

Lothian and Borders Fire and Rescue Board

**Report to Members and the Controller of Audit
on the 2009/10 Audit**

October 2010

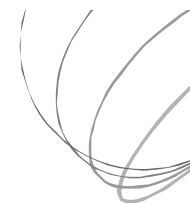


 **AUDIT SCOTLAND**



Contents

Key Messages	1	Governance and accountability	12
Introduction	2	Performance management and improvement	13
Financial statements	4	Appendix A: Action Plan	14
Use of resources	9		



Key Messages

We have audited the 2009/10 financial statements and looked at key aspects of performance management and governance, including the key financial and strategic risks being faced by the board. This report sets out our main findings, summarising key outcomes from the 2009/10 audit and the outlook for the period ahead.

Key outcomes from the 2009/10 audit

Overall we found the financial stewardship of the board to be satisfactory. The main conclusions and outcomes from the audit are highlighted below:

- we have given an unqualified opinion on the financial statements of Lothian and Borders Fire and Rescue Board
- there is scope for increased efficiency in the accounts preparation and audit process
- as at 31 March 2010 the board's reserves remained within the carry forward limits
- sound corporate governance arrangements are in place and are operating satisfactorily and we have relied on the work of internal audit and their conclusions in relation to these arrangements.

Outlook

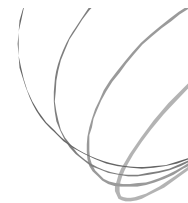
The most significant challenge the board faces is a reduction in funding in the years 2011 to 2014.

Although the exact size of the reduction will not be known until late October 2010, the board can and must take action now to anticipate significant cuts in its budget. The board's corporate management team and the Scrutiny Committee have recognised this and all areas of activity, whether support or front line, have been reviewed in detail to contribute towards demonstrating real reductions in planned expenditure.

Member involvement and support for this process needs to continue as tough decisions are made. The likely scale of the reductions means the board faces the risk of poor morale and motivation amongst staff as well as difficult decisions regarding the level of service that can be afforded relative to that envisaged by the Service Improvement Plan. Never has the case been stronger for sound governance and good financial management.

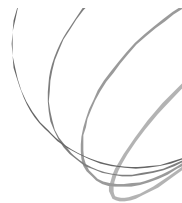
The co-operation and assistance given to us by Lothian and Borders Fire and Rescue Board members, officers and staff as well as the Treasurer's staff in the City of Edinburgh Council (CEC) is gratefully acknowledged.

October 2010



Introduction

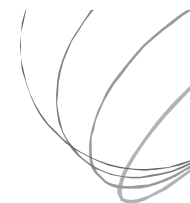
1. This report is the summary of our findings arising from the 2009/10 audit of Lothian and Borders Fire and Rescue Board (the board). The scope of the audit is set out in the Annual Audit Plan which was submitted to the board in February 2010.
2. The financial statements of the board are the means by which it accounts for the stewardship of the resources made available and its financial performance in the use of those resources. It is the responsibility of the board to prepare financial statements that give a true and fair view of its financial position and of its income and expenditure for the year.
3. 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 financial statements and the effective management of assets and interests
 - the board has adequate 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 misstatement, error, fraud or corruption
 - the board has proper arrangements for securing best value in its use of resources.
4. Audit Scotland carries out a national study programme on behalf of both the Accounts Commission and the Auditor General. Reports published in the last year of that may be of interest to the board are:
 - How councils work: an improvement series for councillors and officers - Roles and working relationships: are you getting it right?
 - National Scrutiny Plan for Local Government 2010/11
 - Improving public sector efficiency
 - An overview of local government in Scotland 2009
 - Scotland's public finances: preparing for the future



- Making an Impact: Overview of the Best Value audits 2004-09
- Best Value in Police evaluation

(Full copies of the studies can be obtained from Audit Scotland's web page at www.audit-scotland.gov.uk.)

5. Appendix A is an action plan setting out the high level risks we have identified from the audit. Officers have considered the issues and have agreed to take the specific steps set out in the column headed *Planned Management Action*. We do not expect all risks to be eliminated or even minimised. What we are expecting to see is that the board understands its risks and has in place mechanisms to manage them. Members should ensure that they are satisfied with the proposed management action and have a mechanism in place to be duly assured that the proposed action has been implemented.
6. This report is addressed to members and the Controller of Audit. It will be published on our website after consideration by the board.



