Government and Public Sector

August 2010

Annual Report to the Board of Strathclyde Fire & Rescue and the Controller of Audit
2009/10 Audit

Contents

1. Executive Commentary

Introduction – Section 2

Our overall responsibility as external auditor of Strathclyde Fire & Rescue ("the Board" or "SFR") is to undertake our audit in accordance with the principles contained in the Audit Scotland Code of Audit Practice ("the Code"), revised and published in March 2007. We have a dual reporting responsibility for the audit: to the Board Members of SFR and to the Auditor General for Scotland.

Financial Statements and Audit Opinion – Section 3

The financial statements of the Board for the year ended 31 March 2010 have been prepared to comply with accounting requirements contained in the 2009 SORP and have been properly prepared in accordance with the Local Government (Scotland) Act 1973. We are pleased to report that in our opinion, the financial statements give a true and fair view of the financial position of Strathclyde Fire and Rescue as at 31 March 2010 and of the income and expenditure and cashflows for the year then ended. We are therefore pleased to report that our opinion is unqualified.

The Police and Fire Services (Scotland) Act 2001 makes provision for the Board to carry forward unspent balances each financial year provided they are below 3% of the contributions (precepts) received from the Board's twelve constituent local authorities. In addition, the cumulative balance (the in year surplus including reserves, but excluding the pensions reserve) carried forward into future years should not exceed 5% of the local authority precepts received in year, unless specific consent is obtained from the Scottish Government. The Board was within both limits for the year ended 31 March 2010.

Going Concern

The Board's balance sheet discloses an excess of liabilities over assets of £1,096 million (£679 million in 2008/09) due to the accrual of pension liabilities. An excess of liabilities over assets is one of the indicators that may lead to concerns over the ability of an organisation to continue as a going concern. Therefore in accordance with International Standards on Auditing ("ISA") 520 we have considered whether the Board is entitled to prepare its financial statements on a going concern basis. The Board has adopted the going concern basis for the preparation of its financial statements because the pension liability does not impact on its underlying ability to meet its current and ongoing commitments. Future pension payments will be made as they fall due, and will be funded by the contributions from constituent authorities in the form of the precept levy. Formal representations have been obtained from management in this regard and we agree with the basis of the preparation of the accounts.

Prior Year Restatements

The Board has been required to restate two prior year balances relating to the Pension Reserve and General Fund Balances. These restatements are the result of Scottish Government legislative changes in 2009/10 that must be applied retrospectively. Full details of the changes are provided in Section 3.

Icelandic Bank Impairment

The Board held investments of £3 million in Icelandic banks at the time of the banking collapse in 2008. The investments were impaired in the 2008/09 financial statements based on information provided by the administrators. The carrying value has again been updated at 31 March 2010 to reflect the latest forecasts on expected returns and the balances repaid in the year. The receipt of £1 million during the year and improved expected returns has led to a decrease in the impairment of £0.1 million. As in 2008/09 the Board has taken advantage of the legislation to defer the impact of the impairment until 2010/11.

2009/10 Performance – Section 4

The Income and Expenditure account reports a deficit of £44.695 million for 2009/10. However, after adjusting this in-year deficit to reflect the appropriate statutory and non-statutory adjustments, the Board achieved a surplus, contributing £0.166 million to their General Fund.

The Board has reported efficiency savings of 4.2%, which is above the Scottish Government target of 2% for 2009/10.

Governance and Control – Section 5

We have reviewed the Board's overall governance arrangements including a review of Board and key Forum structures and minutes, financial reporting to the Board, and risk management. Appropriate arrangements appear to be in place to ensure that the Board is able to undertake its governance role effectively.

SFR devotes time and resources to achieve effective partnership working. As a Joint Board, SFR has a close working relationship with the 12 constituent Local Authorities in Strathclyde, as well as other emergency services to ensure services are delivered effectively.

Managing in Uncertain Times – Section 6

Despite entering the downturn with a relatively strong financial position the Board currently faces a period of uncertainty. Impending tightening of public expenditure will impact Local Authorities and the Joint Fire Boards at a time when the cost base will continue to rise.

While some organisations will be more vulnerable than others, all public sector bodies, including SFR, will be impacted. Regardless of whether a body is in a relatively stronger or weaker financial position, difficult decisions are going to have to be made. We recommend looking at six key areas that our experience in other sectors has shown may be relevant to addressing the challenges ahead:

- Honesty and awareness of the size of the challenge
- Strong leadership
- Need to engage with the whole organisation and external stakeholders
- Realistic and detailed plans to resolve the situation
- Rigorous implementation (programme management arrangements)
- Financial control and discipline

The Board is already considering how best to respond to the existing drive for efficiencies. Forecasts for the next four years include "downside" scenarios and budget holders will be challenged by the adoption of priority based budgeting. Tough decisions on which spending plans take priority are likely to be faced by the Board in the coming months and years.

2. Introduction

Purpose of this report

The Annual Audit Report which follows is designed to set out the scope, nature and extent of our audit, and to summarise our opinion and conclusions on issues arising. Specifically this will direct your attention to matters of significance that have arisen out of the 2009/10 audit process and to confirm what action is planned by management to address the more significant matters identified for improvement.

Scope, nature and extent of our audit

Our overall responsibility as external auditor of Strathclyde Fire & Rescue (the Board or SFR) is to undertake our audit in accordance with the principles contained in the Code of Audit Practice issued by Audit Scotland in March 2007. In this regard, the Code sets out the need for public sector audits to be planned and undertaken from a wider perspective than in the private sector involving not only assurance on the financial statements but also consideration of areas such as regularity, propriety, performance and the use of resources. It also sets out the need to recognise that the overall audit process is a co-ordinated approach involving the "appointed auditor" and the Auditor General for Scotland. Our audit has been planned and conducted to take account of these wider perspectives.

