Lancashire County Council

Audit, Risk and Governance Committee

Monday, 28th October, 2019 at 2.00 pm in Cabinet Room 'B' - The Diamond Jubilee Room, County Hall, Preston

Agenda

Part I (Open to Press and Public)

No.	Item	
1.	**Apologies**	
2.	**Disclosure of Pecuniary and Non-Pecuniary Interests** Members are asked to consider any pecuniary and non-pecuniary interests they may have to disclose to the meeting in relation to matters under consideration on the agenda.	
3.	**Minutes of the Meeting held on 29 July 2019** To be confirmed, and signed by the chair.	(Pages 1 - 8)
4.	**The Annual Audit Letter for Lancashire County Council and Lancashire County Pension Fund 2018-19**	(Pages 9 - 26)
5.	**External Audit - Audit Progress Report and Sector Update 2019/20**	(Pages 27 - 42)
6.	**Internal Audit Progress Report**	(Pages 43 - 56)
7.	**Treasury Management Activity 2019/20**	(Pages 57 - 64)
8.	**Urgent Business** An item of urgent business may only be considered under this heading where, by reason of special circumstances to be recorded in the minutes, the chair of the meeting is of the opinion that the item should be considered at the meeting as a matter of urgency. wherever possible, the chief executive should be given advance warning of any member's intention to raise a matter under this heading.	

Lancashire County Council

9. Date of Next Meeting

The next meeting of the Committee will be held on Monday 27 January 2020 at 2pm at County Hall, Preston.

L Sales
Director of Corporate Services

County Hall
Preston

Lancashire County Council

Audit, Risk and Governance Committee

Minutes of the Meeting held on Monday, 29th July, 2019 at 2.00 pm in Cabinet Room 'B' - The Diamond Jubilee Room, County Hall, Preston

Present:

County Councillor Alan Schofield (Chair)

County Councillors

J Burrows	E Nash
B Dawson	J Rear
T Martin	J Shedwick

County Councillors J Burrows and B Dawson replaced County Councillors A Vincent and J Berry respectively.

1. Apologies

Apologies were received from County Councillor S Malik.

2. Disclosure of Pecuniary and Non-Pecuniary Interests

None declared.

3. Constitution, Membership and Terms of Reference 2019/20

The Chair presented The Constitution, Membership and Terms of Reference of the committee for 2019/20. Attention was drawn to the statement of purpose within the terms of reference which stated that the primary function of the committee was to provide independent assurance via the independent review of the Council's governance, risk management and control frameworks. To do so, committee members should be objective and independent in their deliberations and decisions.

Resolved: That

(i) The appointment of County Councillors Alan Schofield and Edward Nash as Chair and Deputy Chair respectively of the Audit, Risk and Governance Committee for the 2019/20 municipal year be noted.

(ii) The membership of the Audit, Risk and Governance Committee for the 2019/20 municipal year, as set out in the report, and the terms of reference of the committee as set out at appendix A be noted.

4. Minutes of the Meeting held on 20 May 2019

Resolved: That the minutes of the Audit, Risk and Governance Committee held on 20 May 2019 be confirmed and signed by the Chair.

It was noted that an update regarding the Neighbourhood Wellbeing Grants from Josh Mynott, Democratic and Member Services Manager, had been circulated to all members and the substitute members for today's meeting.

5. Internal Audit Progress Report

Ruth Lowry, Head of Internal Audit, presented a report outlining the updates on the Internal Audit Service's work. The report included key findings, issues of concern and actions undertaken as a result of the work. The committee considered the final internal audit progress report and outcomes of the work for 2018/19 for the period to 30 June 2019.

It was highlighted that:

- The internal audit annual report for 2018/19 had previously provided moderate assurance overall and this opinion continued to be supported by the audit results since then. There were just two pieces of work outstanding from 2018/19 regarding ICT controls which would be brought to the next meeting of this committee, along with 2019/20 audit work.

- The service areas in which the audit findings had concluded only limited assurance could be given were highlighted and the summary of findings for each was explained.

- Local Pension Partnership Ltd (LPP) had to some degree anticipated the assessments made by its internal auditor, Deloitte, which had reported ineffective assurance in four out of the seven areas reported. The business was currently working through a period of significant adjustment and work was underway to address the issues raised. The audit results and actions to be taken to mitigate these would be reported to the Pension Fund Committee in September 2019.

In response to questions from members the following information was clarified:

- Where limited assurance was given, actions to mitigate the risks were agreed between the internal auditor and the relevant manager/ head of service. The reports and action plans could be provided to members on request. All agreed actions would be then followed up to ensure they had been put in place or superseded and the resulting data would be reported to the committee.

- The re-testing of the LPP functions providing limited assurance would be undertaken by Deloitte and the results would be reported to the Pension Fund committee. A senior manager from LPP would also attend that meeting to answer questions. A succinct update would be requested from the Pension Fund committee.

- Some over payments to staff continued to occur but the systems in place supported the process effectively. It was confirmed that moderate assurance was in place for this area of work, making this a low risk compared to other areas.

Resolved: That the Internal Audit progress report, as presented, be noted.

6. Internal / External Audit Protocol

Ruth Lowry, Head of Internal Audit, presented the protocol setting out how Lancashire County Council's Internal Audit Service and Grant Thornton as its external auditor worked together, differentiated responsibilities and established a framework for coordination, cooperation and exchange of information. The protocol was last issued in 2017 and had been reviewed and revised to include references to the Lancashire Pension Fund and the consideration given by Grant Thornton to the head of internal audit's overall opinion.

Resolved: That the Internal / External Audit Protocol, as presented, be noted.

7. Approval of the County Council and County Pension Fund Letters of Representation 2018/19

Khadija Saeed, Head of Corporate Finance, presented the County Council and County Pension Fund Letters of Representation for 2018/19. Robin Baker, Director and Engagement Lead representing Grant Thornton the county council's external auditors, explained that these were standard letters that were reviewed and agreed by the external audit team before submission.

Resolved: That

(i) The management representation letters at appendix A and appendix B be noted.

(ii) It was agreed that they be signed by the Chief Financial Officer and the Chair of the Audit, Risk and Governance Committee prior to being made available to the external auditor.

8. External Audit - Lancashire County Council Audit Findings Report 2018/19

Robin Baker, Director and Engagement Lead and Angela Pieri, Engagement Manager, representing Grant Thornton, the county council's external auditors, presented the audit findings for Lancashire County Council. The report at appendix A explained the overall findings of the external auditor in relation to the audit of the annual accounts of Lancashire County Council, the external auditor's proposed opinion on the accounts; and the value for money conclusion.

The following points were highlighted:

- This was the standard annual report that was brought to the committee prior to the approval of the accounts and included the key findings and conclusions arising from the statutory audit of Lancashire County Council and the preparation of the financial statements for the year ended 31 March 2019.

- All outstanding items were now completed and subject to the committee's approval, the auditor's intention was to issue an unqualified opinion confirming that the accounts presented a true and fair view of the Council's financial position.

- With regard to the net pension fund liability of £1.2 billion, the auditors challenged and evaluated the work of the actuaries who assess this figure. The auditors had reviewed with officers the potential impact of a national legal case regarding age discrimination for judges and firefighters pension schemes (the McCloud judgement). This resulted in a £17.7 million increase in the pension liability. There was no impact to the useable reserves of the Council as a result of this.

- The audit also looked at the external process of valuing land and buildings assets, which currently stood at just over £2 billion. Around 40% of assets had been revalued during the year. It was highlighted that there was a £3.5 million unadjusted error from 2017/18. There was no impact to the usable reserves of the Council as a result of this and there were no material errors that would impact on the auditor's unqualified opinion of the accounts.

- The auditor's also reviewed the narrative report that set out the picture of the Council's financial position and the annual governance statement. This review confirmed that they were both reflective of the auditor's knowledge of the organisation and had been prepared in accordance with statutory guidance. The auditors could therefore issue a clean, unmodified audit opinion with respect to both these.

- The auditors also looked at whether the Council made appropriate arrangements for ensuring value for money by making the best use of resources. As previously discussed, the internal audit was able to give an overall moderate assurance opinion which was a significant improvement on the position of previous years. On this basis the auditor would issue an unqualified value for money opinion confirming that the Council had appropriate arrangements in place. Detailed work had also been undertaken reviewing the financial sustainability of the Council. It was acknowledged that substantial savings had been made and this would need to be maintained in light of the continuing challenges faced. Progress with regard to this would be monitored going forward.

In response to questions the following information was clarified:

- The auditing standards presumed two significant risks: management override of controls and improper revenue recognition.

- The auditors' statutory powers included the power to issue a formal public report that the Council would have to publicly respond to. They could also seek a declaration in high court that an item in the accounts was contrary to law. The public also had the authority to question the auditor about the accounts and make formal objections. It was noted that these and previous years accounts cannot be certified as closed due to the ongoing police investigation.

- Although Grant Thornton are the group auditors for Lancashire County Council the Council's companies are all individually audited. Grant Thornton liaise with and rely on the information the individual auditors provide for the final figures on the Council's balance sheet.

Resolved: That the adjustments to the financial statements and the other issues raised by the auditor set out in the report be noted.

9. External Audit - Lancashire County Pension Fund Audit Findings Report 2018/19

Robin Baker, Director and Engagement Lead and Angela Pieri, Engagement Manager, representing Grant Thornton, the county council's external auditors, presented the audit findings for Lancashire County pension fund.

The following key messages were highlighted:

- The report presented a summary of the findings and conclusions of the pension fund audit for 2018/19. There was a classification adjustment of the primary statements of £10.8 million which did not impact the bottom line figures.

- All the required verifications of the various investments within the fund had been obtained.

- As a result of the previously explained McCloud legal judgement, a £64 million increase had been made to the promised benefits note to reflect the most likely impact.

- As with the Council's audit there had been good cooperation between the officers and the audit team.

- Subject to the committee's approval, the auditor's intention was to issue an unqualified opinion on the financial statements of the pension fund for 2018/19. It was confirmed that an unmodified opinion would also be issued for the annual report and the annual governance statement.

Resolved: That the adjustments to the financial statements and the other issues raised by the auditor as set out in the report be noted.

10. Approval of the Council's Statement of Accounts 2018/19

Khadija Saeed, Head of Corporate Finance, presented the Council's 2018/19 Statement of Accounts.

The following information was highlighted:

- The accounts were published on the Council's website in May 2019. The main changes from then were detailed in the report and related predominately to the McCloud judgement and the impact of this on the accounts. In addition, as already discussed, the classification issue in relation to the investment management fees for the pension fund and the addition of the taxation figures of the LCDL group accounts.

- In response to a question Abigail Leech, Head of Service for the Pension Fund, confirmed that the classification issue was related to new guidance from the Chartered Institute of Public Finance and Accountancy (CIPFA) on providing more transparency on annual report disclosures with regard to investment management fees.

- Members thanked officers and the audit team for the work in producing the accounts within shorter timescales and were pleased to note the final outturn figure that showed an underspend against the budget for the year.

Resolved: That the 2018/19 Statement of Accounts be approved.

11. Treasury Management Activity Outturn 2018-19

Mike Jensen, Director of Investment for Financial Services presented the Treasury Management Activity Outturn 2018-19.

