

# Milton Keynes Council

Annual Audit Letter for the year ended 31 March 2017

October 2017

Ernst & Young LLP



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Public Sector Audit Appointments Ltd (PSAA) have issued a “Statement of responsibilities of auditors and audited bodies”. It is available from the Chief Executive of each audited body and via the PSAA website ([www.psaa.co.uk](http://www.psaa.co.uk))

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

The “Terms of Appointment (updated 23 February 2017)” 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.

A hand with white nail polish is writing on a document with a blue pen. In the background, there is a calculator, a laptop, and a white mug. A yellow rectangular box is overlaid on the left side of the image.

## 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 2017.

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 2017 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 has put in place proper arrangements to secure value for money in its use of resources.

Area of Work	Conclusion
Reports by exception: ▶ Consistency of Governance Statement	The 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 completed our work in this area and reported to the NAO on 29 September 2017. We noted no issues in respect of the consistency of the financial statements with the WGA toolkit. We were however unable to give assurance on the completeness of the counter-party transactions due to a £1m materiality threshold which the Council applied in respect of counter-parties. We had no other 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 20 September 2017.
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 29 September 2017

In January 2018 we will also issue a report to those charged with governance of the Council summarising the certification work we have undertaken.

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

Maria Grindley

Associate Partner  
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 2016/17 Audit Results Report to the 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 2016/17 audit work has been undertaken in accordance with the Audit Plan that we issued on 28 February 2017 and 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 2016/17 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. We completed our audit procedures on the return and reported to the NAO on 29 September 2017. We noted no issues in respect of the consistency of the financial statements with the WGA toolkit. We were however unable to give assurance on the completeness of the counter-party transactions due to a £1m materiality threshold which the Council applied in respect of counter-parties. We had no other matters to report.

## Responsibilities of the Council

The Council is responsible for preparing and publishing its statement of accounts accompanied by an Annual Governance Statement. In the AGS, 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.

A blurred office desk with a laptop, glasses of water, and financial documents. The scene is brightly lit, likely from a window with blinds in the background. A yellow rectangular box is overlaid on the left side of the image, containing the text 'Financial Statement Audit'.

# 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's Statement 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 an unqualified audit report on 29 September 2017.

Our detailed findings were reported to the 26 September 2017 Audit Committee

The key issues identified as part of our audit were as follows:

Significant Risk	Conclusion
<p>Risk of fraud in revenue and expenditure recognition</p> <p>Under ISA240 there is a presumed risk that revenue may be misstated due to improper recognition of revenue.</p> <p>In the public sector, this requirement is modified by Practice Note 10, issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition</p>	<p>We reviewed and tested revenue and expenditure recognition policies and reviewed and discussed with management accounting estimates on revenue and expenditure recognition for evidence of bias.</p> <p>The most significant accounting estimates in the financial statements relate to the net pension liability and property valuations. We challenged the significant movement in the actuarial valuation and tested the property valuations and assumptions used and found no indication of management bias in these estimates.</p> <p>We reviewed and tested revenue cut-off at the period end date and the valuation of accruals and provisions at the year-end.</p> <p>We reviewed capital expenditure on property, plant and equipment to ensure it met the relevant accounting requirements to be capitalised.</p> <p>We tested the existence and valuation of debtors and accrued income and the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements.</p> <p>Our testing has not identified any material misstatements from revenue and expenditure recognition.</p> <p>Overall our audit work did not identify any material issues or unusual transactions to indicate any misreporting of the Council's financial position</p>



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.

For local authorities the potential for the incorrect classification of revenue spend as capital is a particular area where there is a risk of management override. We therefore review capital expenditure on property, plant and equipment to ensure it meets the relevant accounting requirements to be capitalised.

We obtained a full list of journals posted to the general ledger during the year, and analysed these journals using criteria we set to identify any unusual journal types or amounts. We then tested a sample of journals that met our criteria and tested these to supporting documentation.

The most significant accounting estimates in the financial statements relate to the net pension liability and property valuations. We challenged the significant movement in the actuarial valuation and found no indication of management bias in these estimates. Our work on the property valuations has been completed and we found no material changes to the balances presented within the financial statements.

