Audit Strategy Memorandum

Cleveland Fire Authority

March 2016

MAZARS

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Audit and Governance Committee
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March 2016

Dear Members

Audit Strategy Memorandum for the year ending 31 March 2016

We are delighted to present our Audit Strategy Memorandum for Cleveland Fire Authority for the year ending 31 March 2016.

The purpose of this document is to summarise our audit approach, highlight significant audit risks and provide you with the details of our audit team. It is a fundamental requirement that an auditor is, and is seen to be, independent of its clients, and Appendix A summarises our considerations and conclusions on our independence as auditors.

We value two-way communication with yourselves and we see this document, which has been prepared following our initial planning discussions with management, as being the basis for a discussion through which we can also understand your expectations.

This document was presented to the Audit and Governance Committee meeting on 19 February 2016 and is now being presented for approval by the full Authority on 1 April 2016. If you would like to discuss any matters in more detail please do not hesitate to contact me on 0191 383 6300.

Yours faithfully

Mark Kirkham
Partner, for and on behalf of Mazars LLP

Contents

01 Purpose and Background

Purpose of this document

This document sets out our audit plan in respect of the audit of the financial statements of Cleveland Fire Authority for the year ending 31 March 2016, and was discussed at the Audit and Governance Committee meeting on 19 February 2016.

The plan sets out our proposed audit approach and is prepared to assist you in fulfilling your governance responsibilities. The responsibilities of those charged with governance are defined as to oversee the strategic direction of the entity and obligations related to the accountability of the entity, including overseeing the financial reporting process.

We see a clear and open communication between ourselves and you as important in:

- reaching a mutual understanding of the scope of the audit and the responsibilities of each of us;
- sharing information to assist each of us to fulfil our respective responsibilities;
- providing you with constructive observations arising from the audit process; and
- ensuring as part of the two-way communication process that we, as external auditors, gain an understanding of your attitude and views in respect of the internal and external operational, financial, compliance and other risks you face, which might affect the audit, including the likelihood of those risks materialising and how they are monitored and managed.

Appendix C outlines the form, timing and content of our communication with you during the course of the audit. Appendix D sets out forthcoming accounting and other issues that will be of interest.

Scope of engagement

We are appointed to perform the external audit of your accounts for the year to 31 March 2016. The scope of our engagement is laid out in the National Audit Office's Code of Audit Practice.

Responsibilities

- **Audit opinion and value for money conclusion**

  We are responsible for forming and expressing an opinion on the financial statements. Our audit does not relieve management or the Audit and Governance Committee, as those charged with governance, of their responsibilities. We are also required to reach a conclusion on the arrangements that the Authority has put in place to secure economy, efficiency and effectiveness in its use of resources (our Value for Money conclusion).

- **Whole of Government Accounts**

  We report to the National Audit Office in respect of the consistency of the Authority's Whole of Government Accounts submission with the financial statements.

- **Fraud**

  The responsibility for safeguarding assets and for the prevention and detection of fraud, error and non-compliance with law or regulations rests with both those charged with governance and management. In accordance with International Standards on Auditing (UK and Ireland), we plan and perform our audit so as to obtain reasonable assurance that the financial statements taken as whole are free from material misstatement, whether caused by fraud or error. Our audit, however, should not be relied upon to identify all such misstatements.

We are required to enquire of those charged with governance as to their knowledge of instances of fraud, the risk of fraud and their views on management controls that mitigate the fraud risks.

Significant matters considered

As part of our risk based approach to planning we consider a number of key performance and control environment features together with external developments. The following paragraphs set out some of the key aspects for 2015/16.

We use the Authority's latest financial monitoring reports and medium term financial strategy to consider the current financial position. The following position for period 9 was reported to Audit and Governance Committee on 19 February 2016 and the updated Medium Term Financial Strategy was approved by the Authority meeting on 12 February 2016.

Area	Budget	Position to date	Variance to date	Projected year end
Net revenue expenditure	£27.6m	£19.6m	£0.9m underspend	£1.1m underspend
Capital expenditure	£12.4m	£4.3m	Not reported	£3.4m underspend

The projected revenue underspend is net of contributions to new reserves earmarked for specific initiatives and will be used with resources from the previous year to provide £1.5M of one-off resources. This funding will be used to manage the impact of front loaded grant cuts and provide a slightly longer lead time to phase in the budget cuts required in the next four years. This planned underspending is the result of resolute action taken by the Authority to hold vacancies and reduce the risk of redundancies.

