

# Lothian and Borders Fire and Rescue Board

## Report to Members and Controller of Audit on the 2010/11 Audit



Prepared for the Lothian and Borders Fire and Rescue Board and Controller of Audit  
October 2011

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# Key Messages

We have audited the 2010/11 financial statements and looked at aspects of performance management and governance, including the key financial risks faced by the Lothian and Borders Fire and Rescue Board (the board). This report sets out our main findings, summarising key outcomes from the 2010/11 audit and the outlook for the period ahead.

## Key outcomes from the 2010/11 audit

Overall we found the financial stewardship of the board during the year 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 the board
- the board experienced a smooth transition towards the adoption of International Financial Reporting Standards (IFRSs) and the board's financial statements are now fully IFRS compliant in all material respects
- the general fund balance was in excess of that permitted by statute and was approved by the Scottish Government
- final accounts preparation procedures and working papers were of a high standard, as were responses to audit queries
- matters arising from the audit have been included in the ISA 260 report to those charged with governance on the 2010/11 audit
- we have concluded that board governance arrangements are adequate
- Internal Audit concluded that reasonable assurance could be placed upon the adequacy and effectiveness of the board's internal control system
- The board has effectively participated in the National Fraud Initiative 2010/1
- Statutory Performance Indications for 2010/11 have been prepared and published.

## Outlook

Key issues for the board in the future include:

- Contributing towards the successful establishment of a Scottish Fire and Rescue Service which, subject to the necessary legal and parliamentary processes, will replace all of the current fire and rescue services in due course
- delivering continuous improvement in service delivery and use of resources in the face of increasing financial constraints

Key issues for the attention of members are outlined in an Action Plan included at appendix A of this report. 2010/11 is the final year of this audit appointment and we would like to thank the officers of the board and the City of Edinburgh Council for their support and co-operation over the duration of our appointment. A different audit team from within Audit Scotland's Audit Services Group will be providing the external audit next year.

# Introduction

1. This report summarises the findings from our 2010/11 audit of the board. The scope of the audit is set out in our Annual Audit Plan which was submitted to the Scrutiny Committee in March 2011.
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. The LBFRB audit team with the help of management submitted two data returns to help inform the national report "Scotland's public finances: addressing the challenges" which was published on 24th August 2011.
5. Other reports published in the last year that may be of interest to the board are:
  - National Scrutiny Plan for Local Government
  - The cost of public sector pensions in Scotland
  - An overview of Local Government in Scotland 2010
  - Strathclyde Police and Strathclyde Police Authority
  - 2010/11 Quality Report.

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

6. 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.

# Financial Statements

7. In this section we summarise the key outcomes from our audit of the board's financial statements for 2010/11. We also summarise key aspects of the board's reported financial position and performance to 31 March 2011.
8. We audit the financial statements and give an opinion on whether they:
  - give a true and fair view in accordance with applicable law and the 2010/11 Code of the state of the affairs of Lothian and Borders Fire and Rescue Board as at 31 March 2011 and of its income and expenditure for the year then ended
  - have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2010/11 Code
  - have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973 and the Local Government in Scotland Act 2003.
9. We also review the Annual Governance Statement by considering the adequacy of the process put in place by the board to obtain assurances on the systems of internal financial control and assessing whether disclosures in the statement are consistent with our knowledge of the board.

## Overall conclusion

10. We have given an unqualified opinion on the financial statements of the board for 2010/11.
11. We were satisfied with disclosures made in the Annual Governance Statement and the adequacy of the process put in place by the board to obtain assurances on the systems of internal control.
12. The board's unaudited financial statements were submitted to the Controller of Audit by the deadline of 30 June. Working papers provided to support the financial statements were of a high standard as were the responses to audit queries. The transition exercise for the adoption of IFRSs was also conducted to a high standard.
13. During the audit the most significant change to the draft accounts related to a prior year adjustment in relation to ensuring that comparative actuarial estimates of the liability faced by the board in relation to injury benefit pensions were on the same basis as 2010/11 figures.
14. The accounts were certified and available for publication on 30 September and will be presented to members at a Board Meeting. 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

