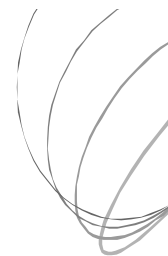


Highland and Islands Fire Board

Report to Members on the 2005/06 Audit

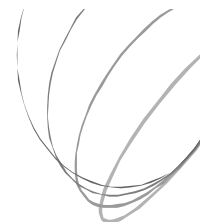
October 2006





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Key Messages

In 2005/06 we have audited the financial statements and looked at aspects of performance and governance within Highland and Islands Fire Board. This report sets out our main findings.

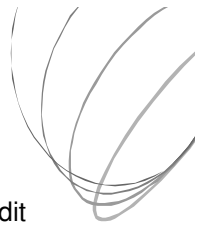
Overall, we found the financial stewardship of Highland and Islands Fire Board during the year to be satisfactory. The main conclusions and outcomes from the audit are highlighted below:

- An unqualified audit opinion has been issued on the financial statements for 2005/06
- The Statement on the System of Internal Financial Control included in the accounts complies with accounting requirements and is not inconsistent with audit findings
- Final accounts preparation procedures and working papers were generally good and this enabled the audit to progress satisfactorily
- The Board has many aspects of a sound corporate governance framework in place. Further work is required, however, to embed risk management within the Board's strategic and operational planning activity.
- Internal Audit concluded that *'reasonable assurance can be placed upon the adequacy and effectiveness of the Board's internal control system in the year to 31 March 2006'*. Our own work concluded that high level controls within the payroll and creditors systems could be improved.
- All four of the Statutory Performance Indicators (SPIs) were assessed as reliable again this year. The Board performed well against the SPIs in 2005/06.

Key issues for the Board in the future include:

- the absorption of transitional funding and the increasing cost of pensions;
- financial reporting changes introduced by the 2006 SORP;
- the need to continue developments in relation to governance arrangements, including the embedding of risk management within the Board's strategic and operational planning process, the completion of a comprehensive asset register and the enhancement of high level controls within the payroll and creditors systems;
- the need to reduce call response times.

Key issues for the attention of members are outlined in the Action Plan included in this report.



This is the final year of our current appointment to the audit of the Board. From 2006/07, however, Audit Scotland will remain as the Board's appointed auditor and Bob Clark will be the engagement lead. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by officers and members of the Board over the five years of our audit appointment.

Audit Scotland
October 2006

Introduction

1. The members and officers of the Board are responsible for the management and governance of the organisation. As external auditors, we review and report on the arrangements in place and seek to gain assurance that:
 - the financial statements have been prepared in accordance with statutory requirements and that proper accounting practices have been observed;
 - the Board's system of recording and processing transactions provides an adequate basis for the preparation of the financial statements and the effective management of assets and interests;
 - the Board has adequate corporate governance arrangements which reflect the three fundamental principles of openness, integrity and accountability;
 - the systems of internal control provide an appropriate means of preventing or detecting material mis-statement, error, fraud or corruption;
 - the Board has proper arrangements for securing best value in its use of resources; and
 - arrangements have been made to collect, record and publish statutory performance information.
2. This report summarises the most significant issues arising from our work during 2005/06.

Financial statements & financial position

3. In this section we summarise key outcomes from our audit of the Board's financial statements for 2005/06, aspects of the Board's reported financial position and performance to 31 March 2006, and provide an outlook on future financial prospects and financial reporting issues.

Auditor's report

4. We have given an unqualified opinion on the financial statements of Highland and Islands Fire Board for 2005/06, concluding that:
 - the financial statements present fairly the Board's financial position at 31 March 2006 and income and expenditure during the year;
 - the financial statements have been properly prepared in accordance with the Local Government (Scotland) Act 1973.
5. The Board's balance sheet has an excess of liabilities over assets of £56.213 million due to the accrual of pension liabilities in accordance with accounting standards. Auditing standards require auditors to consider an organisation's ability to continue as a going concern when forming an opinion on financial statements. One of the indications that may give rise to going concern considerations is an excess of liabilities over assets.
6. The Board has considered it appropriate to adopt a going concern basis for the preparation of the financial statements as future actuarial valuations of the pension fund will consider the appropriate employer's contribution rate to meet the fund's commitments. Future pension liabilities will be met, as they fall due, by government grant and contributions from constituent authorities in the normal way. We are satisfied that the process the Board has undertaken to consider going concern is reasonable.

