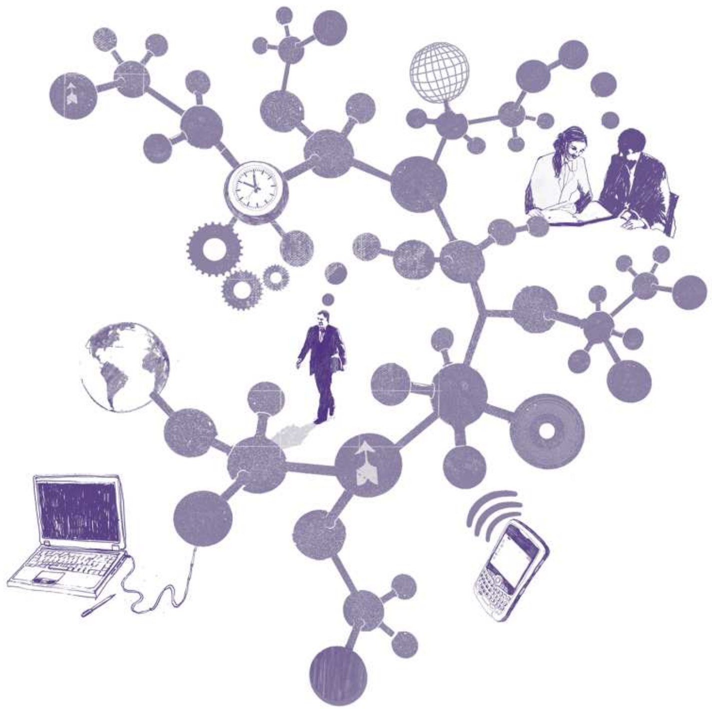
Grant Thornton

# The Audit Findings for Lancashire County Council

**Year ended 31 March 2014**

September 2014



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The contents of this report relate only to those matters which came to our attention during the conduct of our normal audit procedures which are designed primarily for the purpose of expressing our opinion on the financial statements. Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we will report these to you.  In consequence, our work cannot be relied upon to disclose defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify.

We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

# Contents

# Section 1: Executive summary

# Executive summary

## Purpose of this report

This report highlights the key matters arising from our audit of Lancashire County Council's ('the Council') financial statements for the year ended 31 March 2014. It is also used to report our audit findings to management and those charged with governance in accordance with the requirements of International Standard on Auditing 260 (ISA).

Under the Audit Commission's Code of Audit Practice we are required to report whether, in our opinion, the Council's financial statements present a true and fair view of the financial position, its expenditure and income for the year and whether they have been properly prepared in accordance with the CIPFA Code of Practice on Local Authority Accounting. We are also required to reach a formal conclusion on whether the Council has put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources (the Value for Money conclusion).

## Introduction

In the conduct of our audit we have not had to alter or change our planned audit approach, which we communicated to you in our Audit Plan dated 11th June 2014.

Our audit is substantially complete although we are finalising our work in the following areas:

- review of the Annual Governance Statement
- review of the final version of the financial statements
- obtaining and reviewing the final management letter of representation
- updating our post balance sheet events review, to the date of signing the opinion, and
- Whole of Government Accounts

We received draft financial statements and accompanying working papers at the start of our audit, in accordance with the agreed timetable. However, the Annual Governance Statement was not received until 18 September 2014.

Overall, the draft Statement of Accounts was prepared to a good standard and there have been improvements in the quality of the supporting working papers.

## Key issues arising from our audit

**Financial statements opinion**

We anticipate providing an unqualified opinion on the financial statements.

We have identified no adjustments which affect the primary financial statements or the Council's reported financial position at 31 March 2014. However, there have been two material adjusted misstatements to comparatives in the Comprehensive Income and Expenditure Account and several further adjustments to correct significant misstatements and misclassifications, mostly affecting disclosure notes.

A number of other changes have been made in response to audit findings to more fully meet disclosure requirements, improve consistency within the Statement of Accounts and correct trivial arithmetical and presentational errors.

Officers have continued to improve the quality of the financial information contained within the Statement of Accounts by removing non-material disclosures and information that is not required.

Further details are set out in section 2 of this report.

# Executive summary

**Value for Money conclusion**

Based on our review of the Council's arrangements to secure economy, efficiency and effectiveness in its use of resources, we are unable to conclude that the Council has proper arrangements in place to secure value for money.

Our conclusion takes account of the balance between those areas where the Council's arrangements are demonstrably strong, and those areas of corporate and financial governance where the Council has recently identified a number of fundamental weaknesses in its arrangements.

In particular, the Council has identified weaknesses relating to:
- two procurement processes;
- the relationship with and operation of the Council's strategic partnership and associated joint venture company;
- salary payments made to the then Chief Executive of the joint venture company.

In addition, the Council's Chief Internal Auditor has given an overall opinion of limited assurance in respect of her work for the year. This reflects the relatively high proportion of reviews undertaken across the Council where the level of assurance was assessed as either none or limited.

We recognise that these governance issues have emerged in the year but that they relate to arrangements, decisions and actions taken in previous years. It is a positive sign that the Council has identified the issues and is dealing with them appropriately. The actions arising include:

- referring matters to the police for investigation – this remains on-going; and
- renegotiating the relationship with the strategic partner – this includes transferring a number of services back in house from 1 April 2014.

