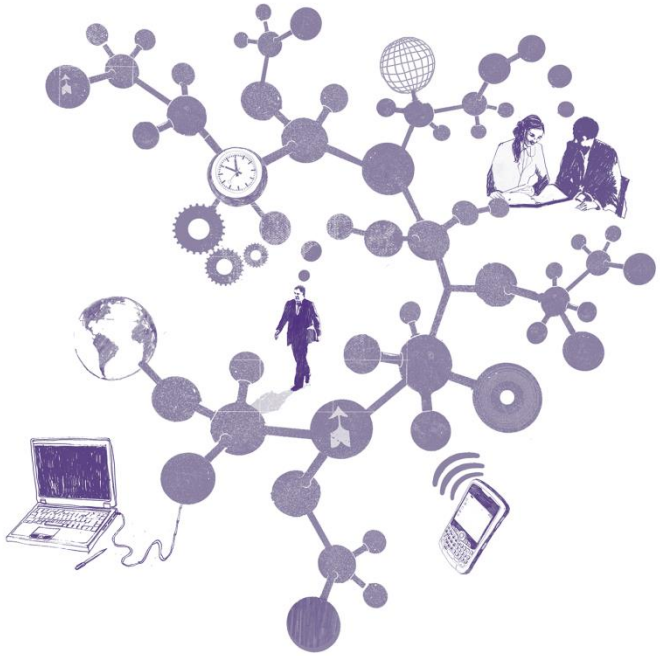
The Annual Audit Letter for Merseyside Fire and Rescue Authority

Year ended 31 March 2016

October 2016



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Executive summary

Purpose of this letter

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at Merseyside Fire and Rescue Authority (the Authority) for the year ended 31 March 2016.

This Letter is intended to provide a commentary on the results of our work to the Authority and its external stakeholders, and to highlight issues that we wish to draw to the attention of the public. In preparing this letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice (the Code) and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'.

We reported the detailed findings from our audit work to the Authority's Policy and Resources Committee as those charged with governance in our Audit Findings Report on 28th July 2016.

Our responsibilities

We have carried out our audit in accordance with the NAO's Code of Audit Practice, which reflects the requirements of the Local Audit and Accountability Act 2014 (the Act). Our key responsibilities are to:

- give an opinion on the Authority's financial statements (section two); and
- assess the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources (the value for money conclusion) (section three).

In our audit of the Authority's financial statements, we comply with International Standards on Auditing (UK and Ireland) (ISAs) and other guidance issued by the NAO.

Our work

Financial statements opinion

We gave an unqualified opinion on the Authority's financial statements on 29th July 2016. Due to the excellent engagement between the finance and audit teams, the on-site work was delivered in a shorter timescale this year. In previous years we have issued our opinion in September. The accounts were prepared to a good standard and we did not identify any adjustments to the reported financial position.

Value for money conclusion

We were satisfied that the Authority put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources during the year ended 31 March 2016. We reflected this in our audit report issued on 29th July 2016.

Whole of government accounts

We completed work on the Authority's consolidation return following guidance issued by the NAO and submitted our Assurance Statement on 24th August 2016.

Certificate

We certified that we had completed the audit of the accounts Merseyside Fire and Rescue Authority in accordance with the requirements of the Code on 24th August 2016.

Other statutory powers and duties

We have not identified any issues that have required us to apply our statutory powers and duties under the Act.

Looking Forward

Working with Merseyside Fire and Rescue Authority

We would like to record our appreciation for the assistance and co-operation provided to us during our audit by the Authority's staff. We reported in our Audit Findings Report that:

- The financial statements submitted for audit were, yet again, of good quality, delivered by an effective closedown process and supported by excellent working papers.
- Of particular note was the speed and efficiency that queries were responded to by Authority staff across all departments.
- We did not identify any material adjustments affecting the Authority's reported financial position. Both the draft and audited financial statements record net expenditure on the provision of services as £34.945million.
- We did identify a relatively small number of disclosure errors to improve the presentation of the financial statements.

Due to the excellent engagement between the finance and audit teams, the on-site work was delivered in a shorter timescale with an opinion being issued in July 2016. In previous years we have issued our opinion in September. This places the Authority is an excellent position to meet the reduced timescales for delivery of the audit which will impact in 2017/18.

The Authority's accounts show a strong financial position going forward, due to:

- Appropriate levels of reserves, specifically usable reserves, with an upward movement in Earmarked Reserves. The Authority's reserves are not used to subsidise the day to day transactions of the Authority.
- A reduced level of long-term borrowing, which is at its lowest level for five years.

