



# Annual Audit Letter

*Year ending 31 March 2018*

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**West Midlands Fire & Rescue Authority**

August 2018



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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 West Midlands Fire & Rescue Authority (the Authority) for the year ended 31 March 2018.

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 & Risk Committee as those charged with governance in our Audit Findings Report on 23 July 2018.

## 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.

## Our work

<b>Materiality</b>	We determined materiality for the audit of the Authority's financial statements to be £2,489,000, which is 2% of the Authority's gross revenue expenditure.
<b>Financial Statements opinion</b>	We gave an unqualified opinion on the Authority's financial statements on 23 July 2018.
<b>Whole of Government Accounts (WGA)</b>	We completed work on the Authority's consolidation return following guidance issued by the NAO.
<b>Use of statutory powers</b>	We did not identify any matters which required us to exercise our additional statutory powers.
<b>Value for Money arrangements</b>	We were satisfied that the Authority had 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 23 July 2018.
<b>Certificate</b>	We certify that we have completed the audit of the accounts of West Midlands Fire & Rescue Authority in accordance with the requirements of the Code of Audit Practice.

# Executive summary

## Key messages

### Financial statements

The draft accounts were provided for audit before the end of May deadline which enabled us to make a prompt start on the audit. The accounts were well supported by appropriate working papers and members of the finance team were available throughout our audit visit to deal with questions and matters arising. We appreciate the support we were given, which enabled us to complete our audit and issue our unqualified audit opinion before the statutory deadline of the end of July.

We did not identify any adjustments affecting the Authority's reported financial position. There were a small number of disclosure errors and we requested some adjustments to improve the presentation of the financial statements. These changes were agreed and made in the final version of the accounts.

### Value for Money Conclusion

We are required to give a conclusion on whether the Authority has proper arrangements in place to secure value for money in the use of its resources. Our work focused on:

- the Authority's progress towards preparing governance arrangements to join the WMCA; and
- the financial strategy and assumptions relating to the Authority once it has joined the WMCA, including income streams and use of reserves.

Since April 2018 the Authority has been seeking to settle its dispute with the Fire Brigades Union. As part of its response the Authority has withdrawn the revised employment contract. As a result "Wider Health Related" services can no longer be provided as planned. This impacts on the delivery of the Financial Efficiency Plan (FEP), reducing projected income generation by £2.0 million.

The Authority has a significant funding issue to respond to. It is likely in the short term that there will be a call on working balances to balance the 2018/19 financial position. Over the medium term the FEP will need a significant re-assessment to ensure a deliverable sustainable financial plan is in place.

It is clearly important that the Fire Authority can demonstrate to the WMCA Board that it has a realistic financial strategy in place to deliver a financially sustainable service as part of the new governance framework.

We gained sufficient assurance that there were no significant VFM risks relating to the proposed WMCA governance arrangements which adversely impact on our VFM conclusion for 2017/18.

Based on the work we performed to address the significant risk, we have concluded that the Authority had proper arrangements in all significant respects to ensure it delivered value for money in its use of resources.

## Working with the Authority

During the year we have delivered a number of successful outcomes with you:

- An efficient audit – we delivered an efficient audit with you in June 2018, finalising the audit work 30 days before the deadline and providing the opinion 7 days before the deadline. This released your finance team to work on other priorities and is a credit to your streamlined reporting processes.
- Sharing our insight – we provided regular audit committee updates covering best practice. We also shared our thought leadership reports.
- Support outside of the audit – we responded to requests for comment or views on various issues throughout the financial year. This was mainly around governance or best practice, sharing our knowledge from the wider sector.

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 2018

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# Audit of the Accounts

## 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 for the audit of the Authority's accounts to be £2,489,000, which is 2% of the Authority's gross revenue expenditure. 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 remuneration disclosures of £100,000 due to their sensitive nature and public interest.