We have not identified any material weaknesses in controls or evidence of management override.

We have not identified any instances of inappropriate judgements being applied.

We did not identify any other transactions during our audit which appeared unusual or outside the Council's normal course of business.

Other Key Findings	Conclusion
Use of specialists: pension disclosures	<p>We note that PWC as part of their central review reported that the discount rate applied by Barnett Waddingham falls outside the top end of their expected range. Our EY pensions team agree with this conclusion. We have assessed and are satisfied with the competency and objectivity of the actuary, Barnett Waddingham.</p> <p>Although we can accept the disclosure in the 2016/17 accounts, the EY pensions team have concluded that: "the methodologies used to derive the discount rate and RPI inflation assumptions are not robust as they do not take adequate account of the specific duration of the scheme's liabilities. In future years, this could lead to unacceptable assumptions."</p> <p>This is an issue that is being discussed centrally with Barnett Waddingham.</p>

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Use of specialists: valuations	<p>We are satisfied that the Council's valuers, Kirkby Diamond and Bruton Knowles, have the necessary qualifications and experience. We engaged our internal valuation specialist to review and critically challenge the basis and method of valuation adopted for a sample of assets, including particularly specialised assets which are valued on a depreciated replacement costs basis. We sampled a selection of school assets valued internally. We did note some variances at an individual asset level but concluded that the assets samples were found to be within an acceptable valuation range as a sample group.</p> <p>We would recommend early dialogue between the internal and external valuers and our EY Property Valuations team to review the methodology in greater detail for future valuations.</p>
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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.

## Our application of materiality

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

Item	Thresholds applied
Planning materiality	<p>We determined planning materiality to be £12,700,000 (2016: £11,300,000), which is 2% of Gross Expenditure reported in the accounts.</p> <p>We consider Gross Expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.</p>
Reporting threshold	<p>We agreed with the Audit Committee that we would report to the Committee all uncorrected audit differences in excess of £635,000 (2016: £564,000).</p>

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We also identified the following areas where misstatement at a level lower than our overall materiality level might influence the reader. For these areas we developed an audit strategy specific to these areas. The areas identified and audit strategy applied include:

- Remuneration disclosures including any severance payments, exit packages and termination benefits:
- Related party transactions.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations.

A close-up, shallow depth-of-field photograph of a stack of coins. The coins are stacked vertically, with the edges of several coins visible. The lighting is warm, highlighting the metallic texture and the embossed details on the coins. A bright yellow rectangular box is overlaid on the left side of the image, containing the text "Value for Money".

