Annual Audit Letter

Lancashire County Council

Audit 2010/11

Contents

Traffic light explanation
Red ■ Amber ◆ Green ●

Key messages

This report summarises the findings from my 2010/11 audit. My audit comprises two elements:

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

Key audit risk	Our findings
Unqualified audit opinion	
Proper arrangements to secure value for money	

Audit opinion and financial statements

My audit of the Council's financial statements, including those of the pension fund, is complete and I provided an unqualified audit report on 26 September 2011.

I did not identify any material errors within the financial statements and those errors which were identified did not affect the underlying financial position of the Council. All errors were corrected and mainly related to disclosure issues.

This has been a particularly challenging year with the introduction of a number of changes, particularly International Financial Reporting Standards (IFRS), for which finance staff needed to prepare.

The preparation of materially correct statements which met the new requirements within this context is a significant achievement.

Value for money

I provided an unqualified VFM conclusion on 26 September 2011.

The Council has responded well to the demands placed on it. A strategic and realistic approach has been taken to the identification and delivery of required savings of £179 million over the next three years.

A more radical approach has been taken to a range of services which has helped the Council to respond to this challenge. This includes:

- the implementation of a new Treasury Management Strategy which in 2010/11 has saved the council £15 million and is planned to deliver a further £10 million over the next three years, and
- the Council's new strategic partnership for the delivery of core back office services which is expected to deliver significant savings, (£14 million over the next three years), as well as improved services.

The challenge for the Council now is monitoring and managing the effective delivery of their financial and operational plans.

Current and future challenges

Economic downturn and pressure on the public sector	The Council is facing unprecedented financial challenges over the next few years. A challenging savings target of £179 million over three years has been set. There remain a number of unknowns which will affect the level of savings needed including future government grant settlements, changes in local taxation rules, new requirements for local authorities relating to public health and proposed changes around landfill waste tax rules. In the meantime the demand for local government services is forecast to rise due to the impact of the economic downturn on individuals. The Council has a strong financial base and a clear strategic approach to dealing with these challenges. Effective monitoring and managing delivery of financial targets and service standards will be key during this difficult period.
Joint arrangements / shared services	As part of the Council's approach to delivering financial savings whilst improving services it entered into a strategic partnership arrangement with British Telecom (BT) to deliver a range of services. This includes procurement, human resources and payroll services, information technology, and payments. The guaranteed cumulative financial benefits to the County Council over the lifetime of the contract (ten years) are over £100 million. The successful delivery of the partnership's aims are crucial to the Council and require a significant change in the way such services are delivered. Again effective and close monitoring of delivery of agreed performance standards and financial targets will be crucial.
Treasury management	The Council has moved away from a relatively simple and traditional approach to Treasury Management to reduce net financing costs whilst also reducing financial risk to the Council. The new strategy is more complex and requires an ability to monitor and react more quickly to market developments than in previous years. We have made recommendations to officers to improve the governance of this more complex environment which involves significant levels of annual transactions. Key elements are strengthening the monitoring and reporting of: ■ key decisions made during the year, ■ financial risks and how they are being managed, and ■ compliance with the regulatory framework.

Management of the Pension Fund and development of a significant in-house portfolio	The Council, as trustee for the Pension Fund, continues to look for ways to improve its management of the pension fund. Over the next few years these include: ■ conducting procurement exercises for a number of services provided to the fund to improve value for money; ■ changes in the underlying portolios to attempt to achieve better rates of return whilst minimising risk; and ■ development of a significant portfolio which it is now managing itself. Continued close monitoring of investment performance and underlying risks and how they are being managed will be important to ensure the ongoing sustainability of the fund.

Financial statements and annual governance statement

The Council's financial statements and annual governance statement are an 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. This was the first year of full implementation of international financial reporting standards which required significant changes to the Council's accounts. In this context the identification of a relatively small number of non-material errors within the accounts was a significant achievement. The overall quality of the accounts reflects the importance which officers place on ensuring that the accounts meet the requirements set out in the Code of Practice on Local Authority Accounting.

Two misclassification errors were identified which impacted on the face of the principal financial statements. A number of other amendments have been made in response to issues raised by ourselves. These have impacted on the explanatory foreword and disclosure notes and were made to improve the internal consistency of the financial statements and improve the clarity and accuracy of disclosures.

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.

Significant weaknesses in internal control

I have not identified any significant weaknesses in internal control.

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 adequate arrangements to secure, economy, efficiency and effectiveness in its use of resources.

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

Value for money criteria and key messages

Criterion	Key messages
1. Financial resilience **The organisation has proper arrangements in place to secure financial resilience.** Focus for 2010/11: 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.	The Council has a history of strong financial management. The Council's short and medium term financial planning show it has risen to the challenge of meeting required savings at an unprecedented level. Following close monitoring and management of the budget during 2010/11 the Council achieved a budget underspend of £24.4 million. Amongst other things the underspend has been used to set aside monies for meeting the costs of future severance costs and to establish a fund for savings plans which require up-front investment. A 3 year budget plan was approved by Council on 17 February 2011 covering financial years 2011/12; 2012/13 and 2013/14. The budget savings to be achieved in those three years, after taking account of the necessary levels of reserves and balances and areas of service growth, such as highway maintenance and waste management, amounted to £179 million.