Under the requirements of International Standard on Auditing (UK and Ireland) ('ISA') 260: "*Communication of audit matters to those charged with governance*", we are required to communicate audit matters arising from the audit of financial statements to those charged with governance of an entity. This Annual Audit Report to Members, together with previous reports to the Audit Committee throughout the year, discharges the requirements of ISA 260.

Acknowledgment

We would like to formally extend our thanks to the management and staff of Strathclyde Fire & Rescue for the assistance they have given us throughout the audit process.

PricewaterhouseCoopers LLP
Glasgow

August 2010

3. Financial Statements and Audit Opinion

Audit opinion

Our audit opinion concerns the presentation of Strathclyde Fire and Rescue's financial position as at 31 March 2010 and its income and expenditure for the year then ended.

Our opinion on the accounts states whether the financial statements:

- give a true and fair view, in accordance with relevant legal and regulatory requirements and the 2009 SORP, of the financial position of the Board as at 31 March 2010 and of its income and expenditure for the year then ended; and
- have been properly prepared in accordance with the Local Government (Scotland) Act 1973.

We are pleased to report that our opinion on the true and fair view of the 2009/10 financial statements is **unqualified**.

Police and Fire Services (Scotland) Act 2001

The Police and Fire Services (Scotland) Act 2001 makes provision for the Board to carry forward unspent balances each financial year within prescribed limits. The surplus carried forward into the future year by the Board must not exceed 3% of the contributions (precepts) received from the Board's twelve constituent local authorities. In addition, the cumulative balance (the in year surplus including reserves, but excluding the pensions reserve) carried forward into future years should not exceed 5% of the local authority precepts received in year, unless specific consent is obtained from the Scottish Government. The Board's performance against these targets for the year ended 31 March 2010 was:

Limit	Limit set %	Actual % carry forward
In year carry forward	3	0.18
Cumulative carry forward	5	3.63

Audit Process

The financial statements and supporting schedules were presented to us for audit within the agreed timetable. The quality of working papers provided by management was of a very high standard. Overall an efficient audit process was achieved through an effective working relationship with your staff.

Basis of Preparation

The financial statements were prepared in accordance with the accounting requirements contained in the Code of Practice on Local Authority Accounting in the United Kingdom 2009: A Statement of Recommended Practice ("SORP").

Approval

The Board's draft financial statements were signed as authorised for issue by the Treasurer to the Board on 28 June 2010 and submitted to the Controller of Audit by the statutory deadline of 30 June 2010.

Unadjusted misstatements

Under ISA 260 - "Communication of audit matters to those charged with governance", we are required to report to you all unadjusted misstatements which we have identified during the course of our audit, other than those which we deem to be of a trivial nature.

As a result of our work, we proposed a number of audit adjustments and all of these have been processed by management in the final version of the 2009/10 financial statements. We therefore have no unadjusted misstatements to report.

Going Concern

The Board's balance sheet discloses an excess of liabilities over assets of £1.096 billion (£678.951 million in 2008/09) due to the accrual of pension liabilities. An excess of liabilities over assets is one of the indicators that may lead to concerns over the ability of an organisation to continue as a going concern. Therefore in accordance with International Standards on Auditing ("ISA") 520 we have considered whether the Board is entitled to prepare its financial statements on a going concern basis. The Board has adopted the going concern basis for the preparation of its financial statements because the pension liability does not impact on its underlying ability to meet its current and ongoing commitments. Future pension payments will be made as they fall due, and will be funded by the Scottish Government Grant Funding. Formal representations have been obtained from management in this regard and we agree with the basis of the preparation of the accounts.

The pension liability on the balance sheet has increased by £407.936 million in 2009/10. This is principally due to the fact that the financial assumptions at 31 March 2010 are less favourable than they were at 31 March 2009, and the mortality assumptions have been amended to reflect improvements in life expectancy.

Pension benefits are linked to price and salary inflation. Central to calculations of future pension benefits, and therefore the pensions liability on the balance sheet, is the real discount rate which is used to determine the current value of future liabilities. A fall in corporate bond yields over the year combined with an increase in the future level of inflation expectations has contributed to lower real discount rates at 31 March 2010 than at 31 March 2009 leading to a higher value being placed on the liabilities. The real discount rate has decreased significantly from 3.7% p.a. as at 31 March 2009 to 1.6% p.a. as at 31 March 2010. The SFR position is consistent with other joint boards that operate similar pension schemes.

Accounting Issues

A number of accounting issues were discussed with management during the audit. The most significant of these are set out below:

Prior Year Adjustment – FRS 17 retirement benefit costs

Scottish Government regulations generally require that the difference between retirement benefit costs as calculated under FRS 17 and the Board's actual employer's pension contributions are charged to the Pensions Reserve. However, during 2008/09 it came to light that no regulation had been put in place to permit this in respect of the New Firefighters' Pension Scheme which came into effect from 6 April 2006.

The cumulative impact of this issue as at 31 March 2009 was calculated as £2.4 million which was material to the financial statements. The Treasurer to the Board agreed to make the necessary adjustments to ensure that the Board had complied with the Accounting Standard. The result was that £2.4 million was charged against the General Fund balance, with a corresponding reduction to the Pension Reserve.

In 2009/10 the Scottish Government amended the regulation, SSI 2010/34 to include the New Firefighters' Pension Scheme and applied the changes retrospectively. The £2.4 million reduction to the General Reserve has therefore been reversed in the 2009/10 accounts as permitted by the regulations.

