

## **Audit and Governance Committee**

Meeting to be held on 28 September 2015

Electoral Division affected: None
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### **Annual Governance Statement - Update**

(Appendix "A" refers)

Contact for further information:

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#### **Executive Summary**

At its meeting held on 30 June 2015 the Committee approved the Council's Annual Governance Statement for 2014/15 for inclusion in the draft Statement of Accounts.

The Annual Governance Statement identified a number of key issues and themes that had started to emerge during 2014/15 and which will continue to feature in 2015/16. This report provides the Committee with an update in relation to those issues which are also relevant to the External Auditor's Value for Money (VfM) conclusion which is contained within the Audit Findings Report which is at item 7 on the Committee's agenda.

#### **Recommendation**

The Committee are asked to note the report including the proposals in relation to the approval of an Internal Audit Plan for the remainder of 2015/16 and the Internal Audit Plan for 2016/17.

#### **Background and Advice**

The Council is required to produce and approve an Annual Governance Statement (AGS) which is then included in its Annual Statement of Accounts. A draft AGS was presented to the Committee in March and approved by the Committee at its meeting held on 30 June.

The AGS highlighted a number of key issues which had emerged during 2014/15 and which will continue into 2015/16. This report provides the Committee with an update of some of those key issues which are relevant to the External Auditor's Value for Money (VfM) conclusion which is contained in the Audit Findings Report for 2014/15 which is at agenda item 7.

## **Risk Management**

The AGS identified that whilst risk management happens "in practice", there was a need for the Council to embed a systematic approach to identifying strategic risks and opportunities.

Following a workshop undertaken by Management Team, facilitated by Grant Thornton, it was reported that a Risk and Opportunity Map was in the process of preparation which classified risks on a "PESTLEDO" basis:

**P**olitical  
**E**conomic  
**S**ocial  
**T**echnological  
**L**egislative  
**E**nvironmental  
**D**emographic  
**O**rganisational

Working from these principles a Risk Management intranet site is under development and which can be accessed from the following link:

<http://lccintranet2/corporate/web/?siteid=7252&pageid=46588>

The content of the site includes a Risk Management Plan and an example of the proposed Corporate Risk and Opportunity Register as well as identifying risk "champions" within service areas. Importantly the site also includes a list of groups managing specialist areas of risk, such as Information Governance and Corporate Contingencies where the approach to managing risk is already well established. In areas such as these only risks with a high residual risk rating once mitigation is applied will also then appear in the corporate register to avoid unnecessary duplication.

It was also reported at the meeting that a proposed corporate approach to reporting was being developed which would be provided to the Committee for consultation. The approach now proposed is that update Risk and Opportunity Reports will be considered by Management Team on a quarterly basis, following which the reports will go to the Cabinet Committee on Performance Improvement and then to the Audit and Governance Committee.

## **Procurement risks**

In relation to procurement risks the AGS reported that the return of the procurement Service from One Connect Limited had provided an opportunity for a high level review of contracts which had identified that a significant number of contracts had either expired or were due to expire without any tendering process in place to award new contracts.

A report was therefore presented to Cabinet in May 2014 recommending a waiver of Procurement Rules to extend a number of the contracts in question. Twenty four contracts with an annual expenditure of £13.4 million were identified as expired and a further 14 with annual expenditure of £4.5 million were to expire over the next 12 months before relevant tender processes could be completed. The Council in total had at that point 499 contracts in place with an annual expenditure of £529 million.

It had been identified that the level of staffing vacancies (22%) had been a significant contributory factor to this situation and the decision to extend contracts provided the Procurement Service with an opportunity to implement a recovery plan at the same time as developing a Procurement Strategy. The report to Cabinet identified the risk of legal challenge where contracts were extended without formal tendering arrangements but this risk had to be balanced against the need to deliver statutory functions which were at risk if contracts were not extended. Cabinet were therefore advised that a failure to extend contracts would create a more significant risk.

Following an extensive consultation exercise with public, private and independent sector organisations, Cabinet subsequently approved an overarching Procurement Strategy in October 2014. The Strategy was supported by a Procurement Improvement Action Plan which set out specific changes that needed to be made in order for the procurement function to deliver the Strategy.