The following points were highlighted:

- Global and national risk factors were likely to carry through to 2019/20 and beyond, and as such it was likely that the current treasury management strategy would continue to take advantage of short term borrowing given the low interest rates in the UK. A minor change had been made this year rebalancing the portfolio to include a small amount of longer term borrowing, as a shift in overall interest rates had made the differential between long term and short term borrowing costs much smaller. This was to mitigate the potential risk of the revocation of article 50 to leave the European Union which would have caused an increase in interest rate. The long term Lender Option Borrower Option (LOBO) loan had now been repaid on very favourable terms and the Council would continue to apply the short term borrowing policy which had proven very successful for the Council.

- For the year ahead, it was anticipated that the interest rates in the UK would be cut further and this would allow the Council to take advantage of the lower rates via the short term borrowing policy.

- Investment in long term holdings would continue and improvements in performance was likely if the interest rate was to further reduce as expected.

- In general there had been a slight decline in the level of indebtedness in 2018/19 due to improved balance positions. This was expected to continue, with the overall level borrowing declining slightly.

- It was noted that in the investment table on page 388 'bank deposit 5 years +' and 'bank & local authority deposits 5 years +' on page 390 should both read 'local authority deposits 5 years +'. Unsecured bank deposits were not made in order to maintain the Council's high quality credit profile, currently classed as AA.

- The outturn for the year showed an under spend of £27.568 million. This was made up of changes to the minimum revenue provision and a better than budgeted treasury management performance of £16.792 million.

- In response to a question, Mike Jensen gave his views on the potential implications of the different scenarios for leaving the European Union from a treasury management perspective.

Thanks were expressed to the Treasury Management team for the funds generated for the authority.

Resolved: That the report detailing the review of treasury management activities for 2018/19 be noted.

12. Corporate Risk & Opportunity Register - Quarter 2 2019/20

Paul Bond, Head of Legal and Democratic Services, presented an update of the Corporate Risk and Opportunities register for quarter two. It was noted that there were no additions or deletions to the register.

Resolved: That the updated Corporate Risk and Opportunity Register as set out at appendix A be noted.

13. Chairman's Annual Report 2018/19

The Chair presented the second Chairman's Annual Report 2018/19. Paul Bond, Head of Legal and Democratic Services, was thanked for his support in producing the report.

The training needs analysis that had been undertaken was highlighted, as was the resulting training sessions from both internal and external sources that were offered to committee members and to all County Councillors.

Resolved: That the Chairman's Annual Report, as presented, be noted.

14. Draft Committee Work Plan 2019/20

Paul Bond, Head of Legal and Democratic Services, presented the draft committee work plan for 2019/20. It was explained that the work plan contained the standard items and other reports would be added as required.

Resolved: That the draft work plan for 2019/20, as set out at appendix A be noted.

15. Urgent Business

There was no urgent business to be considered.

16. Date of Next Meeting

It was noted that the next meeting of the committee would take place at 2.00pm on Monday 28 October July 2019 at County Hall, Preston.

L Sales
Director of Corporate Services

County Hall
Preston

Audit, Risk and Governance Committee
Meeting to be held on Monday 28 October 2019

Electoral Division affected: None

The Annual Audit Letter for Lancashire County Council and Lancashire County Pension Fund 2018/19
Appendix A refers

Contact for further information:
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Executive Summary

The Annual Audit Letter summarises the outcome of the work of the external auditors in 2018/19. It includes the key messages in relation to the financial statements audit and audit opinion, and Value for Money (VfM) conclusion.

Recommendation

The Audit, Risk and Governance Committee is asked to note the Annual Audit Letter for 2018/19 as set out at appendix A.

Background and Advice

Robin Baker, Engagement Lead, will attend the committee to present the report at appendix A and respond to questions.

Consultations

The report has been agreed with the council's management team.

Implications:

This item has the following implications, as indicated:

Risk management

No significant risks have been identified.

Lancashire County Council

Local Government (Access to Information) Act 1985
List of Background Papers

Paper	Date	Contact/Tel
None		

Reason for inclusion in Part II, if appropriate

N/A

Grant Thornton

The Annual Audit Letter for Lancashire County Council and Lancashire County Pension Fund

Year ended 31 March 2019

21 August 2019

Contents

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Executive Summary

Purpose

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at Lancashire County Council (the Council) and its subsidiaries (the group) for the year ended 31 March 2019.

The Letter is intended to provide a commentary on the results of our work to the group and external stakeholders, and to highlight issues that we wish to draw to the attention of the public. In preparing this Letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'. We reported the detailed findings from our audit work to the Council's Audit, Risk and Governance Committee as those charged with governance in our Audit Findings Report on 29 July 2019.

Respective responsibilities

We have carried out our audit in accordance with the NAO's Code of Audit Practice, which reflects the requirements of the Local Audit and Accountability Act 2014 (the Act). Our key responsibilities are to:

- give an opinion on the Council and group's financial statements (section two)
- assess the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources (the value for money conclusion) (section three).

In our audit of the Council and the Group's financial statements we comply with International Standards on Auditing (UK) (ISAs) and other guidance issued by the NAO.

Our work

Materiality	We determined materiality for the audit of the Group's financial statements to be £32,248,000 which is 1.5**%** of the Group's gross operating expenditure.
Financial Statements opinion	We gave an unqualified opinion on the Group's financial statements on 29 July 2019.
Whole of Government Accounts (WGA)	We completed work on the Council's consolidation return following guidance issued by the NAO on 29 July 2019.
Use of statutory powers	We did not identify any matters which required us to exercise our additional statutory powers.
Value for Money arrangements	We were satisfied that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources this year. The Head of Audit has been able to complete a full programme of risk-based reviews and issued a moderate assurance opinion. Progress has been made in stabilising the Council's financial position although it is important the momentum is maintained and actions to bridge the projected budget gaps continues.
Certificate	We have been unable to certify the completion of the audit of the accounts of the Council since 2013 due to an on-going police investigation. Once this investigation is concluded we will be able to assess the impact on our audit responsibilities and update our audit work in order to complete the audits for the relevant years.

Executive Summary

Working with the Council

During the year we have delivered a number of successful outcomes with you:

- An efficient audit – we delivered an efficient audit with you in June and July, delivering the financial statements by the statutory deadline of 31 July 2019
- Sharing our insight – we provided regular update reports to the Audit, Risk and Governance Committee covering best practice key sector developments. We also shared our thought leadership reports.
- Providing training – we provided your teams with training on financial statements and financial reporting at our annual workshop. We are grateful to the Council for hosting the local event at County Hall.
- Support outside of the audit – our insights and analytics team have worked with you through your subscription to the CFO Insights benchmarking software.

We would like to record our appreciation for the assistance and co-operation provided to us during our audit by the Council's management and members.

Grant Thornton UK LLP
August 2019

Audit of the Financial Statements

Our audit approach

Lancashire County Council Materiality

In our audit of the Group's financial statements we use the concept of materiality to determine the nature, timing and extent of our work, and in evaluating the results of our work. We define materiality as the size of the misstatement in the financial statements that would lead a reasonably knowledgeable person to change or influence their economic decisions.

We determined materiality for the audit of the Group financial statements to be £32,248,000, which is 1.5**%** of your gross operating expenditure. We determined materiality for the audit of the Council’s financial statements to be £32,208,000, which is 1.5**%** of the Council’s gross operating expenditure. We used this benchmark as, in our view, users of the Group and Council's financial statements are most interested in where the Group and Council has spent its revenue in the year.

We also set a lower level of specific materiality for senior officers remuneration at £17,000. We set a lower threshold of £1,610,000 above which we reported errors to the Audit, Risk and Governance Committee in our Audit Findings Report.

Pension Fund Materiality

For the audit of the Lancashire County Pension Fund financial statements, we determined materiality to be £84,101,000, which is 1% of the Fund's net assets. We used this benchmark, as in our view, users of the Pension Fund financial statements are most interested in the value of assets available to fund pension benefits.

We set a lower threshold of £4,205,000, above which we reported errors to the Audit, Risk and Governance Committee in our Audit Findings Report.

The scope of our audit

Our audit involves obtaining sufficient evidence about the amounts and disclosures in the financial statements to give reasonable assurance that they are free from material misstatement, whether caused by fraud or error. This includes assessing whether:

- the accounting policies are appropriate, have been consistently applied and adequately disclosed;
- the significant accounting estimates made by management are reasonable; and
- the overall presentation of the financial statements gives a true and fair view.

We also read the remainder of the financial statements and the narrative report and annual governance statement published alongside the financial statements to check it is consistent with our understanding of the Council and with the financial statements included in the Annual Report on which we gave our opinion.

We carry out our audit in accordance with ISAs (UK) and the NAO Code of Audit Practice. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our audit approach was based on a thorough understanding of your business and is risk based. We identified key risks and set out overleaf the work we performed in response to these risks and the results of this work.

The Financial Reporting Council (FRC) is responsible for reviewing and assessing the quality of local public audit work undertaken by Grant Thornton and the other audit firms. In response to the latest feedback from the FRC on local public audit work we have updated and refined our approach to the audit of PPE and Pensions Liabilities, which has resulted in additional audit procedures being undertaken. We have included fee adjustments to cover these additional procedures which are set out at page 13 of this report.

Audit of the Financial Statements

Significant Audit Risks

These are the significant risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Management override of controls Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities. We identified management override of control, in particular journals, management estimates and transactions outside the course of business as a significant risk.	As part of our audit work we have: • evaluated the design effectiveness of management controls over journals; • analysed the journals listing and determined the criteria for selecting high risk unusual journals; • tested unusual journals recorded during the year and after the draft accounts stage for appropriateness and corroboration; • gained an understanding of the accounting estimates and critical judgements applied made by management and considered their reasonableness with regard to corroborative evidence; and • evaluated the rationale for any changes in accounting policies, estimates or significant unusual transactions.	Our audit work did not identify any instances of management override of controls.
Valuation of land and buildings and investment property The Council revalues its land and buildings on a rolling three-yearly basis. Investment properties are revalued annually. These valuations represents a significant estimate by management in the financial statements. We identified the valuation of land and buildings and investment property revaluations and impairments, as a significant risk.	As part of our audit work we have: • evaluated management's processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work; • evaluated the competence, capabilities and objectivity of the valuation expert; • discussed with the valuer the basis on which the valuation was carried out; • challenged the information and assumptions used by the valuer to assess completeness and consistency with our understanding; • tested revaluations made during the year to see if they had been input correctly into the Council's asset register and financial statements; and • evaluated the assumptions made by management for those assets not revalued during the year and how management has satisfied themselves that these are not materially different to current value at year end.	Our audit work confirmed that revaluations were carried out by an appropriate expert. We were satisfied that the value of land and buildings not revalued during the year was not materially different to their reported value at 31 March 2019. No issues were found with the revaluation of land and buildings and investment properties.