Further details are set out in section 2 of this report.

**Whole of Government Accounts (WGA)**

We will complete our work in respect of the Whole of Government Accounts in accordance with the national timetable.

## Controls

The Council's management is responsible for the identification, assessment, management and monitoring of risk, and for developing, operating and monitoring the system of internal control.

Our audit is not designed to test all internal controls or identify all areas of control weakness. Our focus is on whether the financial controls in their totality are sufficiently robust to mitigate; i.e. prevent or detect, material misstatement. However, where, as part of our testing, we identify any control weaknesses, we report these to the Council.

## Controls

Our work has not identified any control weaknesses which we wish to highlight for your attention beyond those which have already been identified by the Council and reported by the Chief Internal Auditor. In her 2013/14 Annual Report the Chief Internal Auditor concluded:

*"I can provide only limited assurance overall that there is a generally sound system of internal control, adequately designed to meet the council's objectives and applied consistently in practice. Weaknesses in the council's systems' design and inconsistent application of controls put the achievement of its objectives at risk and, in particular, significant weaknesses in the council's governance were revealed during the year".*

## The way forward

Matters arising from the financial statements audit and review of the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources have been discussed with Council's Chief Executive and County Treasurer.

## Acknowledgment

We would like to take this opportunity to record our appreciation for the assistance provided by the finance team and other staff during our audit.

**Grant Thornton UK LLP**
**September 2014**

# Section 2: Audit findings

# Audit findings

In this section we present our findings in respect of matters and risks identified at the planning stage of the audit and additional matters that arose during the course of our work. We set out on the following pages the work we have performed and findings arising from our work in respect of the audit risks we identified in our audit plan, presented to the Audit and Governance Committee on 30th June 2014. We also set out the adjustments to the financial statements arising from our audit work and our findings in respect of internal controls.

## Changes to Audit Plan

We have not made any changes to our Audit Plan as previously communicated to you on 30th June 2014.

## Audit opinion

We anticipate that we will provide the Council with an unmodified opinion on the Council's statement of accounts.

Our audit opinion is set out in Appendix A.

# Audit findings against significant risks

"Significant risks often relate to significant non-routine transactions and judgmental matters. Non-routine transactions are transactions that are unusual, either due to size or nature, and that therefore occur infrequently. Judgmental matters may include the development of accounting estimates for which there is significant measurement uncertainty" (ISA 315).

In this section we detail our response to the significant risks of material misstatement which we identified in the Audit Plan. As we noted in our plan, there are two presumed significant risks which are applicable to all audits under auditing standards.

| | Risks identified in our audit plan | Work completed | Assurance gained and issues arising |
|---|---|---|---|
| 1. | **The revenue cycle includes fraudulent transactions**<br>Under ISA 240 there is a presumed risk that revenue may be misstated due to improper recognition | • Review and testing of revenue recognition policies<br>• Testing of material revenue streams<br>• Review of any unusual significant transactions | • Our audit work has not identified any issues in respect of revenue recognition. |
| 2. | **Management over-ride of controls**<br>Under ISA 240 there is a presumed risk of management over-ride of controls | • Review of accounting estimates, judgements and decisions made by management<br>• Testing of journal entries<br>• Review of unusual significant transactions | • The findings of our review of journal controls and testing of journal entries has not identified any significant issues.<br>• We are aware that there is an on-going police investigation. In this context we have not identified any evidence of management override of controls that we wish to bring to your attention.<br>• We set out later in this section of the report our work and findings on key accounting estimates and judgments. |

# Audit findings against other risks

In this section we detail our response to the other risks of material misstatement which we identified in the Audit Plan. Recommendations, together with management responses, are attached at Appendix A.

| Transaction cycle | Description of risk | Work completed | Assurance gained & issues arising |
|---|---|---|---|
| **Operating expenses** | Creditors understated or not recorded in the correct period. | • Documentation of our understanding of processes and key controls over the transaction cycle<br>• Walkthrough of the key controls to assess the whether those controls are designed effectively<br>• Sample testing of operating expenses and year end creditors / accruals including agreement to source documents | Our audit work has not identified any significant issues in relation to the risk identified. |
| **Employee remuneration** | Employee remuneration accrual understated (Remuneration expenses not correct) | • Documentation of our understanding of processes and key controls over the transaction cycle<br>• Walkthrough of the key controls to assess the whether those controls are designed effectively<br>• Sample testing of employee remuneration expenses, including employer contributions<br>• Completion of comprehensive proof in total review procedures to assess whether employee remuneration for the Council is in line with expectations<br>• Review of senior officer remuneration disclosures and substantive testing to supporting records | Our audit work has not identified any significant issues in relation to the risk identified. |
| **Property, plant & equipment** | Revaluation measurement not correct | • Documentation of our understanding of processes and key controls over the transaction cycle<br>• Walkthrough of the key controls to assess the whether those controls are designed effectively<br>• Sample testing of revaluation adjustments, including agreement to valuation report. | Our audit work has not identified any significant issues in relation to the risk identified. |

# Accounting policies, estimates & judgements

In this section we report on our consideration of accounting policies, in particular revenue recognition policies, and key estimates and judgements made and included with the Council's financial statements.