The changing landscape

The fire sector is continues to face a period of unprecedented change. Merseyside Fire and Rescue Authority has demonstrated that it fully supports service wide transformation and has already achieved significant savings following reductions in central government funding of approximately £25 million over the Comprehensive Spending Review (CSR) period 2011/12 to 2015/16.

Funding reductions of this scale impact on both service support and service delivery functions and have required more challenging and innovative approaches to support the delivery of internal and external community facing services. Service transformation has been achieved at the same time as delivering against the Service's priorities and outcomes, set out in the Integrated Risk Management Plan (IRMP). In response to the scale of the financial challenge, the Authority has continued to develop its programme of fire station mergers. The implementation of the fire station merger strategy will take shape over the next two years.

The Authority continues to recognise the importance of the first appliance attending a life risk incident as quickly as possible. The target is to attend within 10 minutes on 90% of occasions. Operational crews have met and exceeded this target steadily each month with a cumulative 96.2% achievement to date.

Looking forward over the next four years (2016/17 to 2019/20), the Authority is expecting further reductions in core funding of approximately £11 million. The Fire Service will continue to explore different approaches to achieve efficiencies to offset these funding reductions by focusing on collaboration and taking a considered view on the options for change in response to the IRMP.

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Audit of the accounts

Our audit approach

Materiality

In our audit of the Authority's accounts, we used the concept of materiality to determine the nature, timing and extent of our work, and in evaluating the results of our work. We defined materiality as the size of the misstatement in the financial statements that would lead a reasonably knowledgeable person to change or influence their economic decisions.

We determined materiality for our audit of the Authority's accounts to be £1,347,000, which is 2% of the Authority's gross revenue expenditure. We used this benchmark, as in our view, users of the Authority's accounts are most interested in how it has spent the income it has raised from taxation and grants during the year.

We also set a lower level of specific materiality for certain areas such as senior officer and auditors remuneration. This is due to the public interest in these disclosures and the statutory requirement for them to be made.

We set a lower threshold of £68,000, above which we reported errors to the Authority in our Audit Findings Report.

The scope of our audit

Our audit involved obtaining sufficient evidence about the amounts and disclosures in the financial statements to give reasonable assurance that they are free from material misstatement, whether caused by fraud or error.

This included assessing whether:

- the Authority's accounting policies were appropriate, had been consistently applied and adequately disclosed;
- significant accounting estimates made by management were reasonable; and
- the overall presentation of the financial statements gave a true and fair view.

We also read the narrative report and annual governance statement to check they were consistent with our understanding of the Authority and with the accounts on which we gave our opinion.

We carried out our audit in line with the ISAs (UK and Ireland) and the NAO Code of Audit Practice. We believe the audit evidence we obtained was sufficient and appropriate to provide a basis for our opinion.

Our audit approach was based on a thorough understanding of the Authority's business and is risk based.

We identified key risks and set out overleaf the work we performed in response to these risks and the results of this work.

Audit of the accounts of Merseyside Fire and Rescue Authority

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk
The revenue cycle includes fraudulent transactions Under ISA (UK&I) 240 there is a presumed risk that revenue may be misstated due to the improper recognition of revenue.	Having considered the risk factors set out in ISA240 and the nature of the revenue streams at Merseyside Fire and Rescue Authority we have determined that the risk of fraud arising from revenue recognition could be rebutted because: • there is little incentive to manipulate revenue recognition; • opportunities to manipulate revenue recognition are very limited; and • the culture and ethical frameworks of Authorities including Merseyside Fire and Rescue Authority, means that all forms of fraud are seen as unacceptable. **Our audit work did not identify any issues in respect of revenue recognition within the financial statements.**
Management over-ride of controls Under ISA (UK&I) 240 it is presumed that the risk of management over-ride of controls is present in all entities. .	As part of our audit work we have : • reviewed the journal control environment and not identified any significant control weaknesses; • tested key journal entries and not found any items which impacted on our opinion; • reviewed the accounting estimates, judgements and decisions made by management; and • reviewed any unusual, significant transactions and not identified anything which would impact on our opinion. **Our audit work did not identify any evidence of management over-riding controls. In particular, the findings of our review of journal controls and testing of journal entries did not identify any significant issues.**
Valuation of pension fund net liability The Authority's pension fund asset and liability, as reflected in its balance sheet, represents a significant estimate in the accounts. The values of the pension fund net liability is estimated by specialist actuaries.	As part of our audit work we have: • documented and walked through the key controls put in place by the Authority to ensure they were designed as expected; • reviewed whether the experts used by the Authority were sufficiently knowledgeable and independent for us to rely on their work. Gained an understanding of the basis on which the IAS 19 valuation was carried out, undertaking procedures to confirm the reasonableness of the actuarial assumptions made; and • agreed receipt of the top-up grant receivable from DCLG to meet the pension fund liability. • reviewed the consistency of the pension fund asset and liability disclosures in the notes to the financial statements and found them to be consistent with the actuarial report. **Our audit work did not identify any issues in respect of the pensions liability.**