Audit of the Financial Statements

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Valuation of net pension liability The Council's pension fund net liability, as reflected in its balance sheet as the net defined benefit liability, represents a significant estimate in the financial statements and group accounts. This valuation represents a significant estimate by management in the financial statements. We identified the valuation of the Council's pension fund net liability as a significant risk.	As part of our audit work we have: • updated our understanding of the processes and controls put in place by management to ensure that the Council's pension fund net liability is not materially misstated and evaluate the design of the associated controls; • evaluated the instructions issued by management to their management expert (an actuary) for this estimate and the scope of the actuary's work; • assessed the competence, capabilities and objectivity of the actuary who carried out the Council's pension fund valuation; • assessed the accuracy and completeness of the information provided by the Council to the actuary to estimate the liability; • tested the consistency of the pension fund asset and liability and disclosures in the notes to the core financial statements with the actuarial report from the actuary; and • undertook procedures to confirm the reasonableness of the actuarial assumptions made by reviewing the report of the consulting actuary (as auditor's expert) and performing any additional procedures suggested within the report. The Council updated their estimate of the IAS 19 pension fund liability due to the outcome of the national ruling on the McCloud case which ruled that there was age discrimination in the judges and firefighters pension schemes. There is an implication for pension schemes where they have implemented transitional arrangements on changing benefits which includes the Local Government Pension Scheme (LGPS). The increase in the net liability was £17,700,000 and was adjusted by management in the final financial statements.	The financial statements and disclosure notes were adjusted by management for the impact of the McCloud legal case. We did not identify any issues in respect of the valuation of the pension fund net liability or with the associated disclosure notes within the financial statements.

Audit of the Financial Statements

Pension Fund Significant Audit Risks

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work on the pension fund.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Valuation of Level 3 investments The Fund revalues its investments on an annual basis to ensure that the carrying value is not materially different from the fair value at the financial statements date. By their nature Level 3 investment valuations lack observable inputs. These valuations represent a significant estimate by management in the financial statements due to the size of the numbers involved and the sensitivity of this estimate to changes in key assumptions. We identified the valuation of Level 3 investments as a significant risk.	As part of our audit work we have: • evaluated management's processes for valuing Level 3 investments; • reviewed the nature and basis of estimated values and consider what assurance management has over the year end valuations provided for these types of investments; to ensure that the requirements of the Code are met; • for a sample of investments, tested the valuation by obtaining and reviewing the audited accounts, (where available) at the latest date for individual investments and agreeing these to the fund manager reports at that date. Reconcile those values to the values at 31 March 2019 with reference to known movements in the intervening period and; • in the absence of available audited accounts, we will evaluate the competence, capabilities and objectivity of the valuation expert.	We did not identify any issues in respect of the valuation of the Level 3 investments within the Pension Fund financial statements.

Audit of the Financial Statements

Audit opinion

We gave an unqualified opinion on the Group's financial statements on 29 July 2019.

Preparation of the financial statements

The Council presented us with draft financial statements one week ahead of the national deadline, and provided a good set of working papers to support them. The finance team responded promptly and efficiently to our queries during the course of the audit.

Issues arising from the audit of the financial statements

We reported the key issues from our audit to the Council's Audit, Risk and Governance Committee on 29 July 2019.

One adjustment to the primary financial statements has been made by management to reflect the impact of a national legal case where events occurring in June 2019 altered the Council's initial accounting treatment. This resulted in a compensating balance sheet and comprehensive income and expenditure classification adjustment for £17.7 million in relation to the IAS19 Pension liability. There is no impact to the useable reserves of the Council as a result of this adjustment.

One other issue identified in 2017/18 which has an impact in 2018/19 of £3.5 million is unadjusted by management. There is no impact to the usable reserves of the Council as a result of this issue. The decision to not adjust did not impact upon our proposed opinion. Other adjustments identified relate to minor changes in wording only and were adjusted by management.

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Annual Governance Statement and Narrative Report

We are required to review the Council's Annual Governance Statement and Narrative Report. The Council published them on its website in the Statement of Accounts in line with the national deadlines.

Both documents were prepared in line with the CIPFA Code and relevant supporting guidance. We confirmed that both documents were consistent with the financial statements prepared by the Council and with our knowledge of the Council.

Pension fund financial statements

We gave an unqualified opinion on the financial statements of Lancashire County Pension Fund on 29 July 2019. We also reported the key issues from our audit of the pension fund to the Council's Audit, Risk and Governance Committee on 29 July 2019.

One adjustment was identified to the financial statements that impacted upon the primary financial statements. Pension Fund officers identified a £10.8 million change in the classification of the Fund Account between unrealised losses in market value and management expenses, with the net impact of the adjustment being nil.

Any other items adjusted relate to disclosure note changes only including a £64 million increase in the promised benefits note for the estimated impact of the McCloud case.

Whole of Government Accounts (WGA)

We carried out work on the Council's Data Collection Tool in line with instructions provided by the NAO. We issued an assurance statement which confirmed that we did not identify any issues for the group auditor to consider on 29 July 2019.

Other statutory powers

We also have additional powers and duties under the Act, including powers to issue a public interest report, make written recommendations, apply to the Court for a declaration that an item of account is contrary to law, and to give electors the opportunity to raise questions about the Council's accounts and to raise objections received in relation to the accounts.

We have not had to use any of these other powers.

Certificate of closure of the audit

We have been unable to certify that we have completed the audit of the accounts of Lancashire County Council since 2013 due to an on-going police investigation. Once this investigation is concluded we will be able to assess the impact on our audit responsibilities and update our audit work in order to complete the audit certificates for the relevant years.

Value for Money conclusion

Background

We carried out our review in accordance with the NAO Code of Audit Practice, following the guidance issued by the NAO in November 2017 which specified the criterion for auditors to evaluate:
In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.

Key findings

Our first step in carrying out our work was to perform a risk assessment and identify the risks where we concentrated our work.

The risks we identified and the work we performed are set out overleaf.

Overall Value for Money conclusion

We are satisfied that in all significant respects the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2019.

The Head of Audit has this year been able to complete a full programme of risk-based reviews and issued a moderate assurance opinion. Progress has been made in stabilising the Council's financial position although it is important that the momentum is maintained and actions to bridge the projected budget gaps continues.

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Value for Money conclusion

Value for Money Risks

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Internal Control The Council's Head of Internal Audit (HoIA) opinion for 2017/18 provided limited assurance on the Council's overall system of internal control because the plan did not provide for coverage of the Council's full internal control system. This resulted in an 'except for' VFM Conclusion qualification in 2017/18. As a result, this area was included as a significant risk and area of focus for 2018/19.	We reviewed the HoIA's opinion and the Annual Governance Statement (AGS) to confirm that the work completed and management's assurances were reflected. We reviewed the work of internal audit during 2018/19 including the outcome of individual reports in risk areas, and the conclusion reached by the Head of Internal Audit in her annual opinion to the Council. The Council's HoIA opinion for 2018/19 issued in May 2019 provided moderate assurance on the Council's overall system of internal control. The audit work covered the full range of the Council's services as well as each element of the control framework. 2018/19 Internal Audit reports finalised to July 2019 since the HoIA opinion would not have altered the opinion given. The AGS included a summary of the HoIA opinion as well as other risk areas noted in the opinion.	There are adequate arrangements in place during 2018/19 over the Council's arrangements for managing risks effectively and maintaining a sound system of internal control, demonstrating and applying the principles and values of sound governance. Our value for money conclusion opinion is unqualified in 2018/19.

Value for Money conclusion

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Financial sustainability The Council faces a significant challenge over the next few years to address a structural deficit in its budget position. Addressing this gap will require the delivery of £120 million of planned savings and a further £47 million of savings as yet unidentified, in order to close the projected funding gap and restore the Council to a balanced financial position by the end of 2022/23. As a result, this area was included as a significant risk and area of focus for 2018/19.	We reviewed the the Council's arrangements for updating, agreeing and monitoring its financial plans including the assumptions within them. This included the consideration of Brexit in the Council's planning processes. We also considered the arrangements in place to monitor the identification, pace, delivery and reporting of savings. The Council reported a financial outturn for the year ending 31 March 2019 as an underspend on budget of £19.3 million. It should be noted that the Council had planned to deploy £44.8 million of its reserves to deliver a balanced budget, but only £25.5 million of this was required leaving the remainder available to support the financial position in future years. The delivery of savings in excess of plan for 2018/19 provides some assurance that the Council's process for delivering savings is robust and effective. The savings programme is closely monitored by the Programme Office and the finance team. The Council's current MTFS projects a funding gap that builds to £47 million by the end of 2022/23. The Council's future financial sustainability depends on the successful delivery of its savings programme and Phase 2 of the 'Service Challenge' transformation process. This assumes that £120 million of planned savings will be successfully delivered in the period. The remaining £47 million gap equates to a further 6% reduction in the net cost of services over three years. This remains highly challenging and it is important that the momentum for change established over the last two years is maintained and financial control remains robust. The Council has taken steps to develop resilience in the MTFS to manage uncertainties and risks. The Council's MTFS is underpinned by scenario analysis. This includes analysis of the impact on the financial position if the £7 million of savings that required consultation prior to implementation were not progressed, which concluded that there remain sufficient reserves to support the budget until part way through 2022/23. Whilst the challenge is significant the Council has significant reserves to draw on, centred around the Transitional Reserve of £164.2 million at the end of 2018/19 (equivalent to 5% of the net cost of services of £833 million). Based on current MTFS projections the level of reserves should enable the Council to bridge the budget gap up to the year 2022/23, while the remaining structural deficit is closed.	There are adequate arrangements in place during 2018/19 over the financial resilience of the Council. Our opinion in this area is unqualified. The Council's financial position remains challenging and continuing reliance on reserves is recognised as unsustainable. The savings programme and budget gap remains highly challenging, and it is important that the momentum for change established over the last two years is maintained and financial control remains robust.

A. Reports issued and fees

We confirm below our final reports issued and fees charged for the audit and provision of non-audit services.

Reports issued

Report	Date issued
Audit Plan – Lancashire County Council	27 February 2019
Audit Plan – Lancashire County Pension Fund	7 March 2019
Audit Findings Report – Lancashire County Council	17 July 2019
Audit Findings Report – Lancashire County Pension Fund	17 July 2019
Annual Audit Letter	August 2019

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Fees

	Planned £	Actual fees £
Statutory audit	87,006	96,006
Audit of Pension Fund	26,310	27,810
Total fees	**113,316**	**123,816**

Audit fee variations

As outlined in our audit plan, the 2018/19 scale fees published by PSAA totalling £113,316 assumes that the scope of the audit does not significantly change. There are three areas where the scope of the audit has changed, which has led to additional work. These area are set out in the following table. The additional fees are subject to approval by Public Sector Audit Appointments Ltd.

Area	Reason	Fee proposed
Assessing the impact of the McCloud ruling	The Government's transitional arrangements for pensions were ruled discriminatory by the Court of Appeal last December. The Supreme Court refused the Government's application for permission to appeal this ruling. As part of our audit we have reviewed the revised actuarial assessment of the impact on the financial statements along with any audit reporting requirements.	3,000 Lancashire County Council and 1,500 Lancashire County Pension Fund
Additional audit procedures on Pensions liabilities	Additional procedures now required in response to the Financial Reporting Council's feedback on audit work on Pensions liabilities.	3,000
Additional audit procedures on PPE valuations	Additional procedures now required in response to the Financial Reporting Council's feedback on audit work on the valuation of local authority Property, plant and equipment.	3,000
Total		10,500

A. Reports issued and fees continued

Fees for non-audit services

Service	Fees £
Audit related services	
- Agreed upon procedures report – Teachers' Pension return	4,200
Non-Audit related services	
- IAS19 assurance letters to other auditors	9,000
- CFO Insights subscription	9,000

Non- audit services

- For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the group. The table summarises all non-audit services which were identified.

