London Borough of Merton
Audit planning report

Year ended 31 March 2022

9 June 2022

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Agenda Item 5

Building a better working world

9 June 2022

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

Dear Committee Members

Audit planning report

We are pleased to attach our audit planning report for the forthcoming meeting of the Standards and General Purposes Committee. The purpose of this report is provide the Committee with a basis to review our proposed audit approach and scope for the 2021/22 audit, in accordance with the requirements of the auditing standards and other professional requirements, but also to ensure that our audit is aligned with the Committees' service expectations.

This report summarises our assessment of the key issues which drive the development of an effective audit for the London Borough of Merton. We have aligned our audit approach and scope with these. This report is intended solely for the information and use of the Standards and General Purposes Committee and management, and is not intended to be and should not be used by anyone other than these specified parties.

We welcome the opportunity to discuss this report with you on 21 July 2022 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.psaa.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 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 London Borough of Merton those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the Standards and General Purposes Committee and management of the London Borough of Merton for this report or for the opinions we have formed. It should not be provided to any third-party without our prior written consent.

01 Overview of our 2021-22 audit strategy

Overview of our 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
Misstatements due to fraud and error	Fraud risk / Significant risk	No Change in risk or focus	As identified in ISA 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that would otherwise appear to be operating effectively. In addition to our overall response, we consider where these risks may manifest themselves and identify separate fraud risks as necessary below.
Inappropriate capitalisation of revenue expenditure	Fraud risk / Significant risk	No Change in risk or focus	Linked to the risk of 'misstatements due to fraud and error', inappropriate revenue or expenditure recognition would most likely be affected through the override of controls. This risk manifests itself in areas where management makes judgements that impact the General Fund balance through determining whether items of expenditure are financed from capital or revenue resources. As such we associate this risk with capital additions and Revenue Expenditure Funded from Capital Under Statute (REFCUS).
Risk of fraud in revenue and expenditure recognition – Covid-19 Grants	Fraud risk / Significant risk	New risk for 2021/22	Under ISA 240, there is a presumed risk that revenue may be misstated due to improper revenue recognition. In the public sector, this requirement is modified by Practice Note 10 issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition. We have identified the accounting for Covid-19 related grant income as a specific area where revenue may be inappropriately recognised.

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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	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. 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. As a result of our work last year we identified 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.
National Non-Domestic Rates (NNDR) Appeals Provision	Inherent risk	No change in risk or focus	Statistics compiled by the Department for Levelling Up, Housing and Communities (DLUHC), 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. In light of this we consider there to be a higher inherent risk of misstatement of the Authority’s NNDR appeals provision.

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Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from PY	Details
Going Concern	Inherent Risk	No change in risk or focus	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. The financial landscape for the Council remains challenging and it will again need to undertake a going concern assessment covering a period up to 12 months from the expected date of final authorisation. It will also need to make an appropriate disclosure in the financial statements. In addition, the revised auditing standard on going concern requires additional challenge from auditors on the assertions being made by management.
Valuation of defined benefit pension scheme	Inherent Risk	No change in risk or focus	The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme. The Council's pension liability is a material estimate and is required to be disclosed on the Council's balance sheet. The information disclosed is based on the IAS 19 report issued by the Pension Fund actuary to the Council. Accounting for these schemes involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on its behalf. We are required to undertake procedures on the use of the use of the actuary as management's expert and the assumptions underlying fair value estimates.

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Overview of our 2021/22 audit strategy

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Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from PY	Details
Infrastructure Asset Valuation	Area of Focus	New Inherent risk	In March 2022, an issue was raised with the National Audit Office's Local Government technical network in relation to the accounting for infrastructure assets. Under the CIPFA Code of Local Authority Accounting, these assets are held at depreciated historic cost. Following more detailed consideration by auditors this year, it has been identified that although local authorities add expenditure incurred on replacing or enhancing such assets, most do not appear to be reviewing the Code requirement to establish whether this spend is a replacement of an asset, or a recognised component, and therefore, are not derecognising the old asset or component. As a consequence the gross cost and gross accumulated depreciation is therefore continually increasing, and the balance sheet may be misstated where the expenditure is a replacement for an asset/component that is not fully depreciated. CIPFA has established a task and finish group to address this. The group will consider the issues arising and how it might assist in their resolution. Such assistance may take the form of producing additional guidance and/or making amendments to the Code of Local Authority Accounting on the matter. We will engage with management to assess the impact of the issue on the Council's accounts.