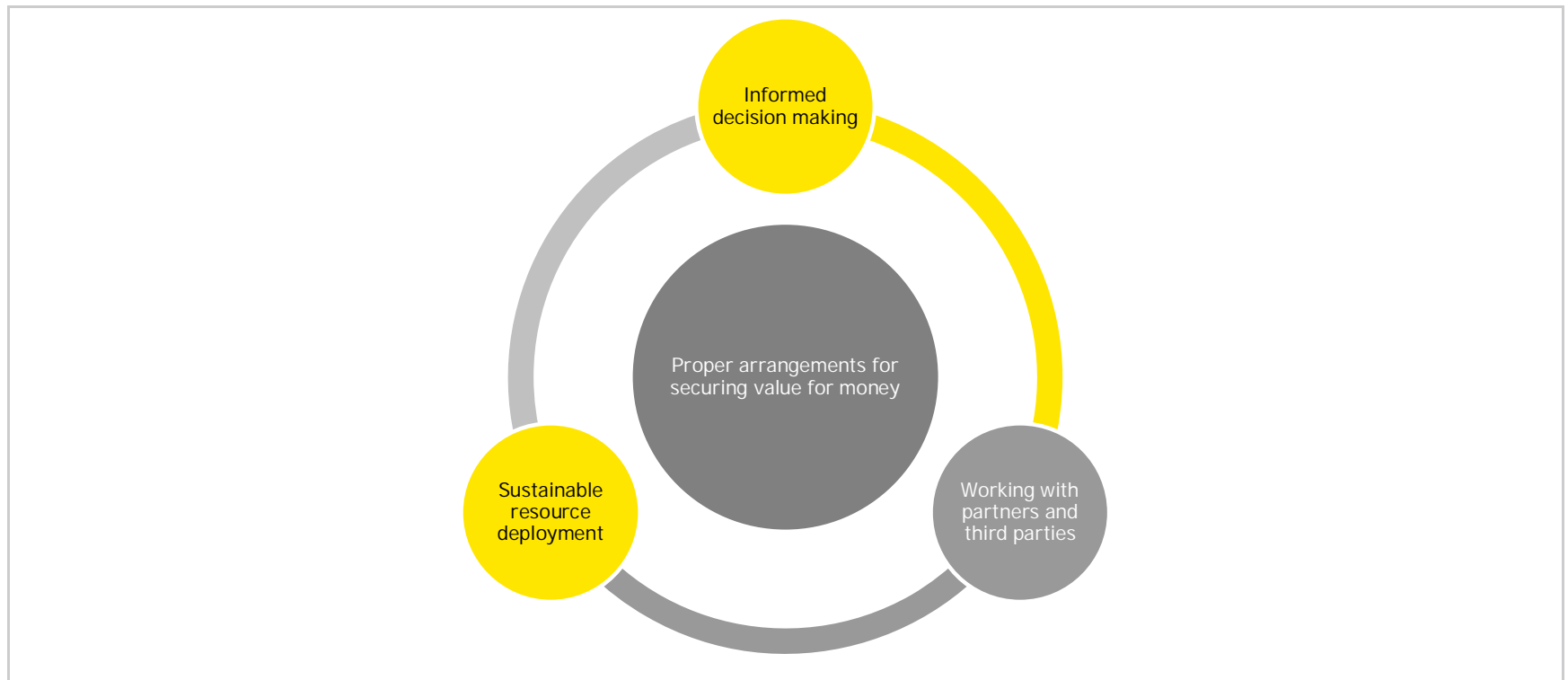
Value for Money

## 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 your arrangements to:

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





We identified two significant risks in relation to these arrangements. The tables below present the findings of our work in response to the risk identified.

We have performed the procedures outlined in our audit plan and communicated to management. We did not identify any significant weaknesses in the Council's arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

We therefore issued an unqualified value for money conclusion on 29 September 2017.

Significant Risk	Conclusion
<p>Sustainable resource deployment: We identified a risk around the Council's financial position. At the time of drafting our audit plan, the Council was projecting a Revenue overspend of £3m. Additionally, it faced increasing financial pressures over the coming years arising from increased demand and reduced funding</p>	<p>To date the Council has responded well to the financial pressure facing public sector bodies, but continues to face significant financial challenges over the next four years, with uncertainty in the levels of future funding it will receive. The Council has a good track record of financial management and achieved a surplus on provision of services of just over £22 million in the year under review.</p> <p>The Council's Medium Term Financial Strategy identified budget gaps of just over £26 million for the 5 years ended 2020/21. The update to the MTFS developed in July 2017 increased this amount to over £39 million and included details of savings, income generation and other efficiencies which have been identified to bridge the gap. The Council continues to develop alternative plans to address the overall gap.</p> <p>Despite the savings and funding plans the Council has in place to bridge the gaps, we note that the Council has sufficient usable reserves to sustain it in future years, though this may not be a sustainable strategy.</p> <p>We have concluded that the Council has put in place appropriate project management arrangements and has commissioned external support to ensure it has the appropriate skills to deliver this programme of work.</p>
<p>Working with Partners and Third parties: We identified a risk in respect of commissioning services effectively to support the delivery of strategic priorities arising from the delays in the completion of the residual waste treatment facility</p>	<p>We reviewed the financial impact the delays of the residual waste project may have had on the Council's resources and confirmed that no costs had been paid on the project in the year under review. £129m is a fixed payment that is due on service commencement date, which is anticipated to be in October 2017 subject to the appropriate governance processes.</p>



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 noted no issues in respect of the consistency of the financial statements with the WGA toolkit. We were however unable to give assurance on the completeness of the counter-party transactions due to a £1m materiality threshold which the Council applied in respect of counter-parties. We had no other matters 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 2016/17 financial statements from member 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 Report to the Audit Committee on 26 September 2017. 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 to you significant deficiencies in internal control identified during our audit.