15. Local authorities in Scotland are required to follow the Code of practice on local board accounting in the United Kingdom (the Code). The Code is based on International Financial Reporting Standards (IFRSs) and 2010/11 is the first year that local authorities are required to be fully IFRS compliant. This presented a significant challenge for both accountants and auditors. In line with good practice the board prepared a restated opening balance sheet and submitted this for review in line with the recommended timetable. Full shadow accounts for 2009/10 were made available for audit review in February 2011. These were supported by a comprehensive package of working papers which were subjected to audit. Progress was achieved through this shadow accounts exercise and its completion to a good standard greatly facilitated the board's move to full statutory IFRS accounts for 2010/11.
16. The code imposes a number of presentational changes to the primary financial statements and these are detailed in the Foreword to the financial statements. The purpose of the board's various reserves is also detailed in the Notes to the Financial Statements.
17. The board has adjusted the financial statements to reflect audit findings. As is normal practice, immaterial unadjusted errors have been reported to the Treasurer and the 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 accounting and financial reporting issues which arose during the course of our audit are summarised below.
18. The completeness and accuracy of financial information from the management information system operated by the Lothian and Borders Fire and Rescue Service (LBFRS) to order goods, record stock, moveable assets and equipment was found to be problematic during the audit process and we drew attention to all relevant matters in our report to those charged with governance. LBFRS finance staff worked hard to produce manual records, where appropriate, to provide a level of audit evidence that was adequate for our purposes.

### Key risk area, Action1

19. The 2010/11 year was the first when local government bodies were required to produce remuneration reports. This development brings local government bodies into line with central government and health public sector bodies as well as private limited companies. We are pleased that the board has made all of the necessary disclosures in the remuneration report in all material respects. These disclosures are material by context because readers of the financial statements are interested in remuneration of senior staff and officials.
20. Disclosures were in compliance with the code in all material respects. There is an opportunity for the board moving forward to demonstrate a greater commitment to the principles of transparency, openness and accountability by giving the remuneration report greater prominence within the financial statements. Private limited companies, central government and health bodies all prepare remuneration reports and include them within financial statements immediately after, or appended to, the foreword to the financial statements. The board includes the remuneration report at the very end of the financial statements.



### Key risk area, Action 2

21. A number of other matters were raised with management during the course of the financial statements audit in order to facilitate the board improving the effectiveness of budgeting and financial reporting.
22. During the audit we followed up our previous work in relation to the combined aerial rescue pump (CARP) appliances. In our annual report last year we concluded it had become apparent that these appliances would not be used by the board as intended. CARP appliances cost the board approximately £800,000 to purchase and, following their withdrawal from operational use have been written down in the board's financial records to a value of £200,000 to reflect their use, after the necessary adaptations had been made, for driver training purposes. We are satisfied with this treatment.

## Financial Position

23. The gross expenditure on the cost of services in the comprehensive income and expenditure statement, excluding an exceptional item was £53.8 million (2009/10: £55.1 million). Net expenditure, excluding an exceptional item, was £48.5million (2009/10: £53.9 million). This financial result reflects the reducing budget available to the board. We note that in 2011/12 - 2013/14 further reductions in expenditure will be the result of further reduced funding availability.
24. Although the useable reserves have reduced from around £4 million as at 31 March 2010 to £3.5 million as at 31 March 2011 the interaction of fund balances relative to funding from Scottish Government and constituent councils means that the balance as at 31 March 2011 was in excess of that permitted by statute. This balance in excess of that permitted was regularised by the Scottish Government formally approving the useable reserves that the board could carry forward. A key reason for board not consuming all of the resources at it's disposal in 2010/11 was employee cost underspends. During the year the decision of the board to cancel or defer some significant capital projects including the Newbridge training centre and the Wallyford Fire Station because of the prospect of structural change for the fire and rescue sector overall resulted in abortive fees being charged to revenue expenditure. Capital expenditure in 2010/11 was around £2 million (2009/10: £2.2 million).
25. The exceptional item in the financial statements amounted to £44.9 million and was the result of revised actuarial assumptions regarding the estimation of board pensions. The change was to use a different basis for estimating inflation in line with a government policy change in this area from Retail Prices Index to Consumer Prices Index. Similarly there was a material prior year adjustment which came to light late during the audit process and this related to actuarial changes in estimation regarding the value of injury benefit liabilities.

## Legality

26. 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 her 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.

## Outlook

27. Funding will continue to be reduced year on year for the board and it will be a challenge for the board to deliver continuous improvement whilst maintaining a level of service cover in the Service Improvement Plan and concurrently contributing to the establishment of a single fire and rescue service.

