

The Annual Audit Letter for Hereford & Worcester Fire Authority

Year ended 31 March 2019

August 2019



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Executive Summary

Purpose

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at Hereford & Worcester Fire Authority (the Authority) for the year ended 31 March 2019.

This Letter is intended to provide a commentary on the results of our work to the Authority and 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 and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'. We reported the detailed findings from our audit work to the Authority's Audit & Standards Committee as those charged with governance in our Audit Findings Report on 30 July.

Our work

Materiality	We determined materiality to be £0.63m (PY £0.63m) for the Authority, which equated to 1.9% of your forecast gross expenditure for the year.
Financial Statements opinion	We gave an unqualified opinion on the Authority's financial statements on 31 July 2019.
Whole of Government Accounts (WGA)	We completed work on the Authority's consolidation return following guidance issued by the NAO. As the Authority is below the threshold, no work was required.
Use of statutory powers	We did not identify any matters which required us to exercise our additional statutory powers.

Respective 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)
- 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) (ISAs) and other guidance issued by the NAO.

Executive Summary

Value for Money arrangements	We were satisfied that the Authority put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources. We reflected this in our audit report to the Authority on 31 July 2019.
Certificate	We certified that we have completed the audit of the financial statements of Hereford & Worcester Fire Authority in accordance with the requirements of the Code of Audit Practice on 31 July 2019.
Governance	We note that the Authority appeal to the Royal Court of Justice for a Judicial Review over the decision to transfer Governance to the Police and Crime Commissioner was heard on 5 and 6 June, but was rejected. We understand that the Authority is considering a further appeal.

Working with the Authority

An efficient audit – we delivered the accounts audit before the deadline of 31 July. 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.

Understanding your operational health – through the value for money conclusion we provided you with assurance on your Medium Term Financial Plan. We highlighted the challenges presented by recent rulings on crewing arrangements and changes to the firefighters’ pension fund.

Providing training – we provided your finance team with training on financial accounts.

We would like to record our appreciation for the assistance and co-operation provided to us during our audit by the Authority's staff.

Grant Thornton UK LLP
August 2019

Audit of the Financial Statements

Our audit approach

Materiality

In our audit of the Authority's financial statements, we use the concept of materiality to determine the nature, timing and extent of our work, and in evaluating the results of our work. We define 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 to be £0.63m (PY £0.63m) for the Authority, which equated to 1.9% of your forecast gross expenditure for the year. We used this benchmark as, in our view, users of the Authority's financial statements are most interested in where the Authority has spent its revenue in the year.

We also set a lower level of specific materiality for separate lower materiality level for the disclosure note on remuneration of individual senior managers. In view of the sensitivity of this note to the reader of the accounts, we have set a materiality level of £100,000.

We set a lower threshold of £31,500, above which we reported errors to the Audit & Standards Committee in our Audit Findings Report.

The scope of our audit

Our audit involves 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 includes assessing whether:

- the accounting policies are appropriate, have been consistently applied and adequately disclosed;
- the significant accounting estimates made by management are reasonable; and
- the overall presentation of the financial statements gives a true and fair view.

We also read the remainder of the financial statements and the narrative report and annual governance statement published alongside the financial statements to check they are consistent with our understanding of the Authority and with the financial statements on which we gave our opinion.

We carry out our audit in accordance with ISAs (UK) and the NAO Code of Audit Practice. We believe that the audit evidence we have obtained is 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 Financial Statements

Significant Audit Risks

These are the significant 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	Findings and conclusions
<p>Valuation of land and buildings</p> <p>The Authority revalues its land and buildings on an annual basis. This valuation represents a significant estimate by management in the financial statements due to the size of the numbers involved and the sensitivity of this estimate to changes in key assumptions.</p> <p>We therefore identified valuation of land and buildings, particularly revaluations and impairments, as a significant risk, which was one of the most significant assessed risks of material misstatement.</p>	<p>As part of our audit work we:</p> <ul style="list-style-type: none">• evaluated management's processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work• evaluated the competence, capabilities and objectivity of the valuation expert• wrote to the valuer to confirm the basis on which the valuation was carried out• challenged the information and assumptions used by the valuer to assess completeness and consistency with our understanding• tested revaluations made during the year to see if they have been input correctly into the Authority's asset register• evaluated the assumptions made by management for those assets not revalued during the year and how management has satisfied themselves that these are not materially different to current value at year end.	<p>Our audit work did not identify any issues in respect of valuation of land and buildings.</p>