Following approval of the Strategy, from December 2014 quarterly reports have been reported to the Cabinet Committee on Performance Improvement. The Cabinet Committee have received a dashboard of performance indicators for key activity aligned to the Strategy including:

- Payment Performance
- Procurement Performance
- Supporting suppliers
- Savings

In May 2015 two reports were submitted to the Deputy Leader each requesting block waivers of Procurement Rules to extend a number of contracts where contract renewals were not going to be completed within the original timelines set. This was necessary due to a high volume of expiring contracts in circumstances where operational resources were being tied up in in stage one of the Council's Transformation process. The two reports related to a total of 16 contracts, 6 of which had expired with a value of circa £1.9 million and 9 due to expire within 5 months of the decision with a value of c £738,000.

However, in relation to two of the expired contracts, the contract renewals were on schedule but existing contracts had to be extended due to insufficient competition and a further three were extended so that the services in question could be incorporated into new services being tendered. As regards the expiring contracts, most of the extensions agreed were very short term, many being for one month only. It is also the case that a number of the contracts in question would not strictly require a formal waiver of Procurement Rules because of the low value of the contract but these were included on the basis that to do so provided greater transparency.

The position in relation to these latter contracts is therefore of far less significance than those for which a blanket waiver was sought in May 2014 and given the high volume and value of procurement activity it is inevitable that there will be instances where tenders have to be abandoned because of insufficient competition or due to technical issues or actual/potential legal challenges. It is not considered that there is any systems-related problem in relation to the Council's procurement service but in any event a Procurement Board has now been re-established to oversee governance issues.

## **Financial Resilience**

The AGS also highlighted the scale of the unprecedented financial challenge facing the Council and signalled the intention to widen the financial planning horizon to take into account the period up to 2020/21.

This further work has now been completed and reported to Cabinet at its meeting on 12 August. The update on the Council's revenue position for 2015/16 reflected the Council's new operational structure with detailed budget monitoring at Head of Service level and also reflected ongoing base budget pressures from 2014/15. Cabinet also received a comprehensive report on the Council's reserves position.

In summary, there is a forecast overspend of £33.251 million on the Council's revenue budget in 2015/16, ongoing pressure of £45.646 million and an estimated funding gap of £223.2 million for the period to 2020/21. This is in addition to the £71.4m identified savings that require delivery during 2016/17 and 2017/18 as outlined in the February 2015 Budget report, ie a total of £294.6m for the period 2016/17 to 2020/21.

In response Cabinet agreed to a proposal to undertake a fundamental base budget review to consider in detail every aspect of all services provided by the Council to inform the process of setting future budgets and to produce budget options for the Council.

The outputs of the exercise will be a detailed schedule for each service, its cost and its status as "statutory" or "non-statutory". It is intended to present this information base to meetings of the Budget Scrutiny Working Group throughout October 2015 and there will also be detailed briefings to all Members during the same period. Cabinet will then publish its budget options for consultation in November 2015 as part of the normal budget cycle.

In the same timeframe Full Council will also be asked to approve a new Corporate Strategy which will be central to shaping the future direction of services to meet the needs of citizens, the identified priorities being used to prepare budget options to be considered by Cabinet. Once the Council's budget is set in February 2016 a line by line review of continuing services will be undertaken including a review of the business model needed to deliver services.

In addition, as the base budget review progresses Management Team receive regular budget and performance reports from the Interim Director of Financial resources with a focus on the delivery of savings identified in the 2015/16 budget,

particularly around those service areas identified as high risk such as adult social care.

### **Statutory requirements relating to risk management, governance and internal control**

New statutory requirements in the shape of the Accounts and Audit Regulations 2015 came into force on 1 April 2015 which supersede earlier Regulations. An Authority must ensure that it has a sound system of internal control which:

- Facilitates the effective exercise of its functions and the achievements of its aims and objectives;
- Ensures that the financial and operational management of the authority is effective; and
- Includes effective arrangements for the management of risk

An authority must also undertake an effective internal audit to evaluate the effectiveness of its risk management, control and governance processes, taking into account public sector internal auditing standards and guidance.

A new requirement is now in place which requires a "narrative statement" to be prepared to accompany the Statement of Accounts which must include comment by the authority on its financial performance and economy, efficiency and effectiveness in its use of resources over the financial year. The requirement to produce an AGS remains in place.

The assurance needed by the Council to satisfy itself that controls have been adequately designed and are operating effectively and that risks are being appropriately managed is available from a variety of sources including external regulators; the AGS for 2014/15 identified some of these sources of assurance and these include the council's own Internal Audit Service in particular.

