

Annual governance report

Merseyside Fire and Rescue Authority

Audit 2010/11



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Key messages

This report summarises the findings from the 2010/11 audit which is substantially complete. It includes the messages arising from my audit of your financial statements and the results of the work I have undertaken to assess your arrangements to secure value for money in your use of resources.

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

Audit opinion and financial statements

- My audit of the financial statements is substantially complete although there are still some elements outstanding. The main matters outstanding are the completion of my testing of the Authority's property, plant and equipment and the net pension liabilities.
- At this stage I have not identified any material errors or uncertainties in the financial statements.
- As Members will be aware this is the first set of accounts prepared under International Financial Reporting Standards (IFRS). It is clear that officers managed the transition to IFRS effectively and my audit has not identified any material errors or uncertainties associated with the change.

- My audit has identified three non-material errors that are detailed in appendix 3. The Assistant Chief Executive and Treasurer has indicated that he does not intend to amend the accounts for these items on the grounds that they are not material. In the Letter of Representation, attached at appendix 5, we ask Members to confirm their agreement to the suggested approach.

Value for money

- I plan to issue an unqualified value for money conclusion confirming that the Authority has proper arrangements in place to secure economy, efficiency and effectiveness in its use of resources.
- The Authority continues to have effective financial planning processes. The medium term financial plan (MTFP) is soundly based and has clear links to underlying efficiency plans. In 2010/11 the Authority identified that significant savings were required and developed an effective strategy to deliver the savings.
- Looking ahead the Fire Authority faces a tough period as it makes further reductions in its budget. Meeting the challenges will require effective leadership and continued close control of costs.

Before I complete my audit

I confirm to you my independence and the scope of my audit work.

My report includes only matters of governance interest that have come to my attention in performing my audit. My audit is not designed to identify all matters that might be relevant to you.

Independence

I can confirm that I have complied with the Auditing Practices Board's ethical standards for auditors, including ES 1 (revised) – Integrity, Objectivity and Independence. I can also confirm there were no relationships resulting in a threat to independence, objectivity and integrity.

Audit Fees

My fee proposals were communicated to you in my Audit Plan for 2010/11. I can confirm that the Audit Commission's Audit Practice has not undertaken any non-audit work for the Authority during 2010/11. I reported to the Audit and Value for Money Scrutiny Panel on 10 March 2011 that I was satisfied that the audit fee was appropriate and no adjustment was required. At the time of drafting this report I do not yet have the final position on the total audit fees for 2010/11. When the total is available I will confirm the final fee in my Annual Audit Letter.

I ask you to confirm to me that you have agreed the letter of representation and approved the financial statements.

I ask the Authority to:

- take note of the adjustments to the financial statements which are set out in this report (appendix 2);
- confirm your agreement not to amend the accounts for immaterial uncorrected errors (appendix 3); and
- approve the letter of representation, provided alongside this report, on behalf of the Authority (appendix 5) before I issue my opinion and conclusion.

Financial statements

The financial statements were prepared by the deadline and contained only a small number of errors. Subject to satisfactory clearance of outstanding matters, I plan to issue an audit report including an unqualified opinion on the financial statements.

Opinion on the financial statements

My audit of your financial statements is largely complete although there are some issues that need to be resolved. The main issues outstanding are:

- assurance from the Merseyside Pension Fund auditor that the Pension Fund's investment valuation is not materially mis-stated;
- completion of my audit of the Authority's Property, Plant and Equipment; and
- final review of the amended accounts.

Subject to satisfactory clearance of outstanding matters, I plan to issue an audit report including an unqualified opinion on the financial statements. If any matters arise as a result of this work I will report this to you verbally at the Authority meeting on 27 September 2011. Appendix 1 contains a copy of my draft report.

In 2010/11 the Authority was required to prepare its financial statements using IFRS for the first time. The financial statements were submitted for audit in advance of the agreed timescale. The Authority's finance officers worked well with my audit team. As last year they responded promptly to audit queries and requests for additional information. The underlying working papers continue to develop. I have noted some areas for further improvement and shared these with finance officers.

