

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

Year ended 31 March 2019

21 August 2019



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Your key Grant Thornton team members are:

Robin Baker

Engagement Lead

T: 0161 214 6399

E: robin.j.baker@uk.gt.com

Angela Pieri

Engagement Manager

T: 0141 223 0887

E: angela.l.pieri@uk.gt.com

Richard Tembo

In-charge auditor Lancashire County
Council audit

T: 0161 234 6352

E: richard.z.tembo@uk.gt.com

Sana Mumtaz

In-charge auditor Lancashire County
Pension Fund audit

T: 0151 224 2445

E: sana.mumtaz@uk.gt.com

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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.

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.

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.

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
<p>Management override of controls</p> <p>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.</p> <p>We identified management override of control, in particular journals, management estimates and transactions outside the course of business as a significant risk.</p>	<p>As part of our audit work we have:</p> <ul style="list-style-type: none"> 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. 	<p>Our audit work did not identify any instances of management override of controls.</p>
<p>Valuation of land and buildings and investment property</p> <p>The Council revalues its land and buildings on a rolling three-yearly basis. Investment properties are revalued annually.</p> <p>These valuations represents a significant estimate by management in the financial statements.</p> <p>We identified the valuation of land and buildings and investment property revaluations and impairments, as a significant risk.</p>	<p>As part of our audit work we have:</p> <ul style="list-style-type: none"> 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. 	<p>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.</p> <p>No issues were found with the revaluation of land and buildings and investment properties.</p>

Audit of the Financial Statements

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>Valuation of net pension liability</p> <p>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.</p> <p>This valuation represents a significant estimate by management in the financial statements.</p> <p>We identified the valuation of the Council's pension fund net liability as a significant risk.</p>	<p>As part of our audit work we have:</p> <ul style="list-style-type: none"> • 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. <p>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.</p>	<p>The financial statements and disclosure notes were adjusted by management for the impact of the McCloud legal case.</p> <p>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.</p>

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
<p>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.</p> <p>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.</p> <p>We identified the valuation of Level 3 investments as a significant risk.</p>	<p>As part of our audit work we have:</p> <ul style="list-style-type: none"> 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. 	<p>We did not identify any issues in respect of the valuation of the Level 3 investments within the Pension Fund financial statements.</p>

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.

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.

Value for Money conclusion

Value for Money Risks

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>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.</p> <p>As a result, this area was included as a significant risk and area of focus for 2018/19.</p>	<p>We reviewed the HoIA's opinion and the Annual Governance Statement (AGS) to confirm that the work completed and management's assurances were reflected.</p> <p>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.</p> <p>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.</p> <p>The AGS included a summary of the HoIA opinion as well as other risk areas noted in the opinion.</p>	<p>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.</p> <p>Our value for money conclusion opinion is unqualified in 2018/19.</p>

Value for Money conclusion

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>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.</p> <p>As a result, this area was included as a significant risk and area of focus for 2018/19.</p>	<p>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.</p> <p>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.</p> <p>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.</p> <p>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.</p> <p>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.</p> <p>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.</p>	<p>There are adequate arrangements in place during 2018/19 over the financial resilience of the Council. Our opinion in this area is unqualified.</p> <p>The Council's financial position remains challenging and continuing reliance on reserves is recognised as unsustainable.</p> <p>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.</p>

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

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 areas 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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