Auditing accounting estimates

International Standard on Auditing (UK) (ISA (UK)) 540, which has recently been revised, deals with the auditor's responsibilities relating to accounting estimates and related disclosures in an audit of financial statements. Specifically, it includes detailed requirements and guidance that refer to other relevant ISAs (UK) applied in relation to accounting estimates and related disclosures. It also includes requirements and guidance on the evaluation of misstatements of accounting estimates and related disclosures, and indicators of possible management bias. We are required to comply with the requirements of the revised ISA (UK), undertake detailed work to understand the material estimates used by the Council to prepare its financial statements, and challenge and test the data and assumptions that underpin them. Due to the specialised nature of some of the estimates made by the Council, for example those relating to PPE and IP valuation and assessment of the IAS 19 pensions liability, the input of appropriately qualified and experienced specialists is required to support our work.

Overview of our 2021/22 audit strategy

Audit scope

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

- Our audit opinion on whether the financial statements of London Borough of Merton give a true and fair view of the financial position as at 31 March 2022 and of the income and expenditure for the year then ended; and
- Our conclusion on the Council's arrangements to secure economy, efficiency and effectiveness.

We will also review and report to the National Audit Office (NAO), to the extent and in the form required by them, on the Council's Whole of Government Accounts return. Our audit will also include the mandatory procedures that we are required to perform in accordance with applicable laws and auditing standards.

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

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

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

We will provide an update to the Standards and General Purposes Committee Members on the results of our work in these areas in our report to those charged with governance which we currently expect to issue in November 2022.

Taking the above into account, and as articulated in this audit plan, our professional responsibilities require us to independently assess the risks associated with providing an audit opinion and undertake appropriate procedures in response to that. Our Terms of Appointment with PSAA allow them to vary the fee dependent on "the auditors assessment of risk and the work needed to meet their professional responsibilities". PSAA are aware that the setting of scale fees has not kept pace with the changing requirements of external audit with increased focus on, for example, the valuations of land and buildings, the auditing of complex investment assets, the valuation of pension obligations, the introduction of new accounting standards such as IFRS 9 and 15 in recent years. Therefore to the extent any of these are relevant in the context of the London Borough of Merton audit, we will discuss these with management as to the impact on the scale fee.

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02 Audit risks

Our response to significant risks

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

Misstatements due to fraud or error*

Financial statement impact

Misstatements that occur in relation to the risk of fraud due to management override could affect a number of areas of the financial statements.

What is the risk?

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.

We identify and respond to this risk on every audit engagement.

What will we do?

- Inquire of management about risks of fraud and the controls put in place to address those risks.
- Understand the oversight given by those charged with governance of management's processes over fraud.
- Consider of the effectiveness of management's controls designed to address the risk of fraud.

Perform mandatory procedures regardless of specifically identified fraud risks, including:

- Testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements
- Assessing accounting estimates for evidence of management bias, and
- Evaluating the business rationale for significant unusual transactions.

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

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

Our response to significant risks (continued)

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

Inappropriate capitalisation of revenue expenditure*

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Financial statement impact

If revenue transactions were financed from capital resources, this would have the impact of understating revenue expenditure (causing the general fund to be overstated) and overstating capital additions and/or Revenue Expenditure Funded from Capital Under Statute (REFCUS) in the financial statements.

What is the risk?

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

Linked to the risk of 'misstatements due to fraud and error', inappropriate revenue or expenditure recognition would most likely be affected through the override of controls.

This risk manifests itself in areas where management makes judgements that impact the general fund balance through determining whether items of expenditure are financed from capital or revenue resources.

As such we associate this risk with capital additions and Revenue Expenditure Funded from Capital Under Statute (REFCUS).

What will we do?

We will:

- test a sample of capital additions. We will examine invoices, capital expenditure authorisations and other evidence that supports the appropriateness of these additions. We will ensure that the items are capital in nature, and do not include revenue items; and
- test a sample of expenditure classified as REFCUS to ensure that it meets the definition in the Local Government Act 2003 and related regulations and directions.