Errors in the financial statements

I have not identified any material errors in the financial statements to draw to your attention. I am required to report all non-trivial errors and uncertainties identified during the audit. The draft accounts were of good quality but they did contain a small number of disclosure and presentational errors. The Assistant Chief Executive and Treasurer has agreed to adjust the notes to the financial statements for the amendments shown in appendix 2. The amendments reflect changes and improvements in the wording of the disclosure notes to ensure compliance with the Code of Practice on Local Authority Accounting in the United Kingdom. The changes do not affect the net Income and Expenditure figures or the Authority's reserves and balances.

Appendix 3 details three misstatements identified during the audit which the Assistant Chief Executive and Treasurer has indicated that he does not intend to amend the accounts on the grounds that the misstatements are not material. Officers propose to action the amendments during 2011/12.

Significant weaknesses in internal control

My audit has not identified any weakness in internal control that might result in a material error in your financial statements.

Financial statements

The Authority's financial statements and annual governance statement are important means by which the Authority accounts for its stewardship of public funds. As Authority members you have final responsibility for these statements. It is important that you consider my findings before you adopt the financial statements and the annual governance statement.

In planning my audit I identified specific risks and areas of judgement that I have considered as part of my audit.

Key audit risk and our findings

Key audit risk	Finding
<p>International Financial Reporting Standards</p> <p>The Authority was required to publish its 2010/11 accounts on the basis of new International Financial Reporting Standards (IFRS). The move to IFRS represented a major technical challenge for authorities. Good progress had been made by Merseyside Fire and Rescue Authority in preparing for IFRS, but this remained a risk area during 2010/11.</p>	<p>This is the first set of accounts that have been prepared under International Financial Reporting Standards and overall the transition arrangements were well managed. My team completed a review of the transitional balance sheet and tested the significant changes. The two main issues arising from the move to IFRS relate to:</p> <ul style="list-style-type: none">■ recognising the value of injury awards; and■ accruing for short term absences. <p><i>Injury Awards</i></p> <p>The 2010/11 accounts include the Authority's estimated liability for serving firefighters' injury benefit awards for the first time. In previous years injury benefit awards for firefighters' have been dealt with by the Actuary as past service costs. The introduction of IAS19 has changed that assumption, and the Actuary now values injury benefit awards as accrued as the firefighters' service is rendered. Using the Actuary's assessment the Authority has included £20.9m in its accounts at the 31 March 2011 as the value of the injury benefit liability in respect of serving firefighters.</p>

Key audit risk

Finding

I have reviewed the approach used to account for the valuation of injury benefit awards. I am satisfied that the Authority has taken a reasonable approach to accounting for injury benefit awards and I have not identified any issue. The Assistant Chief Executive and Treasurer has included an additional disclosure note in the accounts on the unpredictable nature of the timing of injury awards.

Employee Benefits accrual

The Authority is required to recognise in the accounts the expected costs of short-term employee benefits in the form of compensated absences. The Authority prepared a detailed spreadsheet to support the calculation of the accrual of £1.3m for accumulated absence in its accounts as at the 31 March 2011. Testing of the spreadsheet identified an error in the formula for calculating the public holiday element of the accrual. The formula applied the daily shift rate to the 'leave taken' column on the spreadsheet rather than the untaken leave balance.

The error in the spreadsheet understates the amount of the accrual by approximately £0.1m. Officers plan to review the spreadsheet to correct the accrual in 2011/12.

Pension Liability

The Authority's net pension liabilities of £826.8m comprise:

- unfunded liabilities under the Firefighters' Pension Scheme of £767m: and
- funded liabilities under the Local Government Scheme total £59.4m.

The Authority is an admitted body of the Merseyside Pension Fund. The Pension Fund is audited by a separate Audit Commission appointed auditor who provides a letter of assurance to the auditors of admitted bodies

The Authority has compiled its accounts using the actuarial certificates supplied by Mercers' for the Local Government Scheme and the Government Actuary's Department for the unfunded Firefighters Pension Scheme. I have completed a review of the disclosures in the accounts and I have not identified any discrepancies in the figures used.