# Use of resources

## Financial results

28. The board's comprehensive income and expenditure statement result was a surplus of £69.3 million (2009/10: deficit of £137.8 million). The major reasons for this change relates to accounting for pensions. The foreword to the financial statements contains a commentary comparing financial outturn to the board's budget and, because financial monitoring and financial reporting are on quite different bases there is also a note included within the financial statements reconciling each.
29. 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 March 2011 was £3.1million (2009/10: £3.9 million). The balance carried forward was in excess of limits but was approved by the Scottish Government and is therefore within statutory limits and is considered adequate by the board.

## Going concern

30. In September 2011 the Minister for Justice announced to the Scottish Parliament that all fire and rescue services in Scotland will be merged into a single national service. In the meantime the board will continue as a going concern but will be merged with all of the other fire and rescue services in Scotland in due course. This prospective change is drawn attention to in the audited financial statements by way of a narrative note.
31. Financial statements in 2011/12 and 2012/13 will be required to include further disclosures. The board may need to adapt some accounting policies to ensure that they meet the requirements of the Code once the proposed accounting policies of the single body become clear.
32. The board's balance sheet discloses net liabilities of approximately £301.5 million (2009/10: £370.8 million) represented by positive balances on a useable reserves of £3.5 million (2009/10: £4 million) which is offset by unusable reserves of £305 million (2009/10: £374.7 million) to give the above net position. 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.

## Capital expenditure 2010/11

33. In the light of funding constraints that it faces in the current economic climate the board deferred the building of a training centre at Newbridge and Wallyford station development.

## Support services

34. For a number of years we have commented in our reports to the board regarding the level of formality of arrangements relating to recharges from the City of Edinburgh Council for services provided to the board. We note that the service level agreements are due to be finalised shortly.

**Key Risk Area, Action 3**

# Governance and Accountability

## Introduction

35. In this section we comment on key aspects of the board's governance arrangements during 2010/11. We also provide an outlook on future governance issues, including our views on potential risks.

## Overview of arrangements in 2010/11

36. Corporate governance is concerned with structures and processes for decision making, accountability, control and behaviours at the upper levels of the organisation. The board has a responsibility to put in place arrangements for the conduct of the affairs of the organisation, to ensure the legality of activities and transactions, and to monitor the adequacy and effectiveness of those arrangements.

## National fraud initiative

37. The board participated in the national fraud initiative (NFI) by providing payroll data and reviewing all matches arising. The results of this review was that there were no matches arising that warranted fuller investigation. As with previous NFI exercises virtually all matches arose as a consequence of retained fire-fighters having other jobs.
38. We note that there has been no reporting of the results of NFI to the Scrutiny Committee and even though the exercise did not identify any instances of fraud such reporting would raise the profile of the exercise and have a deterrent, preventative effect. We also found that the board was unable to disaggregate pension transactions from data held by the City of Edinburgh Council and, as a result, was unable to submit pensions data for the board alone.

### Key Risk Area, Action 4

## Registers of interest

39. The board is comprised of elected members from constituent councils but is a body corporate in its own right. It is incumbent on all members to ensure that, in the context of their service to the board, all of the necessary disclosures have been made to ensure that the risk of conflicts of interest is adequately managed. In practice this is through the relevant administrative arrangements operated at each Council. Board arrangements would be enhanced if the Clerk

to the Board wrote annually to each member reminding them that the Council register should include any interests to be registered in respect of the board.

- 40. For senior management within the board a register of interests should be established.
- 41. Whilst there are no audit concerns identified from our routine audit procedures current arrangements could be enhanced in order to better demonstrate good governance and to manage actual or perceived conflicts.

### **Key Risk Area, Action 5**

## **Internal Audit**

- 42. Internal audit holds a key role in the board's governance arrangements, providing an independent appraisal service to management by reviewing and evaluating the effectiveness of the internal control system. The board's internal audit service is provided by the City of Edinburgh Council's Chief Internal Auditor. Our review of internal audit was conducted as part of the audit of the City of Edinburgh Council. The review found that the work is conducted in accordance with CIPFA's Code of Practice for Internal Audit in Local Government, that the audit plan was sufficient and that all work on which we planned to place reliance was completed and the relevant assurances obtained.

