Milton Keynes Council

Annual Audit Letter for the year
ended 31 March 2020

July 2021

Contents

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). [OR As part the Auditor Engagement process, we have agreed with you the respective responsibilities of auditors and audited bodies. Copies of the Engagement Letter and Terms and Conditions of our appointment are available from the Chief Executive or via the bodies minutes on their website].

This 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 April 2018)' issued by PSAA [OR The Terms and Conditions of our appointment contained within the Engagement Letter] 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 Audit Results Report is prepared in the context of the Statement of responsibilities / Terms and Conditions of Engagement. 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 Hywel Ball, 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.

Section 1

Executive Summary

Executive Summary

We are required to issue an annual audit letter to Milton Keynes Council Council (the Council) following completion of our audit procedures for the year ended 31 March 2020. Covid-19 had an impact on a number of aspects of our 2019/20 audit. We set out these key impacts below.

Area of impact	Commentary
Impact on the delivery of the audit	
► Changes to reporting timescales	As a result of Covid-19, new regulations, the Accounts and Audit (Coronavirus) (Amendment) Regulations 2020 No. 404, have been published and came into force on 30 April 2020. This announced a change to publication date for final, audited accounts from 31 July to 30 November 2020 for all relevant authorities. We worked with the Council/ Pension Fund to deliver our audit in line with the revised reporting timescale.
Impact on our risk assessment	
► Valuation of Property Plant and Equipment	The Royal Institute of Chartered Surveyors (RICS), the body setting the standards for property valuations, issued guidance to valuers highlighting that the uncertain impact of Covid-19 on markets might cause a valuer to conclude that there is a material uncertainty. Caveats around this material uncertainty have been included in the year-end valuation reports produced by the Council's external valuer. We consider that the material uncertainties disclosed by the valuer gave rise to an additional risk relating to disclosures on the valuation of property, plant and equipment.
► Disclosures on Going Concern	Financial plans for 2020/21 and medium term financial plans will need revision for Covid-19. We considered the unpredictability of the current environment gave rise to a risk that the council would not appropriately disclose the key factors relating to going concern, underpinned by managements assessment with particular reference to Covid-19 and the Council's actual year end financial position and performance.
► Events after the balance sheet date	We identified an increased risk that further events after the balance sheet date concerning the current Covid-19 pandemic will need to be disclosed. The amount of detail required in the disclosure needed to reflect the specific circumstances of the Council.
Impact on the scope of our audit	
► Information Produced by the Entity (IPE)	We identified an increased risk around the completeness, accuracy, and appropriateness of information produced by the entity due to the inability of the audit team to verify original documents or re-run reports on-site from the Council's systems. We undertook the following to address this risk: • Used the screen sharing function of Microsoft Teams to evidence re-running of reports used to generate the IPE we audited; and • Agree IPE to scanned documents or other system screenshots.
► Consultation requirements	Additional EY consultation requirements concerning the impact on auditor reports. The changes to audit risks and audit approach changed the level of work we needed to perform.

Executive Summary (cont'd)

The tables below set out 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 and Group as at 31 March 2020 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 you have put in place proper arrangements to secure value for money in your 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.

Executive Summary (cont'd)

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 23 March 2021 and 8 July 2021
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 19 July 2021

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

Neil Harris
Associate Partner
For and on behalf of Ernst & Young LLP

Section 2

Purpose and Responsibilities

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 2019/20 Audit Results Report to the 23 March 2021 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 of the Appointed Auditor

Our 2019/20 audit work has been undertaken in accordance with the Audit Plan that we issued on 2 November 2020 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- Expressing an opinion:
  - On the 2019/20 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 your Whole of Government Accounts return. The extent of our review and the nature of our report are specified by the NAO.

Responsibilities

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

Section 3

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 Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK), and other guidance issued by the National Audit Office and issued an unqualified audit report on 19 July 2021.

Our detailed findings were reported to the 23 March 2021 Audit Committee.

