

Annual governance report

Cheshire Fire 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 the Authority's financial statements and the results of the work I have undertaken to assess its arrangements to secure value for money in its use of resources.

Audit element	Our findings
Audit opinion	Unqualified
Arrangements to secure value for money	In place

Audit opinion and financial statements

The Authority has maintained the high quality of its financial statements and coped well with the challenge of implementing International Financial Reporting Standards (IFRS). The most significant change to the financial statements arose from the issue of new guidance in August 2011 on the treatment of estimated future liabilities for Firefighters' injury awards. This had the effect of transferring £15.7m of expenditure from 2010/11 into the restated expenditure and liabilities of previous years. The draft statements have also been amended to include further disclosures, of which an exceptional item and segmental information are the most significant. The cash flow statement was amended after the statements were presented to Members but before audit. I am seeking specific representations in relation to the Authority's accounting treatment of New Dimension Assets.

Value for money

Financial resilience

The Authority achieved a surplus of £0.86m in 2010/11, enabling it to further strengthen its healthy level of usable reserves. The Authority's strategy, 'Planning for a safer Cheshire 2011-2015', sets out how the Authority plans to secure a stable financial position over the next four years. This is soundly based, although with increased uncertainty in the last two years.

Securing economy and efficiency

The Authority's financial plan includes £4.8m of efficiencies and savings over the next four years. The Authority's strategy outlines how it intends to achieve these savings whilst maintaining service standards. Whilst plans are in place to achieve £1.9m of savings in 2011/12, most of the planned efficiencies in the last two years are to be realised by changing working arrangements at some fire stations. This will be challenging to deliver. In addition, a three-year programme of value for money reviews has begun.

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.

The Audit Commission's Audit Practice has not undertaken any non-audit work for the Authority during 2010/11.

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

I ask the Authority to:

- take note of the adjustments to the financial statements which are set out in this report; and
 - approve the letter of representation, provided alongside this report, before I issue my opinion and value for money conclusion.
-

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.

Opinion on the financial statements

Subject to satisfactory clearance of outstanding matters I plan to issue an audit report including an unqualified opinion on the financial statements.

I have still to complete the following audit procedures:

- checking the amended financial statements; and
- reviewing the Annual Report for consistency with the financial statements.

If any matters arise as a result of this work I will report this to you verbally at the Authority meeting. A copy of my draft report is provided alongside this report.

Errors in the financial statements

The Authority has maintained the high quality of its financial statements and coped well with the challenge of implementing IFRS. The most significant change to the financial statements arose from the issue of new guidance in August 2011 on the treatment of estimated future liabilities for Firefighters' injury awards. These costs had been included in the 2010/11 actuarial valuation but not in those provided for previous years. Correcting this had the effect of transferring much of the additional cost out of 2010/11 into previous years. In particular, the restated 2009/10 pension liability has increased by £15.7m and 2010/11 total expenditure has reduced by the same amount, with most of the change reflected in the actuarial gain or loss. These changes do not affect the General Fund. The draft statements have also been amended to include further disclosures, of which showing the impact on the pensions liability of the change from RPI to CPI for future pension increases as an exceptional item and providing additional segmental information are the most significant. The cash flow statement was amended after the statements were presented to Members but before audit. Management have amended the financial statements for all non-trivial errors that I have identified.

Financial statements

Audit risks

In planning my audit I identified three main risks that I intended to consider as part of my audit. I reported these to you in April 2011 in my Audit Plan. I set out my findings below.

Key audit risk and my findings

Key audit risk	Finding
<p>1. International Financial Reporting Standards</p> <p>The 2010/11 financial statements of all organisations that are governed by the Statement of Recommended Practice are to be prepared under IFRS, for the first time.</p>	<p>The Authority has prepared its financial statements for the first time in accordance with IFRS. The Authority has maintained the high quality of its financial statements and coped well with the challenge of implementing IFRS. Some amendments and further disclosures have been included following the audit. As discussed above, the most significant change to the financial statements arose from the issue of new guidance in August 2011 on the treatment of estimated future liabilities for Firefighters' injury awards. The Authority's actuary provided the additional information needed to enable the financial statements to be amended. In addition, the segmental reporting note has been expanded to include an analysis of expenditure by type (eg payroll) and analyses provided of all balance sheet notes as at 1 April 2009.</p>
<p>2. Revaluation of the Headquarters building</p> <p>The extension to the Authority's Headquarters building was completed during 2010/11. The land and buildings require revaluation and this is likely to result in a material impairment.</p>	<p>The Authority arranged for an independent professional valuation of its Headquarters site as at 31 March 2011. The revaluation identified an impairment of £2.146m, which has been reflected in the financial statements. As part of this process, the Authority has identified that the site contains three significant components; the original office area, the new extension and the workshop and associated offices. However, it has concluded that these components have the same asset lives. The Headquarters building is the only asset that is valued above the £2m that the Authority has set as material for considering component accounting. Looking more widely, in my view the Authority should consider refining its accounting policy in future to consider whether its Fire stations as a group may contain significant components, such as doors and roofs.</p>

Key audit risk

3. Payroll system controls

In previous years some of the controls in the payroll system were not operating effectively.