The Fund Balances and Reserves total in the 2008/09 financial statements was £6 million. In the 2009/10 restated financial statements this has been increased to £8.4 million.

Prior Year Adjustment – Injury Benefit Treatment

During 2009/10 changes have been made to how pension costs are funded. These changes have included a reclassification of injury benefit payments to remove them from pension costs. As outlined above, Scottish Government regulations allow FRS17 pension costs to be transferred to the Pension Reserve in order that the impact on the General Fund is restricted to the actual in-year cost of making payments to retired firefighters. These regulations no longer extend to Injury Benefit payments. However, further guidance was released by the Scottish Government detailing a new accounting treatment to transfer the injury benefit costs to an Employee Statutory Mitigation Account in place of the Pension Reserve. The implication of the change is the Injury Benefit costs must be separated from those relating to Pensions.

This means that the 2008/09 liability related to Defined Benefit Pension Schemes and Pensions Reserve balances have been split with a new liability on the balance sheet created for Other Retirement Benefit Liabilities and a new Employee Statutory Mitigation Account reserve created. The table below sets out the original and restated balances. The 2009/10 figures, as provided by the Board's Actuary, have been posted as required to the appropriate new account.

	Original Pension Reserve 2008/09 £000s	Injury Benefit Adjustment £000s	FRS 17 Adjustment £000s	Amended Pension Reserve 2008/09 £000s
Liability related to defined benefit pension schemes	(821,035)	13,400	-	(807,635)
Other retirement benefit liabilities	-	(13,400)	-	(13,400)
Pension Reserve	(818,635)	13,400	(2,400)	(807,635)
Employee Statutory Mitigation Account	-	(13,400)	-	(13,400)

Fixed Asset Register

The Board had planned to have an automated fixed asset module in place by the 2009/10 year end. A number of difficulties were experienced during the year that prevented the project from being completed prior to the year end. Plans are now in place to complete the project during 2010.

The delays in the project have meant that as in prior years Excel spreadsheets were used as the fixed asset register. The potential issues arising from using spreadsheets have been highlighted to management in prior years and are included in audit action plans, which are still to be fully implemented.

As in prior years, difficulties were experienced in completing the fixed asset audit work and some audit adjustments were proposed as a result of errors identified in the spreadsheets. Management has acknowledged the issues, and their disappointment at not completing the move to the fixed asset module prior to the year end. Management also agreed to amend the accounts for the adjustments proposed, none of which impacted the General Fund balance. Management should however ensure sufficient resources are directed towards the fixed asset module project in the immediate future to ensure it is completed promptly.

Action 1

The Board does not disclose any intangible assets and does not have an accounting policy covering intangible fixed assets. The change to IFRS accounting requires Boards to restate prior year accounts from a UK GAAP basis to an IFRS basis. The transition process should include a review of accounting policies to ensure they all remain appropriate. As part of the transition to IFRS, the Board should review its accounting policy in relation to intangible assets and review asset registers to ensure that there are no assets currently classified as tangible which meet the definition of intangible assets under IFRS. If any such assets are identified they should be included within the IFRS restatement adjustments processed to prepare the shadow IFRS balance sheet and appropriately separated from Property, Plant and Equipment in the 2010/11 financial statements.

Action 2

Icelandic Bank Impairment

The Board had £3 million invested in Heritable Bank at the time of the collapse of Icelandic banks in 2008. Heritable Bank is now in administration resulting in the carrying value of the investments being impaired. In 2008/09 SFR reduced the carrying value of the investments by £1 million and recognised an impairment in the Income and Expenditure account. The Board took advantage of the Scottish Government Capital Finance Regulations to defer the impact of the impairment on the General Fund with £0.8 million (the impairment charge net of the interest element) being transferred to the Financial Instrument Adjustment Account.

The Scottish Government Capital Finance Regulations permit SFR to defer the impact on the General Fund until 2010/11 and SFR has again decided to take advantage of this by deferring the impact on the General Fund for a further year.

The balance sheet as at 31 March 2010 has been updated to reflect the latest information provided by the administrators regarding the value of the Icelandic investment and repayments that were received during the year. £1.07 million of repayments were received from the administrators during 2009/10. In addition to the repayment received the administrators have projected an improved rate of return, resulting in the £1 million impairment calculated in 2008/09 being reduced by £0.1 million. The carrying amount of the investment includes a further year of accrued interest, totalling £0.2 million, to recognise the investment at amortised cost in the Balance Sheet. The changes made in 2009/10 have been adjusted through the Financial Instrument Adjustment Account as allowed by the statutory guidance.

The carrying value of the investments is now £1.4 million (2008/09: £2.2 million) reflecting the recovery of monies in the year and reduced impairment.

International Financial Reporting Standards (IFRS)

The Chancellor’s announcement in the 2008 Budget introduced the requirement for local government bodies to adopt IFRS for 2010/11, including the restatement of 2009/10 comparatives. The objective is to bring the public sector into line with the private sector, and to introduce greater comparability and consistency across public sector accounting. Central government bodies and NHS Boards are one year ahead of local authorities in this process, and have produced IFRS financial statements for 2009/10, including restated IFRS 2008/09 comparatives. The exercise they followed to prepare their restated shadow IFRS financial statements in early 2009/10 has shown that those organisations which had planned adequately and dedicated sufficient resources to the project were best placed to produce shadow accounts within the deadlines and full IFRS accounts at the year end.

Strathclyde Fire and Rescue has contracted with the CIPFA/PwC IFRS advisory service in order to assist with this project, thus demonstrating its commitment to achieving all deadlines and managing a smooth transition to IFRS.