| Accounting area | Summary of policy | Comments | Assessment |
|---|---|---|---|
| **Revenue recognition** | Fees, charges and rents due from customers are accounted for as income at the date the council provides the relevant goods or services.<br>Grants and contributions are recognised when there is reasonable assurance that the Council will comply with any conditions attached to the payments and the grants or contributions will be received. | The recognition of revenue by the Council is in line with recognised accounting guidance and in line with CIPFA's recommended approach | ● GREEN |
| **Judgements and estimates** | Key estimates and judgements include:<br>– group account considerations useful life of capital equipment<br>– revaluations<br>– accounting for school assets<br>– pension fund assets and liabilities<br>– revaluations | The judgements and estimates included within the financial statements have been based on a sound rationale. The judgements and estimates are supported where necessary by advice given by professional experts including Mercers who provide assurance around the Council's share of the Lancashire County Pension Fund assets and liabilities.<br>Accounting policies disclosure note 1g states that:<br>"Assets included in the balance sheet at fair value are revalued sufficiently regularly to ensure that their carrying amount is not materially different from their fair value at the year-end, but as a minimum every five years"<br>We are satisfied that the carrying amount of Property, Plant & Equipment (based on these valuations) does not differ materially from the fair value at 31 March 2014. | ● GREEN |

**Assessment**

● (red) Marginal accounting policy which could potentially attract attention from regulators

● (amber) Accounting policy appropriate but scope for improved disclosure

● (green)Accounting policy appropriate and disclosures sufficient

# Accounting policies, estimates & judgements

In this section we report on our consideration of accounting policies, in particular revenue recognition policies, and key estimates and judgements made and included with the Council's financial statements.

| Accounting area | Summary of policy | Comments | Assessment |
|---|---|---|---|
| **Judgements and estimates (cont'd)** | | In our view, however, this rolling programme does not meet the Code's requirement in paragraph 4.1.2.35 to value items within a class of property, plant and equipment simultaneously.<br>This paragraph of the Code, which is based on IAS16 Property, Plant and Equipment, does permit a class of assets to be revalued on a rolling basis provided that:<br>• the revaluation of the class of assets is completed within a 'short period'<br>• the revaluations are kept up to date.<br>We would normally expect this 'short period' to be within a single financial year. The Council may wish to consider how its policy demonstrates compliance with the Code. | ● GREEN |
| **Other accounting policies** | We have reviewed the Council's policies against the requirements of the CIPFA Code and accounting standards. | While minor changes have been made to the accounting polices note to the accounts, our review of accounting policies has not highlighted any issues which we wish to bring to your attention. | ● GREEN |

**Assessment**
- ● Marginal accounting policy which could potentially attract attention from regulators
- ● Accounting policy appropriate but scope for improved disclosure
- ● Accounting policy appropriate and disclosures sufficient

# Adjusted misstatements

A number of adjustments to the draft financial statements have been identified during the audit process. We are required to report all misstatements to those charged with governance, whether or not the financial statements have been adjusted by management. The table below summarises the adjustments arising from the audit which have been processed by management.

## Impact of adjusted misstatements

All adjusted misstatements are set out below along with the impact on the primary statements and the reported financial position.

| | Detail | Primary financial statements impact |
|---|---|---|
| **Primary financial statements** | | |
| 1 | The CIPFA Code of Practice on Local Authority Accounting for 2013/14 (the Code) includes revisions to the accounting treatment for pension costs as a result of changes to IAS 19 Employee Benefits. This is a change in accounting policy and applies retrospectively. The main changes involve a reallocation of amounts charged in the Comprehensive Income and Expenditure Statement (CIES), including reporting of the net interest position on the net defined benefit liability. Since comparatives show the gross position for interest income on plan assets and interest cost on the defined benefit obligation, gross income and expenditure included in Financing and Investment Income and Expenditure were overstated by £99.4m. Comparatives in the Amounts Reported for Resources Allocation Decisions note were also affected. | Yes – gross income and expenditure comparatives for Financing and Investment Income and Expenditure in the CIES have both reduced by £99.4m.<br><br>The net expenditure position and deficit for the year are unaffected. |
| 2 | Through discussions with officers, our investigation of significant variances to the previous financial year identified that the gross income and expenditure position impacting on the non distributed costs line was incorrectly reported in 2012/13. While this error has no effect on net expenditure, gross income and expenditure comparatives were overstated by £39.0m. Related comparatives in the Amounts Reported for Resources Allocation Decisions note were also affected. | Yes – gross income and expenditure comparatives for non distributed costs in the CIES have both reduced by £39.0m.<br><br>The net expenditure position and deficit for the year are unaffected. |

