The Annual Audit Letter for West Midlands Fire & Rescue Authority

Year ended 31 March 2019

August 2019

Contents

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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 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 & Risk Committee as those charged with governance in our Audit Findings Report on 29th July 2019

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

Materiality	We determined materiality for the audit of the Authority's financial statements to be £2,396,000, which was 2% of the Authority's gross revenue expenditure.
Financial Statements opinion	We gave an unqualified opinion on the Authority's financial statements on 31st July 2019.
Whole of Government Accounts (WGA)	We completed work on the Authority's consolidation return following guidance issued by the NAO.
Use of statutory powers	We did not identify any matters which required us to exercise our additional statutory powers.
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 31st July 2019.
Certificate	We certified that we have completed the audit of the financial statements of West Midlands Fire & Rescue Authority in accordance with the requirements of the Code of Audit Practice on 31st July 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 for the audit of the Authority's financial statements to be £2,396,000, 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 sensitivity nature and public interest.

We set a lower threshold of £119,802, above which we reported errors to the Audit & 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 financial statements and the narrative report and annual governance statement to check it is 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
Management Override of Controls 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. 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.	As part of our audit work we have: • evaluated the design effectiveness of management controls over journals; • analysed the journals listing and determine 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; and • evaluated the rationale for any changes in accounting policies, estimates or significant unusual transactions.	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.
Valuation of Property, Plant and Equipment The Authority revalue its land and buildings on an annual basis to ensure that the carrying value is not materially different from the current value at the financial statements date. The valuation of land and buildings represents a significant estimate by management in the financial statements due to the size of the numbers involved (£120.675 million) and the sensitivity of this estimate to changes in key assumptions. Management have engaged the services of a valuer to estimate the current value as at 31 March 2019. We therefore considered valuation of land and buildings, particularly revaluations and impairments, as a specific audit consideration.	As part of our audit work we have: • evaluated the design effectiveness of management controls over journals; • analysed the journals listing and determine 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; and • evaluated the rationale for any changes in accounting policies, estimates or significant unusual transactions.	Our audit work did not identify any issues in respect of valuation of land and buildings. We challenged the Authority's valuer with regard to some of the assumptions used in the 2018-19 valuation. Our conclusion was that there was a low risk of material estimation uncertainty from these assumptions.

Audit of the Financial Statements

Significant Audit Risks - continued

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Valuation of Pension Fund Liability 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 (£1,805 million in the Authority's balance sheet as at 31 March 2019) and the sensitivity of the estimate to changes in key assumptions. 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.	We have: • 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 evaluated 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; and • undertook procedures to confirm the reasonableness of the actuarial assumptions made by reviewing the report of the consulting actuary (as auditor's expert) and performing any additional procedures suggested within the report. During the course of the audit the Government was refused leave to appeal to the Supreme Court with respect to the Appeal Court judgement on the McCloud case. This related to an Employment Tribunal decision on age discrimination in the Firefighters and other pension schemes. Our view is that this judgement gives rise to a past service cost and liability as the ruling creates a new obligation. We discussed this with management and the Authority sought a revised report from the actuary to account for the impact of the McCloud judgement.	The revised actuary's reports were provided in July and the accounts updated accordingly. This led to a £53.6 million increase in the net pension liability shown on the face of the balance sheet. It also resulted in a significant number of adjustments to the primary statements and the notes to the accounts. Our audit work did not identify any issues in respect of the revised valuation of the pension fund net liabilities.

Audit of the Financial Statements

Audit opinion

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

Preparation of the financial statements

The Authority presented us with draft financial statements 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 & Risk Committee on 29th 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 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.

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.

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 certified that we have completed the audit of the financial statements 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 31st July 2019 with our audit opinion.

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

We have focused our work on the significant risks that we identified in the Authority's arrangements. In arriving at our conclusion, our main considerations were in relation to the financial sustainability of the Authority, given the continued use of general reserves and the significant risks in relation to pensions costs and increased levels of savings required to deliver a balanced budget.

We considered:

- how the Authority has responded to these challenges in terms of its plans for future years.
- whether your financial position leads to material uncertainty about the going concern of the Authority and reviewed related disclosures in the financial statements.

The 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 2019.