Financial statements

Introduction

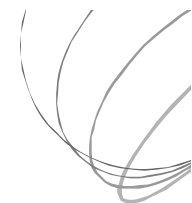
7. In this section we summarise key outcomes from our audit of the board's financial statements for 2009/10, comment on the significant accounting issues faced, and provide an outlook on future financial reporting issues.

Audit opinion

8. We have given an **unqualified** opinion that the financial statements of Lothian and Borders Fire and Rescue Board for 2009/10 give a true and fair view of the financial position and expenditure and income of the board for the year. We also certify that the accounts have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements.
9. We were satisfied with disclosures made in the governance statement and the adequacy of the process put in place by the board to obtain the necessary assurances regarding governance.
10. The board's unaudited financial statements were submitted to the Controller of Audit by the deadline of 30 June. During the course of the audit we identified scope for improved efficiency in the accounts preparation and audit processes. We will continue to work closely with CEC finance staff in planning our 2010/11 audit in order to ensure that the quality and timeliness of documentation we require improves thereby simultaneously increasing the efficiency of the audit process and minimising the audit burden on board staff.
11. The accounts were certified by the target date of 30 September 2010 and are now available for presentation to members and 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.

Accounting issues

12. Local authorities in Scotland are required to follow the *Code of Practice on Local Government Accounting in the United Kingdom – a Statement of Recommended Practice* (the SORP). No major changes were introduced by the 2009 SORP and we were satisfied that the board prepared the accounts in accordance with the 2009 SORP.
13. The board has adjusted the financial statements to reflect audit findings. As is normal practice, these audit findings have been reported to the Treasurer and board via our letter issued in line with International Standard on Auditing 260 (ISA 260) *Communication of audit matters to those charged*

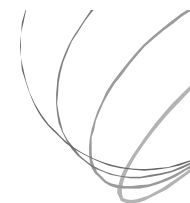


with governance. Details of significant accounting issues which arose during the course of our audit are summarised below.

14. **Pensions Reserve:** An anomaly in the Pensions Regulations was corrected by the Scottish Government, this required the technical adjustment necessary in 2008/09 be reversed in 2009/10. Finance staff correctly processed the appropriate changes.
15. **Land and buildings valuation process:** All land and buildings are subject to formal revaluation once every five years and this took place as at 1st April 2009 for the board. The land and buildings of the board are subject to valuation by relevant qualified CEC staff. The methods, techniques and considerations to be made in such valuations are set out in RICS guidance and compliance with such guidance is a SORP requirement. One component of this guidance is to require that internal valuations are subject to independent review. The absence of independent review of board land and buildings valuation has been considered during the audit process and, in terms of audit risk, we are content that that based on evidence and representations received from management these valuations have a sound basis.
16. **Fixed asset revaluation and depreciation accounting:** The operation of the fixed asset register for land and buildings is carried out by CEC. The audit process revealed that accounting for, and disclosure of asset revaluation and depreciation was strictly not in accordance with the SORP, in that the revaluation amount included in-year additions. Furthermore, the depreciation charge was based on the opening balances rather than the revalued amount. This can affect the amounts charged to the Income and Expenditure Account and revaluation reserve respectively. We acknowledge that the approach adopted is consistent with that applied by the CEC but the impact of these approaches is less significant where there is a rolling programme of asset revaluations.
17. The matter has been resolved for 2009/10 by better presentation of the relevant information in the financial statements and amending the relevant accounting policy, while ensuring the consistency of accounting policies within the CEC Group. This is of particular importance in 2010/11 with the introduction of International Financial Reporting Standards which requires a re-statement of the opening balance sheet position in order to comply with these new requirements. We will revisit this area in the 2010/11 audit to ensure that there are no consequential accounting issues with any rolled forward balances.

Key Risk Area 1

18. **Land at Newbridge:** The accounting treatment for land at Newbridge for the building of the board's training centre was revised as the result of preparatory work for International Financial Reporting Standards (IFRS), when it became apparent that the lease was operational rather than financial in nature. As a consequence this land has now been accounted for as a long term debtor rather than a



fixed asset. From evidence obtained during the course of our audit we are satisfied that the necessary planning and design phases of the training centre are now well advanced.