- We have considered whether non-audit services might be perceived as a threat to our independence as the group's auditor and have ensured that appropriate safeguards are put in place.

The above non-audit services are consistent with the Council's policy on the allotment of non-audit work to your auditor.

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Audit, Risk and Governance Committee
Meeting to be held on Monday, 28 October 2019

Electoral Division affected: None

External Audit - Audit Progress Report and Sector Update 2019/20
Appendix A refers

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Executive Summary

The External Audit - Audit Progress Report and Sector Update 2019/20 at October 2019 is set out at appendix A for the committee's consideration.

Recommendation

The committee is asked to consider the External Audit - Audit Progress Report and Sector Update 2019/20 set out at appendix A.

Background and Advice

This report provides an update including our proposed timescales for the audit of the 2019/20 statement of accounts and the Value for Money (VfM) conclusion. The outcome of the work will be reported to the Audit, Risk and Governance Committee's meeting in July 2020. The report also provides additional information, on sector developments, to members of the committee as those charged with governance for the county council.

Robin Baker, engagement lead, will attend the meeting to present the report at appendix A and respond to questions.

Consultations

N/A

Implications:

This item has the following implications, as indicated:

Risk management

No significant risks have been identified.

Lancashire County Council

Local Government (Access to Information) Act 1985
List of Background Papers

Paper	Date	Contact/Tel
None		

Reason for inclusion in Part II, if appropriate

N/A

Grant Thornton
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Audit Progress Report and Sector Update

Lancashire County Council and Lancashire County Pension Fund
Year ending 31 March 2020

October 2019

Appendix A

Contents

Introduction

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This paper provides the Audit, Risk and Committee with a report on progress in delivering our responsibilities as your external auditors.

The paper also includes a summary of emerging national issues and developments that may be relevant to you as a local authority.

Members of the Audit, Risk and Governance Committee can find further useful material on our website, where we have a section dedicated to our work in the public sector. Here you can download copies of our publications www.grantthornton.co.uk ..

If you would like further information on any items in this briefing, or would like to register with Grant Thornton to receive regular email updates on issues that are of interest to you, please contact either your Engagement Lead or Engagement Manager.

Progress at October 2019

Financial Statements Audit

We issued our unqualified opinion on your 2018/19 Statement of Accounts on 29 July 2019 for Lancashire County Council and Lancashire County Pension Fund. Our Annual Audit Letter is an agenda item for the Audit, Risk and Governance Committee on 28 October 2019.

We will begin our planning for the 2019/20 audit in November and will issue detailed audit plans for Lancashire County Council and Lancashire County Pension Fund, setting out our proposed approach to the audit of the Council's 2019/20 financial statements.

We will begin our interim audits in January 2020. Our interim fieldwork includes:

- Updated review of the Council's control environment
- Updated understanding of financial systems
- Review of Internal Audit reports on core financial systems
- Early work on emerging accounting issues
- Early substantive testing

We will report our work in the Audit Findings Report and aim to give our opinion on the Statement of Accounts by the statutory accounts publication date of 31 July 2020.

Value for Money

The scope of our work is set out in the guidance issued by the National Audit Office. The Code requires auditors to satisfy themselves that; "the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources".

The guidance confirmed the overall criterion as: "in all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people".

The three sub criteria for assessment to be able to give a conclusion overall are:

•Informed decision making

•Sustainable resource deployment

•Working with partners and other third parties

Details of our initial risk assessment to determine our approach will be included in our Audit Plan.

We will report our work in the Audit Findings Report and aim to give our Value For Money Conclusion by the statutory accounts publication date of 31 July 2020.

Other areas

Certification of claims and returns

We have been asked by the Council to certify the Council's Teachers Pension Return for 2018/19 in accordance with the procedures agreed with the Teachers Pension Agency. This certification work is in progress, and will be concluded by the 29 November 2019 deadline.

Meetings

We have regular liaison meetings with the Chief Executive, Director of Finance and Finance Officers regarding emerging developments to ensure the audit process is smooth and effective.

Sector update

There are two significant sector developments that are covered in our update this time:

- the Government's review of Local Government Audit arrangements (the Redmond Review), and
- the National Audit Office consultation on the proposed new Code of Audit Practice.

Further details of the other publications that may be of interest to the Council are set out in our Sector Update section of this report.

Audit Deliverables

2019/20 Deliverables	Planned Date	Status
Fee Letter Confirming audit fee for 2019/20.	April 2019	Complete
Accounts Audit Plan We are required to issue a detailed accounts audit plan to the Audit, Risk and Governance Committee setting out our proposed approach in order to give an opinion on the Council's and Pension Fund's 2019/20 financial statements. .	February 2020	Not yet due
Interim Audit Findings We will report to you the findings from our interim audit and our initial value for money risk assessment within our Progress Report.	April 2020	Not yet due
Audit Findings Report The Audit Findings Reports for Lancashire County Council and Lancashire County Pension Fund will be reported to the July 2020 Audit, Risk and Governance Committee.	July 2020	Not yet due
Auditors Report This is the opinion on your financial statement, annual governance statement and value for money conclusion.	July 2020	Not yet due
Annual Audit Letter This letter communicates the key issues arising from our work.	August 2020	Not yet due

Sector Update

Councils are tackling a continuing drive to achieve greater efficiency in the delivery of public services, whilst facing the challenges to address rising demand, ongoing budget pressures and social inequality.

Page 34

Our sector update provides you with an up to date summary of emerging national issues and developments to support you. We cover areas which may have an impact on your organisation, the wider NHS and the public sector as a whole. Links are provided to the detailed report/briefing to allow you to delve further and find out more.

Our public sector team at Grant Thornton also undertake research on service and technical issues. We will bring you the latest research publications in this update. We also include areas of potential interest to start conversations within the organisation and with audit committee members, as well as any accounting and regulatory updates.

- **Grant Thornton Publications**
- **Insights from local government sector specialists**
- **Reports of interest**
- **Accounting and regulatory updates**

More information can be found on our dedicated public sector and local government sections on the Grant Thornton website by clicking on the logos below:

Public Sector

Local government

CIPFA – CFO confidence survey

In July, the Chartered Institute of Public Finance and Accountancy (CIPFA) reported the results of their annual confidence survey.

The survey found that the majority of local government finance officers have lost confidence in their future financial positions over the last year.

Seventy per cent of respondents said they were either slightly less or much less confident in their financial position this year compared to 2018-19.

The survey also found that 68% said they were either slightly less or much less confident in their ability to deliver services in 2020-21. Sixty-two per cent expressed equal confidence in their financial position for 2019-20 as they had last year.

CIPFA found that the area of greatest pressure for top tier authorities was children's social care, with the number of authorities rating it as the biggest pressure rising by six percentage points.

For districts the greatest pressures were housing, cultural services and environmental services.

Rob Whiteman, CIPFA chief executive, said: "Local government is facing greater demand pressures than ever before, with particularly pressures in adults' and children's social care and housing. Local authorities also lack certainty about their future financial positions, so it's unsurprising to see confidence on the decline.

"We have repeatedly pointed out that local government is in need of a sustainable funding solution, but meeting this demand requires more than pennies and pounds. The sector as a whole must come together to address the challenges of effective service delivery."

CIPFA's survey received a total of 119 responses from authorities in the UK - 56 top tier authorities, 47 English districts, 12 Scottish authorities, and 4 Welsh authorities.

CIPFA The Chartered Institute of Public Finance & Accountancy

On the same theme, a Local Government Association (LGA) survey, also reported in July, found that almost two-thirds of councils believe cash for services like adult social care, child protection and preventing homelessness will dry up by 2024-25.

The survey got responses from 141 of the 339 LGA member councils in England and Wales.

It also found that 17% of councils were not confident of realising all of the savings they had identified this year (2019-20).

The LGA said that councils needed a guarantee they will have enough money to meet growing demand pressures in particular in adult social care, children's services, special educational needs, homelessness support and public health.

Local Government Association

MHCLG – Independent probe into local government audit

In July, the then Communities secretary, James Brokenshire, announced the government is to examine local authority financial reporting and auditing.

At the CIPFA conference he told delegates the independent review will be headed up by Sir Tony Redmond, a former CIPFA president.

The government was "working towards improving its approach to local government oversight and support", Brokenshire promised.

"A robust local audit system is absolutely pivotal to work on oversight, not just because it reinforces confidence in financial reporting but because it reinforces service delivery and, ultimately, our faith in local democracy," he said.

"There are potentially far-reaching consequences when audits aren't carried out properly and fail to detect significant problems."

The review will look at the quality of local authority audits and whether they are highlighting when an organisation is in financial trouble early enough.

It will also look at whether the public has lost faith in auditors and whether the current audit arrangements for councils are still "fit for purpose".

On the appointment of Redmond, CIPFA chief executive Rob Whiteman said: "Tony Redmond is uniquely placed to lead this vital review, which will be critical for determining future regulatory requirements.

"Local audit is crucial in providing assurance and accountability to the public, while helping to prevent financial and governance failure."

He added: "This work will allow us to identify what is needed to make local audit as robust as possible, and how the audit function can meet the assurance needs, both now and in the future, of the sector as a whole."

In the question and answer session following his speech, Brokenshire said he was not looking to bring back the Audit Commission, which appointed auditors to local bodies and was abolished in 2015. MHCLG note that auditing of local authorities was then taken over by the private, voluntary and not-for-profit sectors.

He explained he was "open minded", but believed the Audit Commission was "of its time".

Local authorities in England are responsible for 22% of total UK public sector expenditure so their accounts "must be of the highest level of transparency and quality", the Ministry of Housing, Local Government and Communities said. The review will also look at how local authorities publish their annual accounts and if the financial reporting system is robust enough.

Redmond, who has also been a local authority treasurer and chief executive, is expected to report to the communities secretary with his initial recommendations in December 2019, with a final report published in March 2020. Redmond has also worked as a local government boundary commissioner and held the post of local government ombudsman.

Ministry of Housing, Communities & Local Government

National Audit Office – Code of Audit Practice

The Code of Audit Practice sets out what local auditors of relevant local public bodies are required to do to fulfill their statutory responsibilities under the Local Audit and Accountability Act 2014. 'Relevant authorities' are set out in Schedule 2 of the Act and include local councils, fire authorities, police and NHS bodies.

Local auditors must comply with the Code of Audit Practice.

Consultation – New Code of Audit Practice from 2020

Schedule 6 of the Act requires that the Code be reviewed, and revisions considered at least every five years. The current Code came into force on 1 April 2015, and the maximum five-year lifespan of the Code means it now needs to be reviewed and a new Code laid in Parliament in time for it to come in to force no later than 1 April 2020.

In order to determine what changes might be appropriate, the NAO is consulting on potential changes to the Code in two stages:

Stage 1 involves engagement with key stakeholders and public consultation on the issues that are considered to be relevant to the development of the Code.

