

Audit Strategy Memorandum

Cleveland Fire Authority

For the year ended 31 March 2017



Contents

| | |
|--|----|
| Executive summary | 3 |
| Purpose of this report | 3 |
| Audit scope and approach | 4 |
| Significant risks and key judgements | 6 |
| Timetable and communication | 8 |
| Value for Money Conclusion..... | 10 |
| Fees | 12 |
| Our team | 13 |
| Appendix A – Service organisations and experts | 14 |
| Appendix B – Independence | 16 |
| Appendix C - Materiality | 17 |
| Appendix D – Our added value | 18 |

Executive summary

Purpose of this report

The Audit Strategy Memorandum sets out our audit plan in respect of the audit of Cleveland Fire Authority ('the Authority') for the year ending 31 March 2017, and forms the basis for discussion at the Audit and Governance Committee meeting on 24 February 2017.

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 overseeing the strategic direction of the entity and obligations related to the accountability of the entity, including overseeing the financial reporting process. We have determined that the Audit and Governance Committee are those charged with governance for the purpose of our audit as the full Authority has formally delegated responsibility to them to consider all audit reports.

| | |
|-----------------------------------|--|
| Timing of our work | Our audit will be delivered in four main phases as outlined in page 8 of this report. The statutory deadline for the completion of our audit work is 30 September 2017. |
| Financial Statements audit | <p>Significant risks</p> <p>We have identified the following areas on which we will carry out specific audit procedures to mitigate the risks of material misstatements in the Authority's financial statements.</p> <ul style="list-style-type: none">• management override of controls;• revenue recognition; and• valuation of the defined benefit pension scheme. <p>Materiality</p> <p>At the planning stage of the audit we have set materiality for the financial statements as a whole at £607,000. In reporting the results of our work we do not report identified misstatements below a clearly trivial level. We have set this level at £18,000.</p> |
| Value for Money conclusion | <p>The work we carry out to form a conclusion on whether the Authority has proper arrangements in place for securing economy, efficiency and effectiveness in its use of resources is summarised on page 9. We have identified the following significant risk in respect of our VFM work:</p> <ul style="list-style-type: none">• Sustainable resource deployment beyond the significant reduction in funding expected in 2020/21. |
| Independence | We have considered any actual, potential or perceived threats to our independence on page 16. We have not identified any such threats at this stage of the audit. |

Audit scope and approach

The scope of our work

The detailed scope of our work as your appointed auditor for 2016/17 is set out in the National Audit Office's (NAO) Code of Audit Practice. Our responsibilities and powers are derived from the Local Audit and Accountability Act 2014 ('the 2014 Act') and are summarised below.

Opinion on the financial statements

We are responsible for forming and expressing an opinion on the financial statements. Our audit is planned and performed so to provide reasonable assurance that the financial statements are free from material error and give a true and fair view of the financial performance and position of the Authority for the year.

Our audit does not relieve management or the Audit and Governance Committee, as those charged with governance, of their responsibilities.

Value for Money conclusion

We are required to conclude whether the Authority has proper arrangements in place to secure economy, efficiency and effectiveness in its use of resources. We discuss our Value for Money work in greater detail later in this report.

Whole of Government Accounts (WGA)

We report to the NAO on the consistency of the Authority's financial statements with its WGA submission.

Electors' rights

The 2014 Act requires us to give an elector, or any representative of the elector, the opportunity to question us about the accounting records of the Authority and consider any objection made to the accounts by an elector. We also have a broad range of reporting responsibilities and powers that are unique to the audit of local authorities in the United Kingdom.

Our response to the risk of fraud

International Standards on Auditing (ISAs) require us to obtain reasonable assurance that the financial statements are free from material fraud and/or error. There are a range of ways in which fraud may arise in the context of your financial statements and we formally consider the risk of fraud as part of our planning work and design appropriate procedures to mitigate risks identified. We maintain an appropriate level of professional scepticism throughout the audit and are mindful that a material misstatement due to fraud is possible, however our audit should not be relied upon to identify all such misstatements.

Management and the Audit and Governance Committee, as those charged with governance also have responsibilities in respect of fraud. They are responsible for safeguarding assets and for the prevention and detection of fraud, error and non-compliance with laws and regulations.