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

Significant Risk	Conclusion
Management override Misstatements due to fraud or error As identified in ISA (UK) 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 otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.	Our testing is complete. We did not identify any: • material weaknesses in controls or evidence of material management override; • instances of inappropriate judgements being applied; or • any other transactions during our audit which appear unusual or outside the Council's normal course of business.

Financial Statement Audit (cont’d)

The key issues identified as part of our audit were as follows: (cont’d)

Significant Risk	Conclusion
Incorrect capitalisation of revenue expenditure and revenue expenditure funded by capital under statute (REFCUS) 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 considering how the risk of management override may present itself, we conclude that this is primarily through management taking action to override controls and manipulate in year financial transactions that impact the medium to longer term projected financial position. A key way of improving the revenue position is through the inappropriate capitalisation of revenue expenditure. The Council has a significant fixed asset base and a material capital programme and therefore has the potential to materially impact the revenue position through inappropriate capitalisation. By incorrectly classifying expenditure as REFCUS, the Council could improve the reported revenue position.	Our sample testing of additions to property, plant and equipment and REFCUS: • Found they had been correctly classified as capital and included at the correct value. • Identified one reclassification between PPE Additions, and REFCUS - £600k. This was due to the item being recorded in PPE additions, however, this transaction related to an Academy school and therefore should be classified as REFCUS.

Financial Statement Audit (cont'd)

The key issues identified as part of our audit were as follows: (cont'd)

Significant Risk	Conclusion
Valuation of Recycling Centre A recycling centre with a total carrying value of £133 million was revalued in 2018/19. Due to the significance of the value and the nature of the asset (more specialised in nature and therefore more complex to value), we have identified the valuation of this asset as a separate significant risk. The 2018/19 audit identified a potential difference in valuation of £6m. This was below our materiality in 2018/19, however, as we have lowered our performance materiality in 2019/20, this difference would be material and therefore we will review this asset in detail in 2019/20.	The Council's valuation was undertaken by Wilkes Head & Eve with a further review undertaken by Wood Group (Engineering Consultants). Following the initial review undertaken by the EY Capital Equipment team, we expressed concern about the valuation included in the Council's accounts. The valuation methodology and process adopted by the specialists is limited, with no in-depth details, analysis or methodology. We recommended the Council appoint a Machinery Specialist RICS qualified valuer to undertake the review of the asset valuation. We discussed this with management and they appointed a suitably qualified valuer, Hilco, to revisit and update their assumptions on the asset valuation. The Council's valuer has re-valued the plant and machinery, with an impairment recognised of £11.4million. Our EY Capital Equipment team reviewed Hilco's valuation report and concluded that the valuation methodology was appropriate and the assumptions for specialised building and plant and machinery were within an acceptable range of estimation and uncertainty. In assessing this impairment and in discussion with the Council, we have agreed this impairment impacts through the periods back to 2017/18 when the asset was brought on to the Council's balance sheet. As a result a prior year adjustment has been made, restating the Council's balance sheet back to 2017/18 and the Council's accounts updated to reflect this and the depreciation impacts through 2018/19 and 2019/20. On 1 April 2019 the Council processed an increase in the building value of £4.8m, in re-assessing this as part of the full valuation exercise, this valuation has been reversed back to the building value at 31 March 2019. We are content that the revised valuation of £36.6m is within expectations for this asset. We recommend that the Council continues to appoint and instruct a Machinery Specialist RICS qualified valuer to review the valuation of this asset going forwards from the 2020/21 financial year. In reviewing the circumstances leading to the impairment assessment of this highly specialised asset, we also recommend that the Council undertakes a review to determine whether there were any weaknesses in arrangements during the 2017/18 financial year that could have exposed the Council to an overpayment for this asset at the time. In doing so, the Council should determine any changes necessary to its due diligence and decision making arrangements in the event that it acquires a highly specialised and significant asset in the future. The Council did not have any similar acquisitions in the 2019-2020 financial year but we will revisit this area in case any similar acquisition are expected as part of planning our value for money arrangements work for the 2020-2021 audit.