Audit of the Financial Statements

Significant Audit Risks - continued

These are the significant 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	Findings and conclusions
<p>Valuation of net pension liability</p> <p>The Authority's pension fund net liability, as reflected in its balance sheet as the net defined benefit liability, represents a significant estimate in the financial statements. The pension fund net liability is considered a significant estimate due to the size of the numbers involved and the sensitivity of the estimate to changes in key assumptions.</p> <p>We therefore identified valuation of the Authority's pension fund net liability as a significant risk, which was one of the most significant assessed risks of material misstatement.</p>	<p>As part of our audit work we:</p> <ul style="list-style-type: none"> updated our understanding of the processes and controls put in place by management to ensure that the Authority's pension fund net liability is not materially misstated and evaluate the design of the associated controls evaluated the instructions issued by management to their management expert (an actuary) for this estimate and the scope of the actuary's work assessed the competence, capabilities and objectivity of the actuary who carried out the Authority's pension fund valuation assessed the accuracy and completeness of the information provided by the Authority to the actuary to estimate the liability tested the consistency of the pension fund asset and liability and disclosures in the notes to the core financial statements with the actuarial report from the actuary undertook procedures to confirm the reasonableness of the actuarial assumptions made by reviewing the report of the consulting actuary (as auditor's expert) and performed any additional procedures suggested within the report obtained assurances from the auditor of Worcestershire Pension Fund as to the controls surrounding the validity and accuracy of membership data; contributions data and benefits data sent to the actuary by the pension fund and the fund assets valuation in the pension fund financial statements. 	<p><u>McCloud ruling re age discrimination</u></p> <p>The Court of Appeal ruled that there was age discrimination in the judges and firefighters pension schemes where there were transitional protections given to scheme members. The Government applied to the Supreme Court for permission to appeal, but this has been rejected. The legal ruling around age discrimination (McCloud - Court of Appeal) also has implications for other pension schemes where they have implemented transitional arrangements on changing benefits.</p> <p>The actuary re-ran the valuation reports with their best estimate of the impact re-McCloud. For the LGPS this also updated the return on assets as a result of further information. We agreed with Officers that the financial statements would be amended to reflect the Pension Past Service Cost of £14,969k being a charge to the Provision of Services within the CIES. The Net liability arising from defined benefit obligation increased by the same amount, plus an additional £77k for the decrease in the rate of return on assets. Overall, the net liability increased from £381,370k to £396,416k.</p> <p>It is important to note that this ruling does not arise from anything that the Authority has done, or not done and, as far as we are aware, affects all public sector pension schemes.</p> <p>Our audit work did not identify any other issues in respect of valuation of the pension fund net liability.</p>

Audit of the Financial Statements

Significant Audit Risks - continued

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	Findings and conclusions
<p>Management override of internal controls</p> <p>Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities.</p> <p>We therefore identified management override of control, in particular journals, management estimates and transactions outside the course of business as a significant risk, which was one of the most significant assessed risks of material misstatement.</p>	<p>As part of our audit work we:</p> <ul style="list-style-type: none">• evaluated the design effectiveness of management controls over journals• analysed the journals listing and determined the criteria for selecting high risk unusual journals• tested unusual journals recorded during the year and after the draft accounts stage for appropriateness and corroboration• gained an understanding of the accounting estimates and critical judgements applied made by management and considered their reasonableness with regard to corroborative evidence• evaluated the rationale for any changes in accounting policies, estimates or significant unusual transactions.	<p>Our audit work did not identify any issues in respect of management override of controls.</p>

Audit of the Financial Statements

Audit opinion

We gave an unqualified opinion on the Authority's financial statements on 31 July 2019.

Preparation of the financial statements

The Authority presented us with draft accounts in accordance with the national deadline, 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.

Issues arising from the audit of the financial statements

We reported the key issues from our audit to the Authority's Audit & Standards Committee on 30 July 2019.

Annual Governance Statement and Narrative Report

We are required to review the Authority's Annual Governance Statement and Narrative Report. It published them on its website in the Statement of Accounts in line with the national deadlines.

Both documents were prepared in line with the CIPFA Code and relevant supporting guidance. We confirmed that both documents were consistent with the financial statements prepared by the Authority and with our knowledge of the Authority.

Whole of Government Accounts (WGA)

We carried out work on the Authority's Data Collection Tool in line with instructions provided by the NAO. We issued an assurance statement which confirmed the Authority was below the audit threshold.

Certificate of closure of the audit

We certified that we have completed the audit of the financial statements of Hereford & Worcester Fire Authority in accordance with the requirements of the Code of Audit Practice on 31 July 2019.

Value for Money conclusion

Background

We carried out our review in accordance with the NAO Code of Audit Practice, following the guidance issued by the NAO in November 2017 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

Our first step in carrying out our work was to perform a risk assessment and identify the risks where we concentrated our work.

The risk we identified and the work we performed is set out overleaf.

Overall Value for Money conclusion

We are satisfied that in all significant respects the Authority put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2019.