We will enquire of the Audit and Governance Committee as part of our audit. Our enquiries will focus on:

- What role the Audit and Governance Committee has in relation to fraud and how it is kept informed of fraud related matters by management;
- What anti-fraud measures you have in place and how your policies and procedures are monitored; and
- Whether you are aware of any actual, alleged or suspected fraud.

We will formally write to you, in your role as those charged with governance, making the enquiries above, towards the end of the audit cycle.

Our approach to obtaining assurance over service organisations

There are material entries in your financial statements where the Authority is dependent on an external organisation (Hartlepool Borough Council). We call such entities service organisations. In Appendix A, we outline our approach to understanding the services received from the Council and the approach we intend to take to obtain sufficient appropriate evidence over items of account that derive from them.

Our use of experts and other auditors

Management and auditor experts

There are material entries in your financial statements which are provided by management experts. For some of these entries, we will use our own expert to provide us with the assurance we require in relation to the work of your expert.

In addition to setting out information in respect of service organisations, Appendix A also summarises management's experts and our planned audit approach to obtaining assurance over their work.

Internal audit

We will meet with internal audit to discuss their work programme and findings, and factor this in when determining the most efficient testing strategy. Where appropriate we will seek to utilise the work performed by internal audit to obtain assurance.

Where we intend to rely on the work of internal audit, we will evaluate their work and perform our own audit procedures to determine its adequacy for our audit.

Our approach to the audit of the Authority's group

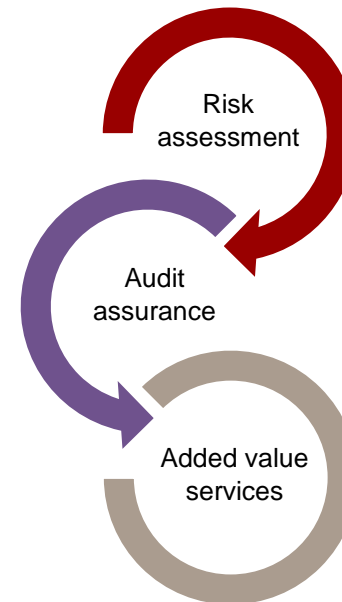
Group audit approach

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. As we have determined that the subsidiary is not a significant component we will not be issuing group instructions but have planned our 2016/17 audit to include:

- communicating with the auditor of the subsidiary company (Waltons Clark Whitehall) to obtain the necessary information, including taking into account any risks they have identified;
- obtaining the subsidiaries audited accounts and using them to conduct analytical procedures at group level; and
- auditing the group accounts, ensuring appropriate consolidation adjustments and disclosure.

Audit efficiency and our use of IT

Innovative and integrated use of IT drives the efficiency and effectiveness of our audit. Your audit team uses the latest IT-based audit solutions and is supported by a team of IT auditors each of who have extensive knowledge of the local government sector and providing assurance and advisory services across the public sector.



We know that all organisations are different and face different risks. Our audit platform is modern and flexible and allows us to tailor our audit approach to the specific risks relevant to the Authority, while ensuring compliance with underlying auditing standards.

We focus on the risks to your business continuity and those that give rise to a risk of material misstatement in the financial statements. Your audit team has access to a full suite of data analytics tools which allow them to determine the most effective and efficient testing strategy using IT-audit techniques where appropriate.

Significant risks and key judgements

Identified significant risks

As part of our planning procedures we have considered whether there are risks of material misstatement in the Authority's financial statements that require special audit consideration. Although we report identified significant risks at the planning stage of the audit, our risk assessment is a continuous process and we regularly consider whether new significant risks have arisen and how we intend to mitigate these risks. Where we identify any significant risks in addition to those set out below, we will report these to the Audit and Governance Committee as part of our Audit Completion Report.