Financial Statement Audit (cont'd)

The key issues identified as part of our audit were as follows: (cont'd)

Other Risk	Conclusion
Valuation of Property, Plant & Equipment & Investment Property – inherent risk The fair value of Property, Plant and Equipment and Investment Properties represent significant balances in the Council's accounts, totalling £1.5 billion and £100 million respectively at 31 March 2020. These balances are subject to valuation changes and impairment reviews. In calculating amounts recorded in the Council's balance sheet, management are required to make material judgements and apply estimation techniques. We consider that where assets are valued at either depreciated replacement cost or existing use value, or on the basis of their market value, the judgments and estimates made by management are more likely to have a significant impact on the valuation of the asset; we will therefore focus our work on assets valued on this basis.	We have: • Considered the work performed by the Council's valuers, including the adequacy of the scope of the work performed, their professional capabilities and the results of their work; • Sample tested key asset information used by the valuers in performing their valuation (e.g. floor plans to support valuations based on price per square metre); • Considered the annual cycle of valuations to ensure that assets have been valued within a 5 year rolling programme as required by the Code for Property, Plant and Equipment, and annually for Investment Property; • Reviewed assets that are not subject to valuation in 2019/20 to confirm the remaining asset base is not materially misstated; • Considered changes to the useful economic lives as a result of the most recent valuation; and • Tested accounting entries, ensuring these have been correctly processed in the financial statements. We have considered how the Council's valuer has addressed the impact of Covid-19 in the year-end valuation of assets and assessment of impairments. We have concluded our work in respect of Property, plant and equipment and investment property valuations. We have no issues to report. We have reviewed the work of Hillier Hopkins LLP in respect of MKDP Investment property. We have no issues to report. Our opinion includes an Emphasis of Matter in respect of 'Material Uncertainty' in respect of consolidated Investment Property balances from MKPD financial statements.

Financial Statement Audit (cont'd)

The key issues identified as part of our audit were as follows: (cont'd)

Other Risk	Conclusion
Pension Liability Valuation– 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 administered by Buckinghamshire Pension Fund. The Council's pension fund deficit is a material estimated balance and the Code requires that this liability be disclosed on the Council's balance sheet. At 31 March 2020 this totalled £324 million. The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the Pension Fund. Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. 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. The information disclosed is based on the IAS 19 report issued to the Council by the Actuary. Accounting for this scheme involves significant estimation and judgement and due to the nature, volume and size of the transactions, in the current uncertain economic environment, we consider this to be a higher inherent risk. In addition, every three years, a formal valuation of the whole fund in carried out in accordance with the LGPS Regulations 2013 to assess and examine the ongoing financial position of the fund. The IAS19 report for 2019/20 will reflect the updated membership numbers provided for this triennial valuation. We will therefore need to seek additional assurances from the Pension Fund auditor over this data. An additional consideration in 2019/20 will be the impact of Covid-19 on the valuation of complex (Level 3) investments held by Buckinghamshire Pension Fund, for example private equity investments where valuations as at 31 March 2020 will have to be estimated. This is likely to impact on the IAS19 reports provided by the actuary and the assurances over asset values that are provided by the pension fund auditor, and consequently the assurance we are able to obtain over the net pension liability in the Council's accounts.	We have: • Liaised with the auditors of Buckinghamshire Pension Fund to obtain assurances over the information supplied to the actuary in relation to Milton Keynes Council. • Assessed the work of the Pension Fund actuary (Barnett Waddingham) 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. • Reviewed and tested the accounting entries and disclosures made within the Council's financial statements in relation to IAS19. • Assessed the results of the triennial valuations, including the assumptions used and the impact on the Council's pension liability. • Engaged with the Council, and their actuary, to understand any ongoing impact of the McCloud judgement, GMP and Goodwin rulings on the IAS19 liability. • Considered the nature and value of level 3 investments held by Buckinghamshire Pension Fund and the proportion of the overall Fund relating to Milton Keynes Council in order to identify any additional procedures required to support the estimates of the valuation of these asset as at 31 March 2020. No additional procedures were required. The Pension Fund Assurance letter we received from Grant Thornton noted that the March 2020 pensions return had not been submitted from the Council to Buckinghamshire Pension Fund by August 2020. We enquired with the Council the timing of the return. The first submission was made within the required deadline of the 30th April 2020, however, queries were raised from this and a subsequent submission was required. The final submission was completed in August 20. We obtained the final March 2020 submission as part of our audit procedures and did not identify any issues in our testing with the results in the IAS 19 Report or the financial statements. We have concluded our work and have no matters to report.

