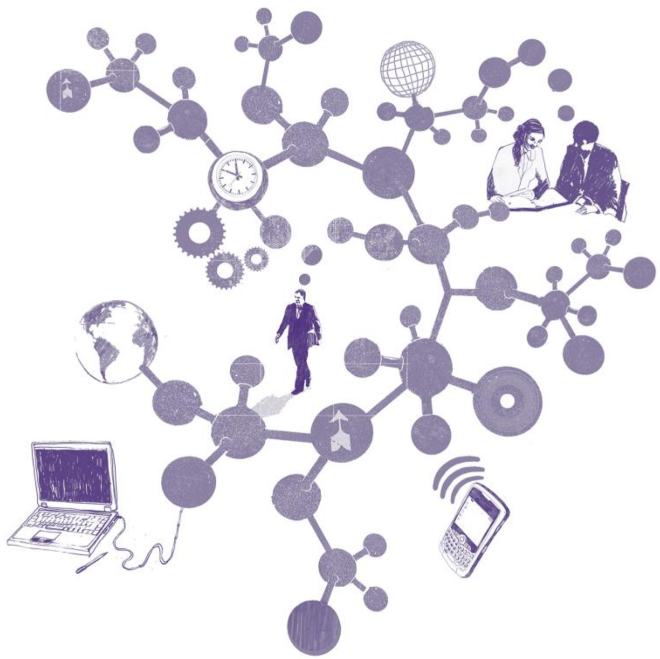
The Audit Findings for Lancashire County Council

Year ended 31 March 2015

September 2015



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September 2015

Dear Members of the Audit and Governance Committee

Audit Findings for Lancashire County Council for the year ending 31 March 2015

This Audit Findings report highlights the significant findings arising from the audit for the benefit of those charged with governance (in the case of Lancashire County Council, the Audit and Governance Committee) , as required by International Standard on Auditing (UK & Ireland) 260. Its contents have been discussed with management.

As auditors we are responsible for performing the audit, in accordance with International Standards on Auditing (UK & Ireland), which is directed towards forming and expressing an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities for the preparation of the financial statements.

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.

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

Yours sincerely

Karen Murray

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Section 1: Executive summary

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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 2015. 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 UK&I).

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 and 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 March 2015. Our audit is substantially complete although we are finalising our work in the following areas:

- finalisation of our sample testing
- final review of the treatment and disclosures in respect of the buy out of the PFI operating company
- review of your final group accounts consideration
- 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
- 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.

Key issues arising from our audit

Financial statements opinion

We anticipate providing an unqualified opinion in respect of the financial statements.

The key messages arising from our audit of the Council's financial statements are:

- The financial statements as submitted for audit were largely complete.
- There have been some amendments and improvements made to the disclosures included to the accounts.
- Several amendments have been made to the accounts and these are set out in the body of this report.

We have identified no adjustments affecting the Council's reported financial position (details are recorded in section 2 of this report). The draft financial statements for the year ended 31 March 2015 recorded net expenditure at the cost of services level of £2,263.3m and there have been no adjustments to the accounts which affect this position.

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

Value for Money conclusion
Our review of the Council's arrangements to secure economy, efficiency and effectiveness has highlighted the following issues which will give rise to an 'except for' VfM conclusion:

- There has been no opinion on the system of internal control by internal audit for 2014/15 because of the narrow scope of work undertaken by internal audit;
- On bringing the Council's procurement function back in house in April 2014, the Council identified several contracts which had either already expired or were due to expire before they could be properly re-procured;
- The Council's financial planning has identified significant financial pressures from 2015/16 onwards. The Council is now working to identified savings to meet a spending gap from 2016/17 to 2020/21 of £294m.

Further detail of our work on Value for Money is set out in section three 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

Roles and responsibilities
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. However, where, as part of our testing, we identify any control weaknesses, we report these to the Council.

Findings
We note that the Council has not been able to demonstrate the operation and monitoring of it's system of internal control. This is disclosed in the Annual Governance Statement. Urgent action is now needed to ensure this is addressed in the current financial year.

We also draw your attention to the fact that our work on your overall IT control environment identified some high level control issues within the operation of your financial systems. Management have responded to the matters we have raised.

Further details are provided within section two of this report.

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 the Director of Governance, Finance and Public Services and the Council's Acting Section 151 Officer.

We have made a number of recommendations, which are set out in the action plan in Appendix A. Key to this is that urgent action is now needed ensure the Council's overall system of internal control is robust in it's design and is operating as intended.

Our recommendations have been discussed and agreed with the Director of Governance, Finance and Public Services, the Council's Acting Section 151 Officer and the finance team.

Certificate of completion

We are unable to issue our certificate of completion of the audit. We cannot formally conclude the audit and issue an audit certificate until we have completed our consideration of matters arising from 2012/13.