We have adopted a fully substantive approach and have therefore not tested the operation of controls. Our audit did not identify any controls issues to bring to the attention of the Audit Committee.

The Council struggled this year to present the required working papers and responses to audit in the timescales agreed. This impacted on the audit and resulted in delays and additional work, as we had to follow-up in a few areas to ensure appropriate evidence was received. The audit was delivered very close to the deadline through a lot of additional effort in the last couple of weeks. This has meant that both teams spent more time on the audit than planned. This will result in an additional audit fee. This also raises a challenge for the Council in getting itself ready for the coming year's earlier close deadlines. We will work with the finance team to share learning from other clients who achieved the earlier deadline of the end of July this year and will set clear and agreed delivery plans with them.



A close-up photograph of a person's face as they look through a pair of black binoculars. The person's eyes are focused on the lenses, and their hands are visible holding the device. The background is a soft, out-of-focus white. A bright yellow rectangular box is overlaid on the left side of the image, containing the text "Focused on your future".

Focused on your  
future

## Focused on your future

Area	Issue	Impact
<p><i>Earlier deadline for production and audit of the financial statements from 2017/18</i></p>	<p>The Accounts and Audit Regulations 2015 introduced a significant change in statutory deadlines from the 2017/18 financial year. From that year the timetable for the preparation and approval of accounts will be brought forward with draft accounts needing to be prepared by 31 May and the publication of the audited accounts by 31 July.</p>	<p>These changes provide challenges for both the preparers and the auditors of the financial statements.</p> <p>To prepare for this change the Council has taken some steps in 2016/17. For example it has started to critically review and amend the closedown process to achieve earlier draft accounts production.</p> <p>As auditors, nationally we have:</p> <ul style="list-style-type: none"> <li>• Issued a thought piece on early closedown</li> <li>• As part of the strategic Alliance with CIPFA jointly presented accounts closedown workshops across England, Scotland and Wales</li> <li>• Presented at CIPFA early closedown events and on the subject at the Local Government Accounting Conferences in July 2017</li> </ul> <p>We have agreed with the Council to engage early, following the completion of the 2016/17 audit, to facilitate early substantive testing for 2017/18 and also to consider steps the Council can take, for example:</p> <ul style="list-style-type: none"> <li>• Streamlining the Statement of Accounts removing all non-material disclosure notes</li> <li>• Bringing forward the commissioning and production of key externally provided information such as IAS 19 pension information, asset valuations</li> <li>• Providing training to departmental finance staff regarding the requirements and implications of earlier closedown</li> <li>• Re-ordering tasks from year-end to monthly/quarterly timing, reducing year-end pressure</li> </ul> <p>Establishing and agreeing working materiality amounts with the auditors</p>

Appendix A

## Audit Fees





## Appendix A Audit Fees

Our fee for 2016/17 is in line with the scale fee set by the PSAA and reported in our 13 March 2017 Audit Plan.

Description	Final Fee 2016/17 £	Planned Fee 2016/17 £	Scale Fee 2016/17 £	Final Fee 2015/16 £
Total Audit Fee – Code work	182,263	175,763	175,763	175,763
Total Audit Fee – Certification of claims and returns	TBC	16,020	16,020	18,302

\*As a result of delays in delivery of the working papers and issues encountered during the audit we will need to raise an additional fee of £6,500. This fee will be subject to review and approval by the Public Sector Audit Appointments Ltd. (PSAA). We will discuss with management and notify Those Charged with Governance once the final figure is agreed.

We confirm we have not undertaken any non-audit work outside of the PSAA's requirements.

The work on claims and returns is currently underway and we will provide a report on this work and update on fee in January 2018 once the work is completed.



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ED None

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