

Annual Audit Letter

Lancashire County Council

Audit 2011/12



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Key messages

This report summarises the findings from my 2011/12 audit. My audit comprises two elements:

- **my audit of your financial statements; and**
- **my assessment of your arrangements to secure value for money in your use of resources.**

Financial statements

My audit of the Council's financial statements, including those of the pension fund, is complete and I issued an unqualified audit report on 27 September 2012.

I have not identified any material errors within the financial statements and those errors which have been identified have not affected the underlying financial position of the Council. All errors have been corrected and mainly relate to disclosure issues.

This has been another challenging year for the finance team with the introduction of a new ledger and the new partnership arrangement with One Connect Limited, (OCL), supporting the delivery of significant financial savings in-year and ongoing re-structuring of the team. The pension fund team have also been dealing with significant changes in the management of the fund and the underlying processes and systems. Within this context, the preparation of materially correct statements, which included bringing onto the balance sheet the new waste PFI assets and heritage assets for the first time, is a significant achievement.

Value for money (VFM)

I provided an unqualified VFM conclusion on 27 September 2012.

The Council has demonstrated a strong financial performance during 2011/12, exceeding extremely challenging delivery targets for the year, whilst showing an overall improvement in performance across its services. It is well placed to deal with the financial and operational challenges ahead. Good progress has been made in strengthening governance arrangements to support treasury management, and in monitoring and managing both the contract with OCL and the financial and operational challenges presented by the waste PFI contract.

Financial statements and annual governance statement

The Council's financial statements and annual governance statement are important means by which the Council accounts for its stewardship of public funds.

Overall conclusion from the audit

I issued an audit report including an unqualified opinion on the financial statements on 27 September 2012.

The overall quality of the accounts was again good reflecting the commitment of the Council's officers to meet the requirements of the Code of Practice of Local Authority Accounting. There were no material errors within the accounts. A number of relatively minor amendments have been agreed to improve the accuracy, clarity and internal consistency of the disclosure notes within the financial statements. All errors identified during the course of the audit have been amended for. None of the amendments have affected the reported surplus or general county fund balance or the underlying position of the Pension Fund.

Weaknesses in control

In my annual governance report on the pension fund, presented to members of the Council's Audit and Governance Committee on 26 September 2012, I referred to the potential risk of misclassification of monies between the Council's accounts and those of the Pension Fund. I am satisfied that there is unlikely to be a material error affecting either set of accounts. However, there is a risk of non-material error between the two sets of accounts. Because of difficulties in being able to fully reconcile the pension fund cash balance. The un-reconciled balance at 31 March 2012 stood at £1.2m. An action plan has been agreed to ensure this issue is addressed during 2012/13 and work is already underway to reconcile the balance.

Value for money

I considered whether the Council is managing and using its money, time and people to deliver value for money. I assessed your performance against the criteria specified by the Audit Commission and have reported the outcome as the value for money (VFM) conclusion.

I assess your arrangements to secure economy, efficiency and effectiveness in your use of resources against two criteria specified by the Audit Commission. My overall conclusion is that the Council has proper arrangements to secure, economy, efficiency and effectiveness in its use of resources.

My conclusion on each of the two areas is set out below..

Table 1: **Value for money conclusion criteria and key messages**

Criteria: Financial resilience - The organisation has proper arrangements in place to secure financial resilience

Focus for 2011/12:

The organisation 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.

Key messages

As reported last year, the Council faced a significant financial challenge following the government's local government spending review. The Council's response to this had been impressive, with a three year budget agreed in February 2011 for 2011/12 to 2013/14. This included plans to save £179m over that period. The development of this budget followed significant work which began some years before to achieve a more cost effective Council whilst still providing the desired level of services. This involved making some radical changes to service delivery, especially around back office services, which required time to develop and implement. The Council's financial planning has continued to progress since then to both deliver on existing plans whilst also responding to, and planning for, new financial risks. At the time of agreeing the 2011/12 budget detailed plans were in place to achieve the full savings needed over the three years subject to a shortfall of £7.5m. Additionally there were also, (and still are), a variety of unknowns and cost pressures which could impact on the deliverability of the budget.

Criteria: Financial resilience - The organisation has proper arrangements in place to secure financial resilience

During the last 12 months the Council has:

- achieved efficiency savings ahead of those planned (£10m);
- achieved additional efficiency savings which have now been built into future years budgets to off-set additional cost pressures (£10m); and
- agreed detailed plans for the £7.4m savings needed to balance the budget for 2013/14.

This strong performance, taken together with exceptional one-off gains arising from management of the Council's bond portfolio, has enabled the Council to agree a programme of one-off investments in specific areas to help address the Council's priorities around economic regeneration, employment, respite care and residential and day care facilities. A total of £59m has been moved into a new strategic investment reserve at year end to fund these plans which will be delivered over the next five years.

The Council still faces significant cost and funding pressures going forwards. The Council is fully aware of these and is taking action to reduce the impact where possible. In addition the Council is continuing to implement a range of initiatives aimed at further reducing costs and improving efficiency in future years. The general fund reserve has reduced slightly from £41.9m at 1/4/11 to £36.5m at 31/3/12, but the Council considers this to be sufficient as a contingency to off-set future spending and funding pressures in the short term.