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 2015

Section 2: Audit findings

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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 the 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 13 April 2015. 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 13 April 2015.

Audit opinion

Our proposed audit opinion is set out in Appendix B.

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 (UK&I) 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.	**Improper revenue recognition** Under ISA (UK&I) 240 there is a presumed risk that revenue may be misstated due to improper recognition	• In our audit plan, we set out that having considered the risk factors set out in ISA240 and the nature of the revenue streams at Lancashire County Council, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because: • there is little incentive to manipulate revenue recognition • opportunities to manipulate revenue recognition are very limited because of the nature of the income received by the Council.	We have not identified any issues in respect of revenue recognition.
2.	**Management override of controls** Under ISA (UK&I) 240 there is a presumed risk of management over-ride of controls	• review of accounting estimates, judgements and decisions made by management • testing of journal entries • review of unusual significant transactions	Our audit work has not identified any evidence of management override of controls. 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	We have undertaken the following work in relation to this risk: • documented our understanding of processes and key controls over the transaction cycle • undertaken walkthrough of the key controls to assess the whether those controls were in line with our documented understanding • Review of reconciliation of accounts payable system control accounts • search for unrecorded liabilities by testing payments to suppliers in 2015/16 to supplier creditor balances as at 31 March 2015 • We have undertaken testing the expenditure of a sample of schools with their own bank accounts in the statement of accounts.	Our audit work has not identified any significant issues in relation to the risk identified
Employee remuneration	Employee remuneration accrual understated	• Documentation and assessment of the design effectiveness and implementation of internal controls, including those operated by BT Lancashire Services Limited • Review of reconciliation of payroll costs to the general ledger • Completion of trend analysis to assess whether employee remuneration is in line with expectations	Our audit work has not identified any significant issues in relation to the risk identified

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
Property, Plant and equipment	Accounting for local authority maintained schools. The 2014/15 CIPFA code of practice included new accounting requirements, in relation to the adoption of new International Financial Reporting Standards on group accounting. The Council has reviewed the control of the assets used by schools. Following this review considers that under the requirements of the 2014/15 CIPFA Code of Practice it is appropriate for the Council to include these assets on its balance sheet as the Council has the effective control of the voluntary aided schools.	• Discussions with Finance staff to confirm compliance with the new accounting requirements included in the 2014/15 CIPFA Code of Practice following the adoption of the new International Financial Reporting Standards on group accounting • We have reviewed the accounting estimates, judgements and decisions made by management in recognising these schools.	The treatment adopted by the Council although in response to changes in the Code, has not led to any changes in the schools recognised on the balance sheet of the Council. We have agreed additional disclosures with the Council in the accounts to explain the assumptions that you have made in coming to this conclusion.
Property, Plant and equipment	City Deal The Council is the accountable body for the Preston, South Ribble and Lancashire City Deal (City Deal). The scheme is delivering new infrastructure with resources from central government, local government and the private sector.	• We have reviewed the entries in your accounts relating to Property plant and equipment, including review of the transactions relating to City Deal	The expenditure on City Deal for the 2014/15 financial year totalled £19m. We are reviewing the transactions for the most significant scheme as part of our property plant and equipment testing.

Audit findings against other risks (cont)

Transaction cycle	Description of risk	Work completed	Assurance gained & issues arising
Debt	During the 2014/15 financial year the Council has ended its waste PFI contract by purchasing the waste operating company (GRLOL) . The Council purchased the operating company for £1. In addition, the Council also made a payment of to settle the outstanding bank debt in respect of the PFI scheme. The transactions reflected in the accounts are complex and involved significant judgements on the part of the Council's accountancy team. Key amongst these is that the difference between the amount paid to settle the debt and the liability included in the accounts at the date of settlement is a premium that the Council can recognise over the remaining life of the asset . This has the impact of allowing the Council to amortise this charge over the remaining life of the original loan, rather than charge the full amount to revenue in 2014/15	We have: • Reviewed the accounting treatment for the transactions relating to this deal • Reviewed the legal advice received on 14 September 2015 in respect of the accounting treatment for the premium arising from the early redemption of debt.	This was a complex series of transactions and the Council's draft accounts broadly reflected them correctly. However, the decision classify the difference between the amount paid to settle the debt and that which was outstanding on the settlement date as a premium for early redemption was a matter of judgement. This is because the regulations covering this type of transaction refer only to the repayment of a loan of money and do not explicitly refer to a debt refinancing arrangement of the type the Council has effectively entered into. Following discussion with the Council, officers sought legal advice to ensure the regulations could be applied in this way. We are satisfied that the Council's decision to account for the difference as a premium in this way is reasonable in the circumstances. On the basis of the Council's legal advice, we do not propose to challenge this decision.
	The Council has had to make some specific disclosures in the accounts to properly reflect this the transactions. However, we have also asked the Council to consider whether there are additional disclosures required to the accounts relating to the acquisition of the company in accordance with IFRS 3 in respect of Business Combinations.	• Reviewed the disclosures made in the Council's accounts for these transactions. This included the Council's assessment of the requirements of IFRS3	We have agreed changes to the disclosures in the accounts to better explain the transactions into which the Council has entered as part of this arrangement. The finance team has considered the additional disclosures required under IFRS3 and was able to demonstrate that these were largely immaterial. We are awaiting final confirmation that there are no additional disclosures required from this assessment.
	The PFI scheme was a joint scheme with Blackpool BC. The change in the arrangement effectively changes the arrangement with Blackpool.	• Considered the implications for accounting treatment in respect of the Blackpool BC element of the scheme and how this is reflected in your accounts.	The element of the transaction which is a long term loan to Blackpool Council was not classified correctly in the accounts. Originally it was included as a long term investment, but is more accurately shown as a long term debtor. The finance team have amended this in the accounts.