The next key deadline is 15 October 2010, by which time the financial value of all necessary IFRS restatements should be identified and reported to the Scottish Government to ensure that appropriate statutory mitigation can be obtained where required to neutralise the financial impact of the conversion to IFRS.

Action 3

4. 2009/10 Performance

Financial Results 2009/10

	£m	£m
Gross Expenditure	155.060	
Gross Income	(12.298)	
Net Cost of Services		**142.762**
Net Operating Expenditure (including impact of loss on disposals, interest receivable & payable and pension interest costs and returns on assets)		**202.745**
Funded by:		
Precepts from Local Authorities		**(158.050)**
Income & Expenditure deficit for the year		**44.695**
Amount required to be credited to the general fund balance		**(44.977)**
Increase in the General Fund balance		**0.282**

Figures confirmed by Sarah O'Donnell, Deputy Director of Finance

The Board's budget for 2009/10 was set at £155.7 million (2008/09 £148.6 million) to be financed primarily by precepts from constituent local authorities of £154.9 million and a £1.8 million contribution from the Scottish Government for pensions pooling of risk. This budget was constructed to enable a £1.1 million contribution to general reserves.

For the year ended 31 March 2010, the Board reported an overall deficit of £44.7 million (£58.1 million in 2008/09) in the Income and Expenditure Account.

After adjusting this in-year deficit to reflect the appropriate statutory and non-statutory adjustments, the Board achieved a surplus, contributing £0.166 million to their General Fund.

These adjustments included £41.8 million relating to Financial Reporting Standard 17 retirement benefits and £9 million relating to the depreciation and impairment of Land and Buildings.

The Board's underspend of £0.166 million was caused as a result of a number of underspends exceeding other overspends. The most significant of these are detailed below:

Employee Costs – underspent £0.741 million

Pay awards were lower than budgeted, reducing overall salary costs. In addition demand led employee costs including retained and volunteer costs were under budget due to reduced demand. Vacancies in Retained, Volunteer and Support positions have also contributed to the underspend. These underspends are partially offset by an overspend caused by the timing of retirements relevant to recruitments during the year.

Pensions – underspent £0.791 million

Monthly pension costs were lower than had been budgeted with efforts to increase scrutiny of medical retirements helping to reduce pension costs in this area. There has also been an increase in pension transfer value income which has reduced overall costs.

Supplies and Services – overspent £0.538 million

Expenditure on protective kit was increased following a review of existing kit and as in prior years hydrant repair costs have continued to increase, resulting in an overspend in the year. Expected efficiencies from the Voice-Over IP phone system have yet to be realised.

Third Party Payments – overspent £0.233 million

SFR has experienced a number of complex technical issues with IT projects that have taken longer than anticipated to deliver projects. These include Firelink; the national radio communications system, on which operational testing revealed further areas for national consideration. Additional contractor hours were also required to strengthen the Board's virus prevention infrastructure.

Other Income – over recovered £0.198 million

Income from sources such as training courses, vehicle maintenance and catering has been higher than anticipated.

Capital Expenditure

A total of £9.9 million of capital expenditure was incurred in the year to 31 March 2010. This was against an original approved 2009/10 capital programme budget of £14 million.

The Board is progressing work on the new Training Centre and Clydesmill station at Cambuslang. Additional work necessary to prepare the site for construction has resulted in a re-phasing of the project with capital expenditure deferred to 2010/11. The Cambuslang project was therefore underspent by £5 million in 2009/10 against the original budget. SFR brought forward £0.5 million of vehicle expenditure from the 2010/11 budget to help manage the capital programme, contributing to a total spend of £5.8 million of vehicle additions in 2009/10.

All capital grants have been carried forward within permitted limits of the grants or with consent from the Scottish Government. The capital programme for 2010/11 reflects the re-phasing of the Cambuslang project with approved capital expenditure for 2010/11 increasing to £18.7 million, £12.3 million of which related to the Training Centre and Clydesmill station.

The re-phasing of the capital programme and underspend on the revenue budget enabled £5.1 million of borrowing to be repaid in the year which will help to reduce future interest payments.

No significant fixed assets were disposed of in 2009/10.

Performance against Key Financial Targets

The Board has operated within both of its financial limits in the year, as follows:

Limit	Limit set %	Actual % carry forward
In year carry forward	3	0.18
Cumulative carry forward	5	3.63

In 2010/11 changes to pension funding arrangements will result in a lower permitted carry forward balance which could impact on the reserves strategy. The change in arrangements will mean that local authority precepts will reduce as pension funding will be received directly from the Scottish Government. The carry forward limits are based on a percentage of the local authority precept income and so a reduction in this income will have an impact upon the level of carry forward permitted. No guidance has been received as yet from the Scottish Government to explain if the current rules will be amended. SFR should monitor this situation closely to ensure future reserve strategies remain appropriate.

Action 4

The Board reported efficiency savings in the year with cash-releasing recurring efficiency savings of £2.8 million and £2.4 million in non-recurring savings contributing to total cash-releasing efficiencies of £5.2 million during 2009/10. This amounted to efficiency gains of 4.2% against the Scottish Government target of 2%.

Managing Financial Performance

Management receives detailed financial information each month to help manage performance against budgets and control expenditure. Detailed management accounts are prepared on a monthly basis. The finance team liaises with budget holders to analyse the management reports and understand key variances against budgets. The outcomes of the monthly reviews are consolidated into financial management reports that are considered by the Corporate Management Team, Budget Scrutiny Forum and the Board at regular meetings. The information produced and frequency of reporting ensures decision makers have appropriate information on which to base decisions. The reporting arrangements were considered during the year and reported in our 2009/10 Interim Management Letter reported to the Performance and Audit Forum.

