London Borough of Merton

Outline Audit Plan

Year ended 31 March 2023

25 February 2023

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Agenda Item 5

Building a better working world

25 February 2023

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 2022/23 audit before detailed planning 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 2021/22 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. This report sets out the areas which we consider to be a focus for our 2022/23 audit.

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, 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 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.

01 2022/23 Audit

2022/23 Audit

2022/23 financial statements audit

Planning for 2022/23

We have met the Interim Executive Director of Finance and Digital and members of the finance team during January and February 2023 to discuss the conclusion of our 2021/22 audit and have a detailed planning meeting for the 2022/23 audit on 2 March 2023.

We have not yet commenced our initial planning work for the 2022/23 audit. However, we set out in this report our initial considerations of the risks for the audit – these are broadly similar to those identified in 2021/22. We will update these risks as our planning progresses and new issues emerge during the course of the year.

We have arranged regular liaison meetings throughout the year to inform our continuous audit planning. We will also take in to account any updated CIPFA guidance for the 2022/23 year.

2022/23 Audit

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

£577m

We consider gross revenue expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Authority. For the Outline Audit Plan, we have taken this figure from the audited 2021/22 group financial statements.

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Planning materiality

£10.4m

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, group planning materiality for 2022/23 has been set at £10.4 million, which represents 1.8% of the prior years gross expenditure on provision of services in the group comprehensive income and expenditure statement. The use of 1.8% of gross revenue expenditure in line with the prior year.

Planning materiality for the Authority has been determined at £10.3 million on the same basis as the group.

Performance materiality

£7.8m

Performance materiality is the amount we use to determine the extent of our audit procedures. We have set performance materiality at £7.8 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 £7.7 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 2022/23 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*	*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.*
Misstatements due to fraud or 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*	*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 and Revenue Expenditure Funded by Capital Under Statute (REFCUS) (if this is material in 2022/23) as an area of risk.*

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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.*
Infrastructure Assets	*Inherent risk*	*New risk at the end of 2021/22 – for 2022/23 reduction in risk from significant to inherent*	*An issue was raised through the National Audit Office's Local Government Technical Group during 2022 that some local authorities were not writing out the gross cost and accumulated depreciation on highways infrastructure assets when a major part / component has been replaced or decommissioned. CIPFA issued an adaptation to the Code of Practice on Local Authority Accounting to allow reporting on a net basis for infrastructure assets and in December 2022 DLUHC issued a Statutory Instrument (The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2022) which allows for the infrastructure assets opening balance to be brought forward without amendment and determines the carrying amount to be derecognised in respect of replaced components to be nil.* *The Council took the option to apply the statutory instrument to their 2021/22 financial statements and amended the presentation of infrastructure assets, included the required disclosure note and updated their accounting policy as required by the statutory instrument. We have reduced the risk to inherent as this still remains an area of focus for the audit.*

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
National Non-Domestic Rates (NNDR) Appeals Provision	*Inherent risk*	*No change in risk or focus*	*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.*
Pension Liability Valuation	*Inherent risk*	*No change in risk or focus*	*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.* *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.*
Going Concern	*Area of focus*	*Change from inherent risk to area of 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, including a comprehensive cashflow forecast.* *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.*

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.

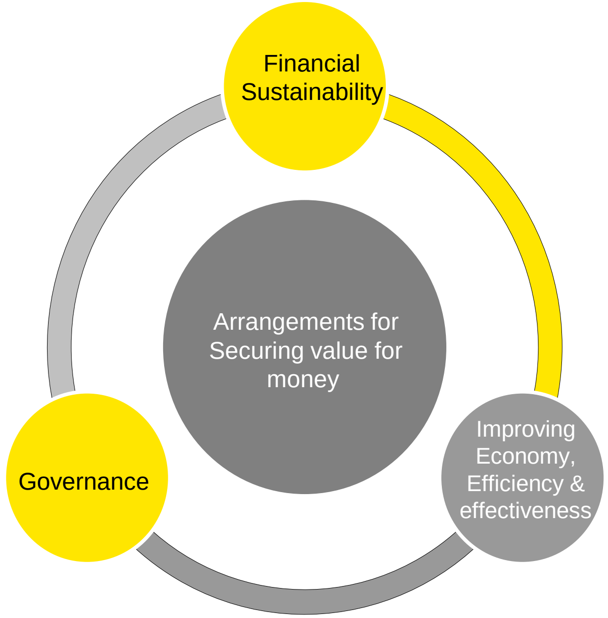
As part of the material published with its financial statements, the Authority is required to bring together commentary on its governance framework and how this has operated during the period in an annual governance statement. In preparing its annual governance statement, the Authority tailors the content 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 a 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 Audit 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.

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Status of our 2022/23 VFM planning

We have yet to commence our detailed VFM planning.

However, one area of focus will be on the arrangements that the Authority had in place during the year for the sale of its wholly owned subsidiary. At this stage of the audit, this is an area of focus for the detailed risk assessment [planning and not a risk of significant weakness.

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 Interim Executive Director of Finance and Digitial following the completion of the audit.

	Planned fee 2022/23	Proposed fee 2021/22	Final fee 2020/21
	£	£	£
Scale Fee – Code work	*£110,493*	*£110,493*	*£110,493*
Final 2020/21 scale fee variation determined by PSAA (Note 1)			*£99,821*
Scale fee rebasing (Note 2)	*£133,276*	*£133,276*	-
Risked based fee variations (Note 3)	*TBC*	*TBC*	-
Total Fees	***TBC***	***TBC***	***£210,314***

All fees exclude VAT

Note 1 – The 20/21 final fee includes a scale fee variation which has been determined by PSAA of £99,821.

Note 2 - Given the number of significant risks and areas of audit focus that we highlighted in our audit plan as areas of additional work 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 undertook additional work at a fee of £133,276 to deliver the audit in 2020/21 which reoccurred in 2021/22 and we expect to reoccur in subsequent years. This also includes the impact of amended auditing standards, and the changing requirements for our VFM responsibilities. PSAA has provided outline amounts to charge for the work required to address these latter areas.

Note 3 - We have identified new and continuing risks for 2021/22 that are not within the scale fee (infrastructure assets). Additional work was required to address these risks and we will quantify the impact of these on the fee and discuss with management.

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