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	• The Council recognises income in the year that it takes place, not simply when cash payments are made or received. • Fees, charges and rents due from customers are accounted for as income at the date the Council provides the relevant goods or services • Revenue relating to such things as council tax are measured at the full amount receivable (net of any impairment losses)	The Council's accounting policy is in line with the requirements of CIPFA code and is adequately disclosed in the accounts.	● (green)

Estimates and judgements	• Key estimates and judgements include:
	  • useful life of capital equipment
	  • revaluations
	  • pension fund valuations and settlements
	  • the accounting treatment of the premium on the early redemption of the PFI debt
		• We have reviewed the estimates and judgements made in the accounts.
		• We have sample tested valuations undertaken in the year to confirm they are appropriately included in the statement of accounts. See page 15 for our work in relation to asset valuations.
		• We have confirmed the entries relating to the pension scheme in the accounts agree through to the actuarial valuation. We have considered the qualifications of and the work completed by the actuary to ensure we can place reliance upon the their work.
		• We have already commented on the PFI transactions
			● (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

Accounting policies, estimates & judgements continued

Accounting area	Summary of policy	Comments	Assessment
Going concern	Management have a reasonable expectation that the statutory services provided by the Council will continue for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.	The Council has reviewed its financial plan We have reviewed this consideration and are satisfied with managements' assessment that the going concern basis is appropriate for the 2014/15 financial statements.	●
Other accounting policies	We have reviewed the Council's policies against the requirements of the CIPFA Code and accounting standards.	The Council has now included an additional accounting policy for prior period adjustments, changes in accounting policies, estimates and errors.	●
Group accounts	The Council has reviewed the requirement for group accounts	We have reviewed the assessment made by management that group accounts are not required on the grounds of materiality. The assessment made is reasonable and sufficient disclosures have been made in the accounts to explain the arrangements that the Council has entered into.	●

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

Accounting policies, Estimates & Judgements– review of issues raised in prior year

	Issue and risk previously communicated	Update on actions taken to address the issue
1.	**Estimates and judgements - Property, Plant & Equipment** In previous years the Council carried out a rolling programme of revaluations. This approach was similar to many other authorities and we were satisfied that you had satisfied yourselves that the carrying amount of Property, Plant and Equipment (based on these valuations) did not differ materially from the fair value at 31 March 2014. However, in our view this rolling programme did not meet the Code's requirement to value items within a class of property , plant and equipment simultaneously, as this Code requirement, which is based on IAS 16 Property, Plant and Equipment, only permits a class of assets to be revalued on a rolling basis provided that: • the revaluation of the class of assets is completed within a 'short period' • the revaluations are kept up to date. In our view, we would normally expect this 'short period' to be within a single financial year. This is because the purpose of simultaneous valuations is to 'avoid reporting a mixture of costs and values as at different dates'. This purpose is not met where a revaluation programme for a class of assets straddles more than one financial year.	The Council explains in its accounting policies that assets included in the balance sheet are revalued sufficiently regularly to ensure that their carrying amount is not materially different to the fair value at the year end. The finance team have undertaken an exercise to confirm that the carrying amount included in the accounts is not materially different from the fair value at 31 March 2015

Assessment
✓ Action completed
X Not yet addressed

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 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. • We have sought a specific representation in respect of licences acquired as part of the deal to acquire the waste management company.
4.	**Disclosures**	• Our review found no non-trivial omissions in the financial statements
5.	**Matters in relation to related parties**	• We are not aware of any related party transactions which have not been disclosed
6.	**Confirmation requests from third parties**	• We seek to obtain direct confirmations for loans and bank and investment balances. • We requested from management permission to send confirmation requests for bank and investment balances. This permission was granted and the requests were sent. Most of these requests were returned with positive confirmation. However, three requests were not received so we undertook alternative procedures, including agreeing these balances to records held by the Council.