Performance Indicators

During July 2010 we reviewed the Board's arrangements for compiling data to submit statutory performance indicator ("SPI") information to Audit Scotland. The Board submits a return for three indicators:

Fire Casualties – number of incidents resulting in casualties and number of fatal/non fatal per 10,000 population;
Accidental dwelling fires – rate per 10,000 population of accidental fires;
Sickness absence – percentage of rider shifts lost due to sickness and percentage of working time lost to sickness for all other staff.

	2009/10 %	2008/09 %	Movement %
FS 1: Fire Casualties			
Number of incidents resulting in casualties, per 10,000 population	1.5	2.4	-0.9
Number of fatal and non-fatal casualties per 10,000 population	1.9	3.3	-1.4
FS 2: Accidental dwelling fires			
Rate per 10,000 population of accidental dwelling fires	10.4	11.1	-0.7
Sickness Absence			
Rider Shifts lost due to sickness and light duties per fire officer (days)	11.2	9.8	+1.4
Working days lost to sickness for all other staff (days)	6.9	8.4	-1.5

We are required by Audit Scotland to comment on the Boards procedures to collect data for the SPIs. Our audit work focused on the controls around the data capture which was used to calculate the SPIs that are reported.

We understand that the systems used to record data and generate the SPIs are live systems and can be changed following post incident reviews. Where the underlying data can be changed it is important that an audit trail exists to demonstrate how the reported SPI figure has been calculated. All documents used in the process of calculating the reported figure should be retained so that external audit can trace the figure to underlying data, in order to fulfil an Audit Scotland requirement.

Action 5

5. Governance and Control

Overall Governance Arrangements

The various governance forums operating below the Board remain in place and are well established. These include the Performance and Audit Forum, the Budget Scrutiny Forum and the Employment and Equality Forum. These forums meet four times per year. The Corporate Management Team meets on a fortnightly basis, providing a link between the governance forums and operational departments.

A review was carried out in 2009 to consider a revised Corporate Management Team structure with a view to enhancing succession planning for senior posts, while ensuring continued and effective leadership in the longer term, during a period of funding pressure. The Board approved the recommendations of the review in December 2009 and transitional arrangements will commence in November 2010 to begin the implementation of the new structure.

The revised structure will see a reduction in Directorates from six to four, while the Corporate Management Team will reduce from seven to five at Strategic Manager level. This will comprise of a Chief Officer and four Assistant Chief Officers. The roles and responsibilities of all these posts have been outlined in the detailed report to the Board. The implementation will be on a phased basis from 1 November 2010 through to 2014 to account for retirements and required succession planning.

It is hoped these revised management arrangements will provide stability, retaining essential experience for the medium to longer term and facilitate effective succession planning within the team ensuring continuity of service performance. In addition, these changes could contribute £235,000 per annum towards savings targets.

The Board plans to undertake a series of wider workforce planning reviews beyond the Corporate Management Team and it is expected these will begin to develop further recommendations following the initial implementation of the revised management structure.

Partnership Working

SFR devotes time and resources towards achieving effective partnership working arrangements. As a Joint Board, SFR has a close working relationship with local authorities as well as other emergency services to ensure services are delivered effectively. The Tripartite agreement between the Scottish Ambulance Service and Strathclyde Police Authority remains in place. This involves collaboration in terms of fleet servicing, including the sharing of vehicle workshops, which has helped to generate savings for the Scottish Government. SFR has also worked with Strathclyde Police Authority to complete the Greenock Fire Station refurbishment during the year; this is a shared facility with Strathclyde Police.

In addition, procurement has been identified as an area for further efficiencies and the use of shared services and contracts with other Joint Fire Boards are central to the strategy to achieve these further efficiencies. The development of the new Human Resources/Payroll system is an example of development in the area of shared services with the contract structured to enable other Boards to utilise the contract should they choose. Contractual savings were also realised in relation to professional services to support the Training Centre at Clydesmill in Cambuslang as well as in the use of Scottish Government licence agreements with Oracle in the development of Information Technology.

Systems of Internal Control

The results of our work on systems of internal control were communicated to the Performance and Audit Forum in our Interim Management Letter on 17 May 2010. The report contained four recommendations to improve controls, none of which were graded as higher risk or business critical in nature. Management has completed an action plan detailing those individuals responsible for implementing our recommendations and the timetable for completion. We will follow up this action plan during the 2010/11 audit process.

Statement on Internal Control

The Code of Audit Practice requires us to review and report on the Board's Statement on the System of Internal Financial Control. The Board has used the correct format for its Statement and has outlined the processes it has employed to identify and evaluate risks. In addition, key elements of the Board's control framework have been highlighted. Based on our normal audit procedures, we do not disagree with the disclosures contained in the Statement.

Follow up of outstanding recommendations

We followed up SFR's progress in implementing recommendations made in the prior year. At the time our work was undertaken, we concluded that 13 agreed actions have been implemented from 22 raised, with the 9 remaining recommendations partially implemented as detailed below:

Status	Follow Up of 2007/08 Reports	Interim Management Report 2008/09	Annual Report to Members 2008/09	IT General Controls Audit 2008/09	Total
Action Implemented	2	6	8	-	**16**
Action in Progress	2	3	1	-	**6**
Limited/Little Progress to Date	-	-	-	-	**-**
Not Yet Due	-	-	-	6	**6**
Total	**4**	**9**	**9**	**6**	**28**

The progress in implementing the agreed audit recommendations demonstrates management's commitment to improving the standards of internal control.