We will utilise our data analytics capabilities to assist with our work through identifying high risk transactions, such as items originally recorded as revenue expenditure and subsequently capitalised.

Our response to significant risks

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

Risk of fraud in revenue and expenditure recognition *	What is the risk?	What will we do?
Financial statement impact Misstatements that occur in relation to the risk of fraud in revenue and expenditure recognition could affect the income and expenditure accounts.	Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition. In the public sector, this requirement is modified by Practice Note 10 issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition. We have considered the income and expenditure streams of the Council and our assessment is that the risk is most prominent with regards to inappropriate recognition of Covid-related grant funding, including incorrect identification of whether the Council is acting as the principal or an agent and whether any associated terms and conditions were met prior to recognition.	• Review the accounting treatment of new Covid-related grants to confirm that they have been correctly accounted for as either a principal or agent arrangement. • Test a sample of Covid-19 related grants to ensure that any terms and conditions were met prior to recognition as income.

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Our response to significant risks (continued)

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

Valuation of land and buildings

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Financial statement impact

Misstatements that occur in relation to the valuation of land and buildings could lead to an under or overstatement of asset values on the balance sheet

What is the risk?

The fair value of land and buildings represents a significant balance in the Council's financial statements and are subject to valuation changes, impairment reviews and depreciation charges.

Management is required to make material judgements and apply estimation techniques to calculate the year-end balances recorded in the balance sheet. 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.

In 2020/21 Significant changes were 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. Our work highlighted

- The incorrect application of amenity land value for undeveloped land in non-school assets; and
- The blanket use of discounted residential land rates to non residential assets valued at DRC.

At the end of 2018/19 the total net book value of PPE increased by approximately £47.5million, with a further £2.2million increase in 2019/20 and a further increase of £5.2million in 2020/21.

What will we do?

We will:

- consider the competence, capability and objectivity of the Council's valuers;
- consider the scope of valuers' work;
- ensure L&B assets have been revalued within a 5 year rolling programme as required by the Code;
- consider if there are any specific changes to assets that should have been communicated to the valuer(s);
- sample test key inputs used by the valuer(s) when producing valuations;
- consider the results of the valuers' work;
- challenge the assumptions used by the Council's valuers by reference to external evidence and our EY valuation specialists (where necessary);
- test journals for the valuation adjustments to confirm that they have been accurately processed in the financial statements;
- test a sample of assets revalued in year to confirm that the valuation basis is appropriate and the accounting entries are correct;
- review any assets that are not subject to valuation in 2021/22 to confirm the remaining asset base is not materially misstated (at the time of writing we expect all relevant assets to be valued in the year); and
- ensure the appropriate disclosure has been made in the accounts in relation to any valuation uncertainty.

Other areas of audit focus

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

What is the risk/area of focus?	What will we do?
National Non-Domestic Rates (NNDR) Appeals Provision (Inherent risk) 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. In light of this we consider there to be a higher inherent risk of misstatement of the Authority's NNDR appeals provision.	We will consider the Council's estimation of the NNDR appeals provision by performing the following: • Review the assumptions made by the Council's NNDR appeals provision specialist Analyse Local; • Assess the reasonableness of any local adjustments made by the Council on the NNDR appeals provision.
Going Concern Disclosure (Inherent risk) 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. The financial landscape for the Council remains challenging and it will again need to undertake a going concern assessment covering a period up to 12 months from the expected date of final authorisation. It will also need to make an appropriate disclosure in the financial statements. In addition, the revised auditing standard on going concern requires additional challenge from auditors on the assertions being made by management.	We will meet the requirements of the revised auditing standard on going concern (ISA 570) and consider the adequacy of the Council's going concern assessment and its disclosure in the accounts by: • Challenging management's identification of events or conditions impacting going concern. • Testing management's resulting assessment of going concern by evaluating supporting evidence (including consideration of the risk of management bias). • Reviewing the Council's cashflow forecast covering the foreseeable future, to ensure that it has sufficient liquidity to continue to operate as a going concern. • Undertaking a 'stand back' review to consider all of the evidence obtained, whether corroborative or contradictory, when we draw our conclusions on going concern. • Challenging the disclosure made in the accounts in respect of going concern and any material uncertainties.