Audit of the accounts of Merseyside Fire and Rescue Authority

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk
Valuation of property plant and equipment The Authority revalues its assets with a full valuation every fifth year. The valuation of such assets involves a degree of estimation uncertainty given the need to make assumptions and use significant judgements.	As part of our audit work we have: • reviewed management's processes and assumptions for the calculation of the valuation. • reviewed the competence, expertise and objectivity of the Valuer used by management. • reviewed the instructions issued to the valuation experts and the scope of their work. • discussed the basis on which the valuation was carried out, and challenged the key assumptions. • tested the revaluations made to ensure they were input correctly into the asset register. • evaluated the assumptions made by management for those assets not revalued during the year and how management satisfied themselves that these were not materially different to current value. **Our review of the valuation of property, plant and equipment has not highlighted any issues which we wish to bring to your attention.**
Operating expenses Creditors understated or not recorded in the correct period (Operating expenses understated)	As part of our audit work we have: • documented and walked through the key controls over the operating expenses transaction cycle to ensure they were designed and operating as expected. • tested the reconciliation of operating expenditure recorded in the general ledger. • tested payments made after the year-end to identify potential unrecorded liabilities and gain assurance over the completeness of the payables balance in the accounts. • substantively tested operating expenses including sample testing of expenditure, year end accruals and creditor balances. **We did not identify any issues to report from our testing of operating expenses.**

Audit of the accounts of Merseyside Fire and Rescue Authority

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk
Employee remuneration Employee remuneration accruals understated (Remuneration expenses not correct)	As part of our audit work we have: • documented and walked through the key controls put in place to ensure they were designed and operating as expected. • substantively tested a sample of staff and officer payroll payments, ensuring that payments are made in accordance with the individual's contract of employment. • tested the reconciliation of payroll expenditure recorded in the general ledger. • analysed trends to identify any anomalous areas for further investigation. • tested to confirm the completeness of payroll transactions and appropriate cut-off. **Our review and testing of employee remuneration did not identify any issues to report. We confirmed that the pay costs for our random sample agreed with the employee's payslip and contract documentation.**
Fire Service Pensions Benefits Payable Benefits improperly computed / Claims liability understated	As part of our audit work we have: • documented and walked through the key controls over the pensions benefits payments transaction cycle to ensure they were designed and operating as expected. • tested the reconciliation of pension benefit payments recorded in the general ledger. • analysed trends and relationships to identify any anomalous areas for further investigation. • substantively tested commutation and monthly pension benefit payments made in the year. **We did not identify any issues to report from our testing of pension payments. Our audit work confirmed that the pension benefits paid agreed with the supporting documentation.**

Audit of the accounts

Audit opinion

We gave an unqualified opinion on the Authority's accounts on 29th July 2016, in advance of the 30 September 2016 national deadline.

The Authority made the accounts available for audit in line with the agreed timetable, and provided a good set of working papers to support them. The Finance Team responded promptly and efficiently to our queries during the course of the audit. We worked with colleagues from the Finance Team to smooth audit delivery this year by bringing forward some of our detailed testing to the pre-year end period and providing earlier in the year the details of the ledger reports and data downloads required for the audit.

Issues arising from the audit of the accounts

We reported the key issues from our audit of the accounts of the Authority to the Policy and Resources Committee on 28th July 2016 . We did not identify any issues that required amendments to the main financial statements. We did identify a relatively small number of changes to the supporting notes to improve presentation and consistency within the notes to the accounts.

Annual Governance Statement and Narrative Report

We are also required to review the Authority's Annual Governance Statement and Narrative Report. The Authority published them on its website with the draft accounts in line with the national deadlines.

Both documents were prepared in line with the relevant guidance and were consistent with the supporting evidence provided by and with our knowledge of the Authority.

Other statutory duties

We also have additional powers and duties under the Act, including powers to issue a public interest report, make written recommendations, apply to the Court for a declaration that an item of account is contrary to law, and to give electors the opportunity to raise questions about the Authority's accounts and to raise objections received in relation to the accounts.

We were not required to invoke our additional powers and duties during the completion of this audit.