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 overall effectiveness of internal control. We considered and walked through the internal controls for Employee Remuneration and Operating Expenses as set out on page 10 above.

The matters that we identified during the course of our audit are set out in the table below. These and other recommendations, together with management responses, are included in the action plan attached at Appendix A.

	Assessment	Issue and risk	Recommendations
1.	● (red)	Review of users and their privileges showed that a number of individuals had access to business processes which raised a risk of segregation of duties within Oracle.	• Privileges should be reviewed and a matrix should be defined to document which combination of responsibilities should not be granted to individuals.
2.	● (red)	Default responsibilities had been issued to some users which included some which allowed too much access to the system.	• Default responsibilities should not be used and monitoring controls should be implemented to review any unsegregated responsibilities.
3.	● (amber)	Access rights and responsibilities are not periodically reviewed. This means that some access rights could be incorrectly given to members of the team.	• Ensure that reports are produced from audit logs created are reviewed.
4.	● (amber)	Our testing of purchase order accruals identified an item that had been accrued for which was not Council expenditure as it had been cancelled in the new year. We extended our testing and found a further three accruals which did not relate to expenditure.	• The Council should review the process for purchase order accruals to ensure they relate to the correct year.

Assessment

● Significant deficiency – risk of significant misstatement

● Deficiency – risk of inconsequential misstatement

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.

Adjusted misstatements

A number of adjustments to the draft financial statements have been identified during the audit process. We are required to report all non-trivial 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	Comprehensive Income and Expenditure Account £	Balance Sheet £	Cash Flow Statement	Impact on total net expenditure £
2	Within the balance sheet an element of short term borrowing had been included as long term borrowing.		£3.3m classification only		0
3	The Council had classified the long term debtor with Blackpool Council, representing the amount that Blackpool Council will repay of the repayment of the PFI debt on settlement of the waste PFI as a long term investment. As the substance of the transaction is a debtor this has been amended. The Council has also included additional disclosures in the accounts to reflect the finance lease arrangement now in place with Blackpool Council.		£35.1m classification only		0
	Overall impact (£)	**0**	**0**		**0**

Unadjusted misstatements

The table below provides details of adjustments identified which we request be processed but which have not been made within the final set of financial statements. The Audit and Governance Committee is required to approve management's proposed treatment of all items recorded within the table below:

	Detail	Comprehensive Income and Expenditure Account £	Balance Sheet £	Reason for not adjusting
1	Included within the long term debtors balance is £3.3m of debtors which should be classified as short term.		3.3m	Management have declined to amend on the grounds of materiality.
	Overall impact (£)	**0**	**3.3m**	**Classification on the balance sheet only.**

Misclassifications & disclosure changes

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

	Adjustment type	Value £	Account balance	Impact on the financial statements
1	There have been several amendment to the grants notes		Note 11, 13 and 14	Note 11 - Council Tax has been increased by £2.1m with a corresponding reduction in business rates income. Note 13 - The comparative in note 13 has been restated to reflect the fact that education services grant is a general grant, rather than credited to services. PFI grant has been reclassified from other central government departments to Department of Education income. A contribution for social care of £25.3m has also been included in the note. Note 14 - An in year adjustment has been added to note 14 so that the dedicated schools grant in the accounts agrees to the Council's financial plan.
2	£8.2m of other capital cash receipts has been reclassified other capital grants and receipts within the cash flow statement and notes.	£8.2m	Note 36 Cash flows from investing activities	This has been an amendment to note 36 cash flows from investing activities.
3	We have agreed several amendments to the disclosures in the accounts to improve the level of information available to the users of the accounts.			

Section 3: Value for Money

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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.

Key findings

Securing financial resilience

We have undertaken a review which considered the Council's arrangements against the three expected characteristics of proper arrangements as defined by the Audit Commission:

- Financial governance;
- Financial planning; and
- Financial control.

Overall, our work highlighted that the Council has had a challenging year. These challenges have impacted on the Council's wider governance framework. The Council has reflected this in its Annual Governance Statement for the year and subsequent update reports to the Audit & Governance Committee.

In 2013/14, the Council's Head of Internal Audit give an overall "limited assurance" opinion on the operation of the Council's overall system of internal control. Management Team set out their commitment to ensuring the issues were addressed in 2014/15 and a decision was taken to re-direct Internal Audit resource for the remainder of the 2014/15 year. A revised audit plan was presented to the Audit & Governance Committee in January 2015.