We set a lower threshold of £124,000, above which we reported errors to the Audit and Risk 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 Statement of Accounts and the narrative report, and annual governance statement published alongside the Statement of Accounts to check that they are consistent with our understanding of the Authority and with the financial statements included in the Statement of Accounts on which we give 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 is 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

## 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><b>Improper revenue recognition</b></p> <p>Under ISA 240 (UK) there is a presumed risk that revenue may be misstated due to the improper recognition of revenue. This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.</p>	<p><b>Auditor commentary</b></p> <p>Having considered the risk factors set out in ISA240 and the nature of the revenue streams at the Authority, we have determined that the risk of fraud arising from revenue recognition can be rebutted, because:</p> <ul style="list-style-type: none"> <li>• there is little incentive to manipulate revenue recognition,</li> <li>• opportunities to manipulate revenue recognition are very limited, and</li> <li>• the culture and ethical frameworks of local authorities, including West Midlands Fire &amp; Rescue Authority, mean that all forms of fraud are seen as unacceptable.</li> </ul>	<p>We did not consider this to be a significant risk for West Midlands Fire &amp; Rescue Authority.</p>
<p><b>Management override of controls</b></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. The Authority faces external scrutiny of its spending, and this could potentially place management under undue pressure in terms of how they report performance.</p> <p>We identified management override of controls as a risk requiring special audit consideration.</p>	<p><b>Auditor commentary</b></p> <p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> <li>• reviewed entity controls,</li> <li>• reviewed journal entry processes and selected unusual journal entries for testing back to supporting documentation,</li> <li>• reviewed accounting estimates, judgements and decisions made by management,</li> <li>• reviewed unusual significant transactions, and</li> <li>• reviewed significant related party transactions outside the normal course of business.</li> </ul>	<p>Our audit work did not identify any issues in respect of management override of controls. In particular, the findings of our review of journal controls and testing did not identify any significant issues.</p>
<p><b>Valuation of pension fund net liability</b></p> <p>The Authority's LGPS pension fund asset and liability as reflected in its balance sheet represent a significant estimate in the financial statements.</p> <p>The Firefighters Pension schemes pension fund liability as reflected in the balance sheet and notes to the accounts represent significant estimates in the financial statements.</p> <p>These estimates, by their nature, are subject to significant estimation uncertainty, being sensitive to small adjustments in the assumptions made.</p> <p>We identified the valuation of the pension fund net liability as a risk requiring special audit consideration.</p>	<p><b>Auditor commentary</b></p> <p>We have undertaken the following work in relation to this risk:</p> <ul style="list-style-type: none"> <li>• identified the controls put in place by management to ensure that the pension fund net liability is not materially misstated and assessed whether those controls were implemented as expected and whether they were sufficient to mitigate the risk of material misstatement,</li> <li>• reviewed the competence, expertise and objectivity of the actuary who carried out the Authority's pension fund valuation,</li> <li>• 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</li> <li>• reviewed the consistency of the pension fund net liability disclosures in notes to the financial statements with the actuarial report from your actuary.</li> </ul>	<p>Our audit work did not identify any issues in respect of the valuation of the pension fund net liabilities.</p>

# Audit of the Accounts

## 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
<b>Employee remuneration</b> Payroll expenditure represents a significant percentage (58%) of the Authority's operating expenses. As the payroll expenditure comes from a number of individual transactions there is a risk that payroll expenditure in the accounts could be understated. We therefore identified completeness of payroll expenses as a risk requiring particular audit attention.	<b>Auditor commentary</b> We have undertaken the following work in relation to this risk: <ul style="list-style-type: none"><li>• documented our understanding of processes and key controls over the transaction cycle,</li><li>• undertaken a walkthrough of the key controls to assess the whether those controls were in line with our documented understanding,</li><li>• review the reconciliation of the payroll system to the general ledger and to the financial statements to agree completeness of costs, and</li><li>• performed a trend analysis and detailed substantive testing of pay costs to ensure employee remuneration costs were accurate and complete.</li></ul>	Our audit work did not identify any issues in respect of employee remuneration.
<b>Operating expenses</b> Non-pay expenses on other goods and services also represents a significant percentage of the Authority's operating expenses. Management uses judgement to estimate accruals of un-invoiced costs. We identified completeness of non-pay expenses as a risk requiring particular audit attention.	<b>Auditor commentary</b> We have undertaken the following work in relation to this risk: <ul style="list-style-type: none"><li>• evaluated the Authority's accounting policy for recognition of non-pay expenditure for appropriateness,</li><li>• gained an understanding of the Authority's system for accounting for non-pay expenditure and evaluate the design of the associated controls, and</li><li>• performed expenditure cut-off testing by agreeing to source documentation to ensure that expenditure is recorded in the correct financial year.</li></ul>	Our audit work did not identify any issues in respect of operating expenses.
<b>Firefighters pension scheme</b> The Authority administers the firefighters pension schemes, with the Firefighters Pension Fund Account being included in the financial statements. We identified completeness and accuracy of pension benefits payable as a risk requiring particular audit attention.	<b>Auditor commentary</b> We have undertaken the following work in relation to this risk: <ul style="list-style-type: none"><li>• gained an understanding of the Authority's systems for calculating, accounting for and monitoring pension benefit payments and evaluated the design of the associated controls, and</li><li>• performed detailed testing on new firefighters pension benefit payments.</li></ul>	Our audit work has not identify any issues in respect of firefighter pension benefits payable.