Financial position

7. The Board's net revenue expenditure amounted to £22.583 million and was met by constituent authorities' contributions of £22.696 million, resulting in a surplus for the year of £0.113 million. In his Report the Treasurer summarises performance against budget. The major factors contributing to the underspend are lower than expected staff and supplies and services costs, offset by increased administration costs, loan charges and capital financed from current revenue.

8. The Board holds a general fund reserve as a contingency for unexpected events or emergencies. The Controller of Audit's 'Overview of the local authority audits 2004' recognises that the appropriate level of balances is for local authorities to determine, taking account of local circumstances, but stresses the need for clear strategies for managing such funds which set out their purpose and intended use. In the absence of clear strategies, there are risks that funds are accumulated unnecessarily or that pressure to restrict rises in constituent authority contribution levels results in an inadequate cushion held to deal with emergencies.
9. At 31 March 2006 the Board held a general fund reserve of £0.919 million but had yet to adopt a clear strategy for the use of these funds. The Board plans to adopt such a strategy by January 2007.

Action point 1

10. Capital expenditure totalled £4.005 million, against a budget of £4.039 million, and was funded by government grant of £2.402 million and from revenue (£1.603 million).

Issues arising

11. The Board's unaudited financial statements were submitted to the Controller of Audit prior to the deadline of 30 June. Final accounts preparation procedures and working papers were generally good and this enabled the audit to progress smoothly.
12. Audited accounts were finalised prior to the target date of 30 September 2006 and are now available for presentation to the Board and for publication. The financial statements are an essential means by which the Board accounts for its stewardship of the resources made available to it and its financial performance in the use of those resources.
13. Local authorities in Scotland are required to follow the Code of Practice on Local Authority Accounting in the United Kingdom —A Statement of Recommended Practice (the 'SORP'). A number of adjustments were made to the figures included in the unaudited accounts made available for public inspection. None of the adjustments made had an impact on the surplus achieved in the year.

Legality

14. Each year we request written confirmation from the Treasurer that the Board's financial transactions accord with relevant legislation and regulations. Significant legal requirements are also included in audit programmes and checklists. The Treasurer has confirmed that, to the best of his knowledge and belief and having made appropriate enquiries of the Chief Fire Officer and the Service Executive, the financial transactions of the Board were in accordance with the relevant legislation and regulations governing its activities.
15. There are no additional legality issues arising from our audit which require to be brought to members' attention.

Statement on the system of internal financial control

16. The 2005/06 financial statements include a Statement on the System of Internal Financial Control which highlights the Treasurer's view that reasonable assurance can be placed upon the adequacy and effectiveness of the Board's internal financial control system, but that work is ongoing to further enhance the control environment and address weaknesses by:
 - reviewing and updating, where necessary, the Board's Financial Regulations;
 - introducing an independent check of the accuracy of the calculation of each indicator into the process for the preparation of the statutory performance indicators, reviewing the guidance available to staff, and introducing a retention policy for the information used in compiling the indicators.
17. The Board operates the corporate financial systems of the Highland Council. The Board's internal auditor (the Highland Council's Head of Internal Audit & Risk Management) has relied on his audits of these corporate financial systems in preparing his Annual Report to support the Treasurer in signing the Statement.
18. The Statement complies with accounting requirements and is not inconsistent with the findings of our audit.

Future outlook

Pension liabilities

19. Accounting for the costs of pensions presents a difficult challenge. The amounts involved are large, the timescale is long, the estimation process is complex and involves many areas of uncertainty that are the subject of assumptions. In addition, the government is currently considering major changes to public sector pension schemes, with one of the aims being to provide an affordable, secure and sustainable benefit structure.
20. Financial Reporting Standard 17 (Retirement Benefits) is based on the principle that an organisation should account for retirement benefits at the point at which it commits to paying them, even if the actual payment will be made years into the future. This requirement results in very large future liabilities being recognised in the annual accounts.
21. The firefighters' pension scheme is unfunded and, therefore, has no assets to be valued. Note 10 to the Balance Sheet highlights that the present value of scheme liabilities at 31 March 2006 is £68.2 million. As the scheme is unfunded, the pension liability will fall to be met by serving firefighters' contributions and by taxpayers in the future (through constituent authorities' contributions).
22. The Board's estimated pension liabilities for support staff at 31 March 2006 exceeded its share of assets in the Highland Council Pension Fund by £2.092 million. The full triennial actuarial valuation of the Highland Council Pension Fund was reported in early 2006. Factors such as the volatile stock market and increasing life expectancy have resulted in the funding level, calculated as the ratio of fund assets to past service liabilities, falling from 105% as at March 2002 to 92% as at March 2005.
23. The actuary is required to make a 3-year assessment of the contributions that should be paid by the employing authorities as from April 2006 to maintain the solvency of the fund. The contribution levels are based on percentages of employee contributions, normally 5% - 6% of salary. The current 3-year assessment shows that budgeted contributions are expected to rise from 270% of employee contributions to 290% by 2008/09.