The consequences of these changes to the audit plan were that:

- management now has assurance that the specific controls identified as not operating during 2013/14 have been addressed;
- Internal Audit's work on 4 key financial systems (General Ledger, Treasury Management, Payroll and Central Accounts Payable) provided assurance over the operation of the controls within those areas; but
- the revised plan (as approved) did not provide sufficient coverage of the Council's activities to support an overall Head of Internal Audit opinion in compliance with the requirements of Public Sector Internal Audit Standards.

Management Team have re-iterated their commitment to ensuring that there is a robust internal control framework in place across the Council and for 2015/16, management intend to use the skills and experience of the Internal Audit team to work with Head of Service across the Council to ensure risks and controls have been properly identified and are being operated as intended. The Internal Audit plan for 2015/16 is expected to reflect this.

Value for Money

A high level plan is to be presented to the Audit & Governance Committee in September 2015 for their consideration. The Committee will then need to identify the other sources of assurance it might need to seek and consider in order to be assured about the Council's overall arrangements for governance and internal control.

We are also concerned that, as at September 2015, the planned work by Internal Audit to support Heads of Service in identifying and assessing risks and controls has not yet commenced.

Other weaknesses in the Council's governance framework identified in 2013/14 and 2014/15 are being addressed:

- action is underway to address failures in the procurement service which were identified when it was brought back in house in April 2014.
- significant progress has been made in strengthening the Council's arrangements for Information Governance;
- the Council's arrangements for identifying, assessing and reporting risks has been developed and work is underway to ensure it is consistent and embedded across the Council.

Challenging economy, efficiency and effectiveness

We have considered the Council's arrangements to challenge economy, efficiency and effectiveness against the following themes:

- Prioritising resources
- Improving efficiency & productivity

Overall our work highlighted the Council has delivered the first phase of its transformation programme during 2014/15. The restructure of the Council's Management Team, with new roles and responsibilities in place, supports a more streamlined and focussed Council. In addition, the Council has moved away from it's former directorate structure and has appointed Heads of Service to lead the operational delivery.

However, the transformation programme has now been paused whilst the Council considers its options for meeting the savings gap and on-going service pressures identified. The scale of the savings needed by the Council mean some very difficult decisions will be required on the way in which statutory services will be delivered, and on the options for, and scale of, discretionary services provided in the future.

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 proposing a qualified "except for" VFM conclusion. This is set out in Appendix B.

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
Key indicators of performance	The Council delivered within budget for 2014/15, reporting an overall underspend of £76.1m. Although a very positive outcome, this was largely a result of some one off Treasury Management gains that are unlikely to arise in future. The Council's County Fund balance remains at £36.0m and earmarked reserves are £376.1m. This includes the risk management reserve of £82m and the down-sizing reserve of £80.6m which will support the on-going transformation of the Council. The Council recognises the significant on-going financial pressures it faces in the medium term and work is now underway to revisit the plans and assumptions. A zero based budget review is underway as part of this challenge. The Council has been through a significant period of change as part of its transformation process. Phase 1 of this plan was the establishment of the new Management Team and a structure at Grade 11 and above within the Council. As a key partner in the delivery of the City Deal the Council is leading a significant investment in the Preston area. In the year the Council has brought its waste disposal facilities back in house, seeking to improve the value for money of the arrangement. This has recognised significant savings for the Council with a revenue saving of £6.2m in 2014/15. The Council is also committed to improving the operation of the plant to ensure greater value for money. The option of a shared Asset and Liability Management Partnership between Lancashire County Pension Fund and the London Pension Fund Authority has continued to progress.	**Green**

Theme	Summary findings	RAG rating
Strategic financial planning	The Council set balanced budgets for both 2014/15 and 2015/16. Both budgets required significant savings to be made by the Council. In February 2015, the budget identified that in the period 2015/16 to 2017/18 further savings of £178m were identified, on top of the savings of £63m identified in the previous year (2014). The total savings of £241m, of which £100m is required in 2015/16 is a significant increase on the savings required when the previous years budget was set. In February 2014, the Council expected to need £161m over the period, of which £73m was required in 2015/16. In August 2015, the Council held an additional cabinet meeting to consider the financial position. At this meeting, members received an update to the medium term financial plan to take account of the additional pressures that had been identified from the budget at the 2014/15 outturn. The financial position sets out an update for the financial position for 2015/16. When considering the outturn for 2014/15, the Council identified £27.3m of on-going financial pressures which had not been reflected in the base budget set in February. Further detailed work by the Council to understand the impact of this, alongside emerging pressures in the current year and the planned use of reserves means the Council has identified an on going pressure of £53.561m against the 2015/16 budget which will remain a pressure in the 2016/17 budget unless action is taken. Accordingly, this has identified risks to the future delivery of the Council's financial plans. The Council is therefore undertaking further work to better understand future levels of demand, inflationary pressures and the impact of the living wage on future expenditure. Regular meetings are held to understand the demand for services in order to provide more intelligent information for forecasting. The Council has identified that the level of demand for services represents a significant continued risk to its financial position. As well as updating the budget for 2015/16, the report also updates the medium term financial strategy (MTFS) to 2020/21. This identifies a spending gap from 2016/17 to 2020/21 of £294.6m. Within this, savings of £71.4m have been identified, but the document clearly sets out the cumulative spending gap of £223.2m and its impact over the life of the medium term. The document considers the position for the Council at 30 June 2015 and provides a clear update on the Council's MTFS for the period from 2016/17 to 2020/21. A detailed report "Money Matters Update on the County Council's Reserves Position for 2015/16" was also presented to the August Cabinet setting out the current position on reserves. This shows a heavy reliance on reserves over the next two years, with overall balances (excluding schools) forecast to reduce from £328.7m to £87m by 31/03/2018. It provides a clear focus for members on how reserves have been committed. While the Council has identified a significant level of savings, these plans are proving very challenging to deliver. The savings identified of £117.6m for 16/17 and 17/18 have now been revised downwards to £71.4m reflecting how difficult it is to deliver reductions in spend, most particularly for demand led services. Work is now underway to identify additional savings schemes in order to close this gap. As well as this, budgets are being reviewed to identify a zero based budget which will identify, on a service by service basis, what services can be stopped and, as part of a two stage process, will establish the future pattern of services to be delivered.	**Amber**

