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Strathclyde Fire and Rescue

Annual Report to the Board of Strathclyde Fire and Rescue and the Controller of Audit

21 November 2011

For the financial year ended 31 March 2011

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Contents

Executive Commentary

Introduction - Section 1

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

Financial Statements and Audit Opinion - Section 2

The financial statements of the Board for the year ended 31 March 2011 have been prepared to comply with accounting requirements contained in the contained in the Code of Practice on Local Authority Accounting in the United Kingdom 2010: A Statement of Recommended Practice ("SORP").

We are pleased to report that our opinion on the financial statements for the year ended 31 March 2011 is **unqualified**.

The draft financial statements and supporting schedules were made available to us at the start of our audit allowing us to progress and complete the audit within the timescales agreed with management.

The draft financial statements produced were of a good standard, with supporting working papers provided by management in accordance with our agreed timetable, allowing us to complete our audit testing as agreed. However, due to the late national notification of a change in accounting for injury benefit liabilities, changes were required to the Balance sheet and supporting notes to the accounts which meant that the audited accounts were not signed until 12 September 2011.

2010/11 Financial Performance - Section 3

After adjusting this in-year deficit to reflect the appropriate statutory and non-statutory adjustments, the Board achieved a surplus, contributing £3.5 million to the General Fund balance.

This position was principally achieved through the successful employment of workforce planning initiatives such as vacancy management, the implementation of 5GDS – a new firefighter roster system – and lower than budgeted pay awards.

After including the 2010/11 revenue underspend, the cumulative general fund balance, available for carry forward, totalled £11.1 million. This exceeds the legislative 5% cumulative carry forward limit. However, the Board has been given Ministerial consent to extend the carry forward limit and make use of these funds going forward. The 2010/11 carry forward balance of £11.1 million is within the revised limit.

Capital spend for the year amounted to £18.7 million against a budget of £18.9 million. This small under spend is due primarily to the timing of expenditure in relation to the new Clydesmill Training Centre.

Financial outlook for 2011/12 - Section 4

The year ahead is expected to bring further challenges to all public sector bodies. The sector must respond to a deep and protracted funding squeeze as public finances are rebalanced. In particular, the Scottish budget has been reduced by £1.3 billion in 2011/12.

The Board's Financial Strategy reaffirmed the Board's position on sharing the pain in respect of reductions in Local Government funding and as a result the Board have budgeted for a 2.8% decrease in their 2011/12 precept income.

Management believe that the cost saving plans such as a voluntary redundancy programme, realising the benefits of key restructuring decisions taken in 2010/11 and the utilisation of an element of carry forward funds available will enable the Board to achieve a balanced budget of £137.5million in 2011/12.

2012/13 and Beyond

The Scottish Justice Secretary's announced, on 8 September 2011, that a national Scotland-wide Fire and Rescue Service would be established. The Board are working with the Scottish Government and other Fire Board's on what the national service will look like and this is something which will be clarified over time. The Board continue to focus on continuing to deliver a best value fire service to the Strathclyde area.

Governance and Control - Section 5

Chief Officer Arrangements

We have assessed the Board's overall governance arrangements including a review of Board and key Committee structures and minutes, financial reporting to the Board, and risk management. The Corporate Management Team has undergone a structural change in the period, reducing the number of members from seven to five at Strategic Manager level.

The Board's Chief Officer retired on 14 July 2011, and was re-employed on 14 August 2011 in the same role as Chief Officer for an expected three year period. This allowed the Chief Officer to access his pension lump sum payment but not his annual pension, which has been abated whilst he is re-employed.

In April 2011 the Board approved the action to set aside £235,000 of Board funding to meet the costs of an unauthorised payment charge incurred by the Chief Officer (employee element of £206,000) alongside the employer scheme sanction charge which would be incurred (employer element of £29,000).

We have reviewed the process followed by the Board to allow the Chief Officer to retire and be re-employed and the decision to subsequently pay the employee unauthorised pension charge.