| Significant risk | How we will mitigate the risk |
|--|---|
| <p>Management override of control</p> <p>In all entities, management at various levels within an organization are in a unique position to perpetrate fraud because of their 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 overrides could occur, we consider there to be a risk of material misstatement due to fraud and thus a significant risk on all audits.</p> | <p>Our testing strategy will include:</p> <ul style="list-style-type: none"> • using a computer audit analytical technique (CAAT) to efficiently identify journals with risk characteristics and testing 100% of such adjustments to the financial ledger; • review of material accounting estimates, which may be subject to management bias, included in the financial statements; and • consideration and review of unusual or significant transactions outside the normal course of business. |
| <p>Revenue Recognition</p> <p>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 2016/17. This does not imply that we suspect actual or intended manipulation but that we continue to deliver our audit work with appropriate professional scepticism.</p> | <p>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:</p> <ul style="list-style-type: none"> • testing receipts in March, April and May 2016 to ensure they have been recognised in the right year; • testing adjustment journals as above for management override with particular focus on journals moving revenue between years; and • obtaining direct confirmation of year-end bank balances and testing the bank reconciliation and other reconciliations to the ledger. |

| Significant risk | How we will mitigate the risk |
|---|---|
| <p>Pension estimation (IAS19)</p> <p>The financial statements contain material pension entries in respect of 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. In addition in 2016/17 a triennial revaluation of pensions took place. This results in an increased risk of material misstatement.</p> | <p>We will discuss with key contacts any significant changes to the pension estimates prior to the preparation of the financial statements. In addition to agreeing pension information in the accounts to that supplied by management's expert and then placing reliance on that expert as set out in Appendix A, we will:</p> <ul style="list-style-type: none"> • evaluate the management controls you have in place to assess the reasonableness of the figures provided by the Actuary; • undertake predictive analytical review to gain assurance over benefits and contributions payable; and • compare the return on assets to the equivalent figure in the pension fund accounts. We are in discussions with the pension fund auditor about obtaining specific assurance relating to the triennial revaluation. |

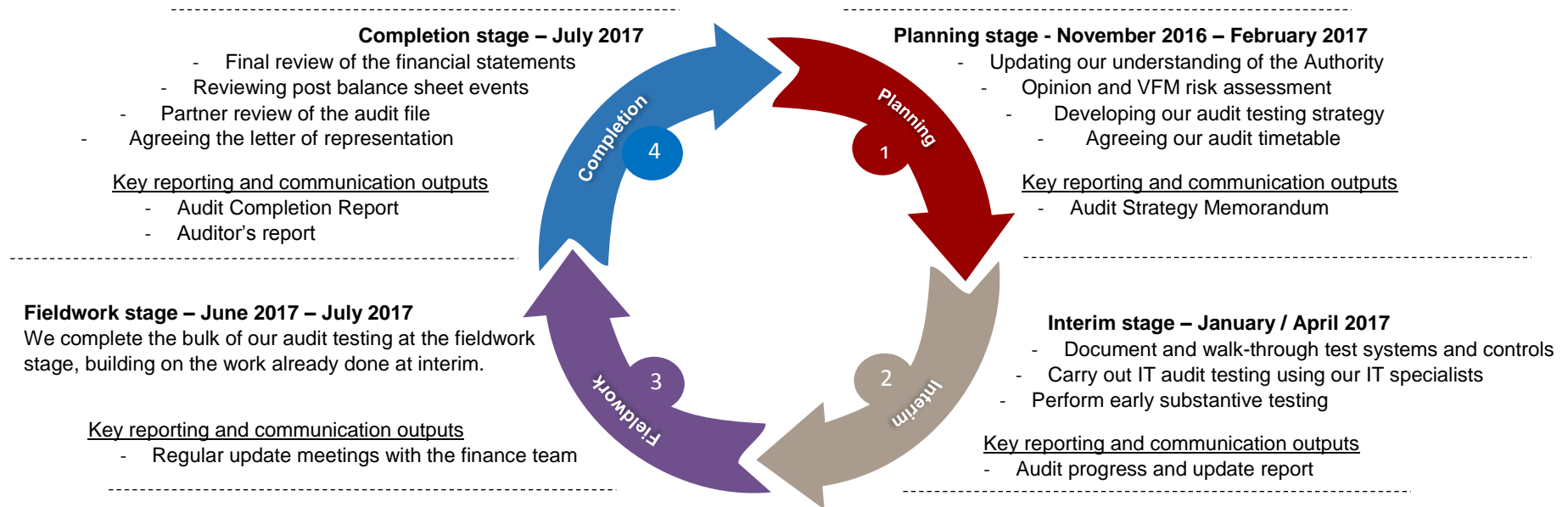
Timetable and communication

Our approach to communication

International Standards on Auditing require us to communicate a number of matters with you at various points during the audit cycle. Later in this section we outline exactly how we will communicate with the Audit and Governance Committee as those charged with governance. As well as being an integral part of our responsibilities under auditing standards, we see two-way communication with the Audit and Governance Committee and the Authority's staff as being critical to building a robust knowledge of your business, the risks and challenges you face and the plans you have in place to meet those challenges.

