Milton Keynes Council

Annual Audit Letter for the year ended 31 March 2016

October 2016

Ernst & Young LLP

Building a better working world

Contents

In April 2015 Public Sector Audit Appointments Ltd (PSAA) issued ''Statement of responsibilities of auditors and audited bodies 2015-16'. It is available from the Chief Executive of each audited body and via the PSAA website (www.psaa.co.uk)

The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The 'Terms of Appointment from 1 April 2015' issued by 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 statute, and covers matters of practice and procedure which are of a recurring nature.

This Annual Audit Letter is prepared in the context of the Statement of responsibilities. It is addressed to the Members of the audited body, and is prepared for their sole use. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure – If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

Executive Summary

Executive Summary

We are required to issue an annual audit letter to Milton Keynes Council (the Council) following completion of our audit procedures for the year ended 31 March 2016.

Below are the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on the Council's: ► Financial statements	Unqualified – the financial statements give a true and fair view of the financial position of the Council as at 31 March 2016 and of its expenditure and income for the year then ended.
► Consistency of other information published with the financial statements	Other information published with the financial statements was consistent with the Annual Accounts.
Concluding on the Council's arrangements for securing economy, efficiency and effectiveness	We concluded that the Council had put in place proper arrangements to secure value for money in its use of resources.

Area of Work	Conclusion
Reports by exception: ► Consistency of the Annual Governance Statement	The Annual Governance Statement was consistent with our understanding of the Council.
► Public interest report	We had no matters to report in the public interest.
► Written recommendations to the Council, which should be copied to the Secretary of State	We had no matters to report.
► Other actions taken in relation to our responsibilities under the Local Audit and Accountability Act 2014	We had no matters to report.

Area of Work	Conclusion
Reporting to the National Audit Office (NAO) on our review of the Council's Whole of Government Accounts return (WGA).	We had no matters to report.

As a result of the above we have also:

Area of Work	Conclusion
Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit.	Our Audit Results Report was issued on 13 September 2016.
Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.	Our certificate was issued on 21 October 2016

We would like to take this opportunity to thank the Council's staff for their assistance during the course of our work.

Maria Grindley

Director
For and on behalf of Ernst & Young LLP

Purpose

Purpose

The Purpose of this Letter

The purpose of this annual audit letter is to communicate to Members and external stakeholders, including members of the public, the key issues arising from our work, which we consider should be brought to the attention of the Council.

We have already reported the detailed findings from our audit work in our 2015/16 Audit Results Reports to the 28 September 2016 Audit Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council.

Responsibilities

Responsibilities

Responsibilities of the Appointed Auditor

Our 2015/16 audit work has been undertaken in accordance with the Audit Plan that we issued on 29 February 2016. Our audit is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- Expressing an opinion:
  - On the 2015/16 financial statements; and
  - On the consistency of other information published with the financial statements.
- Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.
- Reporting by exception:
  - If the Annual Governance Statement is misleading or not consistent with our understanding of the Council;
  - Any significant matters that are in the public interest;
  - Any written recommendations to the Council, which should be copied to the Secretary of State; and
  - If we have discharged our duties and responsibilities as established by the Local Audit and Accountability Act 2014 and Code of Audit Practice.

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

Responsibilities of the Council

The Council is responsible for preparing and publishing its statement of accounts accompanied by an Annual Governance Statement. In the Annual Governance Statement, the Council reports publicly each year on how far it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in year, and any changes planned in the coming period.

The Council is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Financial Statement Audit

Financial Statement Audit

Key Issues

The Council's Statement of Accounts is an important tool for the Council to show how it has used public money and how it can demonstrate its financial management and financial health.

We audited the Council and Group's Statements of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office and issued unqualified audit reports on 28 September 2016.