Financial reporting

24. A number of changes have been made to the 2006 SORP which will have a significant impact on the presentation of the 2006/07 annual financial statements to make them more consistent with the accounts of other public and private sector entities. The Board should take this opportunity to review the presentation of its budget and summary financial results to members and the wider public to ensure that financial planning and activity is fully transparent. The changes include:

- replacement of the revenue account with a traditional income and expenditure account;
- a new statement that reconciles the income and expenditure account surplus or deficit for the year to the general fund surplus or deficit; and
- replacement of the statement of total movement in reserves with a statement of total recognised gains and losses.

Action point 2

Governance

25. In this section we comment on key aspects of the Board's governance arrangements during 2005/06 and provide an outlook on future governance issues.

Overview

26. Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviours at the upper levels of the organisation. Last year we reported that the Board had many elements of a sound corporate governance framework in place.
27. Over the past year, the Board has enhanced its corporate governance arrangements with the adoption of a Risk Management Strategy, Risk Management Policy Statement and Corporate Risk Register. Further work is required, however, to embed risk management within the Board's strategic and operational planning activity.
28. The Board has established an Audit Working Group to consider the work of Internal and External Audit. During the year, the Group assessed itself against the principles outlined in the *Guidance Note on Audit Committee Principles in Local Authorities in Scotland* but is still considering what, if any, changes should be introduced as a result. The Board is currently developing a mechanism for monitoring the implementation of External Audit recommendations.
29. Internal audit plays a key role in the Board's governance arrangements, providing an independent appraisal service to management by reviewing and evaluating the effectiveness of the internal control system. The Highland Council's Internal Audit section provided an internal audit service to the Board during 2005/06.
30. Each year we undertake an overview of internal audit arrangements which includes an assessment of whether or not we can place reliance on internal audit work in order to reduce our own input. We concluded that internal audit work within the Board continues to be of a sufficient standard to allow us to rely on it.

Anti-fraud and corruption arrangements

31. The Board has appropriate arrangements in place to prevent and detect fraud and corruption. These arrangements include a strategy for the prevention and detection of fraud and corruption, written procedures for the investigation of suspected cases of fraud and corruption and a whistle blowing policy.

Systems of internal control

32. Reliance was placed on the work of internal audit in 2005/06 to evaluate a number of key systems in place within the Board. Internal Audit undertook a high level review of the Board's systems of internal financial control and concluded that, based on the audit work carried out during the year, *'reasonable assurance can be placed upon the adequacy and effectiveness of the Board's internal control system in the year to 31 March 2006'*.
33. Our 2005/06 audit also included follow-up of progress made in implementing previous audit recommendations. We found that:
- the Board has yet to set prudential indicators, as required by the Code. We have been advised that this is because there are currently no plans to spend in excess of the annual capital grant received from the Scottish Executive;
 - the Board is continuing to develop asset management planning in order to inform and drive its capital planning decisions. A comprehensive asset register is being populated and the Board has identified the condition and upgrade requirements of all of its properties, including costing these at 2006 prices.
34. As part of our work to provide an opinion on the financial statements we assessed the extent to which we could gain assurance on the Board's payroll and creditors systems. We concluded that these systems were unable to provide us with the necessary level of audit assurance in view of the absence of the following high level controls:

Payroll

- the validity of employees listed on the payroll is not periodically checked against personnel records nor confirmed by employing departments;
- staff are not required to regularly change the passwords controlling access to the database for processing timesheets;
- the specimen signature list of officers permitted to authorise changes to the payroll is not regularly updated.