This stage of the consultation is now closed. The NAO received a total of 41 responses to the consultation which included positive feedback on the two-stage approach to developing the Code that has been adopted. The NAO state that they have considered carefully the views of respondents in respect of the points drawn out from the Issues paper and this will inform the development of the draft Code. A summary of the responses received to the questions set out in the Issues paper can be found below.

Local audit in England Code of Audit Practice – Consultation Response (pdf – 256KB)

Stage 2 of the consultation involves consulting on the draft text of the new Code. To support stage 2, the NAO has published a consultation document, which highlights the key changes to each chapter of the draft Code. The most significant changes are in relation to the Value for Money arrangements. Rather than require auditors to focus on delivering an overall, binary, conclusion about whether or not proper arrangements were in place during the previous financial year, the draft Code requires auditors to issue a commentary on each of the criteria. This will allow auditors to tailor their commentaries to local circumstances. The Code proposes three specific criteria:

a) Financial sustainability: how the body plans and manages its resources to ensure it can continue to deliver its services;

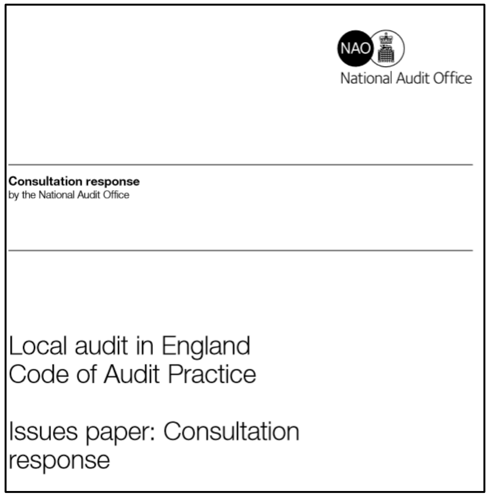
b) Governance: how the body ensures that it makes informed decisions and properly manages its risks; and

c) Improving economy, efficiency and effectiveness: how the body uses information about its costs and performance to improve the way it manages and delivers its services.

The consultation document and a copy of the draft Code can be found on the NAO website. The consultation is open until 22 November 2019. The new Code will apply from audits of local bodies' 2020-21 financial statements onwards.

Link to NAO webpage for the Code consultation:

https://www.nao.org.uk/code-audit-practice/code-of-audit-practice-consultation/


NAO
National Audit Office

Consultation response
by the National Audit Office

Local audit in England
Code of Audit Practice

Issues paper: Consultation response

Local Government Association – Profit with a purpose – delivering social value through commercial activity

The Local Government Association (LGA) report 'Profit with a purpose' focuses on some of the practicalities of how councils can deliver social value through their commercial activity.

Through ‘key questions’ to ask, the guidance supports councils to face the challenge of how to undertake commercial activity and achieve greater value for the public purse in ways that better meet society’s needs and outcomes for people and communities.

In addition, the publication features a number of short case studies highlighting some of the innovative commercial practice already achieving results for communities.

The LGA comments that the best approaches ensure the generation of social value is the primary factor driving commercial activity; from the initial decision to develop a commercial vision to how the approach is developed, and implemented, councils which are pulling ahead ensure social value is placed centre stage.

The guidance starts with an overview of what the LGA understands by ‘profit with a purpose’, the guidance explores different types of social value and the role of councils in driving social value alongside their commercial ambition.

The guidance then looks at how consideration and delivery of social value should be practically considered when deciding on whether to embark on commercial activity, the need for social value to be prioritised alongside financial return and the key questions councils should consider when embarking on a commercial initiative.

Following on from this, there are specific chapters on; embedding social value in governance of alternative service delivery vehicles, the role of procurement in contracting services that deliver social value and finally how to contract and performance manage social value through your service providers.

Each chapter outlines the factors that need to be considered and the ‘key questions’ councils should be asking themselves.

In addition, a number of short case studies are provided to highlight some of the innovative commercial practice already achieving results for communities.

The report can be downloaded from the LGA website:

https://www.local.gov.uk/profit-purpose-delivering-social-value-through-commercial-activity

Local Government Association

Profit with a purpose

Delivering social value through commercial activity

MHCLG – Brexit preparations

Councils should be fully prepared to leave the European Union by the end of October, the Communities and Local Government Secretary announced on 3 August as he ramped up preparations.

Mr Jenrick thanked councils for all the work they have already done, but said they must step up vital preparations and committed £20 million for councils across England to prepare for delivering Brexit on 31 October, whatever the circumstances.

He has asked each council to designate a Brexit lead to work with central government and oversee teams in every community who will work with stakeholders in their area to plan intensively for Brexit.

The new funding comes in recognition of the central role councils will play to make sure their residents are ready for Brexit, and is expected to support a range of activity including communications, training and the recruitment of staff.

Ministry of Housing, Communities & Local Government

The Secretary of State said:

"From Whitehall to town halls – everyone needs to be ready to fulfil our democratic mandate to leave the European Union by the end of October.

Local government has a vital role in helping to make Brexit a success and it is absolutely right that together we intensify preparations in every community.

And to do this successfully I have asked every council to appoint a Brexit lead to work with government. We'll be providing £20 million for councils to support the major step up in preparations.

I want all of us – central and local government – to be fully prepared for leaving the EU on 31 October whatever the circumstances. I know that we can achieve this, by continuing to work side by side with renewed national focus and intensity."

Public Accounts Committee – Local Government Governance and Accountability

The Public Accounts Committee has found that the Government has not done enough to ensure that, at a time when local authority budgets are under extreme pressure, governance systems are improved.

The Ministry of Housing, Communities & Local Government (the Department) is responsible for: ensuring that this framework contains the right checks and balances, and changing the system if necessary. The Secretary of State also has powers to intervene in cases of perceived governance failure. The framework includes: officers with statutory powers and responsibilities; internal checks and balances such as audit committees and internal audit; and external checks and balances such as external audit and sector-led improvement overseen by the Local Government Association. These arrangements represent a significant reduction in the level of central oversight in recent years following the government's decision to abolish the Audit Commission and the Standards Board for England as part of a broader reform of local audit, inspection and reporting.

The Public Accounts Committee report summary notes "Local authorities have a good overall track record with governance arrangements generally robust across the sector, and there is evidence that local authority governance compares favourably to that of the health sector. However, this is not universal and in some authorities governance is under strain, as funding reduces and responsibilities and exposure to commercial pressures change. We are worried to hear about audit committees that do not provide sufficient assurance, ineffective internal audit, weak arrangements for the management of risk in local authorities' commercial investments, and inadequate oversight and scrutiny. This is not acceptable in the more risky, complex and fast-moving environment in which local authorities now operate.

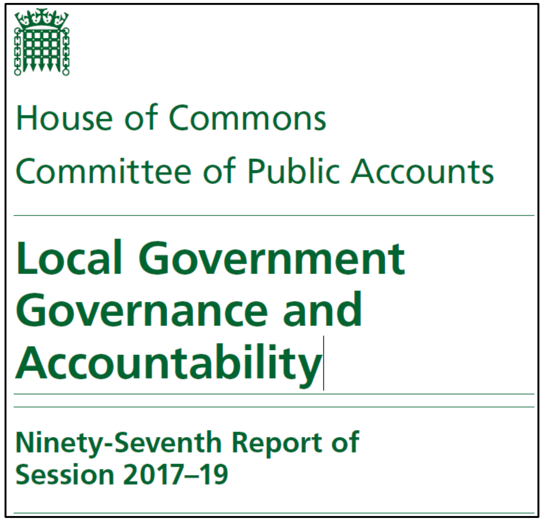
The Department has been reactive and ill-informed in its approach to oversight of the local governance system. However, the Department has now recognised that the network of bodies with responsibility for the local governance framework is fragmented and lacking the leadership needed to drive change. Encouragingly, the Department has now committed to enhancing its oversight role and producing a proactive work programme to deliver this change. We urge the Department to ensure that this activity leads to concrete actions and outcomes on a timely basis. When a local authority fails this has a significant impact on local people and the Department has a responsibility to work with local government to ensure that problems are caught early and that it can pinpoint at-risk councils. Since the abolition of the Audit Commission and other changes culminating in the Local Audit and Accountability Act 2014 there is no central assessment of value for the money, which means the Department's work is fundamental."

The report makes five conclusions, with associated recommendations:

1) The Department is not yet providing effective leadership of the local governance system.
2) The Department does not know why some local authorities are raising concerns that external audit is not meeting their needs.
3) The Department lacks reliable information on key governance risks, or relies on weak sources of information, meaning it has no way of pinpointing the at-risk councils.
4) The Department's monitoring is not focused on long-term risks to council finances and therefore to services.
5) There is a complete lack of transparency over both the Department's informal interventions in local authorities with financial or governance problems and the results of its formal interventions.

The Government response is available on the website below:

https://www.parliament.uk/documents/commons-committees/public-accounts/Gov-response-to-Public-Accounts-on-the-93-98-reports.pdf



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Audit, Risk and Governance Committee
Meeting to be held on Monday, 28 October 2019

Electoral Division affected:
(All Divisions);

Internal Audit Progress Report
Appendices A and B refer

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Executive Summary

In the context of the committee's responsibility to consider updates on the Internal Audit Service's work including key findings, issues of concern and action being taken as a result of internal audit work, the committee is asked to consider the first internal audit progress report and outcomes of the work for 2019/20 for the period to 30 September 2019.

Recommendation

The Audit, Risk and Governance Committee is asked to consider the report.

Background and Advice

This report sets out for the committee the internal audit work performed under the audit plan for 2019/20 approved in May 2019.

Appendix A highlights key issues that the committee should be aware of at this point in fulfilling its role of providing independent oversight of the adequacy of the council's governance, risk management and internal control framework. In particular it sets out a small number of amendments to the audit plan, information about the status of action plans agreed with management, and summaries of the ten audits completed in the period to 30 September 2019.

Appendix B sets out the audit assurance levels and classification of residual risks used by the Internal Audit Service.

Consultations

The chief executive and director of resources, the director of finance, and each of the directors and/or heads of service who have sponsored the audit work reported here has been consulted.

Lancashire County Council

Implications:

This item has the following implications, as indicated:

Risk management

This report supports the Audit, Risk and Governance Committee in undertaking its role, which includes providing independent oversight of the adequacy of the council's governance, risk management and internal control framework.

Local Government (Access to Information) Act 1985
List of Background Papers

Paper	Date	Contact/Tel
None		

Reason for inclusion in Part II, if appropriate

Not applicable.

Matters arising from internal audit work for 2019/20 completed to 30 September 2019

1 Introduction

1.1 This report highlights the issues that the Audit, Risk and Governance Committee should be aware of in fulfilling its role of providing independent oversight of the adequacy of the council's governance, risk management and internal control framework. It sets out the issues arising from the work undertaken during the period to 30 September 2019 by the Internal Audit Service under the audit plan for 2019/20.

2 Work completed

2.1 Ten of the 92 audits in the plan (excluding follow-up work and grant certification) have been completed and assurance has been provided as set out in the table below. Reports on seven further audits are being discussed with management.