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 in our Audit Plan	Findings	Conclusion
1	**Financial Sustainability** We said that: The Authority is forecasting that it will deliver the budget for 2018/19 however this will require the use of £1.5 million of general reserves. The Authority's reserves have reduced from £9.2million in 2016/17 to £6.9 million at the start of 2019/20. It is anticipated that £1.1 million of General Reserves will be utilised in 2019/20 and a further £0.75 million used in 2020/21, reducing general reserves to £5 million. The 2019/20 budget requires savings of £3.8 million to be made in order to achieve the budget. Looking forward, there are significant new risks emerging which will require the Authority to find further efficiency savings which include the impact of: • FFPS – Employers Contributions – potential additional costs of £6.2 million per annum assuming no government funding. • FFPS – Court of Appeal judgement – potential additional costs of £1.5m per annum. We said we would: • assess how the Authority has responded to these challenges in terms of its plans for future years. • consider whether your financial position leads to material uncertainty about the going concern of the Authority and will review related disclosures in the financial statements.	**2018-19 Outturn** The Authority once again delivered an improved position against its approved budget delivering net expenditure of £104.296m against a plan of £107.016m, giving a positive variance of £2.720m. In addition, funding also delivered a positive variance of £607k, with income received of £55.910m against a plan of £55.303m. The net impact for the Authority was to deliver a positive variance to plan of £2.503m, which has been used fully to create new earmarked reserves. In addition, contributions from earmarked reserves were also lower in the year, £8.108m compared to a plan of £8.932m, giving a positive variance of £824k. In June 2018, the Executive Committee approved the removal of New Entrant contracts to avoid industrial action by Grey Book staff. This has impacted the Services ability to generate Alternative Funding and achieve the full level of staff savings reflected within the Financial Efficiency Plan. At the Authority meeting on 17th September 2018, Members supported a reduced level of Voluntary Additional Shifts to make savings of £750k in 2018/19 to offset the shortfall in the FEP. **2019-20 Position:** The Authority approved a budget for 2019-20 in its February 2019 Authority meeting taking into account the latest Government settlement notified to them at the end of January 2019. This will be the final year of the four-year settlement that the Authority signed up to in 2016/17, which required it to deliver savings of £9.895m over the same period. The 2019-20 budget assumes: • Savings of £3.8m to be made in 2019/20 in order to achieve the Financial Efficiency Plan savings. • Increased net costs of £0.5m for Firefighters Pension Scheme – Employers Contributions due to a change in the discount rate for unfunded public sector pensions from 3% to 2.4%, which has the effect of increasing the employer contributions (to include ill-health costs) from an average 17.6% to 30.2% from April 2019. The increase in the 2019/20 Employer's Pension contributions is estimated to be £6.2m. A s31 government grant of £5.7m has been allocated in 2019/20.	**Auditor view** On the basis of our work, having regard to the guidance on the specified criterion issued by the Comptroller and Auditor General in November 2017, we are satisfied that the Authority put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2019.

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 in our Audit Plan	Findings	Conclusion
1	**Financial Sustainability** We said that: The Authority is forecasting that it will deliver the budget for 2018/19 however this will require the use of £1.5 million of general reserves. The Authority's reserves have reduced from £9.2million in 2016/17 to £6.9 million at the start of 2019/20. It is anticipated that £1.1 million of General Reserves will be utilised in 2019/20 and a further £0.75 million used in 2020/21, reducing general reserves to £5 million. The 2019/20 budget requires savings of £3.8 million to be made in order to achieve the budget. Looking forward, there are significant new risks emerging which will require the Authority to find further efficiency savings which include the impact of: • FFPS – Employers Contributions – potential additional costs of £6.2 million per annum assuming no government funding. • FFPS – Court of Appeal judgement – potential additional costs of £1.5m per annum. We said we would: • assess how the Authority has responded to these challenges in terms of its plans for future years. • consider whether your financial position leads to material uncertainty about the going concern of the Authority and will review related disclosures in the financial statements.	• No impact of the Firefighters Pension Scheme Court of Appeal 'McCloud' judgement which found that the transitional protections introduced with the new Pension scheme in 2015 were unlawfully discriminatory on grounds of age. The Authority have estimated that the increase in employer's contribution, if members moved back to the 1992 Scheme, would be in the region of £1.5m per annum. In July 2019, the Government was refused leave to appeal the judgement and therefore the employment tribunal will now consider the repatriations necessary. • the Authority will generate estimated income of £3.079m (£3.877m in 2018/19). This is due to the Executive Committee approving the removal of New Entrant contracts to avoid industrial action by Grey Book staff in June 2018 which has had a significant impact on the Services ability to generate Alternative Funding and achieve the full level of staff savings reflected within the FEP. • Use of £1.1m of general balances to support the net budget requirement. This would result in the Authority's available General Balances being approximately £5.8 million by the end of 2019/20 (6% of the Authority's 2019/2020 Net Revenue Budget). Actual spend to May 2019, including commitments, was £19.683 million compared to a projected budget of £19.701 million, an overall favourable variance of £0.018 million. Management have confirmed as part of regular updates with them that at the end of Quarter 1 the Authority is on track to achieve the savings approved as part of the 2019/20 budget setting process and to deliver the budget position. Management have identified that there are a number of spend pressures emerging for the year but mitigating action is being taken where possible. The Authority is currently maintaining an under borrowed position and is forecast to continue to do so over the next two years.	**Auditor view** On the basis of our work, having regard to the guidance on the specified criterion issued by the Comptroller and Auditor General in November 2017, we are satisfied that the Authority put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2019.