We can see no formal consideration within the process followed by the Board that alternative options other than retirement and re-employment of the Chief Officer were considered in June 2009, nor that further options were explored and considered in April 2011. In addition, the Board has been unable to demonstrate to us that the Chief Officer was fully independent of the decision making process due to his noted involvement and a lack of formal available evidence to the contrary.

Overall, the level of evidence made available to us does not readily support a best value decision concerning retirement, re-employment and the potential use of Board funds to pay the Chief Officer's £206,715 unauthorised payment charge.

Fraud arrangements

The Board suffered financial loss in the period as a result of a fraud perpetrated by an external party. The fraud in question involved a fraudulent request to change supplier bank account details. Bank details were amended and payment made to a third party. While a control was in place to prevent this situation from arising, it was not effective in this instance and the fraud came to light following a query from the Board's bank. An irrecoverable loss of £0.007 million was suffered. Information has now been received from the Police that an individual connected to this fraud and similar frauds has been arrested and successfully prosecuted.

Statement on Internal Control

The Code of Audit Practice requires us to review and report on the Board's Statement on Internal Control. The Board has used the format, set out within the SORP, for its Statement and has outlined the processes in place to identify and evaluate risks. In addition, key elements of the Board's control framework have been highlighted, such as the management information framework, financial regulations, segregation of duties and a system of delegation and accountability. Based on our normal audit procedures, we do not disagree with the disclosures contained in the Statement.

Section 1: Introduction

Purpose of this report

The Annual Audit Report which follows is designed to set out the scope, nature and extent of our audit, and to summarise our opinion and conclusions on issues arising. Specifically this will direct your attention to matters of significance from our 2010/11 external audit and to confirm what action is planned by management to address the more significant matters identified for improvement.

Scope, nature and extent of our audit

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

Under the requirements of International Standard on Auditing (UK and Ireland) ('ISA') 260: "*Communication of audit matters to those charged with governance*", we are required to communicate audit matters arising from the audit of financial statements to those charged with governance. This Annual Audit Report to Members, together with previous reports to the Performance and Audit Forum throughout the year, as summarised at Appendix 2, discharges the requirements of ISA 260.

We would like to formally extend our thanks to the Board's managers and staff for the assistance they have given us during the audit process.

PricewaterhouseCoopers LLP
Appointed Auditor
Glasgow
21 November 2011

Section 2: Financial Statements and Audit Opinion

Basis of Preparation

The financial statements were prepared in accordance with the accounting requirements contained in the Code of Practice on Local Authority Accounting in the United Kingdom 2011: A Statement of Recommended Practice ("SORP").

Government bodies, including Joint Boards, were required to adopt International Financial Reporting Standards (IFRS) from 2010/11 onwards. As a result the Board has restated its 2009/10 financial statements on an IFRS basis to provide prior year comparatives. Producing IFRS accounts for the first time was a substantial change for the Board, requiring significant input by management. Overall, this transition was well planned, and we only identified IFRS disclosure amendments.

Approval

The Board's draft financial statements were signed as authorised for issue by the Treasurer to the Board and submitted to the Controller of Audit by the required timescale of 30 June 2011.

Audit Process

The draft financial statements and supporting schedules were made available to us at the start of our audit allowing us to progress and complete the audit within the timescales agreed with management.

The draft financial statements produced were of a good standard, with supporting working papers provided by management in accordance with our agreed timetable, allowing us to complete our audit testing as agreed. However, due to the late national notification of a change in accounting for injury benefit liabilities, changes were required to the Balance sheet and supporting notes to the accounts which meant that the audited accounts were not signed until 12 September 2011.

In common with a number of other Local Authorities and Joint Board's producing full IFRS statements for the first time, a number of disclosure amendments were required in order to fully meet IFRS requirements. As a result, the production of the final accounts took longer than in prior years.

In addition, the finalisation of this report was delayed until the middle of November due to ongoing discussions in respect of the governance arrangements in respect of the Chief Officer's retirement and re-employment.

Unadjusted Misstatements

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

During the course of our audit we identified a number of proposed adjustments, principally disclosure in nature. Management have accepted all our proposed adjustments and these have been reflected in the final financial statements submitted. Therefore there are no unadjusted differences to report.