The Council has continued to implement its strategy to reduce the risk exposure of its borrowings and lendings. In doing so its has also achieved significant financial benefits for the Council. This has included the achievement of exceptional one-off gains of £55.7m arising from management of the Council's bond portfolio. The governance arrangements to support the more complex treasury management function have been strengthened over the last 12 months. In particular:

- the updated Treasury Management policy framework adopted by the Council in February 2012 is much clearer about its strategy in respect of reducing risks and within this environment, its policy around borrowing and investments;
- the Council is better able to explain and justify its borrowing needs and borrowing is more closely controlled against much tighter limits;
- the monthly Treasury Management meetings with the County Treasurer have been formalised and significant decisions are more clearly documented, explained and supported within the context of the agreed strategy;
- reporting to members is clearer around the impact of general market conditions on the Council's own portfolio and strategy and includes clearer reporting on the impact of decisions on the levels of investment and borrowing and against limits and performance targets;
- additional capacity within the Treasury Management team has been obtained through recent recruitment exercises; and
- members have received additional training in investments and there is a programme of future training covering, for example borrowing and more complex financial instruments.

Work is still ongoing to further strengthen the governance arrangements including:

- acquisition of a new Treasury Management IT system which is expected to improve the production of management information especially around the risk profile of the portfolios;

Criteria: Financial resilience - The organisation has proper arrangements in place to secure financial resilience

- updating of treasury management practice notes; and
 - staff continue to pursue programmes of professional treasury management training although the ability to do so has been restricted due to workload/capacity issues.
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Criteria. Securing economy efficiency and effectiveness - The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.

Focus for 2011/12:

The organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

Findings:

As well as delivering significant financial savings the Council is continuing to perform well against its performance targets. Over 80% of targets have been met in the year, and where targets have not been met, significant improvements have still been achieved. Successes during the year have included a significant reduction in serious road casualties of 226 (25.9%) and increasing the percentage of pupils achieving 5 or more A*- C grades at GCSE level by 4% (56% to 60.1%).

The arrangement with OCL is delivering on its high level objectives. In overall terms, the cost to the council of services provided has reduced as expected. The annual contract figure agreed of £37.3m compares with the cost of seconded staff of £41.5m which has been billed to OCL. A further £11.9m has been paid for agreed service developments such as the implementation of the new HR/payroll system and ledger system. An additional amount of £0.5m has been paid for work requested by Lancashire County Council which is recognised to be outside the agreed contract. Procurement savings achieved through contract negotiations by OCL on the Council's behalf are reported by OCL to be £3.2m.

OCL are largely meeting agreed service targets and two significant service developments have been delivered. As with any significant change, there have been issues in implementation. The contract is being managed robustly and the two parties are working closely together at a management team level to address issues as they arise. Baseline performance levels and targets have been agreed during the year and are now reported against on a monthly basis together with reporting of how any specific issues under each service are being dealt with. Given the significant level of agreed improvement achievements and high level of savings to be delivered by OCL it will be important to ensure a continued close level of management of this arrangement.

The environment team have identified and agreed efficiency savings which are sufficient to offset the current cost pressures created by the waste

management contract. During 2011/12 it became increasingly apparent that the waste contract was not delivering as originally envisaged. Since December 2011 the Council has been working closely with the contractor, Global Renewables Lancashire Ltd, (GRL), to identify and implement changes which will improve the value for money achieved by the contract and reduce the ongoing financial risks to the Council. A memorandum of understanding and change to the contract have recently been agreed which are intended to incentivise diversion from landfill, thereby reducing the financial pressures on the landfill budget. There remain significant challenges in delivery of the expected performance and financial impact of the contract going forwards. The Council together with GRL, have achieved a more stable footing to proceed from and are continuing to explore ways of reducing the financial risks of the contract.

Closing remarks

I have agreed this letter with the Chief Executive and the County Treasurer. I will present this letter at the Cabinet on 11 October 2012. Further detailed findings, conclusions and recommendations in the areas covered by our audit are included in the reports issued to the Council during the year.

Report	Date Issued
Annual governance report – Lancashire County Council	September 2012
Annual governance report – Lancashire County Pension Fund	September 2012

The Council has taken a positive and constructive approach to our audit. I wish to thank the Council staff for their support and co-operation during the audit.

Karen Murray
District Auditor
October 2012

Appendix 1 – Glossary

Annual Governance Statement

Governance is about how local government bodies ensure that they are doing the right things, in the right way, for the right people, in a timely, inclusive, open, honest and accountable manner.

It comprises the systems and processes, cultures and values, by which local government bodies are directed and controlled and through which they account to, engage with and where appropriate, lead their communities.

The annual governance statement is a public report by the Council on the extent to which it complies with its own local governance code, including how it has monitored the effectiveness of its governance arrangements in the year, and on any planned changes in the coming period.

Audit opinion

On completion of the audit of the financial statements, I must give my opinion on the financial statements, including:

- whether they give a true and fair view of the financial position of the audited body and its spending and income for the year in question; and
- whether they have been prepared properly, following the relevant accounting rules.

Opinion

If I agree that the financial statements give a true and fair view, I issue an unqualified opinion. I issue a qualified opinion if:

- I find the statements do not give a true and fair view; or
- I cannot confirm that the statements give a true and fair view.

Value for money conclusion

The auditor's conclusion on whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources based on criteria specified by the Audit Commission.

If I find that the audited body had adequate arrangements, I issue an unqualified conclusion. If I find that it did not, I issue a qualified conclusion.

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