Our detailed findings were reported to the 28 September 2016 Audit Committee. The key issues identified as part of our audit were as follows:

Significant Risk	Conclusion
Management override of controls A risk present on all audits is that management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly, and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Auditing standards require us to respond to this risk by testing the appropriateness of journals, testing accounting estimates for possible management bias and obtaining an understanding of the business rationale for any significant unusual transactions.	We obtained a full list of the journals posted to the general ledger during the year, and analysed these journals using criteria we set to identify unusual journal types or amounts. We then tested a sample of journals that met our criteria to supporting documentation. We considered that the accounting estimates most susceptible to bias were: • Property valuations • Pensions entries based on figures supplied by the actuary Overall there was no indication of bias within the calculation of these accounting estimates. We identified no transactions during our audit which appeared unusual or outside the Council's normal course of business. We did not identify any material weaknesses in controls or evidence of material management override. We did not identify any instances of inappropriate judgements being applied.
Revenue and expenditure recognition Auditing standards also required us to presume that there is a risk that revenue and expenditure may be misstated due to improper recognition or manipulation. We responded to this risk by reviewing and testing material revenue and expenditure streams and revenue cut-off at the	Our testing focussed on the Council's main expenditure streams and on ensuring that creditors and provisions were not understated, as this would also understate expenditure. We also carried out cut-off testing where we examined a sample of receipts and payments after year end to ensure that where the transactions related to 2015/16 that they were properly recorded in the accounts.

Significant Risk	Conclusion
year end.	Overall our testing did not reveal any material misstatements with respect to revenue and expenditure recognition.
Property Asset Valuation Valuation of property assets and capital expenditure are significant accounting estimates that have material impact on the financial statements. One area which may be susceptible to manipulation is the capitalisation of revenue expenditure on Property, Plant and Equipment given the extent of the Council's capital programme. We responded to this risk by assessing and placing reliance on property valuation specialists commissioned by the Council and challenge these valuations by using information provided by an independent valuer. We also tested the additions to the Property, Plant and Equipment balance to ensure that they are properly classified as capital expenditure.	We assessed and placed reliance on the Council's valuer. We used the independent valuer's market report to assess the overall reasonableness of the revaluations undertaken in the year. We also considered an impairment review undertaken by the Council's valuers. Our testing of the processing of revaluation entries did not reveal any errors. We completed our testing of additions to ensure that they were properly capitalised and identified no evidence of mis-classification.
Group Boundary One of the Council's subsidiaries, Milton Keynes Service Partnership LLP (MKSP), ceased trading and its employees transferred back in-house on 1 December 2015. The intention was to wind up the LLP with effect from 31 March 2016 and in order to do this, the LLP could not trade for the previous three months. This gave rise to a risk of potential cut off issues and misclassification in respect of MKSP income received and expenditure incurred from December 2015 to year end. We responded to this risk by reviewing and testing the allocation of transactions relating to MKSP between the accounts of the LLP and the Council in the period December 2015 to March 2016.	MKSP continued in existence and prepared initial accounts as at 31 March 2016 which showed cash of £2.6 million and a pension liability of £22.5 million. We confirmed that the cash was taken back by the Council before year end and shown as a creditor with MKSP in the Council's accounts. MKSP accounts and the group accounts were therefore adjusted to show this as a debtor rather than cash. We considered the treatment of the pension liability in the accounts of MKSP, the Council and the group. As MKSP no longer had employees this liability could not remain in MKSP accounts. The Council has guaranteed MKSP's liabilities and needed to take on the pension liability. The Council obtained revised reports from the actuary on the Council's and MKSP's pension liabilities taking into account the transfer of staff in the year. This reduced the value of the pension liability in MKSP accounts to nil and included the corresponding liability in the Council's accounts. These entries were processed in the Council's, the Group's and MKSP's accounts. Our testing from December 2015 to March 2016 identified no further issues with the allocation of transactions between the Council and MKSP.