Audit testing

19. As part of our work, we took assurance from a number of the main financial systems used by the board and operated by the CEC. Our colleagues in the CEC external audit team assessed the following relevant central systems as having a satisfactory level of control for our purposes:

- Payroll
- Creditors payments
- Main accounting system
- Debtors and income

20. In addition, the external audit team at CEC also assessed the overall adequacy of internal audit and concluded positively. We placed formal reliance on the work of internal audit in relation to their annual report to the board in support of the Annual Governance Statement included with the financial statements as well as in relation to payroll and accounts payable. The work of internal audit was adequate for our purposes and we appreciate the value of sharing information to ensure that we avoid duplication of audit effort.

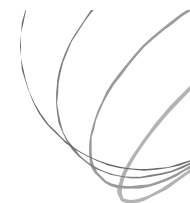
21. Notwithstanding the overall adequacy of record keeping we have identified opportunities for greater audit efficiency if documentation we request is received timeously avoiding the need for reiterating documentation requests. We will work closely with LBFRB staff next year to ensure that obtaining audit evidence is more efficient.

Prevention and detection of fraud and irregularities

22. At the corporate level, the board has appropriate arrangements in place to help prevent and detect fraud, inappropriate conduct and corruption. During the 2009/10 financial year there were no reported instances of fraud or any other irregularity.

Legality

23. Through our planned audit work we consider the legality of the board's financial transactions. In addition the Treasurer confirmed that, to the best of his knowledge and belief, and having made appropriate enquiries of the board's management team, the financial transactions of the board were in accordance with relevant legislation and regulations. There are no additional legality issues arising from our audit which require to be brought to members' attention.



Financial reporting outlook

IFRS adoption

24. International Financial Reporting Standards (IFRS) is a requirement for 2010/11 and, to date, the board have undertaken the necessary preliminary work to ensure a capability to produce IFRS compliant financial statements. This change in financial reporting is part of a wider public-sector move towards international standards. One aspect of financial reporting that will change will be in relation to remuneration of senior staff where more information (including names and pension benefits earned or received) will be required. For 2009/10 senior salary disclosures are SORP compliant.
25. Given that more remuneration information will be provided it is important that relevant staff are made aware that some of their personal details will be disclosed in 2010/11. One challenge will be to ensure that readers of the accounts understand the difference between pension and salary since, where lump sums are involved, overall total remuneration can be distorted. In dealing with this matter it is essential that the board does not lose sight of the principles of transparency, openness and accountability.

Key Risk Area 2

26. LBFRB should take advantage of IFRS to look afresh at a number of accounting matters notwithstanding that each year all of the accounting policies are already subject to high level review for appropriateness. One of the inherent challenges in financial reporting in the local government sector is that financial management and financial reporting are undertaken on quite different bases. Budget setting and monitoring is on the basis of funding and commitments whereas the statutory financial statements include a significant level of accounting estimation to arrive at an overall financial position by complying with the relevant accounting requirements. One way in which this could be better addressed is by curtailing or stopping altogether the inclusion of budget figures within the financial statements. We commented on this in our ISA260 letter regarding the 2009/10 financial statements and drew attention to this departure from best practice.

Key Risk Area 3

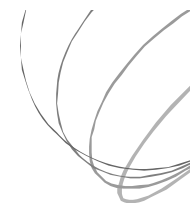
27. Another area where the board's financial statements depart from best practice is that figures are presented to the nearest pound, rather than rounded to £'000. This practice produces inconsistent reporting of financial results with the regards to the public and private sector as a whole.

Key Risk Area 3



Pensions

28. As well as IFRS there will be changes to responsibility for pensions. These changes will mean that pension contributions and payments as well as pension liabilities will be the responsibility of the Scottish Government. A consequence of these changes will mean that the financial statements will better reflect the operational aspects of the board which will no longer be affected by huge pension liabilities and associated reserves. It is important that the board be made fully aware of these changes and what they mean for the financial position of the board.



Use of resources

Financial results

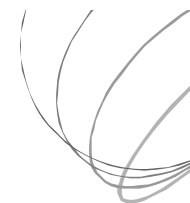
29. The board's net operating expenditure was £68.5 million (2008/09: £63.0 million) resulting in a net deficit on the income and expenditure account of £16.8 million (2008/09: £9.7 million). The surplus or deficit on the income and expenditure account measures the board's financial result for the year, recognising the resources that have been consumed and generated in accordance with Generally Accepted Accounting Principles. The board's net cost of service in 2009/10 was £49.5 million (2008/09: £45.8 million).
30. The balance sheet discloses a net liability position of £363.3 million (2008/09: £242.5 million). The movement on the general fund balance is also an important aspect of the board's stewardship as the main budget reference point. The general fund balance at 31/3/2010 was £3.9 million (2008/09: £3.7 million). The balance carried forward is within statutory limits and is considered adequate by the board.