Financial Statement Audit (cont'd)

The key issues identified as part of our audit were as follows: (cont'd)

Other Risk	Conclusion
Going concern disclosures Covid-19 has created a number of financial pressures throughout Local Government. For Milton Keynes Council there is increased financial pressure. This includes significant reductions in income for the Council from car parks, business rate gains and other income; as well as additional cost pressures. There is currently not a clear statement of financial support from MHCLG that covers all financial consequences of Covid-19. CIPFA's Code of Practice on Local Authority Accounting in the United Kingdom 2019/20 sets out that organisations that can only be discontinued under statutory prescription shall prepare their accounts on a going concern basis. However, International Auditing Standard 570 Going Concern, as applied by Practice Note 10: Audit of financial statements of public sector bodies in the United Kingdom, still requires auditors to undertake sufficient and appropriate audit procedures to consider whether there is a material uncertainty on going concern that requires reporting by management within the financial statements, and within the auditor's report. We are obliged to report on such matters within the section of our audit report 'Conclusions relating to Going Concern'. To do this, the auditor must review management's assessment of the going concern basis applying IAS1 Presentation of Financial Statements. The auditor's report in respect of going concern covers a 12-month period from the date of the report, therefore the Council's assessment will also need to cover this period.	The Council have updated disclosures in respect of the 2019/20 Going Concern assessment. The Council's Chief Financial Officer (CFO) has provided the audit team with management's assessment of going concern (viability and liquidity) projecting at least 12 months from the expected date of authorisation for the 2019/20 accounts. The assessment draws on the Council's 2021/22 revenue budget and medium term financial plan. The assessment sets out the Council's assumptions of the Covid-19 impact on revenue spend, income and ongoing service and operational pressures on forecast budget, savings requirements and available to use reserves. The Council's CFO has also set out the cash, investment and borrowing position and forecast. The Council has not expressed any material uncertainties on the continuity of service provision for the next 12 months. We have asked for the Council's going concern disclosure note and supporting information, in particular the cashflow forecast until the end of July 2022. We have reviewed the appropriateness of the disclosure and consulted with our professional practice team on the work we have performed on the appropriateness of the disclosure note and impact for our audit report. We are expressing no emphasis of matter or material uncertainty associated with the Council's disclosures and judgements. Our audit procedures to review these included consideration of: • Current and developing environment; • Liquidity (operational and funding); • Mitigating factors; • Management information and forecasting; and • Sensitivities and stress testing.

Financial Statement Audit (cont'd)

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	We determined planning materiality to be £11.8m (2019: £11.2m), which is 1.8% of gross expenditure on provision of services. We consider Gross Expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council
Reporting threshold	We agreed with the Audit Committee that we would report to the Committee all unadjusted audit differences in excess of £0.6m (2019: £0.6m)

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 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.

Section 4

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 in its use of resources. This is known as our value for money conclusion.

