses are likely to seek reductions based on a decrease in rental prices on which rateable values are based.</p> <p>In light of this we consider there to be a higher inherent risk of misstatement of the Authority's NNDR appeals provision.</p>

Overview of 2021/22 audit strategy

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Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from PY	Details
Pension Liability Valuation	Inherent risk	No change in risk or focus	<p>The Local Authority Accounting Code of Practice and IAS19 require the Authority to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme.</p> <p>Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.</p>
Going Concern	Inherent risk	No change in risk or focus	<p>There is a presumption that the Authority will continue as a going concern for the foreseeable future. However, the Authority is required to carry out a going concern assessment that is proportionate to the risks it faces. In light of the continued impact of Covid-19 during 2021/22 there is a need for the Authority to ensure it's going concern assessment, including its cashflow forecast, is robust and appropriately comprehensive.</p> <p>The Authority is required to ensure that its going concern disclosure within the statement of accounts adequately reflects its going concern assessment and in particular highlights any uncertainties it has identified.</p>



02

Value for Money



Value for money

Authority responsibilities for value for money

The Authority is required to maintain an effective system of internal control that supports the achievement of their policies, aims and objectives while safeguarding and securing value for money from the public funds and other resources at its disposal.

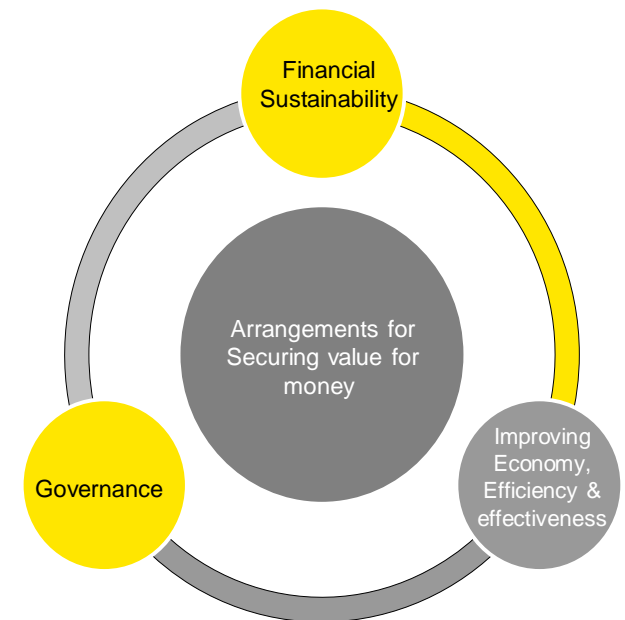
As part of the material published with its financial statements, the Authority is required to bring together commentary on its governance framework and how this has operated during the period in an annual governance statement. In preparing its annual governance statement, the Authority tailors the content to reflect its own individual circumstances, consistent with the requirements of the relevant accounting and reporting framework and having regard to any guidance issued in support of that framework. This includes a requirement to provide commentary on its arrangements for securing value for money from their use of resources.

Auditor responsibilities under the new Code

Under the 2020 Code we are still required to consider whether the Authority has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. The Code requires the auditor to design their work to provide them with sufficient assurance to enable them to report to the Authority and provide commentary against specified reporting criteria (see below) on the arrangements the Authority has in place to secure value for money through economic, efficient and effective use of its resources for the relevant period.

The specified reporting criteria are:

- Financial sustainability
How the Authority plans and manages its resources to ensure they can continue to deliver its services;
- Governance
How the Authority ensures that it makes informed decisions and properly manages its risks; and
- Improving economy, efficiency and effectiveness
How the Authority uses information about its costs and performance to improve the way it manages and delivers its services.





Value for money risks

Planning and identifying VFM risks

The NAO's guidance notes require us to carry out a risk assessment which gathers sufficient evidence to enable us to document our evaluation of the Authority's arrangements, in order to enable us to draft a commentary under the three reporting criteria. This includes identifying and reporting on any significant weaknesses in those arrangements and making appropriate recommendations. This is a change to 2015 Code guidance notes, where the NAO required auditors, as part of planning, to consider the risk of reaching an incorrect conclusion in relation to the overall criterion.

In considering the Authority's arrangements, we are required to consider:

- The Annual Governance Statement
- Evidence that the Authority's arrangements were in place during the reporting period;
- Evidence obtained from our work on the accounts;
- The work of inspectorates (such as Ofsted and CQC) and other bodies; and
- Any other evidence source that we regard as necessary to facilitate the performance of our statutory duties.

We then consider whether there is evidence to suggest that there are significant weaknesses in arrangements. The NAO's guidance is clear that the assessment of what constitutes a significant weakness and the amount of additional audit work required to adequately respond to the risk of a significant weakness in arrangements is a matter of professional judgement. However, the NAO states that a weakness may be said to be significant if it:

- Exposes – or could reasonably be expected to expose – the Authority to significant financial loss or risk;
- Leads to – or could reasonably be expected to lead to – significant impact on the quality or effectiveness of service or on the Authority's reputation;
- Leads to – or could reasonably be expected to lead to – unlawful actions; or
- Identifies a failure to take action to address a previously identified significant weakness, such as failure to implement or achieve planned progress on action/improvement plans.