Key findings

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	Significant risk in Audit Plan	Findings	Conclusion
1	**Financial Sustainability** We said that: The Authority is forecasting that it will deliver the budget for 2018/19 however this will require the use of £1.5 million of general reserves. The Authority's reserves have reduced from £9.2million in 2016/17 to £6.9 million at the start of 2019/20. It is anticipated that £1.1 million of General Reserves will be utilised in 2019/20 and a further £0.75 million used in 2020/21, reducing general reserves to £5 million. The 2019/20 budget requires savings of £3.8 million to be made in order to achieve the budget. Looking forward, there are significant new risks emerging which will require the Authority to find further efficiency savings which include the impact of: • FFPS – Employers Contributions – potential additional costs of £6.2 million per annum assuming no government funding. • FFPS – Court of Appeal judgement – potential additional costs of £1.5m per annum. We said we would: • assess how the Authority has responded to these challenges in terms of its plans for future years. • consider whether your financial position leads to material uncertainty about the going concern of the Authority and will review related disclosures in the financial statements.	**Forward Look:** The Authority's level of general reserves have declined significantly in recent years going from £8.4m (8.8% of net revenue budget) on the 1st April 2018 to £6.9m (7.2%) as at 1 April 2019 and expected to decline to £5.8m (6%) by 1 April 2020. The use of General Balances is not a sustainable means of funding the Authority's revenue budget. Consideration needs to be given to further Service changes to reduce the reliance on General Balances. From 2021/22, the financial plan currently shows a budget deficit of £1.7m. Using general reserves to temporarily fund this gap will further reduce to balances to £3.3m. The Authority's three-year financial strategy continues to be updated to ensure that the revenue budget is sustainable and does not seek to rely on reserves to deliver a balanced budget on an on-going basis. As part of the budget setting process each year, the S151 officer is required to review and confirm that the level of reserves held is prudent in light of the risks that the authority faces. The S151 has determined that the overall level of reserves is deemed reasonable and prudent when compared to the risk assessment set out in the budget and the level of savings required to be identified and achieved over the medium term. The impact of the McCloud judgement and the refusal to allow the government the appeal the judgement will have significant financial implications. These will only be able to be quantified once the Employment Tribunal considers the repatriations necessary and how this will be implemented. It is not yet clear whether any Government funding will be provided to mitigate this additional cost.	**Auditor view** On the basis of our work, having regard to the guidance on the specified criterion issued by the Comptroller and Auditor General in November 2017, we are satisfied that the Authority put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2019.

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	March 2019
Audit Findings Report	July 2019
Annual Audit Letter	August 2019

As outlined in our audit plan, the 2018-19 scale fee published by PSAA of £29,750 assumes that the scope of the audit does not significantly change. There are a number of areas where the scope of the audit has changed due to national issues outside of the Authority's control, which have led to additional work. These are set out in the following table.

These fee variations have been discussed with the Treasurer but are subject to approval by PSAA Limited.

Fees

	Planned £	Actual £	*2017/18 £*
Statutory audit	29,750	33,750	*38,636*
Total fees	**29,750**	**33,750**	***38,636***

Audit fee variation

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.	£1,500
Pensions – IAS 19	The Financial Reporting Council has highlighted that the quality of work by audit firms in respect of IAS 19 needs to improve across local government audits. Accordingly, we have increased the level of scope and coverage in respect of IAS 19 this year to reflect this.	£1,500
PPE Valuation – work of experts	As above, the Financial Reporting Council has highlighted that auditors need to improve the quality of work on PPE valuations across the sector. We have increased the volume and scope of our audit work to reflect this.	£1,000
Total		£4,000

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