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# Audit of the Accounts

## **Audit opinion**

We gave an unqualified opinion on the Authority's financial statements on 23 July 2018, in advance of the national deadline.

## **Preparation of the accounts**

The Authority presented us with draft accounts in advance of 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 accounts**

We reported the key issues from our audit to the Authority's Audit & Risk Committee on 23 July 2018.

## **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 within 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.

## **Other statutory powers**

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 did not identify any matters which required us to exercise our additional statutory powers.

## **Certificate of closure of the audit**

We are also required to certify that we have completed the audit of the accounts of West Midlands Fire & Rescue Authority in accordance with the requirements of the Code of Audit Practice.

Our certificate of audit completion was issued on the 23 July 2018 with our audit opinion.



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# 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 key risks where we concentrated our work. Our work focused on:

- the Authority's progress towards preparing governance arrangements to join the WMCA; and
- the financial strategy and assumptions relating to the Authority once it has joined the WMCA, including income streams and use of reserves.

The governance model being implemented in the West Midlands is similar to the model used in Greater Manchester. The West Midlands Combined Authority (WMCA) will be responsible for the fire service, including all employment responsibilities, all properties, and all rights and liabilities. The Mayor will have the power to 'exercise' these fire and rescue functions and the ability to delegate decision making and operation of functions, as appropriate. It is anticipated that the Mayor will delegate these functions to the CFO.

This arrangement is still subject to Home Office approval. The target date for implementation is 1 April 2019.

Since April 2018 the Authority has been seeking to settle its dispute with the Fire Brigades Union. As part of its response the Authority's Executive Committee has decided that the 'Plan', (the Authority's service and financial strategy for the three years 2018 to 2021), should be revised. In particular the revised employment contract has been withdrawn, resulting in the Authority no longer being able to provide "Wider Health Related" services as planned. This impacts on the delivery of the Financial Efficiency Plan (FEP), reducing projected income generation by £2.0 million.

The Authority has a significant funding issue to respond to. It is likely in the short term that there will be a call on working balances to balance the 2018/19 financial position. Over the medium term the FEP will need a significant re-assessment to ensure a deliverable sustainable financial plan is in place.

It is clearly important that the Fire Authority can demonstrate to the WMCA Board that it has a realistic financial strategy in place to deliver a financially sustainable service as part of the new governance framework.

As part of our Audit Findings report agreed with the Authority in July 2018, we presented our detailed findings against the risks we identified.

The key risks we identified and the work we performed are 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 2018.

## Key findings

We set out below our key findings against the significant risks we identified through our initial risk assessment and further risks identified through our ongoing review of documents.