The Medium Term Financial Strategy has been updated to reflect the provisional Local Government Spending Assessment published in December 2015. Whilst the spending assessment signals continuing austerity with significant, front-loaded cuts in central government funding the distribution of cuts between fire authorities over the next 4 years will be less detrimental for Cleveland Fire Authority than over the previous 4 years due to them being based on total resources rather than just government grant. Accordingly, the challenging but achievable savings proposals in the revised CIRMP should address the reductions in funding for the four years up to 2019/20.

In addition we review the overall position for general fund and earmarked reserves. The Authority held total reserves of £16.5m at 31 March 2015, including the general fund reserve of £1.6m, earmarked revenue reserves of £2M and earmarked capital reserves of £12.9M.

The Medium Term Financial Strategy shows that total reserves will fall to £2M by 2019/20 as earmarked reserves are used on large capital projects set out in the asset management plan and to meet expected pressures, but the general fund reserve will be maintained.

02 Audit scope, approach and timeline

Audit scope

Our audit approach is designed to provide you with an audit that complies with all professional requirements.

Our audit of the financial statements will be conducted in accordance with International Standards of Auditing (UK and Ireland) and in accordance with the National Audit Office's Code of Audit Practice. Our work is focused on those aspects of your business which we consider to have a higher risk of material misstatement such as those impacted by management judgement and estimation, application of new accounting standards, changes of accounting policy, changes to operations or areas which have been found to contain material errors in the past.

Audit approach

We apply a risk-based audit approach primarily driven by the matters we consider to result in a higher risk of material misstatement of the financial statements. Once we have completed our risk assessment we develop our audit strategy and design audit procedures in response to this assessment. The work undertaken could include a combination of the following as appropriate:

- testing of internal controls;
- substantive analytical procedures; and
- detailed substantive testing.

If we conclude that appropriately designed controls are in place then we may plan to test and rely upon these controls. If we decide controls are not appropriately designed, or we decide it would be more efficient to do so, we may take a wholly substantive approach to our audit testing.

Our audit will be planned and performed so as to provide reasonable assurance that the financial statements are free of material misstatement and give a true and fair view. Materiality and misstatements are explained in more detail in Appendix B.

The diagram overleaf outlines the procedures we perform at the different stages of the audit.

Planning

- Planning visit
- Risk assessment
- Considering proposed accounting treatments and accounting policies
- Developing audit strategy
- Agreeing timetable and deadlines
- Preliminary analytical review

Interim work and final fieldwork

- **Interim work**
- Document systems and controls
- Perform walkthroughs
- Interim controls testing
- **Final fieldwork**
- Receiving and reviewing draft financial statements
- Reassessment of audit plan and revision if necessary
- Executing the strategy starting with significant risks and high risk areas
- Communicating progress and issues
- Clearance meeting

Completion

- Final review and disclosure checklist of financial statements
- Final Engagement Lead review
- Agreeing content of letter of representation
- Reporting to the Audit and Governance Committee and Executive
- Reviewing post balance sheet events
- Signing the auditor's report

Group audit approach

Local government and fire bodies are required to consider interests in other entities and whether those interests might necessitate the production of group financial statements. The Authority has determined that group financial statements are required in respect of its wholly owned subsidiary Cleveland Fire Risk Management Services. We have planned our 2015/16 audit to include:

- liaising with the auditor of the subsidiary company (Waltons Clark Whitehall) to obtain the necessary information, including taking into account any risks they have identified; and
- the audit of the group accounts, ensuing appropriate consolidation adjustments and disclosure.

Reliance on Internal Audit

Where possible we will seek to utilise the work performed by internal audit to modify the nature, extent and timing of our audit procedures. We will meet with internal audit to discuss the progress and findings of their work prior to the commencement of our controls evaluation procedures.

Where we intend to rely on the work on internal audit, we will evaluate the work performed by your internal audit team and perform our own audit procedures to determine its adequacy for our audit.

Reliance on other auditors

There are material entries in your financial statements where we will seek to place reliance on the work of other auditors. These are set out in the following table.

Items of account	Other auditor	Nature of assurance to obtain from the auditor
Defined benefit liability and associated IAS 19 entries and disclosures	Ernst and Young (EY)	We will agree a programme of work with EY and a timetable for the receipt of relevant information.