Other Key Findings	Conclusion
Better Care Fund	
The Better Care Fund (BCF) is a major policy initiative between local authorities, CCGs and NHS providers with a primary aim of driving closer integration and improving outcomes for patients, service users and carers. The intention is that partners use the BCF to jointly commission health and social care services at a local level. From 1 April 2015 BCF was set up as a pooled budget between the Council and the local Clinical Commissioning Group (CCG). The pool is hosted by the Council and had total funding of £14 million in 2015/16. We identified a risk that the BCF might be accounted for incorrectly as arrangements could be complex and varied, involving a number of different commissioning, governance and accounting arrangements that raised risks of misunderstanding and inconsistencies between the partners.	We considered the accounting treatment proposed by the Council and agreed with the CCG. This analysed all the projects and funding streams within the Better Care Fund to determine which were jointly controlled and therefore pooled and which were controlled by only one of the participants. We agreed with the conclusions drawn. Our testing confirmed that the Council had correctly accounted for the Better Care Fund transactions. We noted that there was no disclosure made of the Better Care Fund within the accounts. This disclosure was added to the pooled budgets note in the revised accounts.
Related party transactions	
Due to the change in structure of the Council's group during the year following the closure of MKSP, the nature of the Council's relationships with the other entities in the group and how they have changed during the year may not have been fully disclosed. We responded to this risk by reviewing the related party disclosures made in the accounts to ensure these properly reflected the nature of the relationships and how they changed in the year.	We completed our review of the related party transactions note included in the accounts with no issues arising. Following on from our work noted above in respect of MKSP we identified that disclosures included in the accounts related to the group structure required amendment to fully explain the changes in relationship during the year.

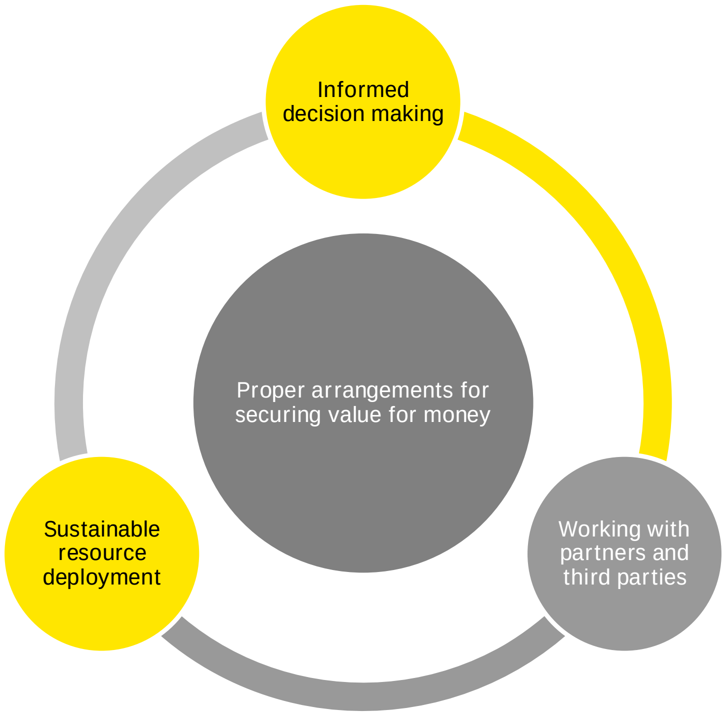
Value for Money

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. This is known as our value for money conclusion.

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

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



We identified significant risks in respect of sustainable resource deployment and taking informed decisions.