# Adjusted misstatements

| | Detail | Primary financial statements impact |
|---|---|---|
| **Disclosure notes** | | |
| 3 | The amount for the 'final DSG for 2013/14 before academy recoupment' in the Dedicated Schools Grant disclosure note related to 2012/13. As a result , this amount was overstated by £23.9m. | No - the impact is limited to the Dedicated Schools Grant disclosure note. |
| 4 | Legally committed capital expenditure as at 31 March 2014 of £74.5m only reflects expenditure that the Council expects to incur in 2014/15. As a result, this amount is understated by £67.5m. | No - the impact is limited to the Future Capital Spending Commitments disclosure note. |
| 5 | Amounts in the valuation table for land and buildings in the Property, Plant and Equipment disclosure note incorrectly related to 2012/13. As a result , there was a £28.1m inconsistency with the gross book value of land and buildings shown elsewhere in the Property, Plant and Equipment disclosure note of £2,081.3m. | No - the impact is limited to the Property, Plant and Equipment disclosure note. |
| 6 | The £29.7m accumulated absences creditor was incorrectly excluded from creditors related financial liabilities at amortised cost in the Financial Instruments disclosure note. | No - the impact is limited to the Financial Instruments disclosure note. |
| 7 | £34.7m of cash and cash equivalent balances were incorrectly excluded from the total amortised cost and fair value of loans and receivables in the Fair Value of Financial Assets and Liabilities disclosure note. A further £2.6m of balances were incorrectly excluded from the total amortised cost of financial liabilities. | No - the impact is limited to the Fair Value of Financial Assets and Liabilities note disclosure note. |
| 8 | The fair value calculation of the PFI liabilities as at 31 March 2013 incorrectly excluded £48.8m of liabilities in respect of 2013/14 due to a formula error.<br><br>Additionally, following a change in the basis for determining the fair value of LOBO borrowing as at 31 March 2014, comparatives have been increased by £23.6m to ensure consistency. | No - the impact is limited to the Fair Value of Financial Assets and Liabilities note disclosure note. |

# Misclassifications

The table below provides details of misclassification changes identified during the audit which have been made in the final set of financial statements.

| | Detail | Primary financial statements impact |
|---|---|---|
| **Primary financial statements** | | |
| 1 | £29.1m of other comprehensive income was incorrectly classified as "other movements in the Movement in Reserves Statement (MIRS)". In addition, the presentation of the CIES has been amended to include £285.7m of items that will not be reclassified to the "(Surplus) or Deficit on the Provision of Services" within the total for other comprehensive income. Comparatives are also affected by these issues. | Yes – other comprehensive income in the MIRS has increased by £29.1M to include other movements which have been removed. Changes to the CIES are presentational.<br><br>The deficit for the year and total comprehensive income are unaffected. |
| **Disclosure notes** | | |
| 2 | In the Private Finance Initiative (PFI) Schemes disclosure note, £19.2m of contingent rentals were incorrectly classified within payments for services rather than interest charges in the future payments analyses for all of the PFI schemes | No - the impact is limited to the Private Finance Initiative (PFI) Schemes disclosure note. |
| 3 | The transfer of two academies with a combined net book value of £7.0M has been included in the Capital Adjustment Account disclosure note within amounts of non-current assets written off on disposal or sale as part of the gain/loss on disposal to the CIES rather than the reversal of charge re transfer of academies. | No - the impact is limited to the Capital Adjustment Account disclosure note. |

# Internal controls

The purpose of an audit is to express an opinion on the financial statements.

Our audit included consideration of internal controls relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported here are limited to those deficiencies that we have identified during the course of our audit and that we have concluded are of sufficient importance to merit being reported to you in accordance with auditing standards.

Our work has not identified any significant control weaknesses which we wish to highlight for your attention, beyond those which have already been identified by the Council and reported by the Chief Internal Auditor.

# Other communication requirements

We set out below details of other matters which we are required by auditing standards to communicate to those charged with governance.

| | Issue | Commentary |
|---|---|---|
| 1. | **Matters in relation to fraud** | • We have previously discussed the risk of fraud with the Audit & Governance Committee. We have not been made aware of any other incidents in the period and no other issues have been identified during the course of our audit. |
| 2. | **Matters in relation to laws and regulations** | • We are not aware of any significant incidences of non-compliance with relevant laws and regulations. |
| 3. | **Written representations** | • A letter of representation has been requested from the Council. |
| 4. | **Disclosures** | • Our audit work identified no material omissions in the financial statements, although a number of changes to defined benefit scheme related disclosures to reflect the changes in the Code. The descriptions for related entries in the CIES and supporting notes have also been amended to match the revised terminology introduced by the Code.<br>• The Council has also amended the presentation of the CIES to separately disclose Public Health Services, responsibility for which was transferred from NHS Primary Care Trusts to local authorities with effect from 1 April 2013 under the Health and Social Care Act 2012, as an acquired operation. A number of changes were made to disclosure notes to improve internal consistency and compliance with the requirements of the Code, as well as to correct trivial arithmetical, typographical and presentational errors.<br>• However, officers have demonstrated a strong desire to further improve the quality of the financial information contained within the Statement of Accounts. Notably, the Council has continued to remove non-material disclosures and information that is not required by the Code so that only key information is included with related party transaction and financial instrument related disclosures seeing the most change. |
| 5. | **Matters in relation to related parties** | • We are not aware of any related party transactions which have not been disclosed |
| 6. | **Going concern** | • Our work has not identified any reason to challenge the Council's decision to prepare the financial statements on a going concern basis. |

# Section 3: Value for Money

# Value for Money

## Value for money conclusion

The Code of Audit Practice 2010 (the Code) describes the Council's responsibilities to put in place proper arrangements to:

- secure economy, efficiency and effectiveness in its use of resources;
- ensure proper stewardship and governance; and
- review regularly the adequacy and effectiveness of these arrangements.

We are required to give our VFM conclusion based on two criteria specified by the Audit Commission which support our reporting responsibilities under the Code. These criteria are:

**The Council has proper arrangements in place for securing financial resilience -** the Council has robust systems and processes to manage effectively financial risks and opportunities, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.