Other areas of audit focus (continued)

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

What is the risk/area of focus?	What will we do?
Valuation of defined benefit pension scheme (Inherent risk) The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme. The Council's pension liability is a material estimated balance and is required to be disclosed on the Council's balance sheet. The information disclosed is based on the IAS 19 report issued by the Pension Fund actuary to the Council. Accounting for these schemes involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on its behalf. We are required to undertake procedures on the use of the use of the actuary as management's expert and the assumptions underlying fair value estimates.	We will: • liaise with the auditors of Merton Pension Fund, to obtain assurances over the information supplied to the actuary in relation to the Council's scheme members; • assess the work of the LGPS Pension Fund actuary including the assumptions they have used by relying on the work of PWC - Consulting Actuaries commissioned by the National Audit Office for all Local Government sector auditors, and considering any relevant reviews by the EY actuarial team; • review Merton Pension Fund's financial statements and compare the year end asset value with the estimate used by the actuary when producing the Council's IAS 19 report; and • review and test the accounting entries and disclosures made within the Council's financial statements in relation to IAS19.
Infrastructure asset valuation (Inherent risk) In March 2022, an issue was raised with the National Audit Office's Local Government technical network in relation to the accounting for infrastructure assets. Under the CIPFA Code of Local Authority Accounting, these assets are held at depreciated historic cost. Following more detailed consideration by auditors this year, it has been identified that while local authorities add expenditure incurred on replacing or enhancing such assets, most do not appear to be reviewing the Code requirement to establish whether this spend is on a replacement of an asset, or a recognised component, and therefore, are not derecognising the old asset or component. As a consequence the gross cost and gross accumulated depreciation is continually increasing, and the balance sheet may therefore be misstated where the expenditure is a replacement for an asset/component that is not fully depreciated.	CIPFA has established a task and finish group to further consider this issue. The group will consider the issues arising and how it might assist in their resolution. Such assistance may take the form of producing additional guidance and/or making amendments to the Code of Local Authority Accounting on the matter. We will engage with management to assess the impact of the issue on the Council's accounts, also considering any additional guidance or changes to the Code of Local Authority Accounting following completion of the review by the CIPFA task and finish group.

03 Value for Money Risks

Value for money

The Council's responsibilities for value for money

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

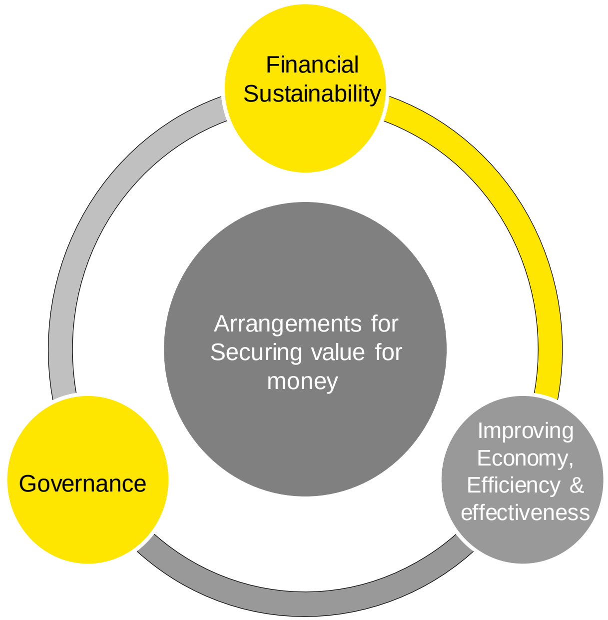
As part of the material published with its financial statements, the Council is required to bring together commentary on its governance framework and how this has operated during the period in a governance statement. In preparing its governance statement, the Council tailors the content to reflect its 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 Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. However, there are no longer overall evaluation criteria on which we need to conclude. Instead the 2020 Code requires the auditor to design their work to provide them with sufficient assurance to enable them to report to the Council a commentary against specified reporting criteria (see below) on the arrangements the Council 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 Council plans and manages its resources to ensure it can continue to deliver its services;
- Governance
  How the Council ensures that it makes informed decisions and properly manages its risks; and
- Improving economy, efficiency and effectiveness:
  How the Council uses information about its costs and performance to improve the way it manages and delivers its services.