Going concern

31. The board's balance sheet discloses net liabilities of approximately £363.3 million (2008/09: £242.5 million) represented by balances on a capital adjustment account of £18.1 million (2008/09: £22.4 million), general fund £3.9 million (2008/09: £3.7 million) offset by a pension reserve balance of £394.3 million (2008/09: £268.6 million). As can be seen from this analysis the liability position arises solely as a result of pension liabilities. Because pension liabilities are accounted for when they arise but are paid when due there is no going concern matter arising since government policy is that pension liabilities be met when due and that funding will be provided for this on an ongoing basis. It is likely that the board in 2010/11 will no longer be in this technically insolvent position because the pension liabilities will be accounted for elsewhere.

Capital expenditure 2009/10

32. The board spent £1.5 million on vehicles, plant and equipment. During the audit we followed up our previous work in relation to the combined aerial rescue pump (CARP) appliances. As with any new design or innovation there were a number of technical teething problems with the new type of appliance. In our annual report last year we concluded that technical teething problems were being addressed by relevant staff and that full operational use of these appliances would be made. As further information came to light and a number of iterations regarding technical loading and tilting tests took place it has become apparent that it is now less likely that these appliances will be used by the board as intended.



33. For a short time one CARP appliance was operational but serious issues (for example unexplained wheel lifting and problems with the boom mechanism) has resulted in them not being serviceable since August 2010. LBFRS management acted swiftly to minimise health and safety risks arising from these problems and have been considering options for what to do with the CARP appliances now that it has been established that they are unable to be deployed as intended. In 2010/11 it is important that the accounting as well as operational impacts of problems with these appliances be considered and acted upon.

Key Risk Area 4

34. The board spent approximately £0.7 million on land and buildings. This included further progress with respect to the Newcraighall Firestation and completion of the design phase, including obtaining the necessary planning permission, for the board's training centre at Newbridge.

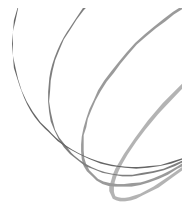
Support services

35. Support functions provided by the CEC to the board, include payroll, legal services, internal audit, accounts payable and accounts receivable. In addition, the CEC's finance function prepares the annual financial statements for the board. In 2009/10 the cost of these services was £0.3 million (2008/09: £0.4 million) which represents 5% of the board's operating costs (2008/09: 7%). As can be seen there has been a 26% reduction in the level of charges made to the board from CEC. These charges are allocated to the board on the same basis to departments of CEC and are predicated on activity levels. Main components of the reduction in charges is less finance costs being recharged, a refund for previous overcharging in relation to employee relations and less demand for legal work.
36. In our report on the 2008/09 audit we drew attention to the fact that these arrangements and the levels of service and performance to be provided were not subject to a formal Service Level Agreement and recommended that the board address this. We note that this has not yet been completed. The additional scrutiny and efficiencies that are in place appear to have borne fruit in the form of lower costs. Nevertheless arrangements, in order to comply with good practice and establish a transparent means for setting and monitoring service delivery criteria for quantity, quality and cost, would be better if they were formalised in service level agreements.

Key Risk Area 5

Firelink

37. In March 2010 the board implemented Firelink which is a government funded national communication system for fire and rescue services and is designed to provide greater communication functionality between all UK fire and rescue services. To date the board's experience of Firelink is positive and it



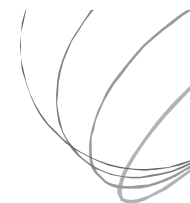
appears to be sufficiently resilient and robust to meet the board's needs. Although there have been a number of Firelink service outages existing contingency arrangements meant that satisfactory communications functionality was preserved and there was no significant impact on operational fire cover or responsiveness.

38. Firelink also enables more seamless communication between different fire and rescue services in the event that more than one is required to attend an incident. The board's legacy communications systems have not been terminated as yet and have remained in place on a contingency basis. The termination of the board's legacy systems and contractual arrangements are currently being progressed.