	Significant risk	Findings	Conclusion
1	<b>Governance</b>	<u>Delivering efficiencies</u>	<b>Auditor view</b>
	Development and implementation of combined governance arrangements for WMFRA and WMCA.	<p>The Authority considers that being part of the Mayoral WMCA will create further opportunities to progress transformation and create greater efficiencies enabled through a single structure with potential for efficiencies across all the governance models which were appraised considering opportunities such as (but not restricted to) emergency planning, shared estates, data sharing.</p> <p>Progressing transformation and delivering greater efficiencies is challenging. The outcome of the recent Fire Brigades Union (FBU) ballot illustrates this. The delivery of the Authority's workforce reform programme included the introduction of revised employment contracts for new firefighters. These are designed to enable sustainable service delivery including wider health activities. Over 100 firefighters have been recruited on this revised contract.</p> <p>The FBU dispute has focused on this new contract, with 74% of FBU members voting to take industrial action over this issue. In June 2018 the Authority's Executive Committee (comprising of Members from constituent authorities) decided to withdraw the new entrant contract. This requires the Authority to reconsider service changes, workforce planning and options to close the funding gap to ensure it delivers its service and financial priorities.</p> <p>The "wider health related" services are a key element of the Authority's wider integration strategy, increasing its role in delivering outcomes in conjunction with other public sector services, including Police, Health bodies and Local Government bodies. The FEP includes £2.0 million of income generated by wider health related services. This is an integral part of the financial strategy and the new entrant contract was a key part of the delivery of this. If the Authority is no longer able to provide the service as planned the ability to expand and grow this strand of the business model will be curtailed.</p>	<p><u>Delivering efficiencies</u></p> <p>It is vital that the fire service remains open and flexible to opportunities for delivering service requirements with limited resources. Partnership working will be key to this which has been recognised by the Senior Leaders of both the Fire Service and the Authority.</p> <p>The Authority needs to demonstrate how financial sustainability is deliverable with the withdrawal of the new entrant contract.</p> <p>It is likely that a use of working balances will be required to support 2018/19 budget delivery. However, the continued use of balances is not sustainable. In our view significant funding alternatives or service reductions should be identified by the Authority before the transfer to WMCA.</p> <p>Without the expansion of wider health related services there will be significant limitations on the level of integration possible with the WMCA constituent Local Authorities, Health partners and West Midlands Police.</p> <p>The Authority needs to re-assess its wider integration strategy.</p>

## Key findings

We set out below our key findings against the significant risks we identified through our initial risk assessment and further risks identified through our ongoing review of documents.

	Significant risk	Findings	Conclusion
1	<b>Governance</b>	<p><u>Pace of change</u></p> <p>WMCA is a key driver of public service reform in the region. In 2016/17 WMFRA signalled its intention to become part of WMCA's overall governance structure. The Policing and Crime Act 2017 was prime legislation for facilitating closer collaboration between the police and fire and rescue services. However, the West Midlands PCC has not exercised this power to take on responsibility for Fire services. This enabled the Authority and WMCA to pursue and progress joint future structural and governance arrangements.</p> <p>There is continuous reporting through WMCA Board. This ensures that members are aware of progress and engages Leaders from the seven constituent West Midlands Local Authorities to enable informed decision making on this key structural issue.</p> <p>WMFRA is managing the 'Future Governance Project' which is in the initial phases of setting up a 'governance implementation project'. To date key milestones have been achieved, but full implementation is dependent on approval of the Parliamentary Order in December 2018. There is a risk that this may be delayed.</p> <p><u>Revised governance arrangements</u></p> <p>The proposed model submitted to the Home Office for approval in May 2018 sets out that:</p> <ul style="list-style-type: none"> <li>• WMCA will be the employer of WMFS staff and will own all properties, rights and liabilities, having the appropriate structures in place to support the requirements of employer status, as well as any liabilities that result from this.</li> <li>• The Mayor (only) will have the power to 'exercise' fire and rescue functions and the ability to delegate decision making and operation of functions, as appropriate.</li> </ul> <p><b>Accountability</b> – the Mayor will delegate functions to the Chief Fire Officer (CFO) enabling the CFO to be directly accountable for managing staff, employee relations, workforce development, resources and assets to support the delivery of day to day functions, as well as the development of future delivery of services aligned to the strategy agreed with the Mayor.</p> <p><b>Scrutiny</b> – development of a proposed Mayoral Fire Advisory Committee, reflecting the membership of each constituent authority. It is proposed that the WMCA Board delegates the role of reviewing decisions made by the Mayor to the committee and receives reports back on these matters.</p> <p>This proposed model seeks to create an efficient and effective decision making structure, which will support the Mayor in focusing on strategy and setting direction for the fire service. A governance review was undertaken with a scheme setting out the roles, accountabilities and powers required by each individual and body in the proposed new governance model. This was followed by consultation with constituent councils and a public consultation. This sets out the importance of a clear split between the advisory/review responsibilities of the Mayoral Fire Advisory Committee and the statutory scrutiny responsibilities of Overview &amp; Scrutiny Committee.</p>	<p><b>Auditor view</b></p> <p><u>Pace of change</u></p> <p>There is continuous reporting through WMCA Board to engage Leaders from the seven constituent West Midlands Local Authorities to enable informed decision making on this key structural issue.</p> <p>There is a risk that full implementation may be delayed by the Parliamentary timetable.</p> <p><u>Revised governance arrangements</u></p> <p>The Governance arrangements should provide a clear split between the roles of holding to account and scrutinising. The proposed sets this out in the roles of the Mayoral Fire Advisory Committee and Overview &amp; Scrutiny Committee.</p>