Theme	Summary findings	RAG rating
Financial governance	This has been another challenging year for the Council in maintaining standards of governance. This must be seen in the context of the backdrop of a significant and complex transformation agenda for the Council. However, there is a recognition at both Member and Management Team level about this and it is clearly articulated through the Council's Annual Governance Statement. In September 2014, the Chief Internal Auditor issued a Head of Internal Audit opinion setting out that only limited assurance could be provided about the Council's systems of internal control as operated in the 2013/14 financial year. Management were committed to addressing these weaknesses as quickly as possible and, in response to the issues raised, the 2014/15 work plan for internal audit was redirected. A revised audit plan was presented to, and approved by the Audit & Governance Committee in January 2015. This led to a focus on the areas of control weakness previously identified by Internal Audit to ensure that Heads of Service were taking appropriate action. As a consequence of this change to the plan, the assurance provided by internal audit to the Council for 2014/15 has been much narrower in scope than the original plan approved by the Audit & Governance Committee in June 2014. This was because work was focussed on ensuring action had been taken in respect of the specific matters raised in previous audits. As a result, the extent and coverage of audit work completed for 2014/15 does not provide sufficient assurance over the operation of the Council's system of internal control overall. Subsequently, the Chief Internal Auditor has been unable to provide an overall assurance opinion for the 2014/15 financial year. We note, however, that assurance has been provided in respect of 4 of the Council's main financial systems general ledger, treasury management, payroll and central accounts payable Management Team remains committed to ensuring the framework of internal control is sound and to addressing internal control deficiencies as they are identified. In 2015/16, Management Team have stated an intention for internal audit to work collaboratively with Heads of Service across the Council to identify risks and controls, advising on the actions needed to address any weaknesses or gaps in those controls. This support is designed to improve control across the organisation and to ensure that good governance is consistently embedded in all areas of the Council's operation but will need to be considered further in the light of the strategic decisions expected to be taken by members about the future size and shape of the Council. The Audit & Governance Committee has not had oversight of management's intent to use internal audit to strengthen the internal control framework for the first 6 months of the year. Furthermore, the intended Internal Audit support in this area has not yet begun. The Council identified a lack of capacity in the finance department to work on a number of key projects and staff from Internal Audit have been seconded out to the finance team to provide operational support. It is anticipated that internal audit staff will return to their substantive posts soon and work will then begin on developing and delivering the high level audit plan presented to the Committee in September 2015. This plan sets out the intention to provide coverage of the key financial systems only and therefore, it is likely that, for 2015/16, internal audit will again be unable to provide an overall opinion for the Council in line with the requirements of public sector internal audit standards. The Audit & Governance Committee has not yet considered the other sources of assurance it might need to in order to be assured about the Council's overall arrangements for governance and internal control.	**Red**