Audit timetable

The diagram below outlines the main phases of your audit, when each will be carried out and the outputs that you will receive at each stage. This is underpinned by a 'no surprises' approach to communication that ensures management and the Audit and Governance Committee are kept aware of significant issues on a timely basis. We have issued this Audit Strategy Memorandum as scheduled in February 2017 and we intend to issue our Audit Completion Report in July 2017 and our Annual Audit Letter in October 2017.



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 matters to you. These matters are set out below.

| Matter to be communicated | Audit Strategy Memorandum | Audit Completion Report |
|--|---------------------------|-------------------------|
| Our responsibilities in relation to the audit of the financial statements and our wider responsibilities | ✓ | |
| Planned scope and timing of the audit | ✓ | |
| Significant audit risks and areas of management judgement | ✓ | |
| Confirmation of our independence | ✓ | ✓ |
| Responsibilities for preventing and detecting errors | ✓ | |
| Materiality | ✓ | ✓ |
| Fees for audit and other services | ✓ | |
| Significant deficiencies in internal control | | ✓ |
| Significant findings from the audit | | ✓ |
| Significant matters discussed with management | | ✓ |
| Conclusions on the significant audit risks and areas of management judgement | | ✓ |
| Summary of unadjusted misstatements | | ✓ |
| Management representation letter | | ✓ |
| Our proposed audit report | | ✓ |

In addition to the matters outlined above which we are required to communicate under auditing standards, we communicate regularly with the Audit and Governance Committee through our Audit Progress Reports, presented on a quarterly basis. We also report to the Authority on an annual basis to summarise our work and main conclusions through our Annual Audit Letter.

Value for Money Conclusion

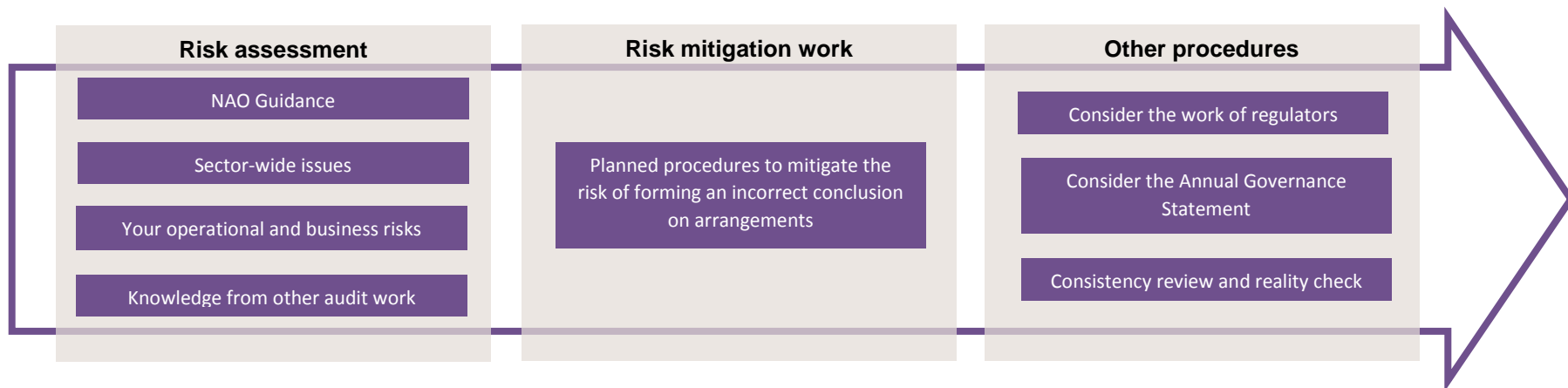
Our approach to Value for Money work

We are required to form a conclusion as to whether the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The NAO issues guidance to auditors that underpins the work we are required to carry out in order to form our conclusion, and sets out the criterion and sub-criteria that we are required to consider.

The overall criterion is that, *'in all significant respects, the Authority had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.'* To assist auditors in reaching a conclusion on this overall criterion, the following sub-criteria are provided set out by the NAO:

- Informed decision making.
- Sustainable resource deployment.
- Working with partners and other third parties.