Value for money

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 Council'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 Council's arrangements, we are required to consider:

- The Council's governance statement
- Evidence that the Council's arrangements were in place during the reporting period;
- Evidence obtained from our work on the accounts;
- The work of inspectorates 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 Council 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 Council'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 Council;
- Financial consequences in comparison to, for example, levels of income or expenditure, levels of reserves, or impact on budgets or cashflow forecasts;
- The impact of the weakness on the Council's reported performance;
- Whether the issue has been identified by the Council'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 Council has had to respond to the issue.

Value for money

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 audit committee.

Reporting on VFM

In addition to the commentary on arrangements, where we are not satisfied that the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources the 2020 Code has the same requirement as the 2015 Code in that we should refer to this by exception in the audit report on the financial statements.

However, a new requirement under the 2020 Code is for us to include the commentary on arrangements in a new 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 Council'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.

Status of our 2021/22 VFM planning

We have yet to fully complete our detailed VFM planning. However, based on our initial planning work undertaken to date we consider the following issues relevant to our work in 2021/22:

- the latest position regarding the Dedicated Schools Grant (DSG) deficit and potential safety valve funding received;
- the outcome of the OFSTED inspection that took place in February 2022;
- the impact of the Council renegotiating its energy contract due to the ongoing situation in Ukraine; and
- The outcome of internally commissioned reviews, including
    - the review of Commercial Services undertaken by Human Engine; and
    - an investment strategy review being undertaken by Grant Thornton

We will confirm our final assessment of risk to the Standards and General Purposes Committee in due course.

04 Audit materiality

2021/22 Audit

Materiality

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

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

Group 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 £9,8 million.

Performance materiality

£7.5m

Group 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 £7.3 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. We have set we have set a lower level of materiality for remuneration disclosures, related party transactions, members' allowances and exit packages – we have set this at £5k which is based on 1% of audit differences above

05 Scope of our audit

Our Audit Process and Strategy

Objective and Scope of our Audit scoping

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

We issue an audit report that covers:

1. Financial statement audit

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

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

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

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

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

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

Our Audit Process and Strategy (continued)

Audit Process Overview

Our audit involves:

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

For 2021/22 we plan to follow a substantive approach to the audit as we have concluded this is the most efficient way to obtain the level of audit assurance required to conclude that the financial statements are not materially misstated.

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

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

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

Internal audit:
We review internal audit plans and the results of internal audit work. We use this to inform our ongoing assessment of risks likely to impact our responsibilities.

06 Audit team

Audit team

Audit team structure:

Elizabeth Jackson
Associate Partner

Ian Young
Senior Manager

Albina Nayga
Senior

EY Real Estates

PWC (consulting actuary) and EY Actuaries

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Use of specialists

- Our approach to the involvement of specialists, and the use of their work.

When auditing key judgements, we are often required to rely on the input and advice provided by specialists who have qualifications and expertise not possessed by the core audit team. The areas where either EY or third party specialists provide input for the current year audit are:

Area	Specialists
Valuation of Land and Buildings	The Council's own internal valuer is engaged by the Council for valuation of its PPE. EY Real Estates
Pensions disclosure	Barnett Waddingham – Actuary to Merton Pension Fund EY Actuaries and PWC (consulting actuary) and EY Actuaries

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

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

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

07 Audit timeline

Audit timeline

Timetable of communication and deliverables

Timeline

Below is a timetable showing the key stages of the audit and the deliverables we have agreed to provide to you through the audit cycle in 2021/22. The final timetable will depend on our ability to obtain sufficient, appropriate audit evidence to support our audit opinion.

From time to time matters may arise that require immediate communication with the Standards and General Purposes Committee and we will discuss them with the Committee's Chair as appropriate. We will also provide updates on corporate governance and regulatory matters as necessary.

Audit phase	Timetable	Committee Meeting timetable	Deliverables
Planning: Risk assessment and setting of scopes Walkthrough of key systems and processes	April		Audit Planning Report Drafted
	July	Standards and General Purposes Committee	Audit Planning Report to be presented to the 21 July meeting of the Standards and General Purposes Committee .
Year end audit	October to November	Standards and General Purposes Committee	Delivery of the year-end audit and Audit Planning Update (if required)
	November	Standards and General Purposes Committee	Audit Results Report Audit opinions and completion certificates
Audit Completion procedures	December	Standards and General Purposes Committee	Auditor's Annual Report which will include commentary on key reporting themes for the Council.