As I reported earlier one of the most significant issues that still needs to be resolved is the completion of the necessary work to provide assurance about the value of the Authority's share of the assets and liabilities of Merseyside Pension Fund.

I am working closely with the auditor of Merseyside Pension Fund to obtain the required assurances and I will update members on the latest position at the meeting on 27th September 2011.

Key audit risk

Pension Fund

The accounting arrangements for the Pension Fund continue to be problematic because of their technical complexity. The IFRS Code requires several additional notes to the Pension Fund accounts.

Finding

My audit of the Firefighters' Pension Fund Account and Net Assets Statements has not identified any material matters arising. As part of my work on the restatement of the Authority's balance sheet under IFRS I identified that the accounts did not disclose an opening IFRS Net Assets Statement at 1 April 2009. The Authority has now amended the Pension Fund accounts to provide the additional disclosures.

Financial statements

Quality of your financial statements

In completing my audit I considered aspects of the Authority's accounting practices, accounting policies, accounting estimates and financial statements disclosures. The table below contains the issues I want to raise with you.

Accounting practices, policies, estimates and financial closures

Issue	Findings and recommendations
<p>Non Distributed Costs</p> <p>The Comprehensive Income and Expenditure Statement includes a figure of £90.292m as Non Distributed Costs income .The figure arises from a decrease in pension liabilities arising from the decision to use the Consumer Price Indices (CPI) rather than Retail Price Index (RPI) in the actuarial assessment.</p>	<p>Accounting for the negative past service gain is one of the most significant entries in the accounts this year. Whilst I acknowledge that the recording of the negative past service gain is not clear cut, I have agreed that the gain should be presented separately in the expenditure column in the Comprehensive Income and Expenditure Statement.</p>
<p>Fully Depreciated Assets</p> <p>The Authority has continued its accounting practice of writing out all fully depreciated assets which have a zero net book value as at the start of the financial year. In 2010/11 fully depreciated assets totalling £0.9m have been written out including £0.4m relating to operational vehicles. This accounting practice is not in accordance with IAS16 paragraph 61 which requires the useful economic life of an asset to be reviewed at the end of each accounting period to assess whether there has been a significant change.</p>	<p>Most of the assets that fall under this category are vehicles and equipment that are over 10 years old and have been correctly written out of the accounts as they are awaiting disposal or donation. However there are nine fully depreciated vehicles remaining on operational fire fighting duties that have also been written out.</p> <p>Accounting standards require the operational life of these vehicles to be re-assessed and the annual depreciation charge re-calculated. My estimate is that by changing the vehicle life from 10 to 11 years the depreciation charge shown in the accounts would reduce by only £10k. Therefore I am satisfied that the Authority has followed a reasonable approach in accounting for its fully depreciated assets and any change would not result in a material amendment to the accounts.</p>

Financial statements

Other significant matters relevant to the reporting process

There are no other matters I need to bring to your attention.

Letter of representation

Before I issue my opinion, auditing standards require me to ask you and management for written representations about your financial statements and governance arrangements. Appendix 5 contains the draft letter of representation.

I have provided the letter of representation as a separate word document as it is not included in this report.

Value for money

I am required to conclude whether the Authority put in place proper corporate arrangements for securing economy, efficiency and effectiveness in its use of resources. This is known as the value for money 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 conclusion on each of the two areas is set out below. I intend to issue an unqualified conclusion confirming that the Authority had proper arrangements to secure economy, efficiency and effectiveness in its use of resources. The Authority delivered significant efficiency savings in 2010/11, achieved its budget and recorded an additional increase in the general fund reserve of £2.1m. The outlook for 2011/12 and 2012/13 remains challenging, however the Authority has approved a savings plan of £8.8m to help it maintain its spending within budget.