A summary of the work we undertake to reach our conclusion is provided below.



Significant Value for Money risk

The NAO's guidance requires us to carry out work at the planning stage to identify whether or not a risk to the VFM conclusion exists. Risk, in the context of our VFM work, is the risk that we come to an incorrect conclusion rather than the risk of the arrangements in place at the Authority being inadequate. As outlined above, we draw on our deep understanding of the Authority and its partners, the local and national economy and wider knowledge of the public sector.

For 2016/17, we have identified a significant risk for our VFM conclusion. Our risk assessment has indicated that the same arrangements are in place that have allowed the Authority to sustain services with significantly reduced funding since 2010 and the medium term financial plan is balanced through challenging but realistic CIRMP savings. However, in 2020/21 the Authority is due to receive an unprecedented year-on-year reduction in funding. In the worst case scenario the Authority could lose £5M of Revenue Support Grant funding without compensating support. The Authority recognises this threat and is introducing new approaches to developing its CIRMP and building up reserves. In the context of these new processes being introduced over the next year there is a significant risk of us making an incorrect VFM Conclusion, which needs to be addressed through further work. A summary of the risk and the work we intend to undertake to ensure we reach the correct conclusion is set out in the following table and we are presenting a more detailed report on our VFM Risk Assessment as a separate agenda item at the Audit and Governance Committee meeting on 24 February 2017.

| Value for Money conclusion risk | Work we intend to carry out |
|---|--|
| <p>Sustainable Resource Deployment beyond 2020/21</p> <p>The Government has indicated that it will cease awarding Revenue Support Grant (RSG) from 2020/21 and has not yet confirmed what if any mitigating funding will be available for fire authorities. For example, it is unclear if the localisation of business rates, which could see the Authority retain 100% of business rates rather than 50% will apply to fire authorities. Cleveland Fire Authority is especially reliant on RSG and may potentially lose £5M funding, one sixth of its annual budget. The potential loss will be partly mitigated by an increase in retained business rates income of £1.7M, although the Authority would still potentially face a net funding loss of £3.3M.</p> <p>The Authority has done well to sustain services through successive years of significant funding reductions. However, a reduction of this size in one year is unprecedented and a new strategy is required to prepare for this worst case scenario. During 2017 the Authority is updating its Community Integrated Risk Management Plan (CIRMP) using a new approach to prioritise limited resources and it is also reviewing its reserves strategy with the intention of increasing earmarked reserves over the next 3 years. There is a risk that the Authority will be unable to sustain delivery of strategic priorities and maintain statutory functions beyond 31 March 2020 unless these new arrangements are strong.</p> | <p>We will review the Authority's processes for:</p> <ul style="list-style-type: none"> • Updating its CIRMP to sustain delivery of strategic priorities and maintain statutory services with reduced resources; • Updating its reserves strategy to build up reserves that will allow it to smooth the impact of a significant loss of funding in 2020/21 over several years. <p>We will also review the 2015/16 financial and performance outturn and the updated VFM Profile produced by the National Audit Office to identify any emerging risks to the VFM Conclusion. At the completion stage of the audit we will obtain evidence that the existing CIRMP projects are on track with particular focus on the recruitment and training of sufficient retained firefighters to crew a further two appliances on a retained basis from 1 April 2018.</p> |

Fees

Fees for work as the Authority's appointed auditor

At this stage of the audit we are not planning any divergence from the scale fees set by Public Sector Audit Appointments Ltd (PSAA) and the specific agreement with them of a fee for group accounts that we communicated to you in our fee letter on 11 April 2016.

| Area of work | 2016/17 proposed fee | 2015/16 final fee |
|-------------------------|-------------------------|----------------------|
| Code audit work | 28,887 | 28,887 |
| Group accounts | 3,800 | 3,800 |
| Total audit fees | 32,687 | 32,687 |

Our team



Partner name – Cameron Waddell

Email: Cameron.Waddell@mazars.co.uk

Phone: 01913836314

Bio: Cameron joined Mazars in November 2012. He is an engagement lead on some of our most prestigious public sector clients with over 23 years' experience of public sector audit. He has been an engagement lead for 3 other fire and rescue authorities over the past 10 years and was appointed as engagement lead for Cleveland Fire Authority in 2016. Cameron will be the key contact for members and the Senior Management Team. He will have overall responsibility for delivering a high quality audit to ensure delivery of a 'safe' Auditor's Report to the Authority.