Service organisations

There are material entries in your financial statements where the Authority is dependent on an external organisation. We call these entities service organisations. The table below outlines our approach to understanding the services the Authority receives from each organisation and the effectiveness of controls in place to reduce the risk of material misstatement in the financial statements.

Nature of services provided and items of account	Name of service organisation	Audit approach to be adopted
All areas of the financial statements. Systems provided for the Authority are: • general ledger; • payroll; • accounts payable; • accounts receivable; • cash receipting; and • treasury management.	Hartlepool Borough Council	We are also the auditor of the Council. We will review the controls in place for production of the financial statements and also within the key financial information systems.

The work of experts

We plan to rely on the work of the following experts:

Item(s) of account	Management's expert	Our expert
Defined benefit liability and associated IAS 19 entries and disclosures	Actuary (Aon Hewitt)	National Audit Office's consulting actuary (PWC)
Property, plant and equipment valuations	Internal valuer from Hartlepool Borough Council	National Audit Office's consulting valuer (Gerald Eve)
Financial instruments: fair value estimates	Capita (Treasury Management advisor)	Central assurance provided by the National Audit Office

Timeline

The diagram below sets out the timing of the key phases of our audit work. We will communicate with management throughout the audit process and will ensure significant issues identified are communicated to those charged with governance on a timely basis.

February to March 2016	• Planning meeting • Issue Audit Strategy Memorandum
February to May 2016	• Interim work (walk through tests, pre-statements substantive testing of expenditure, IT risk assessment) • Report interim findings and update Audit Strategy Memorandum if required - May
June to August 2016	• Fieldwork to be completed over 3 weeks in June or July 2016 • Closure meeting and draft completion report August 2016
30 Sept 2016	• Issue representation letter and finalise completion report • Finalise financial statements review and issue auditor’s report

03 Significant risks

We have performed our planning procedures, including our risk assessment, as detailed in section 2. In addition, we met with management as part of the audit planning process to discuss the risks that, in management's opinion, the Authority faces and have considered the impact on our audit risk. The risks that we identify as significant for the purpose of our audit are the risks of material misstatement that in our judgement require special audit consideration.

We set out below the significant audit risks identified as a result of these meetings and planning procedures which we will pay particular attention to during our audit in order to reduce the risk of material misstatement in the financial statements.

Significant audit risks

Management override of controls

Description of the risk

International Standards on Auditing (ISA) 240 – *The auditor's responsibility to consider fraud in an audit of financial statements* requires us to consider the potential for management override because controls that may be sufficient to detect error may not be effective in detecting fraud. In all entities, management at various levels is in a unique position to perpetrate fraud because of the ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Due to the unpredictable way in which such override could occur, we consider there to be a risk of material misstatement due to fraud and thus a significant risk on all audits.

How we will address this risk

Our testing strategy will include:

- review of material accounting estimates, which may be subject to management bias, included in the financial statements;
- consideration and review of unusual or significant transactions outside the normal course of business; and
- testing of journals recorded in the general ledger and other adjustments made in preparation of the financial statements.

Revenue recognition

Description of the risk

In accordance with ISA 240 we presume there is a risk of fraud in respect of the recognition of revenue because of the potential for inappropriate recording of transactions in the wrong period. ISA 240 allows the presumption to be rebutted but, given the Authority's range of revenue sources we have concluded that there are insufficient grounds for rebuttal in 2015/16. This does not imply that we suspect actual or intended manipulation but that we continue to deliver our audit work with appropriate professional scepticism.

How we will address this risk

We will evaluate the design and implementation of controls to mitigate the risk of income being recognised in the wrong period. In addition, we will undertake a range of substantive procedures including:

- testing receipts in March, April and May 2016 to ensure they have been recognised in the right year;
- testing adjustment journals; and
- obtaining direct confirmation of year-end bank balances and testing the reconciliations to the ledger.

Pension Estimates (IAS 19)

Description of the risk

The financial statements contain material pension entries in respect of the retirement benefits. The calculation of these pension figures, both assets and liabilities, can be subject to significant volatility and includes estimates based upon a complex interaction of actuarial assumptions. This results in an increased risk of material misstatement.