Creditors

- Financial Regulations for the purchase of goods and services are not being complied with. Officers who order goods and services are also authorising the associated invoice for payment (lack of segregation of duties), and authorisers are initialling invoices rather than signing their full name;
- there is a lack of clarity over who can authorise an invoice for payment. Form FIN 75 requires the budget holder to authorise the payment, but this is not always the case;
- the electronic specimen signature list is not regularly updated.

Future outlook

35. In the coming years the Board faces challenges to improve its governance arrangements, including:

- continuing the development of risk management throughout the organisation by embedding it within the Board's strategic and operational planning activity;
- continuing the development of asset management planning by completing a comprehensive register for all the Board's assets;.
- improving the internal controls operating within the payroll and creditors systems.

Action point 3

36. The Board has been participating in the National Fraud Initiative (NFI) which aims to identify and reduce fraud by bringing together data from local authorities and other public agencies to help detect a wide range of frauds against the public sector. The initiative also enables bodies to detect overpayments made in error or through honest misunderstandings. Audit Scotland is working with the Audit Commission to widen the scope of the NFI during 2006/07. Public bodies will provide information again in October this year and will have fresh information to investigate in early 2007. The Board needs to ensure that it uses the opportunities presented by the NFI on an ongoing basis to assist in the detection of fraud.

Performance

37. In this section we summarise key aspects of the Board's reported performance and provide an outlook on future performance.

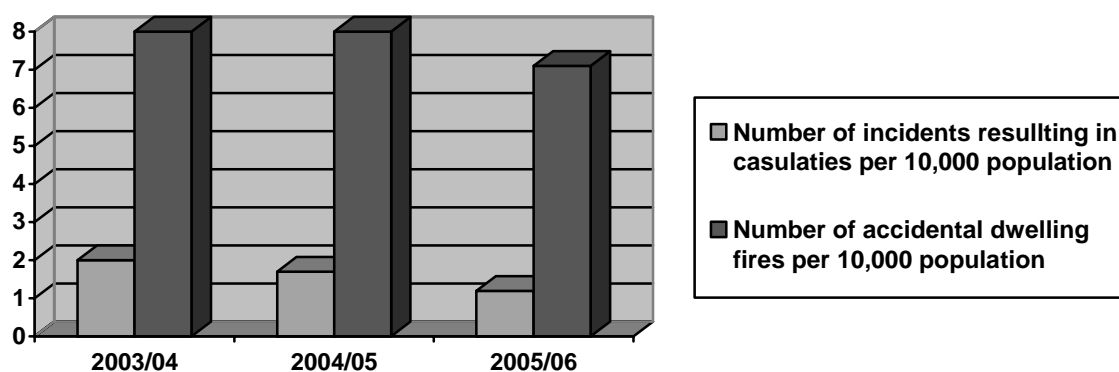
Statutory performance indicators

38. The Board has a statutory duty to collect, record and publish specified performance indicators and, so far as is practicable, ensure they are accurate and complete. The Accounts Commission issue a Direction each year detailing the statutory performance indicators (SPIs) that require to be published and external auditors review the Board's arrangements and return details of the indicators, including an opinion on their reliability, to Audit Scotland headquarters to enable compilation of national reports on performance.

39. We assessed all four of the Board's statutory performance indicators as reliable again this year. Each indicator was independently checked by Board officers this year to ensure that it had been properly calculated in response to the recommendation included in our Report on the 2004/05 Audit.

Community fire safety

40. SPIs show that the number of incidents resulting in casualties and the number of accidental dwelling fires per 10,000 population have decreased again this year. Both these rates are significantly lower than the 2004/05 Scottish average of 2.0 and 11.0 respectively.

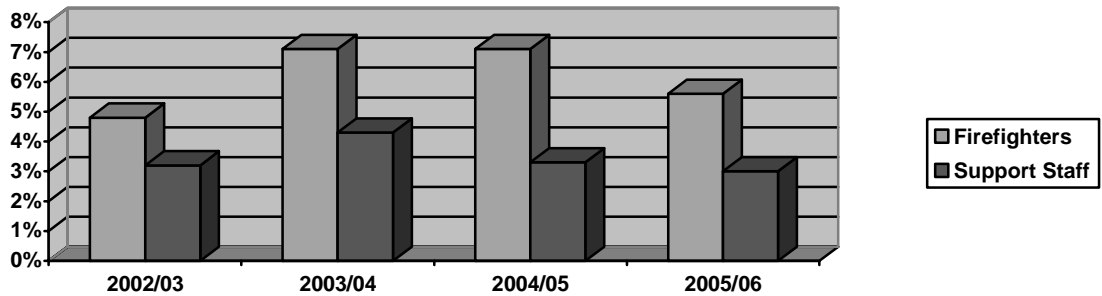


Call response time

41. In 2004/05 the Board was able to answer 96.6% of all calls within 2 minutes which was broadly in line with the 2004/05 Scottish average of 96.3%. In 2005/06 performance has deteriorated slightly, with the Service answering 96.0% of all calls within 2 minutes.