Significant Risk	Conclusion
Financial pressures The Council's finances continue to be under significant pressure in the medium term. The Council has a savings requirement of £21.6 million in 2016/17. The current medium term financial plan has a cumulative budget gap of £31.5 million by 2019/20. During the year the Council was reporting an overspend of £2.7 million on its 2015/16 general fund budget, and that it would deliver 89% of planned savings (£20.1 million). The majority of the savings balance was expected to be delivered in future years. The Council has a good track record of delivering its budgets, with savings identified and delivered to close the budget gaps. However, the Council has to continue to deliver significant savings year on year in order to bridge the gap and balance its budget.	We reviewed the Council's Medium Term Financial Strategy (MTFS) covering 2016/17 to 2019/20 and budget setting for 2016/17. We have also assessed the level of reserves (both general fund and earmarked) that the Council has at 31 March 2016. The Council has well established arrangements for undertaking its medium term financial planning which incorporate key assumptions and sensitivity review. By the end of 2015/16 the Council had overspent its budget by £2.5 million after the use of one-off resources of £3.4 million. This overspend was due to a number of factors including increasing demand on such services as children's social care and homelessness. The level of overspend is increasing compared to prior years outturn (£0.3 million overspend in 2014/15), reflecting the increasing financial challenges the Council faces. The Council delivered 84% of the planned savings (£19.1 million) with a further £2.7 million expected to be delivered in 2016/17. The general fund balance at £7 million was in line with the Council's minimum prudent level having decreased from £8.9 million at March 2015. The level of general fund earmarked reserves increased from £63.5 million in March 2015 to £82.3 million in March 2016, an increase of £18.8 million. This was due primarily to the set aside of specific reserves to fund projects and budget pressures in future year. The 2016/17 budget included an overall increase in council tax of 1.95% together with the social care precept of 2%. The budget was balanced by savings identified of £21.6 million. The budget monitoring report to August 2016 indicated that the Council expected to deliver 95% of this target, although the projected year end outturn was an overspend of £2.1 million. The Council continues to develop its plans for tackling the savings requirement in future years. We are comfortable that the level of reserves held by the Council at 31 March 2016 covers the budget gap identified within the MTFS to an appropriate level. On the basis of our work we concluded that the Council had appropriate arrangements in place for deploying resources in a sustainable manner.

Significant Risk	Conclusion
Transfer of support services to LGSS As part of its response to its financial situation, the Council developed proposals to transfer a number of support services into the Local Government Shared Service (LGSS) partnership with effect from 1 April 2016. LGSS is owned jointly by Northamptonshire and Cambridgeshire County Councils under a joint committee structure and the Council became a partner in the arrangement. The outline business case indicated that savings of £4.5 million would be delivered between 2016 and 2021, which would be shared with LGSS, as well as a range of other non-financial benefits.	The Council joined LGSS on 1 April 2016 and a number of services including Finance, HR and ICT were transferred into the partnership. Since then work has been underway to integrate these services and plan future developments such as new financial IT systems. We reviewed reports and held discussions with officers to understand the process that the Council went through in entering into this arrangement. We also specifically considered the proposals for the provision of internal audit. Our main concern was whether the Council had considered any other provider than LGSS or formally tested the market. We understand that various options were explored including shared services with other councils and other outsourcing options. LGSS was seen to offer most benefit in terms of savings, improved resilience and future service developments. The Council has demonstrated though its business cases that savings will be made from joining the partnership and that further opportunities exist for developing the services within LGSS and potentially including more services in the future.

Based on the results of our work we therefore issued an unqualified value for money conclusion on 28 September 2016.

Other Reporting Issues

Other Reporting Issues

Whole of Government Accounts

We performed the procedures required by the National Audit Office on the accuracy of the consolidation pack prepared by the Council for Whole of Government Accounts purposes. We had no issues to report.

Annual Governance Statement

We are required to consider the completeness of disclosures in the Council's Annual Governance Statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it is misleading.

We completed this work and did not identify any areas of concern.

Report in the Public Interest

We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by the Council or brought to the attention of the public.

We did not identify any issues which required us to issue a report in the public interest.

Written Recommendations

We have a duty under the Local Audit and Accountability Act 2014 to designate any audit recommendation as one that requires the Council to consider it at a public meeting and to decide what action to take in response.

We did not identify any issues which required us to issue a written recommendation.