Two of the outstanding recommendations relate to the fixed assets register and the transition to the new fixed asset module. Management should ensure sufficient resources continue to be directed towards this project to ensure it meets revised implementation schedules.

Information Technology General Controls

ISA (UK&I) 315.93 requires auditors to "… obtain an understanding of how the entity has responded to risks arising from IT". IT General Controls (ITGCs) are controls put in place by management to mitigate those risks. ITGCs help ensure the continued proper operation of information systems to maintain the integrity of information and security of data.

We have conducted a review of information technology general controls as part of the 2009/10 audit programme. Findings of the review into ITGCs conducted in 2008/09 have been included in the Follow Up of 2008/09 Audit Recommendations report.

National Fraud Initiative

The National Fraud Initiative (NFI) brings together data from health bodies, councils, police and fire rescue bodies and other agencies, to help identify and prevent a wide range of frauds against the public sector. These include housing benefit fraud, occupational pension fraud and payroll fraud.

The Board met its mandatory requirements in 2008/09 with regard to the submission of payroll data sets and subsequent investigation of matches. In addition, NFI prescribes that public sector bodies are required to submit additional datasets on a risk-based approach.

As reported in our Interim Management letter, no exceptions were noted to our review of this area during the interim audit process.

Internal Audit

During 2009/10 South Lanarkshire Council continued to act as the Board's internal auditors. We have reviewed the work of internal audit and have, where appropriate, used their work to help develop our audit programme. The Board has increased the number of internal audit days used from prior years and is also contributing additional internal resources to internal audit programmes, assisting with follow up reviews of outstanding recommendations and additional controls testing. Selected personnel have received training from South Lanarkshire Council's internal audit department to facilitate this work.

6. Managing in Uncertain Times

The UK economy went into recession in mid-2008 for the first time since 1991. By summer 2009, UK economic output had fallen for five consecutive quarters. Significant financial pressures remain and the future economic position is uncertain and difficult to predict.

In response to the recession the UK Government almost doubled its level of borrowing to £175 billion in 2009/10 to allow it to increase public spending to support the economy. This level of borrowing means that the UK Government will need to pay higher debt interest payments, which in turn reduces the amount left for spending on the public sector. The recent Westminster General Election has resulted in a change of Government and this has led to a change in the plans for repaying the national debt with the new coalition government planning to halve the deficit by 2013/14. In order to achieve this ambitious target, significant reductions in public sector spending will be required. A recent paper by the Scottish Government Chief Economist predicts that public sector spending in Scotland may fall in real terms by 3% every year to 2014/15 and will take a total of 12 to 15 years to get back to 2009/10 levels.

Further details of this challenge may become clearer after the Westminster Government determines the level of funding available to the Scottish Government for the 2010 Spending Review period, although the impact this will have on the Public Sector in Scotland and the Board specifically may take some time to become apparent.

In April 2009, the UK Government also announced that Public Sector **capital budgets would fall**.

Taken together, these factors will have **serious consequences** for the Scottish budget. As a result of the current financial position, Audit Scotland has issued a number of reports on the matter. Key reporting themes from two of these reports are highlighted below.

Audit Scotland - Scotland's Public Finances: Preparing for the Future

In November 2009 Audit Scotland published their report: 'Scotland's Public Finances: Preparing for the Future'. This report highlighted the fact that the Scottish Government budget is likely to have peaked in 2009/10 for the foreseeable future. This means that individual public bodies will have **smaller budgets** in future years. It highlighted that in addition, **other public sector income is likely to be less than previously forecast** – in particular, capital funding, which may affect the Board's ability to deliver its capital programme.

The report concluded that we are at a real **historical breakpoint** in public finances.

Audit Scotland - Improving Public Sector Efficiencies

Following on from their Scotland's Public Finances report, Audit Scotland published a further report in February 2010: 'Improving public sector efficiency'. It provided a position statement on the first year (2008/09) of the Efficient Government Programme (the Programme), which aims to deliver £1.6 billion efficiency savings over the three years to 2010/11. It also gave an update on how the Scottish Government and public bodies have addressed the recommendations made in a 2006 Audit Scotland report about the previous efficiency programme.

The report noted that Scottish public bodies had reported more efficiency savings than the Government's two per cent target. However, there were serious financial challenges ahead – the biggest since devolution – and making the required savings simply through efficiency will become increasingly difficult.

The report recommends that to deal with reduced future funding, public bodies need to consider fresh approaches to improving efficiency and productivity. They must take a more fundamental approach to identifying priorities, improving the productivity of public services, and to improving collaboration and joint working.

To support these high-level recommendations, Audit Scotland, the Northern Ireland Audit Office and the Wales Audit Office have drawn on their combined experience to develop a detailed good practice checklist. The checklist is intended to promote detailed review and reflection and, if necessary, a basis for improvement. We recommend that those responsible for leading efficiency and improvement work at SFR should formally assess themselves against each question.

Strathclyde Fire & Rescue Perspective

Despite entering the downturn with a relatively strong financial position the Board currently faces a period of uncertainty. Impending tightening of public expenditure will impact Local Authorities and the Joint Fire Boards at a time when the cost base will continue to rise.