**The Council has proper arrangements for challenging how it secures economy, efficiency and effectiveness -** the Council is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

## Overall VFM conclusion

On the basis of our work, and having regard to the guidance on the specified criteria published by the Audit Commission, we are unable to conclude the Council has proper arrangements in place to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2014.

This conclusion takes account of the balance between those areas where the Council's arrangements are demonstrably strong, and the area of corporate and financial governance where the Council has recently identified a number of fundamental weaknesses in its arrangements.

We recognise that these governance issues have emerged in the year but that they relate to arrangements, decisions and actions taken in previous years. It is a positive sign that the Council has identified the issues and is dealing with them appropriately. The actions arising include:

- referring matters to the police for investigation – this remains on-going; and
- renegotiating the relationship with the strategic partner, including transferring a number of services back in house

## Key findings

**Securing financial resilience**

We have considered the Council's arrangements to secure financial resilience against the following themes:

- Key financial performance indicators
- Financial governance
- Financial planning
- Financial control

The Council performs well in respect of the key indicators of financial performance. For example, the Council has maintained the County fund balance at £36m at 31 March 2014 and its net assets (the amount by which the Council's total assets exceed total liabilities) were £831.7m at this date.

# Value for Money

The need for the Council to take £300m of annualised costs out of the annual revenue budget by March 2018 represents a considerable challenge. However the Council is well placed to meet that challenge with £424.9m of usable reserves, including a County Fund of £36m at 31 March 2014. This will support a mix of strategic investment, service transformation, downsizing and "invest to save projects" as the Council restructures and re-configures services in the coming years to create the operating model for the "new" Lancashire County Council.

The Council has strong arrangements in place for financial planning. Like many other council's Lancashire continues to operate within an increasingly challenging financial environment. Against this back drop, the Council set a balanced budget for 2013/14 and delivered a £3.1m underspend against this. The Council has a clear financial strategy articulated through its three year budget and annual review. There are clear links between the budget and the Council's corporate priorities and these are subject to regular review and refresh.

Financial control across the Council is good and it has a good track record of delivering its savings plans. Over the last three year financial planning cycle the Council has delivered savings of £220m. A considerable amount of work has been done to understand, mitigate or redesign demand led services to ensure they are appropriate and affordable for the people of Lancashire.

Reports are provided to Cabinet on a regular basis and these report variances against budget together with the reasons and any planned corrective action. Members are well informed about the financial position and are able to provide robust challenge on financial matters.

However, 2013/14 has been a difficult year for the Council. Fundamental weaknesses in it's overall arrangements for corporate and financial governance have been identified. In particular, the Council has identified weaknesses relating to:

- two procurement processes;
- the relationship with and operation of the Council's strategic partnership and associated joint venture company; and
- salary payments made to the then Chief Executive of the joint venture company.

In addition, the Council's Chief Internal Auditor has given an overall opinion of limited assurance in respect of her work for the year. This reflects the relatively high proportion of reviews undertaken across the Council where the level of assurance was assessed as none or limited. In 2013/14 this was 58%, an increase from 44% in the previous year.

The Council's Leadership and Management Team is committed to addressing the weaknesses that have been identified. In a number of areas, progress has already been made, for example in strengthening the Council's arrangements for information governance and in establishing a Project Group to improve the quality of management information available from the HR/payroll system.

# Value for Money

**Challenging economy, efficiency and effectiveness**

We have reviewed whether the Council has prioritised its resources to take account of the tighter constraints it is required to operate within and whether it has achieved cost reductions and improved productivity and efficiencies.

The Council has robust arrangements in place to ensure that resources are prioritised. In particular, the Council has worked hard to deliver key elements of its agenda including:

- the Preston City Deal – work is now underway to deliver the infrastructure required for this key element of the County's economic regeneration ambition; and
- taking on responsibility for public health and working with partners to deliver the "Better Care Fund". The Lancashire Better Care Fund Plan has now been approved by the NHS England Local Area Team (LAT), although officers and partners recognise that a great amount of work is still needed to put in place the structures and process needed to ensure the plan can be delivered.

The Council has also challenged itself in the way it delivers services. This is evident in the:

- way in which it renegotiated the contract with its strategic partner, bringing some services back in house; and
- recent decision to seek a consensual termination of the waste management contract whereby the Council took ownership of the two waste disposal facilities in Thornton and Leyland and the operating company.

The Council continues to adopt a flexible and challenging approach to the way it delivers its services. The Council still needs to formally approve (and then deliver) the 'service offer' it will make from a budget that, by 2017/18, will be £300m per annum less than at present. However progress to date has been good and will allow a balanced budget to be set for the medium term in February 2015 in line with the normal timetable.