2019/20 assignments relating to:	Total	Assurance provided			
		Substantial	Moderate	Limited	None
Governance	-				
Business effectiveness	-				
Service delivery	7	3	3	1	
Service support	1		1		
Business processes	2	2			
2019/20 assignments: total to date	**10**	**5**	**4**	**1**	**-**
	100%	50%	40%	10%	-

2.2 Brief information about the outcomes of each of the audit engagements competed is set out in section 5 onwards. As described in the audit plan for the year, audit work may be directed towards understanding the control framework of a service, system or process (the first phase of a full audit), testing the operation of an established control framework (the second phase of a full audit), or both (a full risk and control evaluation audit). Each audit in the plan has therefore accordingly been designated as 'type 1', 'type 2' or 'type 1+2', and this broadly indicates the scope of the assurance we can give.

3 Amendments to the audit plan for 2019/20

3.1 The audit plan must necessarily be flexible, as was noted when the audit plan was agreed, and a small number of changes have been made.

3.2 Following the decision not to extend the council's contract with BT Lancashire Services Ltd but instead to bring the services back into the council, the audit of the contract renegotiation process has become an audit of the arrangements being made to prepare for the return of services. We have already started work with the director involved to understand the council's approach to this.

3.3 A revised social care safeguarding model is being developed, with new funding from the Department for Education, which will considerably impact the allocation of social workers and the management of caseloads within Children's Social Care. We have therefore agreed to defer the audit of the control framework until 2020/21 when it will be better established.

3.4 The arrangements supporting renewed oversight of the contracts to operate the schools in Burnley under the former Building Schools for the Future programme are also still being developed. The senior managers involved are doing a lot of work to implement revised arrangements and the audit will therefore be deferred into 2020/21.

3.5 We had planned to undertake an audit to understand the improvements being made to the Property Asset Management System (PAMS) that would have been similar to the work we have previously done on the Highways Asset Management System (HAMS). However improvements to PAMS are being addressed at service level reflecting the different specialisms and nature of the work areas. This is informed by other ongoing audit work on the management and monitoring of changes to the council's core systems, as well as work reported in 2018/19 on the Design & Construction Service, where in both cases individual specialist modules have been implemented.

3.6 The programme of audit work on the council's ICT risks has been revised to focus more closely on service management arrangements within BTLS and the council's Core Systems Team, and on the operation of the Liquidlogic Adults System (LAS) as a fundamental system. The other audits on this ICT audit programme have therefore been removed from the plan. The two audits remaining from the 2018/19 ICT audit programme have been added to this year's plan and one has now been reported, on ICT Service governance (see below).

4 Follow-up work

4.1 During 2019/20 the Internal Audit Service will follow up the action reported by the council as having been taken and some of this work has begun. Managers' own assessments of these actions are as follows:

Numbers of actions agreed in 2017/18, 2018/19 and 2019/20 and now due							
Action status	**As at June 2019***		**As at September 2019**				
	Total		**Total**		**Risk rating**		
					High	**Medium**	**Low**
Complete	255	77%	314	75%	16	184	114
Superseded	28	8%	29	7%	3	18	8
Incomplete	18	6%	24	6%	4	14	6
Awaiting responses	31	9%	50	12%	7	30	13
Total	**332**	**100%**	**417**	**100%**	**30**	**246**	**141**
Arising in: **2017/18**			**195**	47%	18	117	60
2018/19			**214**	51%	12	127	75
2019/20			**8**	2%	-	2	6
* The figures published in June 2019 included 89 actions in total arising from work in 2016/17 that have been excluded from these figures.							

Actions arising in 2016/17

4.2 It was reported in July 2019 that there were just two actions still outstanding from 2016/17, both relating to governance of the Lancashire Enterprise Partnership. These have both now been addressed and managers are reporting that all actions arising in that year have either been completed (70 actions) or superseded (19 actions).

Actions arising in 2017/18

4.3 Some of the actions arising from 2017/18 are proving more intractable and at this point six remain incomplete, two of which were regarded as addressing high risks as set out in the following paragraphs.

Transition from children's to adult services (High risk)

4.4 The actions agreed in July 2018 to improve the process by which children and young people make the transition from children's services and access adults' services were subsumed within a single action for the directors of Children's and Adult Services. It was agreed that they would consider the future strategic direction of transitions services including where key responsibilities should lie, and how information would be gathered and used to best effect. A new transitions strategy would articulate and coordinate the respective roles and responsibilities of Children's Services and Adults Services and a single set of policy and guidance notes would be produced and published for use across both services.

4.5 At this point the director of education and skills and the director of adult social care transformation co-chair a group that is overseeing both the implementation of this action plan and the county council's response to Ofsted's inspection of provision for children with special educational needs and disabilities (SEND). The aim of this group is to manage the interdependencies of improvement across three areas of transition – health, education and social care – and, where necessary, review the current outcome measures, identifying additional measures if necessary. The head of the Learning Disabilities, Autism and Mental Health Service also chairs a group addressing the transition to adulthood that reports to the SEND Partnership Board.

4.6 Additional capacity has recently been secured to accelerate progress. External specialist auditors have recently completed a thorough review of 40 transition plans to ensure that practice is improved by evidence and informed by the experiences of young people. Feedback will be provided to the officers who coordinate young adults' education, health and care plans and shared with external partners to inform improvement. An additional, experienced temporary officer has been employed to research best practice, draft a guide for young people, parents, carers and partners ('Steps to Adulthood') and to develop a detailed action plan to ensure greater coherence and accelerate the rate of progress. She is also working to co-produce a Preparing for Adulthood Strategy for the SEND Partnership Board.

Personal budgets for children's service users and direct payments to their carers (High risk)

4.7 In March 2018 it was agreed that Children's Services would liaise with Adult Services to ensure that their policies and procedures are aligned and communicated consistently. This would involve developing a single training programme to ensure consistency of service delivery across both services and a more effective use of training resources. As part of this process, guidance notes would be checked to ensure that they are factually correct.

4.8 Once agreed, policy, procedures and guidance would be made easily accessible on the pages of the intranet accessed by staff in Children's Services, who would be made aware of the revised guidance and the importance of complying with it (this was treated as a separate action to address a medium degree of risk).

4.9 The SEND Improvement Plan includes work to review the personal budget policy, analyse take-up of personal budgets and determine the future approach in partnership with parent carers. This has begun and will be informed by discussion with the Parent Carer Forum on 18 October 2019: progress will be reported to the SEND Partnership Board at its next meeting on 16 November. Current patterns and trends in the use of direct payments are also being analysed and the outcomes will be reported to the Education and Skills management team in November.

4.10 We have also done further compliance testing in the current year and are discussing a draft report with the managers involved.

Case management of occupational therapy services (Medium risk)

4.11 The only action remaining in relation to occupational therapy is to implement a case-load tracker within LAS, rather than using a set of spreadsheets. However it is unlikely that this improvement will be achieved in the foreseeable future.

Public health commissioning strategy (Medium risk)

4.12 It was agreed that a strategy would be developed to demonstrate a comprehensive evaluation of the needs and priority for the discretionary services most required to improve the health of the local population, and to allocate funds most effectively to these services. This will now be completed by the end of February 2020.

Commissioning, design and monitoring of the capital programme (Medium risk)

4.13 A lot of work has been undertaken on the asset management strategy that will underpin both the capital strategy and the development of a risk register for the capital programme. Having gained a more comprehensive understanding of the risks involved in the capital programme and the mitigating controls in place, senior finance managers will now finalise the risk register within the next three months.

5 Audit work completed on service delivery controls: Adult Services and Health & Wellbeing

Provider-led reviews (Substantial assurance: type 1)

5.1 The council has a legal duty to offer a free carer's assessment if it appears that a carer may need support. N-compass North West and Carers Link Lancashire have been selected to carry out statutory carers' assessments on our behalf and to provide support to adult carers.

5.2 Practice guidance for assessors is being finalised and, once agreed, will be posted on the intranet with other relevant policies, procedures and guidance for social workers. Comprehensive templates for performance management and quality assessment have been developed.

5.3 A control framework has been designed but is not yet in operation. The contract monitoring arrangements' effectiveness in operation will largely depend on the quality of the routines employed to validate and verify the data that will be supplied by the providers.

Direct payments: adults' financial reviews (Moderate assurance: type 1+2)

5.4 Direct payments are one of the ways individuals can choose to receive their personal social care budget and use it to meet their assessed eligible care needs. Some of the direct payment can be used by service users to employ a personal assistant or to pay someone to manage their responsibilities as an employer. The person receiving and/ or managing a direct payment is responsible for keeping records to show how money has been spent and ensuring money is spent as agreed in the support plan.

5.5 Around 4,100 service users – 3,700 adults and 400 children – receive direct payments totalling approximately £4.8 million per month or £57.6 million per year.

5.6 Financial assessment officers in the Finance Directorate follow robust procedures supported by process checklists, policies and guidance, and are comprehensively trained although other than normal supervision processes there is no formal quality assurance of the reviews. It has been agreed that team leaders will periodically undertake dip-sampling of completed reviews to assess the quality of the information recorded and of the judgement regarding level of review, and to identify any issues or training requirements.

5.7 Direct payment agreements are scheduled for review in accordance with their assessed risk. Although there will always be a number of reviews outstanding at any point, the backlogs that had built up are now being addressed and review schedules are monitored and managed. Where reviews are significantly overdue this is generally beyond the control of the financial review team.

5.8 The primary record of details relating to the direct payment reviews is held on the finance software for adult social care (ContrOCC). Where it is clear to the financial assessment officers that social workers should be aware of any information relating to the reviews they also record this on Liquidlogic Adults System (LAS) or Liquidlogic Children's System (LCS).

5.9 A finance team leader attends the monthly Direct Payments Forum which is led by operational managers and also attended by operational and commissioning staff. It addresses any issues relating to direct payments including training, case anomalies and complaints.

Policy development (Moderate assurance: type 1)

5.10 Following the introduction of the Care Act in 2014 the Policy, Information and Commissioning team has reviewed and updated the council's policies relating to adult social care. There is some good practice in current policy development and a good basis to establish a more robust and structured framework going forward. This includes oversight of policy development by a group involving finance, operations and legal staff as well as social care professionals, and the involvement of officers from the Policy, Information and Commissioning team who ensure that policy documents remain consistent with legislative requirements.

5.11 Mechanisms are in place to identify changes to legislation that might affect policy, and efforts are being made to build professional links with other teams around the council to ensure a consistent approach is adopted. The format and content of policy documents are being standardised where possible, and they are drafted to be easily read and understood.

5.12 However action will also now be taken to rationalise the pages on the intranet addressing adult social care policies, and to develop an overarching policy development strategy that clarifies what a policy document should be and how they are quality assured and maintained.

Educational off-site visits (Moderate assurance: type 1+2)

5.13 The Educational Off-Site Visit team is part of the Health, Safety & Resilience Service. It ensures that educational off-site visits are risk-assessed, planned, approved, carried out and evaluated in accordance with statutory requirements and the council's policy.

5.14 The systems in place are well designed and continually reviewed by the team and an advisory board: the actions arising from this audit are largely enhancements, aimed at improving the quality of management information. Although the team has numerous tasks to prioritise, sometimes with conflicting deadlines, its members are all clear about their individual priorities and manage them well. There are several areas of good practice including a comprehensive training programme, a system that supports effective monitoring and control as well as a helpful reporting and information tool, and good dissemination of lessons learned.