## **Systems of internal control**

- 43. The board's financial transactions are processed through the City of Edinburgh Council's financial systems. It is therefore the responsibility of the council's management to maintain adequate financial systems and associated internal controls. The auditor evaluates significant financial systems and associated internal controls for the purpose of giving an opinion on the financial statements and as part of the review of the adequacy of governance arrangements.
- 44. Our review of these systems was conducted as part of the audit of City of Edinburgh Council, supplemented by specific audit work on the board's financial statements and systems of internal control operated by LBFRS. We have drawn attention the section of this report on accounting matters to some concerns we have with respect to the management information system used for ordering, inventories and equipment. Adequate compensating controls and manual records have provided sufficient evidence for us to reduce audit risk to an acceptable level. We are therefore able to conclude that overall there are no material issues or concerns in relation to the main financial systems.
- 45. An Annual Governance Statement was included within the financial statements. The board has put in place arrangements for monitoring and providing evidence of compliance for each element of the CIPFA / SOLACE framework Delivering Good Governance in Local Government. A Principal Officer within the board has been nominated to review the effectiveness of arrangements and will report annually to the board and we support this action.

46. The review of the effectiveness of the board's governance framework, including the system of internal financial control, is informed by senior management, the Treasurer, and internal and external auditors.
47. The Treasurer has provided the Chief Executive with a statement on the adequacy and effectiveness of the board's internal financial control system for the year ended 31st March 2011. It is the Treasurer's opinion that reasonable assurance can be placed upon the adequacy and effectiveness of the board's internal control system. In accordance with good practice, the statement was approved by the board in June 2011. The statement complies with accounting requirements and is not inconsistent with the findings of our audit.

## Prevention and detection of fraud and irregularities

48. The board has arrangements in place to prevent and detect fraud, corruption and inappropriate conduct. These arrangements include standing orders and financial regulations, a whistle blowing policy, an anti-fraud and corruption policy and codes of conduct for elected members and staff. We are pleased to note that the board continues to have appropriate arrangements in place to minimise the risk of fraud and corruption. Each year, Audit Scotland gathers information on such cases of fraud identified by audited bodies. In 2010/11 there were no such cases reported for the board.

# Performance management and improvement

## Best value

49. The board has been actively involved with Audit Scotland's Best Value and Scrutiny Improvement Directorate in piloting a comprehensive best value regime for fire and rescue services. In October 2010 a best value self assessment report was presented to the Scrutiny Committee. This self assessment included a list of characteristics of a best value fire authority that was developed with Audit Scotland. The self assessment also included an action plan. The work that the board has carried out in relation to piloting best value arrangements specific to fire and rescue services will be of value to other fire and rescue boards now and the Scottish Fires Service in due course. One observation we have to make in relation to the improvement action plan is that the action for LBFRS to establish an asset management strategy and equipment register, based on our audit findings reported elsewhere in this report, did not take place as intended in April 2011. It is important that the board continues to monitor implementation of the best value improvement action plan and that management report regularly to the board in relation to this.

### Key Risk Area 6

## Statutory performance indicators

50. The 2010 Statutory Performance Indicators (SPI) direction issued by the Accounts Commission has meant that our audit process in 2010/11 was less about auditing the completeness and accuracy of SPI's and much more about examining public performance reporting arrangements. The board submitted the prescribed SPI return to Audit Scotland within the deadline established by the direction. We subjected this return to review and found that it had been adequately prepared.
51. Regarding public performance reporting the board's best value self assessment in October 2010 identified a need to develop public performance reporting incorporating SPI's and locally developed performance measures. It was envisaged that this would be actioned by June 2011 but, due to other priorities, has not yet taken place. The SPI direction issued by the Accounts Commission places a responsibility on bodies to publish performance information (including SPI's) by the 30th September each year. For the 2010/11 year this responsibility of the board has not been discharged since public performance reporting is still under development.

### **Key Risk Area, Action 7**

## Final Remarks

52. The members of the Lothian and Borders Fire and Rescue Board are invited to note this report. We would be pleased to provide any additional information that members may require.
53. The co-operation and assistance given to us by officers of the board and the City of Edinburgh Council is gratefully acknowledged.