While some organisations will be more vulnerable than others, all public sector bodies, including SFR, will be impacted. Regardless of whether a body is in a relatively stronger or weaker financial position, difficult decisions are going to have to be made. We recommend looking at six key areas that our experience in other sectors has shown may be relevant to addressing the challenges ahead:

- Honesty and awareness of the size of the challenge
- Strong leadership
- Need to engage with the whole organisation and external stakeholders
- Realistic and detailed plans to resolve the situation
- Rigorous implementation (programme management arrangements)
- Financial control and discipline

The Board is already considering how best to respond to the existing drive for efficiencies. Forecasts for the next four years will include "downside" scenarios and budget holders will be challenged by the adoption of priority based budgeting. Tough decisions on which spending plans take priority are likely to be faced by the Board in the coming months and years.

Action 6

2010/11 Budget

Figures confirmed by Sarah O'Donnell, Deputy Director of Finance

Projected 2010/11	£'m	£'m
Gross Expenditure	141.238	
Gross Income	(1.290)	
Net Cost of Services		**139.948**
Funded by:		
Precepts from Local Authorities	126.610	
Additional Commutations	-	
Additional Pension Funding	-	
Scottish Government Pension Contribution Grant	13,732	
Total Funding		**(140.342)**

Financial Plan

The Board approved the Medium Term Financial Strategy 2010-2014 in October 2009. However, this includes a number of assumptions that will require to be re-visited following the result of the comprehensive spending review in 2010. The 2010/11 budget was approved as part of this Medium Term Financial Strategy. It has been prepared on the assumption that SFR will be required to identify savings equal to those passed on to local government. This resulted in a reduction in the precept increase by 1.2%.

Management should ensure the Medium Term Financial Strategy and 2010/11 budgets and reserves strategies are reviewed following further Treasury announcements.

Action 7

Efficiency Savings

The Board is required by the Scottish Government to achieve efficiency savings of 2%. The Board has identified the key areas for 2010/11 to achieve the 2% and generate a further £2.5 million of savings towards the annual target.

The general areas for efficiencies have been identified as workforce planning, procurement, shared services and asset management. However, specific areas and targets are still being quantified on an ongoing basis.

It is important when identifying efficiencies and possible cuts in the future that service delivery and performance considerations are fully considered in all decisions. The Efficiency Statement includes a section on impact on service delivery and performance. In addition the Performance and Audit Forum reviews performance information on a quarterly basis to ensure service delivery is being maintained. However SFR should ensure that all specific efficiencies are linked to the performance indicators so monitoring can be carried out and any potential impact on service delivery identified in a timely manner. Risk management should also be embedded into the efficiencies process to ensure efficiencies and cuts represent a tolerable risk to the Board.

Action 8

Appendices

Appendix A – Action Plan

Ref	Issue and Recommendation	Management Response
1	Management should ensure sufficient resources are directed towards the fixed asset module project in the immediate future to ensure it is completed in time for the preparation of the 2010/11 financial statements. **Risk Rating: Medium**	**Management Response:** Agreed **Responsible Officer:** Deputy Director of Finance **Due Date:** 31/03/2011
2	As part of the transition to IFRS, the Board should review its accounting policy in respect of intangible assets and review asset registers to ensure there are no assets currently classified as tangible that meet definitions of intangible assets under IFRS. If any such assets are identified they should be included within the IFRS restatement adjustments processed to prepare the shadow IFRS balance sheet and appropriately separated from Property, Plant and Equipment in the 2010/11 financial statements. **Risk Rating: Low**	**Management Response:** Agreed **Responsible Officer:** Deputy Director of Finance **Due Date:** 31/03/2011

Ref	Issue and Recommendation	Management Response
3	The next key deadline for IFRS conversion is 15 October 2010, by which time the financial value of all necessary IFRS restatements should be identified and reported to the Scottish Government to ensure that appropriate statutory mitigation can be obtained where required to neutralise the financial impact of the conversion to IFRS. Management should ensure that this deadline is achieved in order to secure any necessary statutory mitigation required to neutralise the impact of conversion. **Risk Rating: Medium**	**Management Response:** Agreed **Responsible Officer:** Deputy Director of Finance **Due Date:** 15/10/2010
4	In 2010/11 changes to pension funding arrangements will result in a lower permitted carry forward balance. The funding change means that local authority precepts will reduce as pension funding will be received directly from the Scottish Government. The carry forward limits are based on a percentage of the local authority precept income meaning that any fall in precept will result in a reduction in carry forward. No guidance has been received as yet from the Scottish Government to explain if the current rules will be amended. SFR should monitor this situation closely to ensure future reserves strategies remain appropriate. **Risk Rating: High**	**Management Response:** This has been raised with the Scottish Government through the Chief Fire Officer Association Finance Committee, and will continue to be followed up. **Responsible Officer:** Deputy Director of Finance **Due Date:** 31/03/2011
5	We understand that the systems used to record data and generate the SPIs are live systems and can be changed following post incident reviews. Where the underlying data can be changed it is important that an audit trail exists to demonstrate how the reported SPI figure has been calculated. All documents used in the process of calculating the reported figure should be retained so that external audit can trace the figure to underlying data, in order to fulfil an Audit Scotland requirement. .**Risk Rating: Low**	**Management Response:** Agreed **Responsible Officer:** Director of Strategic Planning **Due Date:** 31/03/2011