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08 Independence

Introduction

The FRC Ethical Standard and ISA (UK) 260 “Communication of audit matters with those charged with governance”, requires us to communicate with you on a timely basis on all significant facts and matters that bear upon our integrity, objectivity and independence. The Ethical Standard, as revised in December 2019, requires that we communicate formally both at the planning stage and at the conclusion of the audit, as well as during the course of the audit if appropriate. The aim of these communications is to ensure full and fair disclosure by us to those charged with your governance on matters in which you have an interest.

Required communications	
Planning stage	**Final stage**
▸ The principal threats, if any, to objectivity and independence identified by Ernst & Young (EY) including consideration of all relationships between you, your affiliates and directors and us; ▸ The safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality review; ▸ The overall assessment of threats and safeguards; ▸ Information about the general policies and process within EY to maintain objectivity and independence.	▸ In order for you to assess the integrity, objectivity and independence of the firm and each covered person, we are required to provide a written disclosure of relationships (including the provision of non-audit services) that may bear on our integrity, objectivity and independence. This is required to have regard to relationships with the entity, its directors and senior management, its affiliates, and its connected parties and the threats to integrity or objectivity, including those that could compromise independence that these create. We are also required to disclose any safeguards that we have put in place and why they address such threats, together with any other information necessary to enable our objectivity and independence to be assessed; ▸ Details of non-audit/additional services provided and the fees charged in relation thereto; ▸ Written confirmation that the firm and each covered person is independent and, if applicable, that any non-EY firms used in the group audit or external experts used have confirmed their independence to us; ▸ Details of any non-audit/additional services to a UK PIE audit client where there are differences of professional opinion concerning the engagement between the Ethics Partner and Engagement Partner and where the final conclusion differs from the professional opinion of the Ethics Partner ▸ Details of any inconsistencies between FRC Ethical Standard and your policy for the supply of non-audit services by EY and any apparent breach of that policy; ▸ Details of all breaches of the IESBA Code of Ethics, the FRC Ethical Standard and professional standards, and of any safeguards applied and actions taken by EY to address any threats to independence; and ▸ An opportunity to discuss auditor independence issues.

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

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

Independence

Relationships, services and related threats and safeguards

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

Overall Assessment

Overall, we consider that the safeguards that have been adopted appropriately mitigate the principal threats identified and we therefore confirm that EY is independent and the objectivity and independence of Elizabeth Jackson, your audit engagement partner, and the audit engagement team have not been compromised.

Self interest threats

A self interest threat arises when EY has financial or other interests in the Council. Examples include where we receive significant fees in respect of non-audit services; where we need to recover long outstanding fees; or where we enter into a business relationship with you. At the time of writing, there are no long outstanding fees.

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

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

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

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

Self review threats

Self review threats arise when the results of a non-audit service performed by EY or others within the EY network are reflected in the amounts included or disclosed in the financial statements.

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

Management threats

Partners and employees of EY are prohibited from taking decisions on behalf of management of the Council. Management threats may also arise during the provision of a non-audit service in relation to which management is required to make judgements or decision based on that work.

There are no management threats at the date of this report.

Relationships, services and related threats and safeguards

Other threats

Other threats, such as advocacy, familiarity or intimidation, may arise.

There are no other threats at the date of this report.

Other communications

EY Transparency Report 2021

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

Details of the key policies and processes in place within EY for maintaining objectivity and independence can be found in our annual Transparency Report which the firm is required to publish by law. The most recent version of this Report is for the year ended 1 July 2021 and can be found here:

EY UK 2021 Transparency Report | EY UK

09 Appendices

Appendix A – Audit Fees

Services provided by Ernst & Young

The table below includes a summary of the proposed fees for the year ended 31 March 2022 in line with the disclosures set out in FRC Ethical Standard and in statute.

Full details of the services that we have provided are shown below.