Value for Money

Background

We carried out our review in accordance with the NAO Code of Audit Practice (the Code), following the guidance issued by the NAO in November 2015 which specified the criterion for auditors to evaluate:

In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.

Key findings

The key risks we identified and the work we performed are set out in the table on pages 11 and 12. Our main considerations in arriving at our value for money conclusion were:

- the Authority's medium tern financial position and future projected savings efficiency requirements; and
- the collaborative developments and link to future strategies.

We reviewed relevant documents up to the date of giving our report, and did not identify any significant risks where we needed to perform further work. The Authority has general fund balances of £2 million and earmarked reserves of £26.2 million as at 31 March 2016. which appear adequate at the present time.

The Authority set a balanced budget for 2016/17 which forms the first year of the Medium Term Financial Strategy (MTFS) for the 4 year period to 2019/20. The MTFS currently anticipates further savings and efficiency requirement of £11million over the MTFS period.

The Authority continues to respond effectively to meeting the challenges of on-going reductions in central government funding. The Chief Fire Officer has maintained a focus on maintaining operational performance and is continuing to work with officers from Merseyside Police Service to identify to identify areas for collaboration and savings.

Overall VfM conclusion

We are satisfied that in all significant respects the Authority put in place proper arrangements to secure economy, efficiency and effectiveness in the use of resources for the year ending 31 March 2016.

Value for Money

Risk identified	Work carried out	Findings and conclusions
Overall vision for the Service The Authority has made significant progress in developing its Fire Station Merger Strategy. This is projected to deliver a reduction of 86 whole-time equivalent (WTE) posts, reduce the Authority asset base down from 26 stations to 22 and deliver additional savings from a reduction in premises overheads. Following the provisional LG finance settlement it is inevitable that the Authority will need to make further changes to the number of stations or the way in which fire engines are crewed. The Authority will need to take a considered view and evaluate the change in response times arising from the options. The risk is that the merger strategy may not deliver the performance outcomes required due to delays in the planning process.	We reviewed the Authority's progress in updating its fire station merger strategy. We also enquired from key officers the delivery of the merger strategy against plans. The work included a review as to whether the IRMP needs to be developed further to take into account the financial challenges and the progress in developing the Fire Station Merger Strategy	A key consideration for the Authority has been the move to merge fire stations which is designed to deliver savings and provide resilience to the service. The merger strategy along with the operational plans form a key part of the IRMP. Significant progress has been achieved with the closure of Allerton Fire Station and the construction of a Fire and Police Station on the Prescot Business Park. Discussions are continuing with the merger of St. Helens and Eccleston Fire Stations on a new site on Canal Street. Progress on the site at Saughall Massie on the Wirral has stalled as the scheme cannot proceed to planning application without an ecological survey. The Authority also undertakes a detailed analysis of external drivers via its financial modelling economic and political considerations. The analysis highlights the potential impact on the Authority of various identified changes and the action the Authority has already taken in response to these identified issues. There is evidence of sensitivity analysis on projections. The Authority has not planned further than 4 years ahead financially as there is such uncertainty around grant funding**.** An update report was taken to the Authority in December 2015 provided a high level briefing on the discussions around the merger programme. Once projects receive planning approval the update reports could be developed further to contain information on milestone achievements and their financial impact. The Authority's Service Delivery plan sets out the key plans and efficiencies intended for the Authority and is supported by the IRMP supplement for 2015 - 17. Performance reports show a decrease in the number of deaths and serious injuries from Road Traffic Collisions (RTCs) and the number of injuries and deaths from fire compared with 2014/15. The Service continues to work closely with its partners in relation to RTC's and its prevention activity is continuing to have an impact on the key deliverable of the decreasing the number of deaths, injuries, accidental dwelling fires and deliberate fires. **On that basis we concluded that the risk was sufficiently mitigated and the Authority has proper arrangements in place.**