Criterion	Key messages
	A strategic approach has been taken to identifying potential savings with an emphasis on taking as much out of 'below the line' costs as possible before front line services are affected. (Below the line' costs are incurred in supporting and managing both service delivery and maintaining the infrastructure of the County Council). 45 per cent of savings are planned to be achieved from changes to 'below the line' services. Consideration has also been given to the likely impact of the savings on services; the staffing implications; whether the savings result in a full or partial cessation of a service along with an assessment of the impact of the savings on service users and the risks associated with delivering the proposed savings. Effective consultation both within and outside the Council has taken place to help ensure the deliverability of the savings plans. Progress on the achievement of savings will be reported to the Council's Cabinet with areas where savings are not being delivered in line with expectations clearly highlighted. Latest budget monitoring reports indicate that the Council is ahead on its delivery of targeted savings in 2011/12. The Council's County Fund balance stands at £41.9 million at 31 March 2011 and is considered to be at an appropriate level by the County Treasurer in view of the delivery risk involved in such a challenging financial climate. The Council plans to re-visit this as the assessed delivery risk changes over the life of the three year plan. The arrangements put in place to identify the planned savings over the next three years are impressive. But in many ways the identification of planned savings is just the start of the process. The real challenge for the Council over the next three years will be to ensure delivery of the planned savings at the same time as ensuring services remain efficient and effective as well as economic. The Council should ensure that the range of initiatives to measure and monitor savings and wider value for money going forward are properly co-ordinated in terms of assessments being made and reported to Members. The Council's new Treasury Management Strategy has delivered significant savings during 2010/11 (£15 million), and is a key element of planned savings for 2011/12 and future years. The achievement of such savings has required a significant departure from the previous traditional approach to treasury management. A move to a more complex portfolio of borrowing and investments brings with it greater flexibility and requires close and careful management to ensure

Criterion	Key messages
	the Council does not suffer unnecessarily from changes in the markets. The Council is aware of this and is taking action to ensure it can manage such risks effectively. The Council needs to ensure that it continues to closely manage this area and that reports to Members are clear about the impact of significant decisions made about the portfolio on its risk exposure and how those risks are being managed.
2. Securing economy efficiency and effectiveness **The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.** Focus for 2010/11: The organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.	The Council has a good record of understanding its relative costs and exploring new ways of delivering services to achieve better value for money. Value for money is to be monitored through a variety of means, including: ■ service reviews; ■ unit cost comparisons; ■ a new corporate scorecard and a Cabinet Committee on Performance; and ■ regular cost and performance benchmarking. During 2011 the Council entered into a strategic partnership arrangement with British Telecom (BT) to deliver a range of services. This includes procurement, human resources and payroll services, information technology, and payments. This arrangement is expected to achieve significant improvements in value for money for the Council. The agreement with BT and the creation of One Connect Ltd are designed to: ■ reduce the cost of current services transferred to the partnership by 10 per cent of the current price; ■ deliver procurement savings of a minimum of 2 per cent of the addressable spend; and ■ establish a procurement centre of excellence. The Council's financial plan to 2013/14 includes £14 million of savings from this agreement. The guaranteed cumulative financial benefits to the County Council over the lifetime of the contract (ten years) are over £100 million. The intention of the strategic partnership is to: ■ maximise the benefit of investment in ICT; ■ improve the Council's customer service centre; ■ respond to the financial and improvement challenge;

Criterion	Key messages
	■ integrate the HR and payroll system; and ■ act as a catalyst for innovation and improvement. The key objective of the partnership is to improve outcomes and at the same time to reduce costs. The partnership demonstrates a strong commitment to reduced costs, better value for money and innovation and improvement in service delivery. The key to success will be in the ability to measure and assess the difference the partnership is making in each of the above areas. Monitoring the delivery of planned improvements and effective reporting to Members on the performance of the partnership will be important going forward. The Council has a significant long term contract for waste management with contractual obligations over its lifetime estimated to be £2.1 billion. This 25 year contract was entered into in 2007 with the aim of reducing waste going to landfill thus achieving environmental improvements whilst also achieving savings in future landfill tax costs and landfill allowance penalties. As with any contract of this type, long term and wide ranging assumptions needed to be made to develop the original business case including financial projections of future costs. The contract clearly allocated where the Council and the contractor were bearing specific risks around such assumptions. During 2010/11 the two waste treatment sites built under this contract have become operational and entered their test phase. The Council is now able to assess the potential impact on the Council's finances of the actual operation of the facilities. Key factors influencing the costs to the Council which are being reviewed currently include the overall level of household waste being produced, the extent to which waste is being diverted from landfill, energy prices, and transport costs. Government policy changes could also impact on the cost of taking waste to landfill. Officers are taking appropriate action to understand and model the impact of the changes in the key factors affecting Council finances as well as exploring a variety of options to improve the value for money of its waste management arrangements.

Closing remarks

I have discussed and agreed this letter with the Chief Executive and the County Treasurer. I will present this letter at the Cabinet on 5 January 2012 and will provide copies to all board members.

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
IT risk assessment	August 2011
Annual Governance Report – Lancashire County Council	Sept 2011
Annual Governance Report – Lancashire County Pension Fund	Sept 2011
Treasury Management (Draft)	October 2011

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.

Clive Portman
District Auditor

November 2011

Appendix 1 – Fees

	Actual	Proposed	Variance
Main County Council audit	£246,669	£279,000	£32,331*
Lancashire County Pension Fund audit	£61,795	£61,795	£0
Non-audit work	0	0	0
Total	**£308,464**	**£340,795**	**£32,331**

* The variance between the planned an actual audit fee reflects the rebates issued to the Council from the Audit Commission to subsidise the one-off element of the cost of transition to international financial reporting standards and the reduction in VFM conclusion work.

Appendix 2 – 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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November 2011