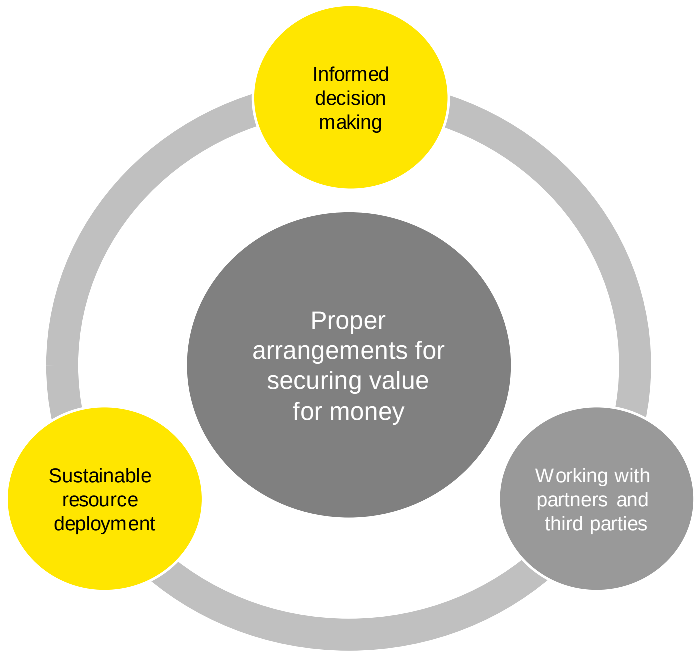
Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

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

On 16 April 2020 the National Audit Office published an update to auditor guidance in relation to the 2019/20 Value for Money assessment in the light of Covid-19. This clarified that in undertaking the 2019/20 Value for Money assessment auditors should consider NHS bodies’ response to Covid-19 only as far as it relates to the 2019-20 financial year; only where clear evidence comes to the auditor’s attention of a significant failure in arrangements as a result of Covid-19 during the financial year, would it be appropriate to recognise a significant risk in relation to the 2019-20 VFM arrangements conclusion.

We identified two significant risks around these arrangements. The tables below present our findings in response to the risks in our audit planning report and any other significant weaknesses or issues we want to bring to your attention.

- Financial resilience: The Council is operating in a challenging financial environment. We have not identified any matters in respect of this work.
- Contract Management: Follow up of the 2018/19 value for money qualifications and all recommendations in respect of contract performance management and governance. We have not identified any matters in respect of this work and are satisfied that during the 2019/20 financial year the Council has addressed the recommendations made.



Value for Money (cont'd)

We therefore issued an unqualified value for money conclusion on 19 July 2021.

Significant Risk	Conclusion
Financial resilience The Council is operating in a challenging financial environment, with uncertainty linked to the United Kingdom's decision to leave the EU and changes in funding through the Fairer Funding Review and Business Rates Retention.	We have: • Identified the key assumptions contained in the medium-term financial plan and the reasonableness of the basis of these; • Reviewed the Council's stress testing of these assumptions; sensitivity analysis and mitigating actions. • Assess the Council's track record on delivering savings and the robustness of its future savings plans. • Stress test the Council's financial resilience and adequacy of available reserves and balances before and in light of Covid-19. We have not identified any weaknesses in arrangements for the Council's financial resilience.
Follow up of the 2018/19 risk and all recommendations in respect of contract performance management and governance	Our approach has focussed on: • A follow up of the recommendations we made to support our qualification on the Council's value for money arrangements in 2018/19 financial year. • Consideration of the impact on the Council's contract management arrangements for any recommendations that have not been addressed. We are satisfied that the recommendations made in the prior year have been addressed and the risk of weaknesses in contract management arrangements has been mitigated.

Section 5

Other Reporting Issues

Other Reporting Issues

Whole of Government Accounts

We are required to perform the procedures specified by the National Audit Office on the accuracy of the consolidation pack prepared by the Council for Whole of Government Accounts purposes.

We completed this work and 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.

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 2019/20 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 Report to the Audit Committee on 23 March 2021. 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.

Other Reporting Issues (cont'd)

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 audit approach and have therefore not tested the operation of controls.

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. We wish to report the following matters:

<u>Journals – No formal authorisation process on ERP in place for approving journals</u>. During the audit we noted a large number of employees with access to posting manual entries within ERP. There is no formal authorisation process in ERP for this. From our discussions with management, we note that there is a process in place where journals are approved by email. There remains a risk that not all journals go through this process.