We should also be informed by a consideration of:

- The magnitude of the issue in relation to the size of the Authority;
- Financial consequences in comparison to, for example, levels of income or expenditure, levels of reserves (where applicable), or impact on budgets or cashflow forecasts;
- The impact of the weakness on the Authority's reported performance;
- Whether the issue has been identified by the Authority's own internal arrangements and what corrective action has been taken or planned;
- Whether any legal judgements have been made including judicial review;
- Whether there has been any intervention by a regulator or Secretary of State;
- Whether the weakness could be considered significant when assessed against the nature, visibility or sensitivity of the issue;
- The impact on delivery of services to local taxpayers; and
- The length of time the Authority has had to respond to the issue.

Value for money risks

Responding to identified risks

Where our planning work has identified a risk of significant weakness, the NAO's guidance requires us to consider what additional evidence is needed to determine whether there is a significant weakness in arrangements and undertake additional procedures as necessary, including where appropriate, challenge of management's assumptions. We are required to report our planned procedures to the Standards and General Purposes Committee.

Reporting on VFM

In addition to the commentary on arrangements, where we are not satisfied that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources we are required to refer to this by exception in the audit report on the financial statements.

We are also required to include the commentary on arrangements in our Auditor's Annual Report. The 2020 Code states that the commentary should be clear, readily understandable and highlight any issues we wish to draw to the Authority's attention or the wider public. This should include details of any recommendations arising from the audit and follow-up of recommendations issued previously, along with our view as to whether they have been implemented satisfactorily.

Where we have sufficient evidence to determine that there is a significant weakness on VFM related arrangements we are able to report that weakness, and an associated recommendation for improvement, at that time and not wait until we issue our Audit Results Report on the audit of the statement of accounts.

Status of our 2021/22 VFM planning

We have yet to commence our detailed VFM planning.

However, one area of focus will be on the arrangements that the Authority has in place in relation to financial sustainability in light of the impact Covid-19 continues to have on the Authority's finances. At the 7 February 2022 Cabinet meeting, the Financial Report 2021/22 for the period to 9 December 2021 highlighted that for the 2021/22 revenue budget, the Authority was forecasting a net adverse variance at year-end of £7.3 million. The report highlighted that in common with other London Boroughs, the Authority's services remain under pressure due to the need to support businesses and residents, and there has been a major reduction in the Authority's income which is expected to continue. In addition, the report highlights the continued significant pressures on the Dedicated Schools Grant (DSG) which ended the 2020/21 year with a cumulative deficit of £24.9 million and is now forecast to increase in 2021/22 to an estimated £37.8 million.

We also consider the impact on the specified reporting criteria of the findings from the work of external inspectorates. We are aware that OFSTED are currently carrying out an inspection and we will consider their findings when concluding if the Authority has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources.

We will update the Committee on the outcome of our VFM planning and our planned response to any identified risks of significant weaknesses in arrangements.



03

Fees



Fees

Fees

The duty to prescribe fees is a statutory function delegated to Public Sector Audit Appointments Ltd (PSAA) by the Secretary of State for Housing, Communities and Local Government.

This is defined as the fee required by auditors to meet statutory responsibilities under the Local Audit and Accountability Act 2014 in accordance with the requirements of the Code of Audit Practice and supporting guidance published by the National Audit Office, the financial reporting requirements set out in the Code of Practice on Local Authority Accounting published by CIPFA/LASAAC, and the professional standards applicable to auditors' work.

The table sets out our expected fees for 2020/21 and 2021/22. However, these figures could change, and need to be agreed with officers and the PSAA. Any further additional fees (over and above VFM and ISA540) for 2020/21 will be communicated to the Director of Resources following the completion of the audit.

	Planned fee 2021/22	Proposed fee 2020/21	Final proposed fee 2019/20
	£	£	£
Scale Fee - Code work	£110,493	£110,493	£110,493
Planned 2019/20 recurrent fee variation reflecting the underlying level of additional risk at the Authority yet to be agreed by the Authority or PSAA (See Note 1)	£102,541	£102,541	£102,541
Revised Proposed Scale Fee	£213,034	£213,034	£213,034
Risk based fee variations (see Note 2)	TBC	TBC	£36,300
Code of Audit Practice 2020 and updated auditing and accounting standards 2020/21 (see note 3)	-	£14,400	-
Total Fees	TBC	TBC	£249,334

All fees exclude VAT

Note 1 - In order to meet regulatory and compliance audit requirements not present in the market at the time of our most recent bid to PSAA, we undertook additional work at a fee of £102,541 to deliver the audit in 2019/20 which reoccurred in 2020/21 and we expect to reoccur in subsequent years. This additional fee has not been agreed with the Authority and is yet to be approved by PSAA.

Note 2 - The 2019/20 risk based fees have been agreed with the Director of Corporate Services but are yet to be fully approved by PSAA. We are yet to fully quantify 2020/21 risk based fee variations and agree them with the Authority. These variations will include the extensive valuation work by EYRE and consultation for the prior period adjustment. We will provide an update in due course.

Note 3 - The impact on audit fees of the new requirements in the Code of Audit Practice 2020 and new or updated auditing and accounting standards for 2020/21 audits as set out in the Additional information for 2020/21 audit fees issued by PSAA in August 2021. This paper sets out agreed fee ranges for the new requirements. For London Borough of Merton we determined this to be £10,000 for VFM and £4,400 in relation to the new estimates standard ISA540. This does not cover the additional work in relation to additional pensions assurance which was identified in September 2021. We will discuss the additional fee with officers as part of preparing the 2020/21 Auditor's Annual Report.