Proportion of working time lost due to sickness absence

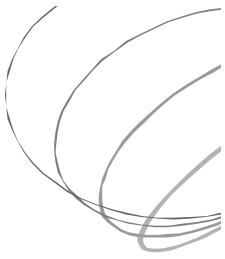
42. The level of absence for firefighters has reduced significantly since 2004/05 and currently stands at 5.6% compared with the 2004/05 national average of 7.4%. The level of absence for support officers has also decreased to 3.0% during 2005/06 which is significantly below the 2004/05 national average of 6.6%:



Future outlook

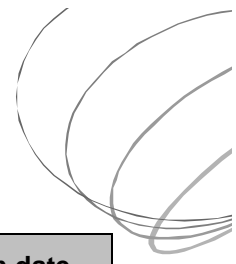
43. The Board has performed well against the SPIs in 2005/06 and in most cases exceeded the 2004/05 Scottish average performance. The main area for continuing attention in the coming years are reducing call response times.

44. A national performance audit study of fire and rescue services is currently underway, with the individual reports scheduled for publication in December 2006 and the national report in Spring 2007. The Board should take the opportunity to review their own arrangements in the light of the recommendations, and best practice, highlighted by the study.



Risk summary and action plan

No.	Issue & risk	Responsible officer	Response & agreed action	Action date
1.	<p>Financial strategy</p> <p>The Controller of Audit's <i>'Overview of the local authority audits 2004'</i> report recognises that the appropriate level of balances is for local authorities to determine, taking account of local circumstances, but stresses the need for clear strategies for managing such funds which set out their purpose and intended use.</p> <p>The Board holds a general fund reserve totalling £0.919 million but has yet to adopt a clear strategy for the use of these funds.</p> <p><i>Risk: funds are accumulated unnecessarily or that pressure to restrict rises in constituent authority contribution levels results in an inadequate cushion held to deal with emergencies.</i></p>	Head of Corporate Services	Proposals for a formal strategy on the management and use of resources will be submitted to the Board.	30 November 2006



No.	Issue & risk	Responsible officer	Response & agreed action	Action date
2.	<p>Financial reporting</p> <p>Changes have been made to the 2006 SORP which will have a significant impact on the presentation of the 2006/07 financial statements to make them more consistent with the accounts of other public and private sector entities. The Board should take this opportunity to review the presentation of its budget and summary financial results to members and the wider public to ensure that financial planning and activity is fully transparent.</p> <p><i>Risk: in the event of insufficient preparation, the 2006/07 financial statements may not comply with accounting requirements. Differences between financial reporting requirements and budget monitoring during the year may result in a lack of transparency for members and the public.</i></p>	Treasurer	Procedures are in place to review the SORP and to ensure that the 2006/07 financial statements will comply with accounting requirements. A reconciliation will be provided at the year end to provide a transparent link between monitoring information provided during the year and the financial statements.	31 March 2007
3.	<p>Governance</p> <p>The Board requires to continue ongoing developments to improve governance arrangements, including embedding risk management throughout the organisation, completion of a comprehensive asset register, and enhancing high level controls operating within the payroll and creditors systems.</p> <p><i>Risk: the Board may fail to identify and manage significant risks to its objectives including failures in the internal control. The Board may be unable to demonstrate a robust, affordable and sustainable approach to capital planning in the longer-term.</i></p>	Head of Corporate Services	<p>Revised financial regulations and contract standing orders to be produced.</p> <p>Risk management actions will continue to be a high visibility issue within the management of the delivery of the service. A review of these actions will be included in the 2007/08 service plan.</p> <p>Asset register to be updated throughout the year as property advisers visit each area as part of their regular property survey routine.</p> <p>High level controls within the payroll and creditors systems will be enhanced.</p>	<p>30 November 2006</p> <p>Ongoing</p> <p>Ongoing</p> <p>31 March 2007</p>