Value for money criteria and our findings

Criterion	Findings
<p>1. Financial resilience</p> <p>The organisation has proper arrangements in place to secure financial resilience.</p> <p>Focus for 2010/11:</p> <p>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.</p>	<p>The Authority continues to have strong arrangements in place for financial planning. In 2010/11 the Authority set its budget in the context of a longer-term financial strategy and a medium-term financial plan (MTFP) covering a five-year period. Following the announcement of government grant reductions of 13 per cent over two years the Authority amended the MTFP to take account of changes in assumptions on grant funding, inflation and capital expenditure. The Authority developed its strategy to maximise savings in 2010/11 to contribute towards a plan of building up reserves to meet the future financial challenge and avoid compulsory redundancies if possible.</p> <p>The Authority is slightly ahead of schedule in delivering its savings plan. In 2010/11 the Authority achieved additional savings of £3.4m which allowed it to increase reserves in accordance with the financial strategy. This was a significant achievement and confirmed that the Authority has a proven track record of identifying and delivering savings.</p>

Criterion	Findings
	<p>The Authority also reported a £2.1m increase in general fund balances due to a range of savings in revenue expenditure budgets and the capitalisation of Home Fire Safety Checks without an equivalent revenue contribution. As I reported to members last year, my view is that the Authority should continue to ensure that any borrowing to fund the capitalisation of smoke alarm installations remains part of a prudent medium term financial plan.</p> <p>Financial Planning arrangements have been strengthened for 2011/12. The updated MTFP now covers the four-year period, 2011/12 to 2015/16. Work is being undertaken to address the 2011/12 savings target and it is clear that the Authority is monitoring its financial position closely.</p>
<p>2. Securing economy efficiency and effectiveness The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.</p> <p>Focus for 2010/11:</p> <p>The organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.</p>	<p>During 2010/11 the Authority updated its Medium Term Financial plan following the comprehensive spending review and it now has a clear framework in place for prioritising resources and reviewing its strategic priorities for the next two years. In 2010/11 the key priority was achieving efficiency savings and boosting reserves.</p> <p>The Authority has continued to strengthen the integration of its financial and operational planning processes. While the achievement of £4.6m savings in-year was a result of a well managed focus on finances, the Authority also delivered on a number of key operational targets. In line with the requirements of the standards of fire cover, the Authority successfully met its target of 90 per cent for the 1st appliances attending a high risk fire within 5 minutes and the 2nd within 10 minutes. It has also demonstrated improvements in areas such as the number of accidental fires in the home and the number of fatalities from accidental fires in the home.</p> <p>Challenges remain for 2011/12. The Authority faces a tough period as it makes further reductions in its budget. Meeting the challenges will require effective leadership and continued close control of costs. The Authority needs to continue to ensure that budget monitoring arrangements remain effective to ensure that the savings targets are delivered.</p>

Report by exception

The Audit Commission requires me to report by exception where significant matters come to my attention, which I consider to be relevant to proper arrangements to secure economy, efficiency and effectiveness in your use of resources. I have not identified any such exceptions relating to 2010/11.

Appendix 1 – Draft audit report

My audit report is available as a separate word document.

Appendix 2 – Amendments to the draft financial statements

I identified the following misstatements during my audit and management have adjusted the financial statements. I bring them to your attention to aid you in fulfilling your governance responsibilities.

		Comprehensive income and expenditure statement		Balance sheet	
Adjusted misstatement	Nature of adjustment	Dr £000s	Cr £000s	Dr £000s	Cr £000s
Accounting policies	Inclusion of amended policy on <ul style="list-style-type: none"> ■ Termination benefits charged to CIES. ■ Injury awards accounting policy. ■ Componentisation threshold. ■ Disclosure of the range of asset lives. ■ Employee benefit prepayments netted off the accrual. 				
Comprehensive Income and Expenditure Statement	Improved presentation of the negative past service gain.				

**Comprehensive income and
expenditure statement**

Balance sheet

Note 4 – Other sources of estimation uncertainty	Amended wording on pension liabilities.				
Note 15 – Financial instruments	Inclusion of analysis of long term and short term leases. Addition of the fair value of the MRD debt Amended wording on the fair value of liabilities. Inclusion of amounts for short term debtors and creditors.				
Note 36 – Related Party Transactions	Inclusion of analysis of precept payments and superannuation contributions.				
Note 37 – Capital financing Requirement	Inclusion of movements in the financing requirement.				
Note 46 – Nature and Extent of Risks Arising from Financial Instruments	Inclusion of a maturity analysis for the Merseyside Residual Debt. Inclusion of wider bands for PWLB debt.				
Pension Fund	Addition of an opening IFRS Net Assets Statement at 1 April 2009 in line with IFRS 1				