We set out below our detailed findings against six risk areas which have been used to assess the Council's performance against the Audit Commission's criteria. We summarise our assessment of each risk area using a red, amber or green (RAG) rating, based on the following definitions:

| | |
|---|---|
| **Green** | Adequate arrangements |
| **Amber** | Adequate arrangements, with areas for development |
| **Red** | **Inadequate arrangements** |

The table below and overleaf summarises our overall rating for each of the themes reviewed:

| Theme | Summary findings | RAG rating 2012-13 | RAG rating 2013-14 |
|---|---|---|---|
| **Key indicators of performance** | Overall, the Council continues to perform well.<br>The Council has a strong balance sheet. At 31 March 2014, the County Fund balance had been maintained at £36m in line with the County Treasurer's advice to members. The Council has a further £255m available in earmarked revenue reserves. These includes reserves totalling £103m set up to meet the costs of organisational change going forwards.<br>The Council continues to deliver against its three year budget. The revenue outturn position for the year was an underspend of £3.1m after allowing for contributions to reserves. Capital expenditure for the year was £139.4m in line with the Council's revised plans.<br>The Council's net assets (the amount by which the Council's total assets exceed total liabilities) are £1,103.2m at 31 March 2014 compared with £863.7m for the previous year.<br>The Council's working capital ratio (which indicates whether the Council has enough current assets to meet its immediate liabilities) is low and has decreased from the previous year. However, this is consistent with the Council's overall treasury management strategy whereby the Council holds a significant element of its investment portfolio in bonds. These have long term maturity dates but are highly liquid financial instruments. The Council is therefore capable of meeting its current liabilities.<br>The County's schools hold balances of £55.9m at 31 March 2014. This has increased from £51.5m in the previous year. The Council has a policy in place to "claw back" excessive balances and as a result £0.24m is being recycled to the schools budget. | **Green** | **Green** |

| Theme | Summary findings | RAG rating 2012-13 | RAG rating 2013-14 |
|---|---|---|---|
| **Strategic financial planning** | The Council's overall strategic financial plan is clearly set out. The Council has a balanced budget for the current year together with a three year budget plan to 2017/18. This identifies a total savings need of £300m by 2017/18.<br>The Council has identified its corporate priorities and these underpin the three year budget to 2017/18. The plans take account of the impact of a range of external and internal factors such as reductions in central government funding, legislative changes, the economic climate, including pay and price inflation, and demand for its services. The assumptions made by the Council are soundly based. The impact of capital spending is also taken account.<br>Taking account of the savings planned for the current year, the Council has identified the need for further savings of £161m in the period from 2015 to 2018. Work is well underway to ensure a balanced budget can be set for 2015/16 and going forwards. This includes the planned use of reserves to support the creation of a new operating model for the Council. The Council currently has £103m earmarked to support downsizing.<br>Despite the financial challenges, the Council's reserves also allow for some investment in its priority areas. This includes £29m for strategic investments, modern apprentices and local welfare support. A further £65.8m as been earmarked to deliver priorities at directorate level.<br>The Council has well developed processes for service and financial planning to rely on. Although the level of savings required in the medium term is significant, the Council is well placed to deliver. Historically, the savings required by the Council have been delivered in full, often earlier than planned.<br>Savings plans are subject to robust assessment and sensitivity analysis.<br>The Council looks to the future to identify pressures which may subsequently emerge and which could present a financial risk. | **Green** | **Green** |

| Theme | Summary findings | RAG rating 2012-13 | RAG rating 2013-14 |
|---|---|---|---|
| **Financial governance** | There is clear leadership from senior officers and members in considering and setting the budget.<br>The level of understanding of the financial challenge is good at both member and officer level.<br>There is regular reporting to Cabinet by the County Treasurer on the financial position. The reports are clear and informative, providing an appropriate level of detail about the Council's revenue position and capital programme. The reports include information about emerging financial pressures and any corrective action to be taken. The reports make clear the impact on the year end position and how this has changed from the previous period. This is important in allowing members to assess whether the corrective actions are delivering, and to provide effective review and challenge.<br>There is a good level of engagement with stakeholders including partners and employees. The Council has just ended its employee consultation on a new management structure.<br><br>However, 2013/14 has been a difficult year for the Council. Fundamental weaknesses in it's overall arrangements for corporate and financial governance have been identified. In particular, the Council has identified weaknesses relating to:<br>• two procurement processes;<br>• the relationship with and operation of the Council's strategic partnership and associated joint venture company; and<br>• salary payments made to the then Chief Executive of the joint venture company.<br><br>We recognise that these governance issues have emerged in the year but that they relate to arrangements, decisions and actions taken in previous years. It is a positive sign that the Council has identified the issues and is dealing with them appropriately. The actions arising include:<br><br>• referring matters to the police for investigation – this remains on-going; and<br>• renegotiating the relationship with the strategic partner, including transferring a number of services back in house | Green | Red |