5.15 Where visits have not been recorded on the system by schools they cannot be subjected to the same dip sampling, compliance checks or monitoring. There is therefore a risk that some visits are incorrectly classified by schools and that the council does not have a complete picture of all the visits being carried out or an accurate number of incidents, accidents or near misses that may have occurred on these.

5.16 The team relies on schools and other establishments submitting information about their planned visits but a significant proportion of even relatively high risk visits are submitted late (40% within four weeks of the visit). However in the majority of cases the team is able to respond before the visit takes place.

5.17 An audit was undertaken by the team itself in mid-2018 to determine which establishments were using the system and whether they recorded all visits, higher risk visits only, or none at all and, if so, why. This work identified establishments that routinely misclassified visits or made unapproved visits, and those without an educational visit coordinator, and the team made direct contact with them.

6 Audit work completed on service delivery controls: Education & Children's Services

Special Educational Needs and Disabilities (SEND) Partnership improvement plan (Substantial assurance: type 1+2)

6.1 Ofsted and the Care Quality Commission jointly inspected the local area's special educational needs and disabilities service in November 2017. They identified 12 areas of significant concern across the area including strategic leadership and vision, understanding of the local area, joint commissioning and engagement with parents and carers.

6.2 A partnership was formed of all the relevant agencies to address the issues, and its board includes representatives from the education and health sectors, parents and carers, young people and the county council. It is accountable to the Lancashire Health and Wellbeing Board, the Joint Committee of the Clinical Commissioning Groups, and Lancashire County Council's Cabinet.

6.3 A written statement of actions was initially developed by the partnership to address the 12 areas of concern and this has since been supported by a longer term improvement plan. This addresses four key priorities across 27 areas supported by 94 specific actions which directly address Ofsted's findings.

6.4 The partnership's governance structures, decision making and monitoring processes are sufficient to facilitate the management and implementation of the improvement plan. This control system is operating as intended and, as at September 2019, most of the actions have been reported as delivered or are progressing. Ten have been delayed and the reasons, with updates, are being reported to the board. Detailed evidence and data are retained by the SEND Partnership team within the council's Education & Children's Services.

Lancashire Safeguarding Children's Board (LSCB) governance of expenditure (Limited assurance: type 1+2)

6.5 The Lancashire Safeguarding Children Board was a statutory body with an independent chair, accountable to the county council's chief executive. Its members were senior managers from all the agencies in Lancashire with statutory safeguarding responsibilities and its purpose was to ensure these agencies work together effectively. It did this for example through reviewing cases where a child has died or been significantly harmed, and by providing guidance and training. It was supported by a team within the council's Safeguarding, Inspection and Audit Service and the council's Oracle financial system is used to record the board's budgets and financial transactions.

6.6 However the board has had no effective financial management arrangements and the absence of an adequate financial control framework has created conditions in which illegitimate or uncontrolled spending, or error, could occur. Nor has there been adequate oversight and scrutiny of the board's expenditure. We did not identify any illegitimate or inappropriate spending but it is likely that this lack of oversight contributed to the unchallenged accumulation of £307,000 of reserves at the end of 2018/19.

6.7 We understand that similar arrangements are in place to support the Lancashire Safeguarding Adults Board. The council's senior managers are therefore now taking action to ensure that board's financial arrangements are strengthened and that there is appropriate transparency in its use of funds.

6.8 The LSCB was replaced in September 2019 by new statutory area safeguarding arrangements across the whole of Lancashire under the Blackburn with Darwen, Blackpool and Lancashire Children's Safeguarding Assurance Partnership and its financial arrangements will be different from those for the LSCB.

Schools' Financial Value Standard (SFVS) self-assessments

(Substantial assurance: type 2)

6.9 All schools submitted self-assessments for 2018/19 reflecting their governance and financial arrangements, and the ones we tested were supported by evidence.

6.10 Schools' governing bodies review and approve annual budgets prior to submission to the council and regularly monitor progress, with variances explained in reports and challenged during meetings. Full governing board meetings are professionally clerked and capture governor challenge and scrutiny, and key approvals. Most schools were able to provide governor competency matrices identifying key skills and development needs, and meeting minutes confirm that they are actively used to assess and address governors' training requirements.

Safekeeping of heritage assets held in museums and libraries

(Substantial assurance: type 1)

6.11 Heritage assets are items with historic, artistic, cultural or information value and the council has an extensive collection displayed or stored in its own and partners' museums, libraries and archives. It is important that they are managed effectively to reduce the risk of damage, theft or loss.

6.12 The Collections Management Strategy is comprehensive and sets out strategies for collections' information, access, care and conservation. Supporting policies include information on asset storage, display, security and transport. Further procedures and guidance cover insurance, loans and donations, building security, CCTV, and counter terrorism amongst other things. Staff expertise is concentrated in museums and the archive office, where the majority of significant cultural items and collections are displayed and stored.

7 Work completed on business process controls: financial systems and processes

VAT (Substantial assurance: type 2)

7.1 The council's statutory activities are outside the scope of VAT but special rules mean it can recover VAT on goods and services purchased for non-business activities and VAT incurred on exempt supplies such as property or certain education services, provided that it is not significant (not more than 5% of the total VAT incurred).

7.2 There are effective procedures to ensure that the council's VAT returns are accurate, reconcile to source data and submitted on time to HMRC. The VAT team checks the accuracy and completeness of returns monthly, and compliance with HMRC's rules for reclaiming VAT on exempt supplies is regularly monitored by the VAT manager.

8 Work completed on service support controls: technology

ICT Service governance (Moderate assurance: type 1+2)

8.1 The service provision agreement sets out heads of terms for the service provided by BTLS and is supported by detailed service-specific schedules and performance management arrangements. Reports on projects, payroll, and recruitment as well ICT service delivery are shared at a monthly service governance meeting. The contract's key performance indicators have recently been amended to become more robust before the contract ends in March 2021.

8.2 The council’s oversight of and support for BTLS's work and ICT service delivery are achieved through a number of different groups although, taken together, they perhaps form an unnecessarily complex framework of governance. Assurance over various aspects of ICT service provision is available from a number of sources but this is not routinely collated and considered.

8.3 Until October 2019 the council lacked the key policies – a Digital Strategy and IT Strategy in particular – which should support a strategic view of its current and future business needs. It is expected that, as they become available, ICT services will be aligned with them.

Assurance provided by internal audit assignments in 2019/20

Audit assurance

Note that our assurance may address the adequacy of the control framework's design, the effectiveness of the controls in operation, or both. The wording below addresses all of these options and we will refer in our reports to the assurance applicable to the scope of the work we have undertaken.

Substantial assurance: the framework of control is adequately designed and/ or effectively operated overall.

Moderate assurance: the framework of control is adequately designed and/ or effectively operated overall, but some action is required to enhance aspects of it and/ or ensure that it is effectively operated throughout the service, system or process.

Limited assurance: there are some significant weaknesses in the design and/ or operation of the framework of control that put the achievement of the service, system or process' objectives at risk.

No assurance: there are some fundamental weaknesses in the design and/ or operation of the framework of control that could result in failure to achieve the service, system or process' objectives.

Classification of residual risks requiring management action

All actions agreed with management are stated in terms of the residual risk they are designed to mitigate.

Extreme residual risk: critical and urgent in that failure to address the risk could lead to one or more of the following: catastrophic loss of the county council's services, loss of life, significant environmental damage or significant financial loss, with related national press coverage and substantial damage to the council's reputation. *Remedial action must be taken immediately.*

High residual risk: critical in that failure to address the issue or progress the work would lead to one or more of the following: failure to achieve organisational objectives, significant disruption to the council's business or to users of its services, significant financial loss, inefficient use of resources, failure to comply with law or regulations, or damage to the council's reputation. *Remedial action must be taken urgently*.

Medium residual risk: failure to address the issue or progress the work could impact on operational objectives and should be of concern to senior management. *Prompt specific action should be taken*.

Low residual risk: matters that individually have no major impact on achieving the service's objectives, but where combined with others could give cause for concern. *Specific remedial action is desirable*.

Audit, Risk and Governance Committee
Meeting to be held on 28 October 2019

Electoral Division affected: None;

Treasury Management Activity 2019/20
Appendix A refers

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Executive Summary

To provide a summary of treasury management activity for the first half of the financial year 2019/20.

Recommendation

The committee is asked to:
(i) Note the activity for the first half of 2019/20.

(ii) Recommend to Full Council the increase in the Authorised Borrowing Limit from £1,375m to £1,600m for the remainder of 2019/20.

Background and Advice

As part of the council's governance arrangements for treasury management, the Audit, Risk and Governance Committee is charged with the oversight of the council's treasury management activities. To enable the committee to fulfil this role, it receives regular reports on treasury management issues and activities. Reports on treasury activity are discussed on a monthly basis with the Director of Finance and the content of these are used as a basis of this report to the committee.

The review at appendix A provides a summary of the treasury management activity undertaken 1 April 2019 to 30 September 2019. It provides details of recent changes in borrowing rates and raises the possibility of taking additional long term borrowing if economic conditions mean this is advantageous. Consequently an increase in the Authorised Borrowing Limit is proposed. Information on the activities carried out under the non-treasury investment strategy is also provided in the report.

Consultations

Arlingclose are the council's external treasury advisers and their advice and analysis is referenced in the activity review.

Implications:

This item has the following implications, as indicated:

Risk management

The council's treasury management and non-treasury management investment strategies set out policies in respect of managing the risks associated with the council's borrowing and investment activity.

Local Government (Access to Information) Act 1985
List of Background Papers

Paper	Date	Contact/Tel
Treasury Management Strategy and Non Treasury Management Investment Strategy	February 2018	Paul Dobson 01772 534725
The Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Code of Practice	2017	Paul Dobson 01772 534725

Reason for inclusion in Part II, if appropriate

N/A

Treasury Management Activity 2019/20: April to September 2019

The council's treasury management activity is underpinned by the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management ("the Code"). The Code recommends that members are informed of treasury management activities. This report provides a brief update on treasury management activity between 1 April and 30 September 2019.

Economic context

The economic situation continues to be dominated by the uncertainty arising from the unknown impact of the UK's withdrawal from the European Union and the trade dispute between the worlds' two largest economies namely the USA and China. Despite this, the first quarter of 2019 showed relatively strong growth of 0.5% (1.8% year on year). However, it was considered that this was partly due to stockpiling ahead of the expected date for leaving the European Union and was followed by a contraction of 0.2% in the second quarter.

The uncertainty in the economy has influenced the forecast interest rates. The Bank of England has in recent times raised expectations of gradual increases in interest rates and this has been reflected in interest rate forecasts. Recent forecasts though have reduced this expectation. In their May forecast Arlinglose, the council's treasury advisers, were forecasting that the bank rate would see a 0.25% increase in March 2020 and September 2020. However, with the prevailing economic situation they have changed the forecast to reflect no change in the Bank Rate for the foreseeable future. However, there are risks to this forecast which could see rates moving in either direction.

Recent economic data has suggested that weaker economic growth has occurred, and is anticipated to continue, globally. One of the consequences of this together with the political uncertainty has been that Gilt yields have been volatile over the period and they have fallen to historically low levels. For example the 20 year Gilt yield fell from 1.35% to 0.88% from the end of June to the end of September.