Audit Opinion

Our audit opinion concerns the presentation of Strathclyde Fire and Rescue's financial position as at 31 March 2011 and its income and expenditure and cashflows for the year then ended.

Our opinion on the accounts states whether the financial statements:

- give a true and fair view, in accordance with relevant legal and regulatory requirements and the 2010 SORP, of the financial position of the Board as at 31 March 2011 and of its income and expenditure and cashflows for the year then ended; and
- have been properly prepared in accordance with the Local Government (Scotland) Act 1973.

We are pleased to report that our opinion on the true and fair view on the financial statements and on the regularity of income and expenditure is **unqualified**.

We also provide a view as to whether those parts of the Remuneration Report subject to audit have been properly prepared – this only includes tables 1 to 5, as set out within the remuneration report. Our opinion on the Remuneration Report is also **unqualified**.

Going Concern

The Board's balance sheet discloses an excess of liabilities over assets of £911 million (£1,112 million in 2009/10). This liability position is wholly attributable to the accrual of pension liabilities. An excess of liabilities over assets is one of the indicators that may lead to concerns over the ability of an organisation to continue as a going concern. Therefore in accordance with International Standards on Auditing ("ISA") 520 we have considered whether the Board is entitled to prepare its financial statements on a going concern basis.

The pension liability on the balance sheet has decreased by £180 million in 2010/11. This is principally due to the fact that the actuarial assumptions used to account for the pension position were more favourable at 31 March 2011 than they were at 31 March 2010.

The Board has adopted the going concern basis for the preparation of its financial statements because the pension liability does not impact on its underlying ability to meet its current and ongoing commitments. Formal representations have been obtained from management in this regard and we agree with the basis of the preparation of the accounts.

Consultations are presently ongoing at a UK and Scottish Government level with a view to addressing the public sector pension deficit. The Board's position is consistent with other joint boards that operate unfunded pension schemes and we do not disagree with management's decision to prepare the financial statements on a going concern basis.

Accounting Issues

During the course of our final audit work we discussed a number of accounting issues, particular areas of judgement within the financial statements with management, with the more significant matters outlined below.

Pension Scheme Increases

On 22 June 2010 the government announced changes to the measure of price inflation for the purposes of determining the statutory minimum rates of increases to pensions in payment and revaluation in deferment. In future, pension scheme increases will be based on CPI (consumer price index) instead of RPI (retail price index). This was confirmed in December 2010 when the relevant statutory instrument was published.

This reflects a change in pension scheme rules and has resulted in a gain of £132.6 million being recognised as a negative past service cost within the Comprehensive Income and Expenditure Statement, in accordance with UITF Abstract 48. This does not reflect a cash gain and merely reflects a reduction in the pension scheme liability, as held on the balance sheet. As a result, the impact of this gain is reversed through the Movement in Reserves Statement and does not impact on the Board's surplus. However, the reduction in the pension liability as a result of the RPI to CPI change was partially offset by a change in the accounting treatment of injury benefits. The change dictated that the Board should be accruing for 2 elements in respect of injury benefits, one statutory element and one in respect of length of service. As the Board had previously only been accruing for the statutory element, further provisioning was required for the length of service aspect.

Provisions

Included within the financial statements are provisions totalling £3.4 million. These are principally in relation to insurance claims (£0.6 million) and costs associated with restructuring certain aspects of the Board's support service functions (£2.5 million) with certain costs having been incurred between 31 March and our audit testing in July 2011, due to commitments made in the 2010/11 financial year.

In order to recognise a provision in accordance with IAS 37, 3 criteria must be met, namely;

- An entity has a present obligation (legal or constructive) as a result of a past event;
- It is probable (i.e. more likely than not) that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- A reliable estimate can be made of the amount of the obligation. The Standard notes that it is only in extremely rare cases that a reliable estimate will not be possible.

This is an area whereby management are required to exercise a significant degree of judgement. We obtained the appropriate comfort over the accounting treatment of the material balances provided for within the financial statements through undertaking procedures such as confirmation with the Board's legal department, Board and other Committee minutes and review of management's supporting working papers.