Finding

The Authority has strengthened its control framework during 2010/11 and I was able to rely on the operation of the new controls during the period November 2010 to March 2011. This work identified areas where the Authority can make further improvements to its control framework, particularly around properly evidencing decisions on payroll changes and payroll checks. Payroll controls are included in the areas for improvement in the Annual Governance Statement.

Quality of the financial statements

As part of my audit, I consider aspects of your accounting practices, accounting policies, accounting estimates and financial statements disclosures.

As I have previously stated, the quality of the Authority's financial statements is of a high standard. Within this context, I wish to draw Members' attention to the fact that the cash flow statement presented to the Closure of Accounts Committee on 29 June 2011 was amended by management prior to being provided for audit following a review of the presentation of the statement.

I set out below two areas of the Authority's accounting practices and disclosures that I considered during the course of my audit and how I have resolved them with management.

Accounting practices, policies, estimates and financial disclosures

Issue

1. New Dimension Assets

New Dimension Assets are specialist equipment owned by the Department for Communities and Local Government (DCLG) but located at fire authorities and available to them for the delivery of services. DCLG is seeking to transfer ownership of these assets to authorities, but a transfer to the Authority has yet to take place. The Authority has not recognised these assets on its balance sheet. In my view it should do so if it will benefit from their future service potential.

Findings and recommendations

I have accepted the Authority's accounting treatment because there is uncertainty over when the Authority will reach agreement with DCLG to take ownership of the assets located on its premises. Before I issue my opinion, auditing standards require me to ask you and management for written representations about your financial statements and governance arrangements. I have therefore requested specific representations on this issue in the Letter of Representation. I have asked the Authority to confirm that it has not yet agreed with DCLG to take ownership of the assets and the reasons why, that it will be required to return them if it does not do so and that the Authority's future plans for service delivery are not dependent on the availability of these assets.

Issue

2. Change from RPI to CPI for pensions increases

In the UK budget statement on 22 June 2010 the Chancellor announced that with effect from 1 April 2011 public service pensions would be up-rated in line with the Consumer Prices Index (CPI) rather than the Retail Prices Index (RPI). As a consequence of this change, the 2010/11 actuarial pensions liability has reduced by £42.11m. The Authority had correctly included this within non-distributed costs on the Comprehensive income and expenditure statement, but had not disclosed it as an exceptional item.

Findings and recommendations

Management have amended the financial statements to include an additional disclosure note, based on LAAP Bulletin 89, cross referenced from the Comprehensive income and expenditure statement.

Annual governance statement

The Authority's Annual governance statement includes the required information. It is consistent with the financial statements and my knowledge of the Authority.

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 assessed the Authority's arrangements to secure economy, efficiency and effectiveness in its use of resources against the 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 stating that the Authority had proper arrangements to secure economy, efficiency and effectiveness in your use of resources.

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 achieved a surplus of £0.86m in 2010/11, enabling it to further strengthen its healthy level of usable reserves. The Authority's strategy, 'Planning for a safer Cheshire 2011-2015', sets out how the Authority plans to secure a stable financial position over the next four years. The financial plan envisages that the Authority will be able to maintain its expenditure within available resources each year, without drawing upon reserves. The plan is soundly based, although with increased uncertainty in the last two years. This is because the amount by which the government grant will be reduced has not yet been announced and the planned efficiencies will be challenging to deliver.</p>

Criterion

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.

Findings

The Authority's financial plan includes £4.8m of efficiencies and savings over the next four years, of which £2m will be transferred to reserves to help fund capital expenditure. The Authority's strategy outlines how it intends to achieve these savings whilst maintaining service standards. Members and staff have been involved in developing the strategy and Integrated Risk Management Plan (IRMP). Plans are in place to deliver the £1.9m of savings scheduled for 2011/12. Most of the planned £2.3m efficiencies in the last two years are to be realised by changing working arrangements at some fire stations. This may involve significant capital investment and will be challenging to deliver within the timescales in the IRMP. In addition, a three-year programme of value for money reviews has begun, involving the use of benchmarking.

Appendix 1 – 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.

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