Theme	Summary findings	RAG rating
Financial governance (cont)	The Council identified a need to strengthen its risk management framework. Although risks are being managed across services, the Council did not have a systematic and robust framework to underpin the way in which risks are identified, managed and mitigated. However, progress has now been made to address this and the intranet has been updated with information about how the risk strategy will be formalised. A draft of the risks and opportunities register has now been prepared. This draws on the risks the Council had previously considered, but has been refreshed to reflect additional risks and opportunities identified. Going forward, the Audit and Governance Committee will receive regular reports on risk management as part of it's overall role in receiving assurance about the Council's systems and processes. In May 2014 Cabinet approved a "waiver" of 38 separate contracts with a total value of £17.8m which had either expired in the period 2012 to May 2014 or would expire within the period required for a procurement process to be completed. These contracts were identified when the Council brought its procurement function back in house when the Council renegotiated its arrangement with it's former strategic partner. The report to Cabinet set out the legal risks the Council was exposed to as a result of its failure to properly re-procure these contracts. During 2014/15, a significant amount of work has been undertaken to provide a better understanding of the contracts the Council is party to and to properly document these on a comprehensive contract register. Inevitably, this process identified additional contracts which should also have been re-procured. As a result, contract extensions have been approved by Cabinet where the value of extension is £1.384m for care service contracts and £1.274m for construction and asset contracts. The Council has extended these contracts for a variable time periods, reflecting the fact that the procurement team is now able to ensure that processes will be followed to re let these contracts over the medium term. Internal audit work on capital expenditure within the Highways Service provided only limited assurance. The main weaknesses identified related to the arrangements for the procurement of sub-contractors and materials. These did not comply with the Council's procurement framework. Follow up work on the issues identified has indicated that there are now better arrangements in place for monitoring capital expenditure. The Council has identified that the improvements to its procurement function need to be embedded and applied consistently across the range of the Council's services.	**Red**

To support our VfM conclusion against the specified criteria we performed a risk assessment against VfM risk indicators specified by the Audit Commission. and additional indicators identified by ourselves. Following completion of our work we noted the following residual risks to our VfM conclusion:

Residual risk identified	Summary findings	RAG rating
Financial control	The outturn position for the 2014/15 financial year was reported to Cabinet in July 2015. It showed an overall underspend by services of £6.498m underspend on services. The capital financing outturn was overall £69.583m under budget, largely due to a positive variance of £64.997m in income received. Although the Council has delivered an overall underspend, both for services and corporately, financial planning undertaken to refresh the financial plan has identified that there is significant pressure on budgets in 2015/16 and beyond. This pressure arises from increased demand for some Council services. A review is now underway to identify further the causes of the increased demand and to seek actions to contain it. In addition, the Council has identified the need to improve the way it recharges internally for some central services, such as IT, in order to ensure that budgets are allocated and costs are borne proportionately by services. The Council is now restricting all non-essential spend as one immediate action to manage the current financial pressure. Cabinet agreed in August 2015 that a base budget review would be undertaken. This will review all services provided by the Council, including identifying expenditure on statutory services. Following this the expenditure required to provide statutory services will be identified, and expenditure on non statutory services will be reviewed in line with the Council's corporate strategy, which will also be refreshed on the same timescale. The impact of this will mean the Council is significantly different in terms of services provided and how these services will be delivered. The Council has recognised the need to improve income and debt recovery particularly of older debts. The Council has begun . The implementation of Liquid Logic has had an impact on the recovery of care debt via direct debit with the number of direct debits falling during the financial year. There has been significant work to improve the processes and the quality of the billing, and reviews are now being undertaken of older debt to assess recoverability. This should be reflected in 2015/16.	

To support our VfM conclusion against the specified criteria we performed a risk assessment against VfM risk indicators specified by the Audit Commission. and additional indicators identified by ourselves. Following completion of our work we noted the following residual risks to our VfM conclusion:

Residual risk identified	Summary findings	RAG rating
Prioritising resources	The Council has been through a significant period of change as part of its transformation process. Phase 1 of this plan was the establishment of the structure at Grade 11 and above within the Council. Staff have now been appointed into post following this phase. 2015/16 represents a significant move forward for the Council in continuing to appoint into its new structures throughout the Council. A strong understanding of progress and delivery will therefore be essential. Heads of Service have now designed the structures for their department, with a couple of exceptions. However, this is now on hold pending a wider consideration of how the Council will meet the increased financial pressure. The Council is currently reviewing all services to identify and better understand the elements of current provision that are statutory and that which is discretionary. As part of this the Council will need to consider how services will need to be redesigned or stopped in order to meet priorities from the available resources. As a key partner in the delivery of the City Deal the Council has been key in ensuring the investment in the city has been realised. Working in partnership with South Ribble Borough Council, Preston City Council, Lancashire Enterprise partnership and the Homes and Communities agency the City Deal will deliver homes, jobs and growth to the area. There has already been significant investment in transport infrastructure and identification of areas for investment for homes and business development in and around Preston, with significant enabling works taking place on key routes into the centre and work on the delivery of the significant number of houses planned begun.	**Green**
Improving efficiency & productivity	In the year the Council has brought its waste disposal facilities back in house, seeking to improve the value for money of the arrangement. This has recognised significant savings for the Council with a revenue saving of £6.2m in 2014/15. The Council is also committed to improving the operation of the plant to ensure greater value for money. The option of a shared Asset and Liability Management Partnership between Lancashire County Pension Fund and the London Pension Fund Authority has continued to progress. At the Pension Committee in July 2015 it was decided to proceed further with the creation of the partnership following consideration of the outline business case.	**Green**