Asset management and local purchase order processing

39. The IT system used by the board to manage vehicle, plant and equipment assets as well as stock and other equipment has also been used for purchase order processing and aspects of accounts payable. We are aware that during 2009/10 technical problems with this software from previous years had still not been fully resolved. Technical difficulties with this software were further exacerbated by staff users not processing transactions properly.
40. All these difficulties meant that stock records in year contained some inaccuracies that were proactively investigated and resolved by management and further delayed full integration with CEC systems so that there was no need for transactions to be input twice. Since this software was purchased a number of years ago and problems have been ongoing we remain concerned with the level of staff resource being consumed by dealing with problems and uncertain that a software solution now exists. The board needs to consider the most pragmatic way forward in relation to this system.

Key Risk Area 6



Governance and accountability

Introduction

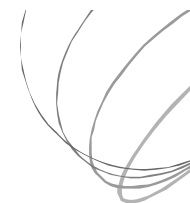
41. We believe that an effective organisation is committed to high standards of probity and can demonstrate high standards of governance and accountability. It has effective managerial structures and processes to govern decision-making and the exercise of authority within the organisation.

Structure and policies

42. Corporate governance is about direction and control of organisations. The board has assessed its own arrangements against the CIPFA/SOLACE guidance: *Delivering Good Governance in Local Government*. The assessment results suggest that the board has a sound governance framework.
43. Effective scrutiny is central to good governance, with a significant role for members to scrutinise performance, hold management to account, and support continuous improvement. The board scrutiny committee receives and reviews all reports and plans from internal and external audit. In 2009/10 the scrutiny committee has met more often than normal in order to consider dealing with financial pressures being brought to bear across the public sector.
44. The Accounts Commission issue a range of national study reports and an overview of local government each year. Recommendations are generally directed at all councils but may be applicable to the board as well. It would be appropriate for the board to consider findings and ensure that significant matters are being addressed. We will draw management attention to those reports we believe may be of value to the board in the expectation that they will be considered at board meetings as appropriate.

Public performance reporting

45. The board produces a number of reports each year regarding the Service Improvement Plan. The E-Zine of the Lothian and Borders Fire and Rescue Service represents the main media through which performance and initiatives of the service are communicated to citizens. The E-zine appears accessible and informative.
46. With the move to IFRS there may be some scope for developing an overall publication incorporating an annual report from the fire and rescue service along with the financial statements of the board. Not only would such a publication give a more comprehensive picture to stakeholders and citizens of the board's business and activities but may also create more interest in reading the financial statements as well.



Performance management and improvement

Performance management

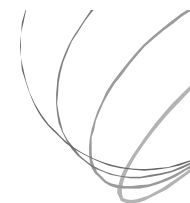
47. Whilst we remain vigilant to any performance management matters that may come to light during the course of our audit our primary focus is the audit of the board's financial statements. The board are currently assisting to develop best value methodologies for fire and rescue services with our colleagues from our best value team in Audit Scotland and we will monitor developments in this area.
48. SPI arrangements in 2009/10 have changed in that much more emphasis, in the audit process, is being placed on performance management generally.

Risk management

49. Risk is the threat that an event, action or inaction will adversely affect an organisation's ability to achieve its objectives. Risk management is the process of identifying, evaluating and controlling risks. Risk management supports decision making and contributes to performance.
50. The board's business means that many of the risks faced are operational in nature and arrangements appear to be in place to prepare for and plan for dealing with incidents adequately and in partnership with other bodies as circumstances may dictate. The board has a good approach to managing risk. There is a risk register that is regularly updated and monitored by senior management.

Outlook

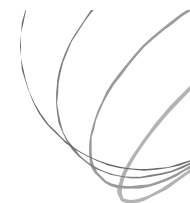
51. As with all public sector bodies the current economic climate means that board will increasingly be under pressure to bear budget cuts. At the time of writing this report funding decisions for the public sector overall in 2011/12 are yet to be made. Whilst the nature and extent of funding cuts is unknown in detail it is known that they will be significant. Strong leadership by the board and senior management will be essential to effectively manage funding challenges including working effectively with other fire and rescue services as well as the Scottish Government.