	Planned Fee 2021/22	Final Fee 2020/21	Final Fee 2019/20
	£	£	£
Scale Fee – Code work	110,493	110,493	110,493
Final 2019/20 scale fee variation as determined by PSAA (See Note 1)	N/A	N/A	84,440
Proposed 2020/21 scale fee variation yet to be determined by PSAA (see Note 2)	N/A	159,458	N/A
2021/22 scale fee variation not yet quantified (see Note 3)	133,276	N/A	N/A
Total Fees	TBC	269,991	192,934

Note 1 - Given the number of significant risks and areas of audit focus that we highlighted in our audit plan as areas of additional work required to meet our responsibilities, and 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 provided an estimate of the additional recurrent fee that will be incurred in 2019/20 and in future years of £102,541. We also estimated an additional non-recurrent fee of £36,300 relating to specific risk based fee variations of the Council in 2019/20. PSAA ultimately determined that an additional 2019/20 fee of £84,440 should be paid by the Council on a non-recurrent basis.

Note 2 - Our proposed 2020/21 scale fee variation of £159,458 has been shared with the Council and submitted to PSAA, but not yet determined. Of the total proposed scale fee variation we consider that approximately £133,276 is for recurring issues and the cost of regulatory compliance, and approximately £26,222 relates to the specific audit risks of the Council in 2020/21.

Note 3 – We have yet to quantify our proposed scale fee variation for 2021/22. We will report our proposed 2021/22 scale fee variation to management the Standards and General Purposes Committee in due course.

Appendix B

Required communications with the Standards and General Purposes Committee

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

		Our Reporting to you
Required communications	**What is reported?**	**When and where**
Terms of engagement	Confirmation by the Standards and General Purposes Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Our responsibilities	Reminder of our responsibilities as set out in the engagement letter	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Planning and audit approach	Communication of the planned scope and timing of the audit, any limitations and the significant risks identified. When communicating key audit matters this includes the most significant risks of material misstatement (whether or not due to fraud) including those that have the greatest effect on the overall audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team	Audit Planning Report, July 2022 meeting of the Standards and General Purposes Committee.
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	Audit Results Report, November 2022 meeting of the Standards and General Purposes Committee.

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

		Our Reporting to you
Required communications	**What is reported?**	**When and where**
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	Audit Results Report, November 2022 meeting of the Standards and General Purposes Committee.
Misstatements	• Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation • The effect of uncorrected misstatements related to prior periods • A request that any uncorrected misstatement be corrected • Corrected misstatements that are significant • Material misstatements corrected by management	Audit Results Report, November 2022 meeting of the Standards and General Purposes Committee.
Fraud	• Enquiries of the Standards and General Purposes Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity • Any fraud that we have identified or information we have obtained that indicates that a fraud may exist • A discussion of any other matters related to fraud	Audit Results Report, November 2022 meeting of the Standards and General Purposes Committee.
Related parties	Significant matters arising during the audit in connection with the entity'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 entity	Audit Results Report, November 2022 meeting of the Standards and General Purposes Committee.

Appendix B

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

		Our Reporting to you
Required communications	What is reported?	When and where
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	Audit Planning Report, July 2022 meeting of the Standards and General Purposes Committee. Audit Results Report, November 2022 meeting of the Standards and General Purposes Committee.
External confirmations	• Management's refusal for us to request confirmations • Inability to obtain relevant and reliable audit evidence from other procedures	Audit Results Report, November 2022 meeting of the Standards and General Purposes Committee.
Consideration of laws and regulations	• Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off • Enquiry of the Standards and General Purposes Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Committee may be aware of	Audit Results Report, November 2022 meeting of the Standards and General Purposes Committee.
Internal controls	• Significant deficiencies in internal controls identified during the audit	Audit Results Report, November 2022 meeting of the Standards and General Purposes Committee.
Representations	• Written representations we are requesting from management and/or those charged with governance	Audit Results Report, November 2022 meeting of the Standards and General Purposes Committee.

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

		Our Reporting to you
Required communications	What is reported?	When and where
Material inconsistencies and misstatements	• Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	Audit Results Report, November 2022 meeting of the Standards and General Purposes Committee.
Auditors report	• Key audit matters that we will include in our auditor's report • Any circumstances identified that affect the form and content of our auditor's report	Audit Results Report, November 2022 meeting of the Standards and General Purposes Committee.

Additional audit information

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

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

Additional audit information (continued)

Purpose and evaluation of materiality

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

Materiality determines:

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

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