How we will address this risk

We will discuss with key contacts any significant changes to the pension estimates prior to the preparation of the financial statements. In addition to our standard programme of work in this area, we will:

- evaluate the management controls you have in place to assess the reasonableness of the figures provided by the Actuary; and
- consider the reasonableness of the Actuary's output, referring to an expert's report on all actuaries nationally which is commissioned annually by the National Audit Office.

04 Value for Money Conclusion

Scope of work

For 2015/16, we are required to satisfy ourselves the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. We perform our work in this area in accordance with guidance set out by the NAO in Auditor Guidance Note 3. This requires us to consider one overall criterion which is made up of three sub-criteria.

Overall criterion: *in all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.*

Sub-criteria	Guidance
Informed decision-making	• Acting in the public interest, through demonstrating and applying the principles and values of sound governance. • Understanding and using appropriate and reliable financial and performance information (including, where relevant, information from regulatory/monitoring bodies) to support informed decision making and performance management. • Reliable and timely financial reporting that supports the delivery of strategic priorities. • Managing risks effectively and maintaining a sound system of internal control.
Sustainable resource deployment	• Planning finances effectively to support the sustainable delivery of strategic priorities and maintain statutory functions. • Managing and utilising assets effectively to support the delivery of strategic priorities. • Planning, organising and developing the workforce effectively to deliver strategic priorities.
Working with partners and other third parties	• Working with third parties effectively to deliver strategic priorities. • Commissioning services effectively to support the delivery of strategic priorities. • Procuring supplies and services effectively to support the delivery of strategic priorities.

As part of our work, we will also:

- review your annual governance statement;
- review your risk register; and
- carry out any risk-based work we determine appropriate.

At this stage we are not aware of any regulatory work or inspection activity that would be relevant to our audit.

We have considered the risks that are relevant to our value for money conclusion and have not identified any significant risks. Our value for money risk assessment is described in more detail in a separate report to Audit and Governance Committee on 19 February 2016. This report explains that there are some potential risks, which we need to follow up. Any emerging risks and work to address them will be reported to Audit and Governance Committee in May 2016.

05 Your audit team

Below are your audit team and their contact details.

Engagement lead (Partner)	• Mark Kirkham • mark.kirkham@mazars.co.uk • 0191 383 6300 or 07747 764 529
Engagement manager (Manager)	• Ross Woodley • Ross.woodley@mazars.co.uk • 0191 383 6303 or 07881 283 349
Team leader (Assistant Manager)	• Angela Tetradis • angela.tetradis@mazars.co.uk • 0191 383 6350

06 Fees for audit and other services

Our audit fees for the audit of the financial statements and for any assurance or other services are outlined in the tables below.

Area of work	2015/16 Proposed fee	2015/16 Scale Fee	2014/15 Actual fee
Code audit work	28,887	28,887	38,516
Group accounts audit work	3,800	0	3,800
Total fee	**32,687**	**28,887**	**42,316**

Appendix A - Independence

We are required by the Financial Reporting Authority to confirm to you at least annually in writing that we comply with the Auditing Practices Board's Ethical Standards. In addition we communicate any matters or relationship which we believe may have a bearing on our independence or the objectivity of the audit team.

Based on the information provided by you, and our own internal procedures to safeguard our independence as auditors, we confirm that in our professional judgement, there are no relationships between us, and any of our related or subsidiary entities, and you, and your related entities, creating any unacceptable threats to our independence within the regulatory or professional requirements governing us as your auditors.

We have policies and procedures in place which are designed to ensure that we carry out our work with integrity, objectivity and independence. These policies include:

- all partners and staff are required to complete an annual independence declaration;
- all new partners and staff are required to complete an independence confirmation and also complete computer based ethical training;
- rotation policies covering audit engagement partners and other key members of the audit team who are required to rotate off a client after a set number of years; and
- use by managers and partners of our client and engagement acceptance system which requires all non-audit services to be approved in advance by the audit engagement lead.

We wish to confirm that in our professional judgement, as at the date of this document, we are independent and comply with UK regulatory and professional requirements. However, if at any time you have concerns or questions about our integrity, objectivity or independence please discuss these with Mark Kirkham, Engagement Lead.

Prior to the provision of any non-audit services the Engagement Lead will undertake appropriate procedures to consider and fully assess the impact that providing the service may have on our auditor independence.

No threats to our independence have been identified.

Appendix B – Materiality

Materiality is an expression of the relative significance or importance of a particular matter in the context of financial statements as a whole.