# 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	18	<p><b>LBFRS management information system</b></p> <p>The management information system operated by LBFRS to record orders for goods and services, inventory, moveable non current assets and equipment cannot produce complete and accurate financial information to support aspects of the financial statements.</p> <p><b>Risk</b></p> <p>The 2011/12 financial statements may be incomplete regarding non-current assets, inventories and goods received not invoiced.</p>	<p>Ongoing staff training will be undertaken to minimise the risk of data inaccuracies or transaction processing problems arising from user input errors. In addition ongoing data cleansing activities will minimise the extent of inaccuracies arising. Furthermore consideration will be given to developing efficient year end close down processes and procedures, whether manual or computer based, so that complete and accurate year end information is available.</p>	Head of Central Services	April 2012
2	20	<p><b>Remuneration report</b></p> <p>The remuneration report is included at the very end of the financial statements but normal practice in other sectors is to include the remuneration report immediately after the foreword to the financial statements.</p> <p><b>Risk</b></p> <p>There is a risk that readers of</p>	<p>There is no statutory prescription as to where the Remuneration Report should be placed in the financial statements. The Local Government Finance Circular No 8/2011 (Revised and Re-issued)</p>	Treasurer	N/A



Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
		<p>the financial statements may perceive a reluctance to make the necessary remuneration disclosures by their position within the financial statements. The principles of transparency, openness and accountability could be perceived as being given a lower priority by the board than they should be.</p>	<p>dated 13 May 2011 suggests that the Remuneration Report follows the Annual Governance Statement. The Board's Treasurer agreed to place these statements at the end of the Board's Final Accounts to ensure prominence is given to the financial statements. This is in keeping with all other Boards and the City of Edinburgh Council.</p> <p>In the absence of statutory guidance, currently, there are no plans to change the position of the Remuneration Report.</p>		
3	34	<p><b>Service Level Agreements</b></p> <p>Service level agreements between the Lothian and Borders Fire and Rescue Board and the City of Edinburgh Council should be formalised and presented to the board for their approval.</p> <p><b>Risk</b></p> <p>The board cannot fully monitor the performance of services provided by the City of Edinburgh Council.</p>	<p>A revised draft of an SLA has been developed and will be subject to final review.</p>	Treasurer	April 2012

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
4	38	<p><b>NFI</b></p> <p>The results of NFI have not been reported to the Scrutiny Committee.</p> <p><b>Risk</b></p> <p>There is a risk that the deterrent effect of the NFI exercise is not maximised and that the Scrutiny Committee, in their governance capacity, are not given the positive assurance that the results of NFI yields for the board.</p>	<p>Consideration will be given to tabling the national NFI report to the board in due course along with a summary paper with the results of NFI for the board.</p>	Director of Corporate Services	February 2012
5	41	<p><b>Registers of interest</b></p> <p>Currently there is not a register of interests for senior management and members interest are not formally confirmed or reviewed by management.</p> <p><b>Risk</b></p> <p>There is a risk that not all relevant interests have been disclosed to and assessed by management.</p>	<p>Revised members interests arrangements taking account of Audit Scotland observations will be devised and submitted to the board for approval in November 2011.</p> <p>Consideration will be given to establishing a register of interests for senior management in due course.</p>	<p>Clerk to the Board</p> <p>Director of Corporate Services</p>	<p>November 2011</p> <p>April 2012</p>
6	49	<p><b>Best value improvement action plan</b></p> <p>Management reported to the board in October 2010 the results of a best value self assessment. This included a</p>	<p>Arrangements in place for reporting to the board best value are already in</p>	Director of Corporate Services	April 2012

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
		<p>best value improvement action plan setting out target dates for implementation. We note that not all of the actions to date have taken place within the timescales planned.</p> <p><b>Risk</b></p> <p>There is a risk that best value improvements do not take place as planned or implementation of actions becomes delayed. It is important that members are kept apprised of progress.</p>	<p>place. Future reporting to the board regarding best value will update members regarding progress in achieving the best value improvement plan, as well as the outcome of the Audit Scotland Best Value Audit carried out in October 2011.</p>		
7	51	<p><b>SPI's</b></p> <p>Since public performance reporting is still under development by the board there has been no public performance reporting for the 2010/11 year. The deadline of 30th September set out by the Accounts Commission in their direction was therefore not met.</p> <p><b>Risk</b></p> <p>There is a risk that the board may miss future public performance reporting deadlines.</p>	<p>Arrangements for public performance reporting are well developed and will include all statutory performance indicators as well as locally developed measures.</p>	Head of Central Services	December 2012