| Theme | Summary findings | RAG rating 2012-13 | RAG rating 2013-14 |
|---|---|---|---|
| **Financial control** | The Council has good controls in place to ensure it can deliver it's financial plans.<br>There are strong arrangements in place to support the delivery of the Council's financial plans. Effective budget monitoring is undertaken by both budget holders and finance staff. Variances are identified and are followed up to ensure corrective action can be taken .<br>The Council has worked hard to ensure it delivered savings on a recurrent basis and as quickly as possible. It has taken action to understand and manage the pressures on demand for some services. For example, a significant amount of work has been done to reduce demand for adult social care services. However, increasing demand remains a key risk for the Council and is an area kept under regular review.<br>Where savings plans have looked to be "at risk" corrective action, or alternative plans, are identified.<br>The Council's finance team was restructured during 2013. As a result, the available capacity has been clearly focussed on strategic financial planning, financial monitoring and financial reporting (including technical accounting).<br>The Council has an effective Internal Audit function in place. Internal Audit produces a risk based annual plan which is agreed by the Council's Audit and Governance Committee. The Committee then receives regular reports on progress delivering the plan, including the findings of work undertaken to date.<br>The Council's Chief Internal Auditor has given an overall opinion of limited assurance in respect of her work for the 2013/14 year. This reflects the relatively high proportion of reviews undertaken across the Council where the level of assurance was assessed as none or limited. In 2013/14 this was 58%, an increase from 44% in the previous year. It covers a wide range of service areas and indicates that the Council's control framework has not been operating as management intended.<br>The Council's Leadership and Management Team is committed to addressing the weaknesses that have been identified by Internal Audit. In a number of areas, progress has already been made, for example in strengthening the Council's arrangements for information governance and in establishing a Project Group to improve the quality of management information available from the HR/payroll system.<br>The Audit and Governance Committee will have a key role to play going forwards in ensuring that actions are being taken in response to audit reports.<br>The Council does not have a formal risk management framework although the Audit and Governance Committee does receive reports twice a year summarising the significant risks currently being considered by the Leadership and Management Team. | **Green** | **Amber** |

| Theme | Summary findings | RAG rating 2012-13 | RAG rating 2013-14 |
|---|---|---|---|
| **Prioritising resources** | The Council has a good understanding of its costs and performance across services.<br>There is clear managerial and political leadership provided for the way the Council prioritises resources. This is driven by the Council's corporate planning processes and is subject to regular review.<br>The Council has worked hard to direct resources to deliver key elements of its agenda including:<br>• the Preston City Deal where work is now underway to deliver the infrastructure required for this key element of the County's economic regeneration ambition; and<br>• taking responsibility for public health and working with partners to deliver the "Better Care Fund". The Lancashire plan has been approved by the NHS England Local Area Team (LAT), although officers and partners recognise work is still needed to put in place the structures and processes necessary to ensure it can be delivered.<br>The Council is willing to challenge the way in which it does things. This is evident in the way in which it renegotiated the contract with its strategic partner to address concerns about cost and quality. As a result, some services have been brought back in house and the rest, which are now provided by BTLS, have been respecified.<br>Over the last few years, the Council has been seeking to address the relatively high costs of its waste management service. The cost pressures have sat alongside performance levels which have been below those required by the Council. The Council has worked with the operator over a number of years and in a range of ways to address these issues before reaching a decision to seek a consensual termination of the contract. At the end of July 2014, the Council took ownership of the two facilities and the operating company. The Council also secured a contingency against any capital expenditure required following transfer of the assets. The is expected to deliver significant revenue savings to the Council. We will work with the Council to consider the accounting treatment in advance of the closedown for 2014/15 accounts.<br>Looking forward, the Council continues to adopt a flexible and challenging approach to the way it delivers its services. The Council still needs to formally approve (and then deliver) the 'service offer' it can make from a budget that will, by 2017/18, be some £300m per annum less than at present. However, progress to date has been good and will allow a balanced budget to be set for the medium term in February 2015 in line with the normal timetable. | **Green** | **Green** |

# Section 4: Fees, non audit services and independence

# Fees, non audit services and independence

We confirm below our final fees charged for the audit.

### Fees

| | Per Audit plan £ | Actual fees £ |
|---|---|---|
| Council audit | 151,560 | 151,560 |
| Grant certification | 1,190 | 1,190 |
| **Total audit fees** | **152,750** | **152,750** |

### Fees for other services

| Service | Fees £ |
|---|---|
| Waste PFI Contract | 20,528 |

### Independence and ethics

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Auditing Practices Board's Ethical

Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

Our independence is not compromised by the agreed work on the waste PFI contract since:

- it is restricted to reviewing the financial models used to prepare information and we are not be part of any decision making process
- the work is conducted by a separate team within Grant Thornton which is overseen by a separate engagement lead

We confirm that we have implemented policies and procedures to meet the requirement of the Auditing Practices Board's Ethical Standards.

# **Section 5:** Communication of audit matters

# Communication of audit matters to those charged with governance

International Standard on Auditing (ISA) 260, as well as other ISAs, prescribe matters which we are required to communicate with those charged with governance, and which we set out in the table opposite.

The Audit Plan outlined our audit strategy and plan to deliver the audit, while this Audit Findings report presents the key issues and other matters arising from the audit, together with an explanation as to how these have been resolved.

## Respective responsibilities

The Audit Findings Report has been prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission (www.audit-commission.gov.uk).

We have been appointed as the Council's independent external auditors by the Audit Commission, the body responsible for appointing external auditors to local public bodies in England. As external auditors, we have a broad remit covering finance and governance matters.

Our annual work programme is set in accordance with the Code of Audit Practice ('the Code') issued by the Audit Commission and includes nationally prescribed and locally determined work. Our work considers the Council's key risks when reaching our conclusions under the Code.