Value for Money

Risk identified	Work carried out	Findings and conclusions
Financial health - arrangements to secure financial balance The Authority has historically managed its finances well, achieving financial targets and is on course to deliver its 2015/16 budget. Nevertheless the scale and pace of change for the Fire Service will effect future projections, particularly following announcements from the Comprehensive Spending Review, Autumn Statement 2015 and then more recently the provisional Local Government Finance Settlement 2016/17 published in December 2015. The Authority has approved a 4 year plan from 2016/17 to achieve savings of £11m by 2019/20. The savings are to be achieved from variety of factors including new ways of working and the retirement profile of uniformed employees. However actual spending in this period will be under pressure as costs increase.	We reviewed the Authority's progress in updating its financial position and forward strategy. We also review the arrangements for putting together and agreeing the medium term financial plans and the identification of savings plans. The work included a review of the finance reports to the Authority, review of the out-turn position for 15/16 and the financial plans going forward for 2016/17.	The Authority has a detailed medium-term financial strategy which sets out expected changes in income and expenditure over the period to 2019/20. The MTFP allows the Authority to model future expenditure budgets by varying assumptions about staff and officer pay inflation, non-pay inflation and other key factors. We have reviewed the expenditure assumptions in the latest version of the financial strategy. In our view the assumptions in respect of pay and non-pay inflation are reasonable and broadly in line with those used by other similar organisations. The budget assumptions applied in the forecast includes sensible expectations that pay and non pay inflation will increase and that grant funding as a whole is likely to go down; which is consistent with those used by other fire bodies. The sensitivity analysis detailed in the MTFP considers the main sources of funds grant and precept income and pay and price rises. The Authority has a proven track record for meeting significant financial challenges in the past. The Authority has delivered over £19m of savings in the last three financial years but the financial challenges remain. In the period from 2016/17 to 2019/20 the target for efficiency savings is £11m. The MTFP shows that in 2016/17 the budget gap is met by the use of reserves and efficiency savings of £1.1m. Subsequent years 2017/18 to 2019/20 show savings of £8.3m are required. At around 14%, the level of savings being targeted by 2019/20 appears challenging and will require a long term solution. This may mean further remodelling of the budget and savings profile be required to deliver the savings set out above from 2017/18 onwards. While it is clear that the Authority faces a financial challenge, the overall approach of balancing a long-term, strategic cost saving programme with a planned use of available reserves to support the budget position and invest in the capital schemes is reasonable. There is a risk that, as the operational response changes are completed, the anticipated benefits may vary from that envisaged in medium term financial strategy. Linked to this the options will be fully evaluated over the coming months and officers will consult with the public on the response options as part of the IRMP 2017/20 pre-planning. **On that basis we concluded that the risk was sufficiently mitigated and the Authority has proper arrangements in place.**

Working with Merseyside Fire and Rescue Authority

Our work with you in 2015/16

We are really pleased to have worked with you over the past year. We have established a positive and constructive relationship. Working together, we have contributed to:

An efficient audit – we delivered the accounts audit by the 29 July 2016, in advance of the 30 September deadline and in line with the timescale we agreed with you. Our audit team are knowledgeable and experienced in your financial accounts and systems. Our relationship with your team provides you with a financial statements audit that continues to finish ahead of schedule releasing your finance team for other important work. We will continue to work with you to identify further efficiencies in the process to ensure a continued, smooth audit delivery.

Improved financial processes – during the year we reviewed your financial systems and processes including employee remuneration, non-pay expenditure and Fire Service pensions payments.

Understanding your operational health – through the value for money conclusion we examined your operational effectiveness. We tracked your financial budget position, medium term planning arrangements and strategic partnership working and considered this as part of our value for money assessment.

Sharing our insight – we provided independent external audit commentary and insight in your key issues through senior attendance at every Audit Committee. We have also shared with you our insights on various accounting issues including earlier closure timetables.

Technical dialogue – we have been involved in early discussions on a number of developments to ensure that appropriate accounting and audit implications are identified

Provided information - we provided regular audit committee updates covering best practice. Areas we covered included e.g. 'Advancing closure – Transforming the financial reporting of local authority accounts '

Supporting development – we provided workshops for senior finance officers on accounting changes. We also attended your budget strategy events to see first-hand how you were working with other organisations to create ideas for budget savings that would improve value for money and impact positively in your performance.

We are looking forward to working with you next year and will continue to support you. Locally, our focus will be on:

- An efficient audit – continuing to deliver an efficient audit
- Improved financial processes – we will challenge our approach to ensure that as much work is brought forward as possible to support faster close
- Understanding your operational health – we will focus our value for money conclusion work on challenges from new models of working
- Supporting development – we will be in discussion with you on providing access to our CEO Room to provide space and support for your Chief Fire Officer as he works more strategically as part of the Liverpool City Region.

Appendix A: Reports issued and fees

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

Fees

	Planned £	Actual fees £	2014/15 fees £
Statutory audit of Fire and Rescue Authority	32,424	32,424	43,232
Total fees (excluding VAT)	**32,424**	**32,424**	**43,232**

Fees for other services

Service	Fees £
Audit related services	**0**
Non-audit services	**0**

Reports issued

Report	Date issued
Audit Plan	July 2016
Audit Findings Report	July 2016
Annual Audit Letter	October 2016



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