Ref	Issue and Recommendation	Management Response
6	While some organisations will be more vulnerable than others, all public sector bodies, including SFR, will be impacted by the spending review. Regardless of whether a body is in a relatively stronger or weaker financial position, difficult decisions are going to have to be made. We recommend looking at six key areas that our experience in other sectors has shown may be relevant to addressing the challenges ahead: • Honesty and awareness of the size of the challenge • Strong leadership • Need to engage with the whole organisation and external stakeholders • Realistic and detailed plans to resolve the situation • Rigorous implementation (programme management arrangements) • Financial control and discipline **Risk Rating: Medium**	**Management Response:** Agreed **Responsible Officer:** Chief Officer **Due Date:** Ongoing
7	The Board approved the Medium Term Financial Strategy 2010-2014 in October 2009. However, this includes a number of assumptions that will require to be re-visited following the results of the comprehensive spending review in 2010. The 2010/11 budget was approved as part of this Medium Term Financial Strategy. It has been prepared on the assumption that SFR will be required to identify savings equal to those passed on to local government. This resulted in a reduction in the precept increase by 1.2%. Management should ensure the Medium Term Financial Strategy and 2010/11 budgets and reserve strategies are reviewed following further Treasury announcements. **Risk Rating: Medium**	**Management Response:** Agreed, this is being reviewed on an ongoing basis. **Responsible Officer:** Deputy Director of Finance **Due Date:** 31/03/2011

Ref	Issue and Recommendation	Management Response
8	It is important when identifying efficiencies and possible cuts in the future that service delivery and performance considerations are fully considered in all decisions. The Efficiency statement includes a section on impact on service delivery and performance. In addition the Performance and Audit Forum reviews statutory performance indicators on a quarterly basis to ensure service delivery is being maintained. However SFR should ensure that all specific efficiencies are linked to the performance indicators so monitoring can be carried out and any potential impact on service delivery identified in a timely manner. Risk management should also be embedded into the efficiencies process to ensure efficiencies and cuts represent a tolerable risk to the Board. **Risk Rating: High**	**Management Response:** Agreed, plans are underway to ensure that risk is built into efficiency reporting. **Responsible Officer:** Director of Strategic Planning **Due Date:** 31/03/2011

Appendix B – Communications to Management

International Standards on Auditing ("ISA") (UK&I) 260 – Reporting to those charged with Governance, requires that the External Auditor communicates certain matters to those charged with governance. Those charged with Governance is taken to be the Members of the Performance and Audit Forum with responsibility discharged through the regular meetings of the Performance and Audit Forum during the year. Summarised below are the requirements set out within ISA 260 together with reference to the relevant communication with you during 2009/10 or comments as appropriate.

Communication Required under ISA 260	Reference/Comment
Engagement letters	Signed Engagements Letter with Audit Scotland at the start of our 5 year appointment and updated annually.
Independence	Audit Planning document report to 14 December 2009 Performance and Audit Forum and confirmed no member of audit team has any direct interest, financial or otherwise, in Strathclyde Fire & Rescue.
Audit Approach and Scope	Audit Planning document (reported to Performance and Audit Forum 14 December 2009)
Accounting Policies/Practices with a Material Effect on the Financial Statements	Sections 3 and 4 of our Annual Report to Board Members and the Auditor General for Scotland.
Potential Effects of Material Risks and Exposures	Audit Planning document (14 December 2009).
Audit Adjustments	Section 3 of our Annual Report to Board Members and the Auditor General for Scotland.
Material Uncertainties relating to Going Concern	We identified the net liability position on the balance sheet, resulting from the pension cost liability as a potential uncertainty regarding going concern. However, we are satisfied that the Board of Strathclyde Fire and Rescue will be able to continue to fund pension costs as they arise.
Disagreement with Management about Matters that could be Significant to the Financial Statements	Not applicable.
Expected Modifications to the Auditor's Report	Not applicable
Letter of Representation	Signed by the Treasurer to the Board on 19 August 2010.
Material Weaknesses in Internal Control	Internal Controls findings reported separately in our Interim Management Letter (17 May 2010), Section 5 of our Annual Report to Board Members and the Auditor General for Scotland.
Fraud	Discussed fraud arrangements at Performance and Audit Forum and with management.

Communication Required under ISA 260	Reference/Comment
Laws and Regulations	We have not identified any material braches of laws and regulations in the period which impact on the 2009/10 Financial Statements.
Audit materiality	Audit Planning document – presented to Performance and Audit Forum in 14 December 2009.
Fair Value Measurement and Disclosure	Included in representation letter, signed by the Treasurer to the Board dated 19 August 2010.
Related Parties	Other than those transactions disclosed in the financial statements we have not identified any further transactions requiring disclosure.

Formal Reporting to Management during 2009/10

During the year we have presented a number of formal reports to Management and the Performance and Audit Forum and produced certain outputs. Our principal outputs during 2009/10 are summarised below:

Formal Output	Timing
Audit Plan	14 December 2009
Detailed Timetable for 2009/10 Financial Audit	14 December 2009
Interim Management Letter	17 May 2010
Annual Report to Board Members and the Auditor General for Scotland	16 August 2010
Follow-up of 2008/09 Recommendations	16 August 2010
Audit Opinions 1. True and fair view on the financial statements and regularity of income and expenditure ✓ 2. Have been properly prepared in accordance with the Local Government (Scotland) Act 1973. ✓ Unqualified Audit Opinions	16 August 2010

Freedom of Information Act (Scotland) 2002

In the event that, pursuant to a request which the Board has received under the Freedom of Information Act (Scotland) 2002 or the Environmental Information Regulations 2004 (as the same may be amended or re-enacted from time to time) or any subordinate legislation made thereunder (collectively, the "Legislation"), Strathclyde Fire and Rescue "SFR" is required to disclose any information contained in this report, it will notify PwC promptly and will consult with PwC prior to disclosing such report. SFR agrees to pay due regard to any representations which PwC may make in connection with such disclosure and to apply any relevant exemptions which may exist under the Legislation to such report. If, following consultation with PwC, SFR discloses any of this report or any part thereof, it shall ensure that any disclaimer which PwC has included or may subsequently wish to include in the information is reproduced in full in any copies disclosed.