Objections Received

We did not receive any objections to the 2015/16 financial statements from members of the public.

Other Powers and Duties

We identified no issues during our audit that required us to use our additional powers under the Local Audit and Accountability Act 2014.

Independence

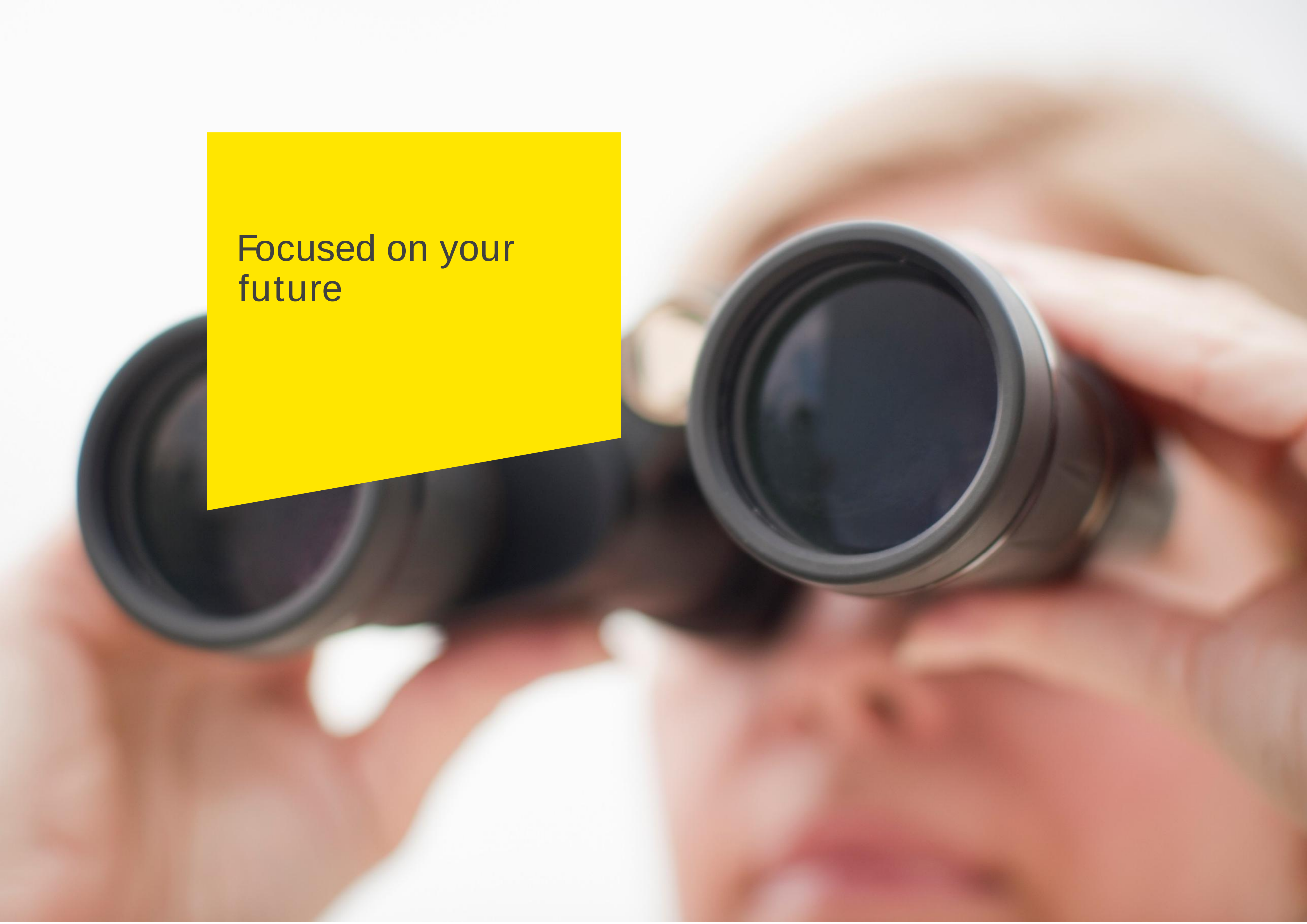
We communicated our assessment of independence in our Audit Results Reports to the Audit Committee on 28 September 2016. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning regulatory and professional requirements.