Icelandic Bank Impairment

The Board had £3.0 million invested in Heritable Bank at the time of the Icelandic bank's collapse in 2008. Heritable Bank subsequently went into administration resulting in the carrying value of the investment being impaired.

The Board took advantage of the Scottish Government Capital Finance Regulations to defer the impact of the impairment on the General Fund until 2010/11. However, reflecting the latest administrator information and in line with CIPFA guidance, the Board has recognised an impairment loss of £0.4 million in the 2010/11 Consolidated Income and Expenditure Statement. This resulted in a reduction in the Board's general fund carry forward, at 31 March 2011. We can confirm this treatment is correct based on available guidance.

Automated Fixed Asset Module

During 2010/11 the Board introduced a new automated fixed asset module, in order to replace a manual, spreadsheet based system. This transition represented a significant challenge for management in relation to the reconciliation of fixed asset information and data migration. During our work we reviewed this reconciliation and did not identify any significant issues.

Initial benefits from this new system were identified during the 2010/11 year end process. However, further benefits will be realised in 2011/12 as more information will be available automatically and less manual interpretation will be required.

Section 3: 2010/11 Financial Performance

Financial Position

The Board's budget for 2010/11 was set at £139.9 million (2009/10 £156.7 million) to be financed primarily by precepts from the 12 constituent local authorities. The reduction in budget, from that set in 2009/10, is attributed to the transfer of Firefighters pension funding to the Scottish Government.

For the year ended 31 March 2011, the Board reported an overall deficit of £50.0 million (£38.0 million in 2009/10) in the Comprehensive Income and Expenditure Statement. However, following statutory adjustments the final financial position was a surplus of £3.5 million.

Set out below is a summary of the 2010/11 outturn position, as reflected in the financial statements:

	£m	£m
Gross Expenditure	178.0	
Gross Income	(22.1)	
Net Cost of Services		**155.9**
Net Operating Expenditure (including impact of loss on revaluations, interest receivable & payable and pension interest costs and returns on assets)		**220.2**
Funded by:		
Precepts from Local Authorities	(127.0)	
Scottish Government Grants	(43.2)	
		(170.2)
Income & Expenditure deficit for the year		**50.0**
Amount required to be credited to the general fund balance		**(53.5)**
(Increase) in the General Fund balance		**(3.5)**

Compared with Budget the Board achieved an underspend of £3.5 million. This underspend was principally attributable to:

- Pay awards were lower than initially forecast. Actual awards were 0% for uniform and 0.65% for support staff compared with budgeted awards of 2%, resulting in a saving of £2.103 million;
- Transfer of £1.372 million of Earmarked Firefighters Pension Reserve;
- Vacancy management; and
- The introduction of a new roster system allowing better planning has resulted in reduced overtime of £0.145 million in the year as part of an anticipated saving of £0.6 million

Capital Expenditure

Capital spend for the year amounted to £18.7million against a budget of £18.9million. This small under spend is due primarily to the timing of expenditure in relation to the new Clydesmill Training Centre.

A key focus of capital work during 2010/11 was the construction and completion of the Clydesmill Fire Station and the sale of Cambuslang which became surplus to requirements as a result and was subsequently sold during 2010/11 for a total of £0.245 million. The introduction of this new site has facilitated the merger of Cambuslang and Parkhead Fire Stations with the aim of achieving cost savings and efficiencies going forward.

Considerable spend was also noted in relation to the training centre on the Clydesmill site. This will continue until the Centre's completion, currently expected during Spring 2012.

Severance costs

During 2010/11 all members of support staff, were asked to express their interest in taking voluntary redundancy. A number of expressions of interest were received and several have been approved with termination dates phased predominantly until March 2012. As a result, severance costs recorded during 2010/11 were low, however, this situation will be expected to change during 2011/12.

Performance against Key Financial Targets

The Police and Fire Services (Finance) (Scotland) Act 2001 restricts cumulative carry forward fund balances to no more than 5% of the contributions made by the constituent authorities for that year. The Board has been given Ministerial consent for 2010/11 to extend the carry forward limit, to 3% in year and a total balance of £11.096 million cumulative, and make use of these funds going forward.