Recommendation: The Council should put in formal segregation of duties for approval of journals within the ERP system. The Council should reduce the number of employees with the ability to post manual entries in the General Ledger.

Management Response: The Council operates a shared ERP system with partner councils and changes have to be done system wide. The Future Northants Programme meant all system changes were paused during 2020/21. We have operated a compensatory control and aim to replace this with a control within ERP. A list of staff with journal access has been reviewed and reduced in 2020/21.

<u>Contracts Register – Completeness of the Contract register</u>. As the contract register is a live system, any contracts completed are archived and are then not reflected on the register. We obtained the listing from management which included all contracts (past, completed, archived) however noted that there were two contracts in the 2018/19 contract register which were not reflected in the contract listing we obtained. Management explained that at the time of audit these were completed and archived. However, both contracts completed in 2020/21, and should have been recorded on the 2019/20 contract register. Due to the live nature of the portal, some archived contracts did not reflect on the list. This creates a potential risk around the completeness of the Contract register for 2019/20 from which we perform our testing. From our testing of Contracts, we also noted there was one contract with a value of £949k but was recorded at £94 million on the contract register.

Recommendation: Ensure the contract register can be maintained and viewed for each financial year. Ensure that the contract register receives a thorough review to ensure all contract amounts are correct.

Management Response: The Council has recently invested in a new Corporate Contracts system and is reviewing all contracts as part of this work. The two contracts identified have been reviewed as part of this work.

Other Reporting Issues (cont'd)

Pensions - Pension returns not submitted to Buckinghamshire Pension Fund. The Pension Fund Assurance letter we received from Grant Thornton noted that the March 2020 Pension return had not been submitted from the Council to Buckinghamshire Pension Fund by August 2020, despite several efforts made by officers to obtain the return. This creates a risk that the Actuary might not have accurate and complete data to be able to complete their IAS 19 Report.

Recommendation: The Council should ensure all returns are made to Buckinghamshire Pension Fund on a timely basis to ensure that actuary has the most accurate information to include in their report.

Management Response: The first submission was made within the required deadline of the 30th April 2020, however, queries were raised from this and a subsequent submission was required. The final submission was completed in August 20. This issue has been escalated to the Head of Service in Northamptonshire County Council whose team oversee this process to ensure that this issue is managed effectively. NCC are currently working with Bucks LGPS Pensions Team to automate pension reporting which would remove this issue in the future.

Assets Not valued in within a five year cycle. We noted that there was one asset which was last revalued in 2014 and was not revalued in the current year. This has been discussed with the finance team and will be revalued.

Recommendation: Ensure all assets are valued within the five year cyclical requirements of the CIPFA Code of Practice for Financial Reporting.

Management Response: This was a one off omission due to a misunderstanding of a disposal which was only a part disposal. This has been adjusted in the 2019/20 accounts - £94k.

Creditors. From our testing, we noted a debt relating to Highways S278 which was a number of years old and not paid by MKC. We have reviewed a notification to the supplier but the payment was not made. The supplier has also not contacted the Council for payment. Therefore, this remains a creditor at 31 March 2020. There may be other similar balances within the creditors listing.

Recommendation: Ensure all balances are reviewed and cleared in a timely manner.

Management Response: The Council will review all old balances within the accounts to ensure that payments are made/received, and ensure sufficient evidence is available for all items on our balance Sheet.

Section 8

Audit Fees

Audit Fees

Our fee for 2019/20 is in line with the scale fee set by the PSAA and reported in our February 2021 Audit Plan.