Section 4: Fees, non-audit services and independence

01. Executive summary
02. Audit findings
03. Value for Money
04. Fees, non-audit services and independence
05. Communication of audit matters

Fees, non-audit services and independence

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

Fees

	Per Audit plan £	Actual fees £
Council audit	150,660	150,660
Grant certification on behalf of Audit Commission	2,800	*2,800
Total audit fees	**153,460**	**153,460**

Fees for other services

Service	Fees £
Reasonable assurance report on the 2014/15 Teacher's Pensions return	*4,200

* These fees are estimated based on the fees for 2013/14. We will confirm the final fees chargeable to the Audit and Governance committee on completion of the work.

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 Financial Reporting Council's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

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

Ethical standards and International Standards on Auditing ISA (UK&I) 260 require us to give you full and fair disclosure of matters relating to our independence. In this context, we disclose the following to you:

- In the 2015/16 financial year our advisory team facilitated a workshop with senior managers in respect of your risk management arrangements. This work was undertaken by staff in a different department to the audit team and focused on facilitating management team to populate their own risk framework. This will also be reported in our 2015/16 audit plan

Section 5: Communication of audit matters

01. Executive summary

02. Audit findings

03. Value for Money

04. Fees, non-audit services and independence

05. Communication of audit matters

Communication of audit matters to those charged with governance

International Standard on Auditing ISA (UK&) 260, as well as other (UK&I) 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. Details of non-audit work performed by Grant Thornton UK LLP and network firms, together with fees charged 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: Action plan

Rec No.	Recommendation	Priority	Management response	Implementation date & responsibility
	• Privileges should be reviewed and a matrix should be defined to document which combination of responsibilities should not be granted to individuals.	Medium	In the short term a review of users will be performed by LCC's control and compliance team to ensure future segregation of duties. Our long term strategy had already been identified to assign access permissions based on posts not individuals.	December 2015
	• Default responsibilities should not be used and monitoring controls should be implemented to review any unsegregated responsibilities.	Medium	There will be regular monitoring of the use of default unsegregated responsibilities. Where these privileges are needed for a short period of time to help resolve helpdesk calls requests should be processed through the standard processes.	December 2015
	• Ensure that reports are produced from audit logs created are reviewed.	Medium	Access rights and responsibilities will be undertaken quarterly and documented	December 2015
	• The Council should review purchase order accruals made to ensure they relate to items of expenditure incurred by the Council	Medium		
	• The Council should consider the actions needed to improve the overall system of internal control including how members of the Audit & Governance committee will gain assurance about the effectiveness of the system.	High		

Priority

High, Medium or Low

Appendix B: Audit opinion

We anticipate we will provide the Council with an unmodified audit report, and a qualified "except for" value for money conclusion

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

We have audited the financial statements of Lancashire County Council for the year ended 31 March 2015 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 2014/15.

This report is made solely to the members of Lancashire County Council, as a body, in accordance with Part II of the Audit Commission Act 1998 and as set out in paragraph 48 of the Statement of Responsibilities of Auditors and Audited Bodies published by the Audit Commission in March 2010. Our audit work has been undertaken so that we might state to the members those matters we are required to state to them in an auditor's report and for no other purpose. 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 Acting Section 151 Officer and auditor

As explained more fully in the Statement of the Acting Section 151 Officer's Responsibilities, the Acting Section 151 Officer 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 2014/15, 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 also 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 Acting Section 151 Officer; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the introduction 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 2015 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 2014/15 and applicable law.

Opinion on other matters

In our opinion, the information given in the introduction 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 are required to 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; or
we issue a report in the public interest under section 8 of the Audit Commission Act 1998; or
we designate under section 11 of the Audit Commission Act 1998 a 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 in October 2014.

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 review in accordance with the Code of Audit Practice, having regard to the guidance on the specified criteria, published by the Audit Commission in October 2014, 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 2015.
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:

the Council's Chief Internal Auditor has been unable to give an overall opinion on the operation of the Council's system of internal control for the year; and
when the Council's procurement function was brought back in-house on 1 April 2014, management identified contracts in excess of £20m for which a tender waiver was required since the contract had either already expired, or would do so before a procurement process could be run;

These matters are evidence of weaknesses in the Council's arrangements for financial governance.

Qualified Conclusion

On the basis of our work, having regard to the guidance on the specified criteria published by the Audit Commission in October 2014, with the exception of the matters reported in the basis for the 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 2015.

Delay in certification of completion of the audit

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

for and on behalf of Grant Thornton UK LLP, Appointed Auditor

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September 2015

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