Control Themes and Observations

As part of our work, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Although our audit was not designed to express an opinion on the effectiveness of internal control, we are required to communicate significant deficiencies in internal control identified during our audit.

We did not identify any significant deficiencies in the design or operation of an internal control that might result in a material misstatement in the Council’s financial statements of which it was not already aware.

Focused on your future



Focused on your future

Area	Issue	Impact
EU referendum	Following the majority vote to end the UK's membership of the European Union (EU) in the EU Referendum held on 23 June 2016 there is a heightened level of volatility in the financial markets and increased macroeconomic uncertainty in the UK. All three major rating agencies (S&P, Fitch and Moody's) took action on the UK Sovereign credit rating and rating action on the UK Government. For entities in the public sector, there is likely to be an impact on investment property valuations if confidence in the wider UK property market falls; and the valuation of defined benefit pension obligations may also be affected. It is too early to estimate the quantum of any impact of these issues, but there is likely to be significant ongoing uncertainty for a number of months while the UK renegotiates its relationships with the EU and other nations.	Many of the issues and challenges that face the UK public sector will continue to exist, not least because continued pressure on public finances will need responding to. Additionally it may well be that the challenges are increased if the expected economic impacts of the referendum and loss of EU grants outweigh the benefits of not having to contribute to the EU and require even more innovative solutions. We are committed to supporting our clients through this period, and help identify the opportunities that will also arise. We will engage with you on the concerns and questions you may have, provide our insight at key points along the path, and provide any papers and analysis of the impact of the referendum on the Government and Public Sector market.
Highways Network Asset (HNA)	The Code of Practice on Transport Infrastructure Assets (TIA Code) was first published in 2010 and updated in 2013. The key aim of this document was to improve the asset management of TIA. During 2016, this guidance has been renamed and updated, with the Highways Network Asset (HNA) Code, Guidance Notes and Accounting Guidance being published. Local Government has historically used depreciated historic cost as the valuation approach for infrastructure assets. The introduction of the HNA Code will see this valuation basis change to depreciated replacement cost with effect from 1 April 2016. The change will be applied prospectively from that date, so highways authorities are not required to disclose comparative information. This is a fundamental change in approach which will require new accounting and estimation approaches as well as amendments to existing systems, or implementation of new systems.	The impact on the Council's Balance Sheet will be highly significant; with the recognition of a single highways network asset. The impact on the audit will also be significant, as auditors will need to obtain sufficient assurance over the material accuracy of this asset. We will work closely with the Council at both the local level, regarding system implementation, valuation procedures and accounting, and at the wider level through the continuation of our HNA Client Workshops.

Appendix A

Audit Fees

Appendix A Audit Fees

Our fees for 2015/16 are in line with the scale fees set by the PSAA and reported in our Audit Plan and Audit Results Report.

Description	Final Fee 2015/16 £	Scale Fee 2015/16 £	Final Fee 2014/15 £
Total Audit Fee – Milton Keynes Council	175,763	175,763	233,280
Total Certification Fee – Housing Benefits grant claim	18,302	18,302	21,360
Non-audit work - Teachers' Pensions return	See note below	N/A	12,850
Non-audit work – Pooling of housing capital receipts return	See note below	N/A	6,000

We confirm we have not undertaken any non-audit work outside of the PSAA's requirements to date in respect of the 2015/16 financial year.

In previous years we have carried out work on the teachers' pensions and housing capital receipts pooling returns. We have been requested to carry out work on the 2015/16 returns and will agree a fee for this work in due course.

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ED None

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