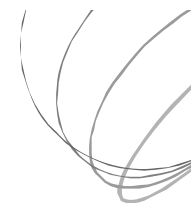
Appendix A: Action Plan

Key Risk Areas and Planned Management Action

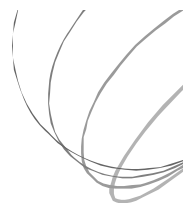
Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
1	17	<p>Fixed Assets: Revaluation and Depreciation</p> <p>Balances rolled forward to 2010/11 may not be accurate because of the way in which the CEC fixed asset register works.</p> <p>Risk <i>There is a risk that accurately accounting for fixed assets and depreciation may be impacted by the way in which the CEC fixed asset register works.</i></p>	<p>The system used by CEC to provide asset balances and depreciation figures has been reconciled to the 2009/10 financial statements and forms the basis for the 2010/11 opening position.</p>	Treasurer	Completed
2	25	<p>IFRS preparedness: remuneration</p> <p>More extensive remuneration disclosures will be made in 2010/11 and it is essential that both senior staff and the board approach this matter with due regard to the principles of transparency, openness and accountability.</p> <p>Risk <i>There is a risk that either senior staff will attempt to limit remuneration disclosures or that there is insufficient clarity in the disclosures made.</i></p>	<p>Arrangements for remuneration disclosures are currently being reviewed and are planned to be incorporated on the Service's Internet site.</p>	Corporate Communications Manager	April 2011



Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
3	26 & 27	<p>IFRS: rounding and budget figures</p> <p>Preparation of financial statements to the nearest pound is a departure from best practice and makes them less accessible than they could be.</p> <p>Notwithstanding the adequacy of disclosures in the 2009/10 financial statements drawing attention to the different bases used for in year financial management and financial reporting it would be better practice to curtail or cease including budget figures within the financial statements.</p> <p>Risk</p> <p><i>There is a risk that readers of future year's financial statements may perceive apparent variances from budget that are, in actuality, merely arising as a result of different accounting purposes. Similarly there is a risk that readers of the financial statements are discouraged from reading them in full when they see how many numbers there are to take in.</i></p>	As part of the new IFRS reporting requirements, the financial statements will be presented in £'000s in future. Budget figures will cease to be presented alongside actual figures throughout the financial statements.	Treasurer	April 2011
4	33	<p>Combined aerial rescue pumps</p> <p>The board purchased combined aerial rescue pumps two years ago and a number of manufacturer errors and technical problems were being addressed. Subsequently these appliances marginally failed technical testing regarding loading and tilting.</p>	Accounting for the carrying values of CARP appliances in the March 2011 balance sheet will be subject to normal impairment review in the light any additional information coming to light during the 2010/11 financial year and the necessary bookkeeping action taken.	Treasurer	March 2011



Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
		<p>Risk</p> <p><i>There is an accounting risk that the values of these appliances in the fixed asset register are overstated and accounting requirements indicated that they may require to be impaired. Similarly there is an asset management risk as a consequence of these appliances becoming non-operational and a need to acquire operationally readied appliances to address the emerging shortfall of operational appliances.</i></p>	<p>This issue will be reported to the Scrutiny Committee by the Chief Fire Officer in October 2010. The legal and mitigation options are currently being analysed. There is no risk to Operational readiness as other appliances are being used instead.</p>	Chief Fire Officer	November 2011
5	36	<p>Service Level Agreements</p> <p>A service level agreement between the Lothian and Borders Fire and Rescue Board and the CEC should be formalised and presented to the board for their approval.</p> <p>Risk</p> <p><i>The Board cannot easily monitor the performance of services provided by the CEC.</i></p>	<p>Work is ongoing. A draft SLA has been developed and is currently being reviewed.</p>	Treasurer / Chief Fire Officer	April 2011
6	40	<p>Equipment, stock and procurement software</p> <p>Technical problems with software and user error (possibly as the result of a lack of training) mean that long standing difficulties in this area remain and result in a lack of full integration with CEC systems.</p> <p>Risk</p> <p><i>There is a risk that a software solution will not be reached and that ongoing difficulties will continue along with inefficiencies</i></p>	<p>The need to review and improve the Procure to Pay process was highlighted within the Finance Best Value Review reported to the Scrutiny Committee on 28th April 2010.</p> <p>A range of options to improve this process are currently being analysed.</p>	Head of Central Services	April 2011



Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
		<i>inherent in current arrangements (i.e. double keying of all transactions to be paid).</i>			