Investment activity

Investments at 30 September 2019 totalled £595m and consisted of £18m in bank and local authority deposits and £577m in corporate and government bonds. The following table shows the investment activity between 1 April and 30 September 2019.

Bank and Local Authority Deposits	**Call £m**	**Fixed £m**	**Other £m**	**Total £m**
Balance 1 April 2019	**46**	**61**	**-**	**107**
Maturities	-47	-72	-	-119
New Investments	8	22	-	30
Balance 30 September 2019	**7**	**11**	**-**	**18**

Bonds	Local authority £m	Gilts £m	Others £m	Total £m
Balance 1 April 2019	**33**	**84**	**199**	**316**
Maturities and sales	-1	-2,125	-385	-2,511
New investments	0	2,265	507	2,772
Balance 30 September 2019	**32**	**224**	**321**	**577**

The period saw some significant volatility in the price of the Gilts held. This resulted in the opportunity being taken to sell some of the holdings to enhance the overall return on the investments and is reflected in the level of new investments during the period.

The current rate of return on the investment portfolio measured by Arlingclose is 1.37% which compares favourably with the benchmark 7 day money market rate that averaged 0.68% over the same period.

Borrowing activity

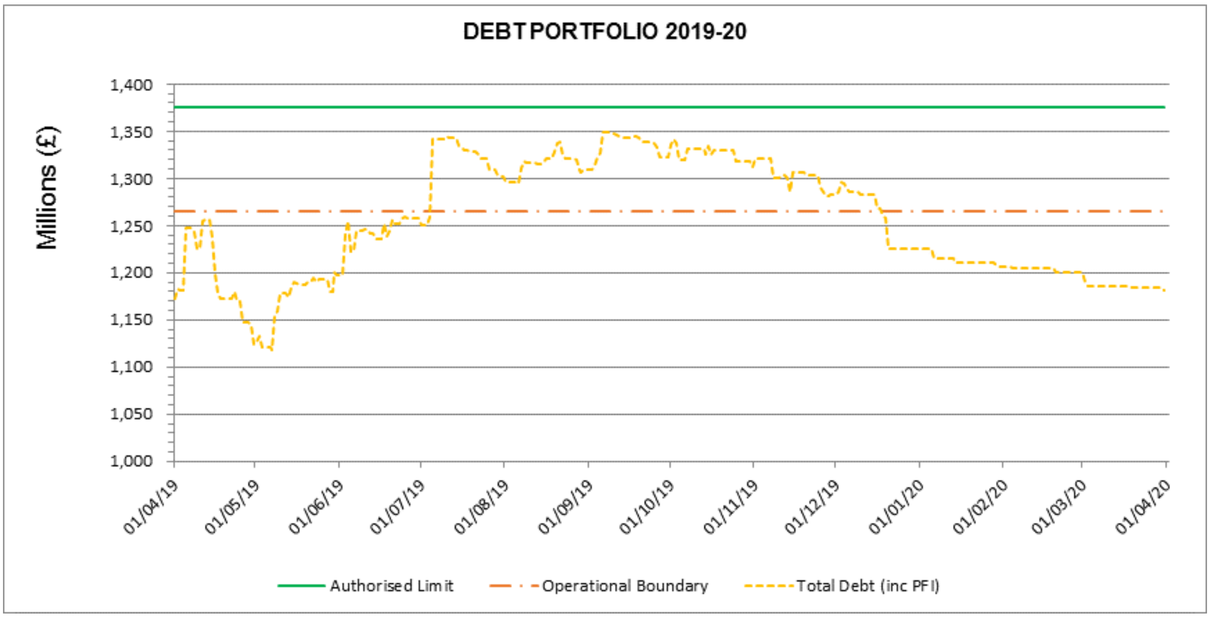
The council's capital programme includes a requirement to borrow to fund new capital investment. The table below summarises the borrowing activity which has taken place between 1 April and 30 September 2019.

Borrowing	**Public Works Loan Board Fixed**	**Public Works Loan Board Variable**	**Other Local authorities**	**Police, Fire & Lancashire District Councils**	**Total**
	£m	**£m**	**£m**	**£m**	**£m**
1 April 2019	**236**	**126**	**603**	**71**	**1,036**
New Borrowing	70	0	520	301	891
Maturities	0	0	-472	-279	-751
30 September 2019	**306**	**126**	**651**	**93**	**1,176**
Public Finance Initiative (PFI) Liability	-	-	-	-	147
Total					**1,323**

Total borrowing at the end of September was £1,323m including the financing of £147m of assets through remaining Public Finance Initiative schemes. The outstanding borrowing has increased by £140m in the period.

With the low interest rates anticipated to continue, borrowing taken has principally been short term in nature, in line with the recent strategy. However, the Public Works Loan Board rates are linked to the Gilt yields. The period has seen Gilt yields, and therefore the Public Works Loan Board rates fall to historically low levels. Therefore, some £70m of fixed term loans were taken in the period to provide some certainty of future cost. The average interest rate of the loans taken during the year is 1.8%; which is lower than the 2.7% provision made in the Medium Term Financial Strategy for fixing some debt on a long term basis. The strategy is to take up to £100m, for which budget provision has been made in the Medium Term Financial Strategy, based on the future maturities of long term debt and the desire to keep a balanced debt portfolio between long term fixed and short term borrowing to manage interest rate risk and provide a degree of budget certainty. There is no evidence of a short term liquidity problem and this was not a factor in the decision. Opportunities to take further fixed term loans will continue to be evaluated.

Borrowing is undertaken within the framework set by the Authorised and Operational Limits. The following graph shows the level of debt for the current financial year compared with the prudential indicator operational and authorised boundaries. It is expected that the debt may exceed the operational limit on occasions but it should not exceed the Authorised Limit. The debt shown from 30 September represents the debt position if no maturing debt was replaced rather than an estimate of the expected position.



Total debt during the year has remained below the authorised limit but has exceeded the operational limit. The operational limit has been exceeded partly due to the opportunity to take long term borrowing at low rates which needed to be taken before existing debt matured. There is a possibility that borrowing rates may fall further in the remainder of the year and the opportunity to secure advantageous rates may be lost due to the timing of existing debt maturing aligned to our authorised limit. Although it is not anticipated that this is a likely scenario, with the significant economic and political uncertainty that exists, it is recommended that an increase in the Authorised Limit for 2019/20 will enable the council to be in a position to take advantage of any unusual fall in rates. An increase from £1,375m to £1,600m is therefore requested and is reflective of the anticipated need to borrow in future years.

The current interest rate payable on debt measured by Arlingclose is 1.71%. The most recent benchmarking figure available of the average rate for all Arlingclose clients (as measured on 31 March 2019) is 3.65%.

Non-treasury investment strategy

A non-treasury investment strategy was approved by the Full Council in February 2019. This enabled the investment in bonds for commercial purposes where cash-flow permits. In accordance with this, a number of other local authority loans were purchased from a bank. The cost of these at 30 September was £82m. As the assets are considered to be a trading activity, any change in the market value of the assets as at 31 March 2020 will be charged or credited to the revenue account.

A major factor causing changes in the value of the investments will be interest rate movements. To mitigate the risk of adverse movements, agreements were made in the period to buy Gilts at a future date as the impact would negatively correlate (have the opposite effect) with the impact on the investments. It is anticipated that the net change in the market value will be broadly neutral although there may be some limited variation by the year-end.

In addition, some corporate bonds and Gilts are held in the trading book which will also be subject to the same market value charge or credit to revenue. No market value changes have been recognised to date. It should be noted that the market values change on a daily basis and the charge or credit to the accounts will be based on the market value on the 31 March 2020.

Budget monitoring position

It was reported to Cabinet in September that there is a forecast underspend against the treasury management budget of £7m. This is primarily as a result of extra income received through the continuing volatility in the price of Gilts and other bonds enabling sales to be made which have generated a surplus. This represented the outcome of activity during quarter 1 and the quarter 2 position is being updated and will be reported at a future Cabinet meeting with the final outturn likely to be significantly different, and improved, from this last reported forecast, due to recent and continued market volatility.

The position is kept under regular review and discussed with the Director of Finance on a monthly basis.

Prudential Indicators

The Treasury Management Strategy included some prudential indicators which provide a framework for the operation and risk management of the Treasury Management function. These are shown below for 2019/20 with the latest available actual position.

Authorised and Operational Limits for debt

The 'authorised limit' is a prudent estimate of external debt, but allows sufficient headroom for unusual cash flow movements. During the year the Director of Finance approved the re-allocation of the Authorised Limit between the borrowing and other long term liabilities to provide some additional flexibility to take long term borrowing. This approval is in accordance with the Prudential Code.

	Initial limit	Revised limit	Actual
	£m	£m	£m
Borrowing	1,200	1,225	1,176
Other long term liabilities	175	150	147
TOTAL	1,375	1,375	1,323

The 'operational limit' for external debt is based on the same estimates as the authorised limit. However, although it reflects a prudent estimate of debt, there is no provision for unusual cash flow movements. In effect, it represents the estimated maximum external debt arising as a consequence of the council's current plans. As required under the Code, this limit will be carefully monitored during the year. The proposed operational limits for external debt are:

	Limit	Actual
	£m	£m
Borrowing	1,110	1,176
Other long term liabilities	155	147
TOTAL	1,265	1,323

As explained in the report the timing of taking long term loans has resulted in the level of borrowing being above the operational limit. It is anticipated that by the end of the financial year the level will be within the operational limits unless a decision is taken to borrow in advance for future needs as permitted by the Prudential Code.

Gross debt and the capital financing requirement

CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the authority's total debt should be lower than its highest forecast capital financing requirement over the next three years. The county council's overall borrowing is in excess of the capital financing requirements however, in making this comparison certain borrowing is included in the total but does not count against the capital financing requirement. These include the shared investment scheme, premiums paid and the transferred debt. Once these sums are removed, the level of borrowing is within the capital financing requirement conditions.

Interest rate exposure

In order to control interest rate risk the council measures its exposure to interest rate movements. These indicators place limits on the overall amount of risk the council is exposed to. The one year impact indicator calculates the theoretical impact on the revenue account of an immediate 1% rise in all interest rates over the course of one financial year.

	Upper Limit	Actual
Upper limit on one-year revenue impact of a 1% rise in interest rates	£30m	£24m

Maturity structure of debt

Limits on the maturity structure of debt help control refinancing risk.

	Upper Limit	Actual
Under 12 months	75%	42%
12 months and within 2 years	75%	27%
2 years and within 5 years	75%	4%
5 years and within 10 years	75%	5%
10 years and above	75%	21%

Investments over 1 year

Limit on the level of long-term investments helps to control liquidity, although the majority of these investments are currently held in securities which may be readily sold. The limit is largely determined by the forecast of reserves and balances held at the year-end.

	Upper limit	Actual
Total invested over 1 year	£475m	£447m
Operational/forecast limit at 31 March 2020	£375m	£447m

The indicator excludes investments undertaken as part of the trading portfolio as they are not part of the in- year liquidity requirements.

Minimum Average Credit Rating

To control credit risk the council requires a very high credit rating from its treasury counterparties.

	Benchmark	Actual
Average counterparty credit rating	A	AA