Description	Final Fee 2019/20 £	Scale Fee 2019/20 £	Final Fee 2018/19 £
Total Audit Fee – Code work	135,338	135,338	224,338 – Note 1
*Group	4,825		
*Covid-19	6,921		
*Audit Delays – inc difficulties with transaction listings and other delays	8,269		
*Additional Work – inc EFA restatement, VFM conclusion 18/19 follow up, review of Hillier Hopkins files, CCLA PYA, Recycling centre revaluation and PYA, significant and other risks including Capital Expenditure, PPE Valuations and Pensions	26,359		
Total Audit Fee	181,712		
Pricing for Quality	82,005 – Note 3		
Total Audit Fee	263,717	135,338	224,338
Non-audit work – Housing Benefits, Teachers Pensions, Housing Pooling of Capital Receipts	N/A	N/A	66,580

Note 1 – This included an additional fee of £89,000 agreed by PSAA in respect of working undertaken to complete the audit.

*Note 2 – This includes a number of areas completed to ensure a Code compliant audit was completed.

Note 3 - For 2019/20, the scale fee will be impacted by a range of factors which will result in additional work. The factors that have led to this significant increase in estimate are set out in the following two pages, 27 and 28. This fee does not take account of the additional audit procedures undertaken in Note 2.

Fees in Note 2 and 3 are subject to approval from PSAA.

Appendix A

Fees (continued)

We do not believe the existing scale fees provide a clear link with both a public sector organisation's risk and complexity. For an organisation such as Milton Keynes Council the extent of audit procedures now required mean it will take approximately 2,000 hours to complete a quality audit. Your scale fee is £135,388 and our current estimate is a final fee of £217,393.

Summary of key factors

1. Status of sector. Financial reporting and decision making in local government has become increasingly complex, for example from the growth in commercialisation, speculative ventures and investments. This has also brought increasing risk about the financial sustainability / going concern of bodies given the current status of the sector.

   - To address this risk our procedures now entail higher samples sizes of transactions, the need to increase our use of analytics data to test more transactions at a greater level of depth. This requires a continual investment in our data analytics tools and audit technology to enhance audit quality. This also has an impact on local government with the need to also keep pace with technological advancement in data management and processing for audit.

2. Audit of estimates. There has been a significant increase in the focus on areas of the financial statements where judgemental estimates are made. This is to address regulatory expectations from FRC reviews on the extent of audit procedures performed in areas such as the valuation of land and buildings and pension assets and liabilities.

   - To address these findings, our required procedures now entail higher samples sizes, increased requirements for corroborative evidence to support the assumptions, use of our internal specialists and increased correspondence with external specialists.

3. Regulatory environment. Other pressures come from the changing regulatory landscape and audit market dynamics:

   - Parliamentary select committee reports, the Brydon and Kingman reviews, plus within the public sector the Redmond review and the new NAO Code of Audit practice are all shaping the future of Local Audit. These regulatory pressures all have a focus on audit quality and what is required of external auditors.
   - This means continual investment in our audit quality infrastructure in response to these regulatory reviews, the increasing fines for not meeting the requirements plus changes in auditing and accounting standards. As a firm our compliance costs have now doubled as a proportion of revenue in the last five years. The regulatory lens on Local Audit specifically, is greater. We are three times more likely to be reviewed by a quality regulator than other audits, again increasing our compliance costs of being within this market.

Appendix A

Fees (continued)

Summary of key factors (cont'd)

4. As a result public sector auditing has become less attractive as a profession, especially due to the compressed timetable, regulatory pressure and greater compliance requirements. This has contributed to higher attrition rates in our profession over the past year and the shortage of specialist public sector audit staff and multidisciplinary teams (for example valuation, pensions, tax and accounting) during the compressed timetables.

   - We need to invest over a five to ten-year cycle to recruit, train and develop a sustainable specialist team of public sector audit staff. We and other firms in the sector face intense competition for the best people, with appropriate public sector skills, as a result of a shrinking resource pool. We need to remunerate our people appropriately to maintain the attractiveness of the profession, provide the highest performing audit teams and protect audit quality.

   - We acknowledge that local authorities are also facing challenges to recruit and retain staff with the necessary financial reporting skills and capabilities. This though also exacerbates the challenge for external audits, as where there are shortages it impacts on the ability to deliver on a timely basis.

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