It is the responsibility of the Council to ensure that proper arrangements are in place for the conduct of its business, and that public money is safeguarded and properly accounted for.  We have considered how the Council is fulfilling these responsibilities.

| Our communication plan | Audit Plan | Audit Findings |
|---|---|---|
| Respective responsibilities of auditor and management/those charged with governance | ✓ | |
| Overview of the planned scope and timing of the audit. Form, timing and expected general content of communications | ✓ | |
| Views about the qualitative aspects of the entity's accounting and financial reporting practices, significant matters and issues arising during the audit and written representations that have been sought | | ✓ |
| Confirmation of independence and objectivity | ✓ | ✓ |
| A statement that we have complied with relevant ethical requirements regarding independence, relationships and other matters which might be thought to bear on independence.<br>Details of non-audit work performed by Grant Thornton UK LLP and network firms, together with fees charged<br>Details of safeguards applied to threats to independence | ✓ | ✓ |
| Material weaknesses in internal control identified during the audit | | ✓ |
| Identification or suspicion of fraud involving management and/or others which results in material misstatement of the financial statements | | ✓ |
| Compliance with laws and regulations | | ✓ |
| Expected auditor's report | | ✓ |
| Uncorrected misstatements | | ✓ |
| Significant matters arising in connection with related parties | | ✓ |
| Significant matters in relation to going concern | | ✓ |

# Appendices

# Appendix A: Audit opinion

**We anticipate we will provide the Council with an unmodified audit report**

**INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF LANCASHIRE COUNTY COUNCIL**

**Opinion on the Authority financial statements**

We have audited the financial statements of Lancashire County Council for the year ended 31 March 2014 under the Audit Commission Act 1998. The financial statements comprise the Movement in Reserves Statement, the Comprehensive Income and Expenditure Statement, the Balance Sheet, the Cash Flow Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2013/14.

This report is made solely to the members of Lancashire County Council in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 48 of the Statement of Responsibilities of Auditors and Audited Bodies published by the Audit Commission in March 2010. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Authority and the Authority's Members as a body, for our audit work, for this report, or for the opinions we have formed.

**Respective responsibilities of the County Treasurer and auditor**

As explained more fully in the Statement of the County Treasurer's Responsibilities, the County Treasurer is responsible for the preparation of the Statement of Accounts, which includes the financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom, and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

**Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Authority's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the County Treasurer; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the explanatory foreword to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

**Opinion on financial statements**

In our opinion the financial statements:

give a true and fair view of the financial position of Lancashire County Council as at 31 March 2014 and of its expenditure and income for the year then ended; and
have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2013/14 and applicable law.

**Opinion on other matters**

In our opinion, the information given in the explanatory foreword for the financial year for which the financial statements are prepared is consistent with the financial statements.

**Matters on which we report by exception**

We report to you if:

in our opinion the annual governance statement does not reflect compliance with 'Delivering Good Governance in Local Government: a Framework' published by CIPFA/SOLACE in June 2007;
we issue a report in the public interest under section 8 of the Audit Commission Act 1998;
we designate under section 11 of the Audit Commission Act 1998 any recommendation as one that requires the Authority to consider it at a public meeting and to decide what action to take in response; or
we exercise any other special powers of the auditor under the Audit Commission Act 1998.

We have nothing to report in these respects.

**Conclusion on the Authority's arrangements for securing economy, efficiency and effectiveness in the use of resources**

***Respective responsibilities of the Authority and the auditor***

The Authority is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to review regularly the adequacy and effectiveness of these arrangements.

We are required under Section 5 of the Audit Commission Act 1998 to satisfy ourselves that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the Audit Commission requires us to report to you our conclusion relating to proper arrangements, having regard to relevant criteria specified by the Audit Commission.

We report if significant matters have come to our attention which prevent us from concluding that the Authority has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. We are not required to consider, nor have we considered, whether all aspects of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

***Scope of the review of arrangements for securing economy, efficiency and effectiveness in the use of resources***

We have undertaken our audit in accordance with the Code of Audit Practice, having regard to the guidance on the specified criteria, published by the Audit Commission in October 2013, as to whether the Authority has proper arrangements for:

securing financial resilience; and
challenging how it secures economy, efficiency and effectiveness.

The Audit Commission has determined these two criteria as those necessary for us to consider under the Code of Audit Practice in satisfying ourselves whether the Authority put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2014.

We planned our work in accordance with the Code of Audit Practice. Based on our risk assessment, we undertook such work as we considered necessary to form a view on whether, in all significant respects, the Authority had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

**Basis for qualified conclusion**

In seeking to satisfy ourselves that the Council has made proper arrangements for securing financial resilience we have considered the following matters:

- weaknesses highlighted in two procurement processes;
- the relationship with, and operation of, the Council's strategic partnership and associated joint venture company;
- salary payments made to the then chief Executive of the joint venture company
- the Council's Chief Internal Auditor has given an overall opinion of limited assurance in respect of her work on the Council's system of internal control for the year.

**Qualified Conclusion**

On the basis of our work, having regard to the guidance on the specified criteria published by the Audit Commission in October 2013, with the exception of the matters reported in the basis for qualified conclusion paragraph above, we are satisfied that in all significant respects, Lancashire County Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2014.

**Certificate**
We cannot formally conclude the audit and issue an audit certificate until we have completed our consideration of matters brought to our attention by the Council in 2013. We are satisfied that these matters do not have a material effect on the financial statements or a significant impact on our value for money conclusion.

Karen Murray *** September 2014
Director
for and on behalf of Grant Thornton UK LLP, Appointed Auditor
Grant Thornton UK LLP,
4 Hardman Square,
Spinningfields, Manchester M3 3EB