Appendix 3 – Unadjusted misstatements to the financial statements

I identified the following misstatements during my audit, but management has not adjusted the financial statements. I bring them to your attention to help you in fulfilling your governance responsibilities and ask you to correct these misstatements. If you decide not to amend, please tell me why in the representation letter. If you believe the effect of the uncorrected errors, individually and collectively, is immaterial, please reflect this in the representation letter. Please attach a schedule of the uncorrected errors to the representation letter.

Unadjusted misstatement	Nature of required adjustment	Comprehensive income and expenditure statement		Balance sheet	
		Dr £000s	Cr £000s	Dr £000s	Cr £000s
Correction of the error in the holiday pay accrual spreadsheet.	The correction increases the amount of the accrual by approximately £0.1m	100			100
Fully depreciated assets are written out of they accounts. The policy does not account for vehicles that remain on operational use.	Re-assessing the asset life from 10 to 11 years would result in a £10k decrease to the depreciation charge.		10	10	

Comprehensive income and expenditure statement

Balance sheet

<p>Revaluation Reserve – the adjustment to the revaluation reserve for fire stations included in the PFI scheme is based on the combined valuation of land and buildings and not just the separate increase in value of the buildings. The land is not depreciated and will remain after demolition of the buildings.</p>	<p>Adjustment to the revaluation reserve is overstated, and the corresponding debit to CAA understated. The PFI unitary charge due in 2013 is not disclosed in note 39.</p>	126	126
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Appendix 4 – Glossary

Annual governance statement

A statement of internal control prepared by an audited body and published with the financial statements.

Audit closure certificate

A certificate that I have completed the audit following statutory requirements. This marks the point when I have completed my responsibilities for the audit of the period covered by the financial statements.

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.

Materiality and significance

The Auditing Practices Board (APB) defines this concept as ‘an expression of the relative significance or importance of a particular matter for the financial statements as a whole. A matter is material if its omission would reasonably influence users of the financial statements, such as the addressees of the auditor’s report; also a misstatement is material if it would have a similar influence. Materiality may also be considered for any individual primary statement within the financial statements or of individual items included in them. We cannot define materiality mathematically, as it has both numerical and non-numerical aspects’.

The term ‘materiality’ applies only to the financial statements. Auditors appointed by the Commission have responsibilities and duties under statute, as well as their responsibility to give an opinion on the financial statements, which do not necessarily affect their opinion on the financial statements.

'Significance' applies to these wider responsibilities and auditors adopt a level of significance that may differ from the materiality level applied to their audit in relation to the financial statements. Significance has both qualitative and quantitative aspects.

Weaknesses in internal control

A weakness in internal control exists when:

- a control is designed, set up or used in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements quickly; or
- a control necessary to prevent, or detect and correct, misstatements in the financial statements quickly is missing.

An important weakness in internal control is a weakness, or a combination of weaknesses that, in my professional judgement, are important enough that I should report them to you.

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.

The Code of Audit Practice defines proper arrangements as corporate performance management and financial management arrangements that form a key part of the system of internal control. These comprise the arrangements for:

- planning finances effectively to deliver strategic priorities and secure sound financial health;
- having a sound understanding of costs and performance and achieving efficiencies in activities;
- reliable and timely financial reporting that meets the needs of internal users, stakeholders and local people;
- commissioning and buying quality services and supplies that are tailored to local needs and deliver sustainable outcomes and value for money;
- producing relevant and reliable data and information to support decision making and manage performance;
- promoting and displaying the principles and values of good governance;
- managing risks and maintaining a sound system of internal control;
- making effective use of natural resources;
- managing assets effectively to help deliver strategic priorities and service needs; and
- planning, organising and developing the workforce effectively to support the achievement of strategic priorities.

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.

Appendix 5 – Letter of Representation

The draft letter of representation is available as a separate word document.

If you require a copy of this document in an alternative format or in a language other than English, please call:
0844 798 7070

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