Misstatements in financial statements are considered to be material if they, individually or in aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

Judgements on materiality are made in light of surrounding circumstances and are affected by the size and nature of a misstatement, or a combination of both. Judgements about materiality are based on consideration of the common financial information needs of users as a group and not on specific individual users.

The assessment of what is material is a matter of professional judgement and is affected by our perception of the financial information needs of the users of the financial statements. In making our assessment we assume that users:

- have a reasonable knowledge of business, economic activities and accounts;
- have a willingness to study the information in the financial statements with reasonable diligence;
- understand that financial statements are prepared, presented and audited to levels of materiality;
- recognise the uncertainties inherent in the measurement of amounts based on the use of estimates, judgement and the consideration of future events; and
- will make reasonable economic decisions on the basis of the information in the financial statements.

We consider materiality whilst planning and performing our audit.

Whilst planning, we make judgements about the size of misstatements which we consider to be material and which provides a basis for determining the nature, timing and extent of risk assessment procedures, identifying and assessing the risk of material misstatement and determining the nature, timing and extent of further audit procedures.

We have set materiality at the planning stage at £609,000 with a clearly trivial threshold of £18,000 below which identified errors will not usually be reported. We have set lower materiality levels for the disclosure of officer remuneration and emoluments and members' allowances as we consider these items to be of specific interest to users of the accounts sufficient to warrant audit procedures which would not otherwise be applied based on the materiality level for the audit as a whole. The materiality determined at the planning stage does not necessarily establish an amount below which uncorrected misstatements, either individually or in aggregate, will be considered as immaterial.

We revise materiality for the financial statements as our audit progresses should we become aware of information that would have caused us to determine a different amount had we been aware of that information at the planning stage.

We discuss with management any significant misstatements or anomalies that we identify during the course of the audit and we report in our Audit Completion Report all unadjusted misstatements we have identified other than those which are clearly trivial, and obtain written representation that explains why these remain unadjusted.

Appendix C – Key communication points

ISA 260 'Communication with Those Charged with Governance' and ISA 265 'Communicating Deficiencies In Internal Control To Those Charged With Governance And Management' require us to communicate a number of points with you.

Relevant points that need to be communicated with you at each stage of the audit are outlined below.

Form, timing and content of our communications
We will present to the Audit and Governance Committee the following reports:

- our Audit Strategy Memorandum;
- our VFM Conclusion Risk Assessment;
- our Audit Completion Report; and
- Annual Audit Letter.

These documents will be discussed with management prior to being presented to the Audit and Governance Committee and their comments will be incorporated as appropriate.

Key communication points at the planning stage as included in this Audit Strategy Memorandum

- Our responsibilities in relation to the audit of the financial statements.
- The planned scope and timing of the audit.
- Significant audit risks and areas of management judgement.
- Our independence.
- Responsibilities for preventing and detecting errors.
- Materiality.
- Fees for audit and other services.

Key communication points at the completion stage to be included in our Audit Completion Report

- Significant deficiencies in internal control.
- Significant findings from the audit.
- Significant matters discussed with management.
- Our conclusions on the significant audit risks and areas of management judgement.
- Unadjusted misstatements.
- Management representation letter.
- Our proposed draft audit report.
- Independence.

Appendix D – Forthcoming accounting and other issues

The 2015/16 CIPFA Code of Practice on Local Authority Accounting (the Code) has made several changes, of which you should be aware. We provide workshops explaining these changes and invite officers from the Authority responsible for preparing the financial statements. The workshops in January 2016 provided full details of the changes in the 2015/16 Code as well as a forward look to potential future accounting changes that may be of relevance to the Authority and the Authority was suitably represented. If you require detailed information on any of these changes or any other emerging issues, please contact any member of the engagement team.

Forthcoming accounting issues

Early deadlines	How this may affect the Authority
The Accounts and Audit Regulations 2015 outline earlier deadlines for local authorities to produce their statements of account to 31 May from the 2017/18 financial year. The deadline for the completion of the audit will also move forward to 31 July.	The impacts of this change on local authorities and their auditors are significant and we have begun to discuss how we will meet the challenges the new dates place on us all with Authority officers.
Fair Value accounting	**How this may affect the Authority**
The Code adopts the principles of IFRS 13 in respect of measuring fair value for the first time in 2015/16.	If any assets are held as surplus assets (e.g. vacated premises) they will need valuing at market value rather than existing use value.