Manager name – Ross Woodley

Email: Ross.Woodley@mazars.co.uk

Phone: 0191 3836303

Bio: Ross also joined Mazars from the Audit Commission in 2012 and has over 20 years post qualification experience of public sector audit. Whilst at the Audit Commission Ross specialised in the audit of fire authorities and undertook several regional and national roles including the role of National Fire Audit Lead. Ross has been the Audit Manager for Cleveland Fire Authority for 3 years. Ross will be the main contact for the Treasurer, liaising with the team preparing the accounts and managing both the opinion and VFM Conclusion work on a daily basis.



Team-leader name – Angela Tetradis

Email: Angela.Tetradis@mazars.co.uk

Phone: 0191 3836300

Bio: Angela is also a fully qualified accountant who joined Mazars in 2012. She previously worked both for the Audit Commission on public sector clients and for a private sector accountancy firm in the Tees Valley. She lives in Stockton and has worked mainly on the Stockton and Hartlepool Borough Council audits for the past 10 years. Angela will supervise work on-site and liaise closely with the audit team leader for Hartlepool Borough Council to ensure a co-ordinated and efficient approach.

Appendix A – Service organisations and experts

Service organisations

As we outline in the main body of this report, the Authority makes use of service organisations. ISA 402 defines a service organisation as one that provides services to another entity that form part of that entity’s information systems relevant to financial reporting. The table below sets out the service organisations that we have identified as part of our planning work together with a description of how we intend to obtain assurance over the entries in your financial statements that are derived from them.

| Service organisation | Services provided | Planned audit approach |
|-----------------------------------|--|--|
| Hartlepool Borough Council | Preparing the financial statements and maintaining all the material systems underpinning these statements: <ul style="list-style-type: none"> • general ledger; • payroll; • accounts payable; • accounts receivable; • fixed assets; and • treasury management. | We are also the auditor of the Council and have direct access to accounting records and staff. Accordingly, we can substantively test the financial statements in the same way as if they were prepared by the Authority. We will review and document the controls in place for production of the financial statements and also within the material financial information systems. |

Experts

The Authority also uses experts to provide entries in its financial statements. The table below outlines the areas of the financial statements where we expect the Authority to use experts and an explanation of the approach we will take to obtaining assurance over those entries.

| Financial statement area | Management's expert | Planned audit approach |
|---|---|---|
| Defined benefit liability and associated IAS 19 entries and disclosures | Actuary (Aon Hewitt) | Use National Audit Office's consulting actuary (PWC) to confirm we can rely upon information provided by management's expert. |
| Property, plant and equipment valuations | Internal valuer from Hartlepool Borough Council | Use National Audit Office's consulting valuer (Gerald Eve) to consider the reasonableness of the approach taken by management's expert. |
| Financial instrument notes: fair value estimates | Capita (Treasury Management advisor) | Use central assurance provided by the National Audit Office to confirm we can rely upon fair value estimates provided by management's expert. |

Appendix B – Independence

We are required by the Financial Reporting Council 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 partner.

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 either Cameron Waddell or Ross Woodley.

Prior to the provision of any non-audit services, Cameron Waddell 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 C - 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 our audit, 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.

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 D – Our added value

Our primary responsibilities as the Authority’s external auditor are outlined in the main body of this report. As your external auditor we are ideally placed to provide added value in delivering those responsibilities and the diagram below provides a summary of how we do this.

Insight

Analysis of emerging issues shared regularly with you through our Audit Progress Reports.

Sharing knowledge from our membership of a range of professional networks including those hosted by CIPFA and NAO.

Regular updates from our public services advisory team on lessons learned from its work across the UK public sector.

Access to our public sector governance forum allowing free and open discussion of governance issues.

Expertise

Specialist public sector financial reporting advisory service, providing expert analysis of emerging accounting issues.

A dedicated IT audit and advisory team, with expertise and experience of providing services across the public sector.

Provision of annual accounting workshops attended by your finance team.

Support for continuous improvement

Clear and open communication, allowing for a sensible basis of resolving emerging issues.

Internal control recommendations and follow-up work in conjunction with internal audit.