## Key findings

We set out below our key findings against the significant risks we identified through our initial risk assessment and further risks identified through our ongoing review of documents.

	Significant risk	Findings	Conclusion
1	<b>Governance</b>	<u>Managing risk</u>	<u>Auditor view</u>
	Development and implementation of combined governance arrangements for WMFRA and WMCA.	<p>In response to this changing agenda (both politically and structurally), the Authority has continued to report progress against its strategic risks which includes Public Service Reform. There is an acceptance that to meet the complex and diversifying needs of the public, more cross sector working is required.</p> <p>The Corporate Risk Assurance Map reported to the Audit Committee focuses on key strategic risks for the Authority. Whilst this broadly touches on the governance reform, the project of driving structural and governance change has a separate risk register. This is reported to the Authority's internal programme board and/or the Executive team, depending on the level of risk and its status. General monitoring takes place via project meetings.</p> <p>Our review has identified additional risks for which there is currently no resolution. These are known to the Authority and will be addressed as part of the 'getting into the detail' once the overarching governance structure is approved. In summary, they relate to financial, people, governance and wider public sector risks.</p> <p>Financial risks – these include the financial impact of the decision to withdraw the new entrant contract, revenue funding and precepting, funding of pension liabilities, budget setting responsibilities and the discharge of the Chief Finance Officer role under section 151 of the Local Government Act 1972, management of assets and the impact of harmonising accounting policies.</p> <p>People risks – these include staff management and liaising with trade unions.</p> <p>Governance risks – includes managing tensions between fire service objectives and the broader Combined Authority priorities where these are not consistent.</p> <p>Wider public sector risks – including the impact of the likely curtailment of wider health related services on further integration with public sector partners, and opportunities to extend and develop partnerships with other emergency service organisations including Warwickshire Fire and Rescue Service and West Midlands Ambulance Service.</p>	<p><u>Managing risk</u></p> <p>Risks are being managed at an Authority level and at a project level but the detail of how arrangements will be delivered is not yet being worked through due to the uncertainty of the over-arching governance arrangements. This will be addressed as part of the next phase of the project, but should not be over-looked as there are significant issues which remain unresolved.</p> <p>The CFO should continue to ensure that risks are appropriately managed and reported on to those with oversight of the arrangements.</p>

# A. Reports issued and fees

We confirm below our final reports issued and fees charged for the audit.

## Reports issued

Report	Date issued
Audit Plan	March 2018
Audit Findings Report	July 2018
Annual Audit Letter	August 2018

## Fees for non-audit services

Service	Fees £
<b>Audit related services</b>	Nil
- None	
<b>Non-Audit related services</b>	Nil
- None	

## Fees

	Planned £	Actual fees £	2016/17 fees £
Statutory Authority audit	£38,636	£38,636	£38,636
<b>Total fees</b>	£38,636	£38,636	£38,636

The planned fees for the year were in line with the scale fee set by Public Sector Audit Appointments Ltd (PSAA).