### **Internal Audit Plan 2015/16**

The AGS reported that whilst the Chief Internal Auditor's Annual Report provided substantial assurance over the Council's key centrally-managed financial controls, the approach taken in 2014/15 to remedy areas of high/ medium risk meant that it was not possible to complete the Audit Plan for the remainder of 2014/15. In turn this meant that the Annual Report for 2014/15 did not therefore provide an overall opinion.

The AGS also recognised that 2015/16 would be a year of significant challenges for the Council in the context of implementing the new operating structure. The attendant risks must now be regarded as higher given the scale of the financial savings that must be achieved that have now been identified as referred to above.

In that context it was reported that one of the mitigation measures proposed, which also reflected the limited capacity within the Internal Audit Service, was to limit Internal Audit's activity to audits of the key financial systems and for remaining capacity to be focussed on providing support (not attracting any audit opinion) to

Heads of Service. A number of Internal Audit staff have therefore been seconded in the Finance Service to work on key projects which have to be given a higher priority. As a consequence, the Internal Audit Service will again not complete a risk-based programme of work to support an overall opinion on the Council's framework of governance, risk management and control for 2015/16.

It will instead focus its assurance work solely on the Council's centrally managed key financial systems:

- The general financial ledger
- Cash and banking
- Accounts payable system
- Accounts receivable and debt management system
- Payroll
- Treasury management
- VAT.

The Internal Audit Service will continue to deliver service to external organisations within Lancashire with whom there are existing contracts although these will be reviewed to determine whether they should continue.

As the report notes under the "Financial Resilience" section above, there are key risks around the delivery of savings including both those already identified in budget decisions for 2014/15 and 2015/16 as well as those which will be required for the Council to set a balanced budget for 2016/17. However, the detail of savings for 2016/17 will only become clear once budget options are consulted upon from November 2015 and decisions will only be made in February 2016.

To achieve savings of the level required it will be necessary for decisions to be taken to cease providing some services – decisions which will be informed by the base budget review – and inevitably this means that the Council's operating structure will again change, with a smaller workforce required to deliver fewer services. In some cases this will mean that re-designed control frameworks will again have to change and it is likely that there will be a greater emphasis and reliance on monitoring controls rather than preventative controls. Overall it is inevitable that the Council's risk appetite must increase.

Going forward a decision will need to be made about the future size and structure of the Council's Internal Audit Service, reflecting the fact that the Council will become a smaller organisation delivering fewer services, albeit there must be a recognition of the consequential risks, particularly during the process of moving to being a smaller organisation. At the request of Management Team the Interim Director of Financial Resources has undertaken an exercise to review and benchmark the staffing structure of the Internal Audit Service against other county council internal audit services, the purpose being to inform decisions around the transformation process.

The analysis of the information obtained from other local authorities makes it clear that there is no consistent model adopted. However, it is difficult to establish the existing assurance level of the organisations concerned and to be sure that the capacity of Lancashire's Internal Audit Service is comparable with other local

authorities. Determining the new structure has, as with all service areas, been considered in the context of an affordability envelope reflecting the need to make savings on staffing costs.

The proposed model will now be considered by Management Team in the context of the budget forecasts to 2021 referred to above and the Council's decisions on service delivery which will be published for consultation in November 2015. It is likely however, as a minimum, that it will be proposed that there will be increased reliance on external support in relation to audit work in connection with specialist areas such as ICT and a reduction in capacity for internal investigations.

However, recognising the need for the Committee to have oversight of Management Team's intention to use Internal Audit to strengthen the internal control framework it is intended to bring a revised Internal Audit Plan for the remainder of 2014/15 to the Committee's meeting in January 2016. This update Plan will identify the areas where Internal Audit will work collaboratively with Heads of Service to identify risks and controls. Pending approval of the update Plan the Internal Audit Service will focus on auditing the key financial systems as referred to above.

In addition, at the Committee's meeting in January it is also intended to present for approval an Internal Audit Plan for 2016/17. The Committee should however note that the draft Plan for 2016/17 may require further revision dependent upon the decisions to be taken by Full Council in February 2016 when setting its budget.

## **Consultations**

n/a

## **Implications:**

Risk management implications are highlighted in this report.

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

Paper	Date	Contact/Tel
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N/A

## **Reason for inclusion in Part II, if appropriate;**

N/A