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Value for Money conclusion

Value for Money Risk

Risk identified in our audit plan	How we responded to the risk	Findings and conclusions
<p>Medium Term Financial Plan (MTFP)</p> <p>The latest Medium Term Financial Plan (MTFP) was approved in February. As with many other public sector bodies, the Fire Authority has had to make significant efficiencies in order to ensure it is financially viable in the long term. We have looked at the MTFP in previous years and found the assumptions to be prudent, with sufficient reserves set aside specifically to allow the Authority to implement transformational changes without adversely affecting service delivery. However, with the financial challenges ongoing, and uncertainty around the crewing changes implementation and changes to the Firefighters' Pension Fund contributions, this remains a significant risk. The MTFP shows that, as things stand, by 2022/23 the Authority will have exhausted the Budget Strategy Reserve, but still be faced with annual deficits of over £1m.</p> <p>We will:</p> <ol style="list-style-type: none"> 1) Review the financial impact of crewing changes and implementation; 2) Review the impact of increased pension fund contributions and the Fire Authority response; 3) Review the February 2019 MTFP and test any new significant savings projects to assess whether they are realistic and robust. 	<ol style="list-style-type: none"> 1) Since the CRMP in 2014, the Authority has been working towards increasing crewing availability with existing resources, whilst recognising the need to make efficiencies. Recent court rulings mean that the preferred crewing options are no longer available. The Authority has been discussing with staff and the FBU to find an acceptable alternative. While these discussions are ongoing, the Authority does not expect any increase in cost as a result. 2) Changes to the firefighters' pension fund have a total impact of £1.4m per year. The MTFP was presented to the Full Authority in February. Before these changes the Authority would have essentially had a balanced budget each year from 2023/24, without the need for reserves. This would have resulted in £1.435m of the budget reduction reserve being available for other one off purposes. Whereas the MTFP has a balanced budget to 2023/24 with an expected gap of only £0.3m in 2024/25, the pension changes would produce a balanced budget only to 2020/21 with gaps of £1.3m, £1.8m and £1.6m in subsequent years and an on-going gap of around £1.5m from 2024/25. At this stage it is unclear what government funding will be available to help bridge the gap. Consequently, the Fire Authority has not made any plans for large scale efficiencies or savings until the outcome of the financial settlement is known. 3) Review of the MTFP presented to Full Authority in February 2019 indicates that there are no new schemes or plans to address the gap. Officers are waiting to see what the financial settlement is before assessing the impact and then deciding how best to respond. 	<p>Auditor view</p> <p>The MTFP approved in February 2019 showed the Authority in a sound financial position, with planned use of reserves in the short term while transformational projects took effect. The Authority would have essentially had a balanced budget each year from 2023/24, without the need for reserves. This would have resulted in £1.435m of the budget reduction reserve being available for other one off purposes. Changes to the firefighters' pension fund have a total impact of £1.4m per year. Officers are waiting to see the outcome of the financial settlement before making any decisions, which is a sensible approach.</p> <p>Changes to crewing arrangements are ongoing, and the Authority is ensuring that new arrangements are appropriately agreed and take account of relevant legal cases.</p> <p>Once the details of the financial settlement are known officers will need to work quickly to ensure the MTFP that will be approved in February 2020 takes account of the changes and provides an appropriate response to the financial challenge. The key to the future funding gap is whether or not government provides additional funding to cover the additional pension costs. If it does not the whole of the sector will face increased financial challenges.</p> <p>Management response</p> <p>Notwithstanding the existing uncertainty as a result of the pending Spending Review, the Fair Funding Review and Reform to the Retained Business Rates system, the key issue for financial planning is funding of the increased pension costs. Without these unexpected and significant cost increase the Authority was on track with the MTFP to achieve a balanced budget as planned by the end of the period. Government's view on funding these costs is not yet clear and the Authority has sufficient reserves to cover the short term impacts whilst formulating a plan to deal with whatever with the long term impact may be.</p>

A. Reports issued and fees

We confirm below our final reports issued and fees charged for the audit and confirm there were no fees for the provision of non audit services.

Reports issued

Report	Date issued
Audit Plan	April 2019
Audit Findings Report	July 2019
Annual Audit Letter	August 2019

Fees

	Planned £	Actual fees £	2017/18 fees £
Statutory audit	25,311	27,311	32,872
Total fees	25,311	27,311	32,872

Audit fee variation

As outlined in our audit plan, the 2018-19 scale fee published by PSAA of £25,311 assumes that the scope of the audit does not significantly change. The McCloud ruling means that the scope of the audit has changed, which has led to additional work. This is set out in the following table.

Area	Reason	Fee proposed (£)
Assessing the impact of the McCloud ruling	The Government's transitional arrangements for pensions were ruled discriminatory by the Court of Appeal last December. The Supreme Court refused the Government's application for permission to appeal this ruling. As part of our audit we have reviewed the revised actuarial assessment of the impact on the financial statements along with any audit reporting requirements.	2,000
Total		2,000

Fee variations are subject to PSAA approval.