The final Board financial position, detailed below, demonstrates that for 2010/11 the Board ended the year within the revised Ministerial limits set:

Limit	Limitset %/£m	Actual %/£m carry forward
In year Carry Forward	3%	2%
Cumulative carry forward	11.096	11.096

Section 4: Financial outlook for 2011/12

2011/12 and in particular beyond is anticipated to bring significant financial challenge to all public sector organisations. The overall Scottish budget has reduced by £1.3 billion in 2011/12 and the Board is seeing a continued decrease in level of precepts received from constituent authorities. Therefore, achieving financial balance looking forward will require the delivery of challenging savings plans and continued cost improvements.

In November 2010, the Scottish Government detailed its proposed (2011/12) funding settlements for each Scottish Council. While the average Local Government reduction is 2.6%, the average reduction for the Board's constituent authorities is 2.8%. The Board's financial strategy outlines a commitment to reduce spending and therefore the income received via precepts to match the overall decline in local government funding.

The Board's budgeted revenue position for 2011/12 is summarised below:

Projected 2011/12	£m	£m
Gross Expenditure	138.797	
Gross Income	(1.292)	
Net Cost of Services		**137.505**
Funded by:		
Constituent Authority Contributions	123.445	
Reserves	1.000	
Scottish Government Pension Contribution Grant	13.060	**137.505**
Total Funding		

Achieving Budget

The Board has adopted '5 key principles' to manage its reducing income stream:

- Protect service delivery;
- Ensure firefighter safety;
- Maximise efficiency in the back office;
- Aim to avoid compulsory redundancies; and
- Consider requests for voluntary severance.

Maximising efficiency in support services and the consideration of voluntary severance requests are the two identified principles that management has highlighted as presenting the greater option to achieve cost savings. In particular, management wrote to staff in October 2010 in relation to potential voluntary service and received 104 confirmations of interest. While a headcount reduction of this scale will give rise to significant cost savings, there may be a risk that the Board loses vital skill sets, resulting in a reduction in the quality of service delivery.

Recommendation 1

In addition, ongoing reductions in cost are anticipated from the merger of Parkhead and Cambuslang fire stations, further management restructures and further planned reduction of overtime.

In order to achieve a breakeven position for 2011/12 the Board are forecasting utilising £1.0 million from reserves. This is in accordance with the Board's Medium Term Financial Strategy and assuming the budgeted break-even revenue position is achieved during 2011/12, will leave the Board with £8.5 million of general reserves to draw upon from 2012/13 onwards. This would ensure that the general reserve balance remained in line with the approved Board policy, namely a minimum of 1.5% of constituent authority precepts.

It is noted from review of the Board's financial papers, that the Board is assuming the ability to carry forward funds greater than the 3% and 5% limits into the 2012/13 financial year and ministerial consent is still required for this.

Recommendation 2

Capital Plan

The Board has an approved capital programme in place, totalling £29.0 million. Of this £29.0 million, it is planned that £22.3 million be invested in the new training centre on the Clydesmill site. Other significant capital projects include the purchase of six new rescue pumps and three bodybuilds (£1.6 million) and the completion of the refurbishment of Kilwinning Fire Station (£1.5 million of a £1.9 million refurbishment) and Castlemilk Fire Station (£0.4 million of a £1.9 million refurbishment).

2012/13 and Beyond

The Scottish Justice Secretary's announced, on 8 September 2011, that a national Scotland-wide Fire and Rescue Service would be established. The Board are working with the Scottish Government and other Fire Board's on what the national service will look like and this is something which will be clarified over time. The Board continue to focus on continuing to deliver a best value fire service to the Strathclyde area.

For example, the Board's '2011-2015 Medium Term Financial Strategy' plots a series of assumptions and scenarios, giving high level consideration as to how these would be best dealt with by the Board in order to ensure ongoing service delivery within the financial constraints modelled.

Significant cost drivers and financial management mechanisms such as pensions, pay awards, reserve utilisation and revenue/capital grant funding have all been considered within this strategy.

Section 5: Governance and Internal Control Arrangements

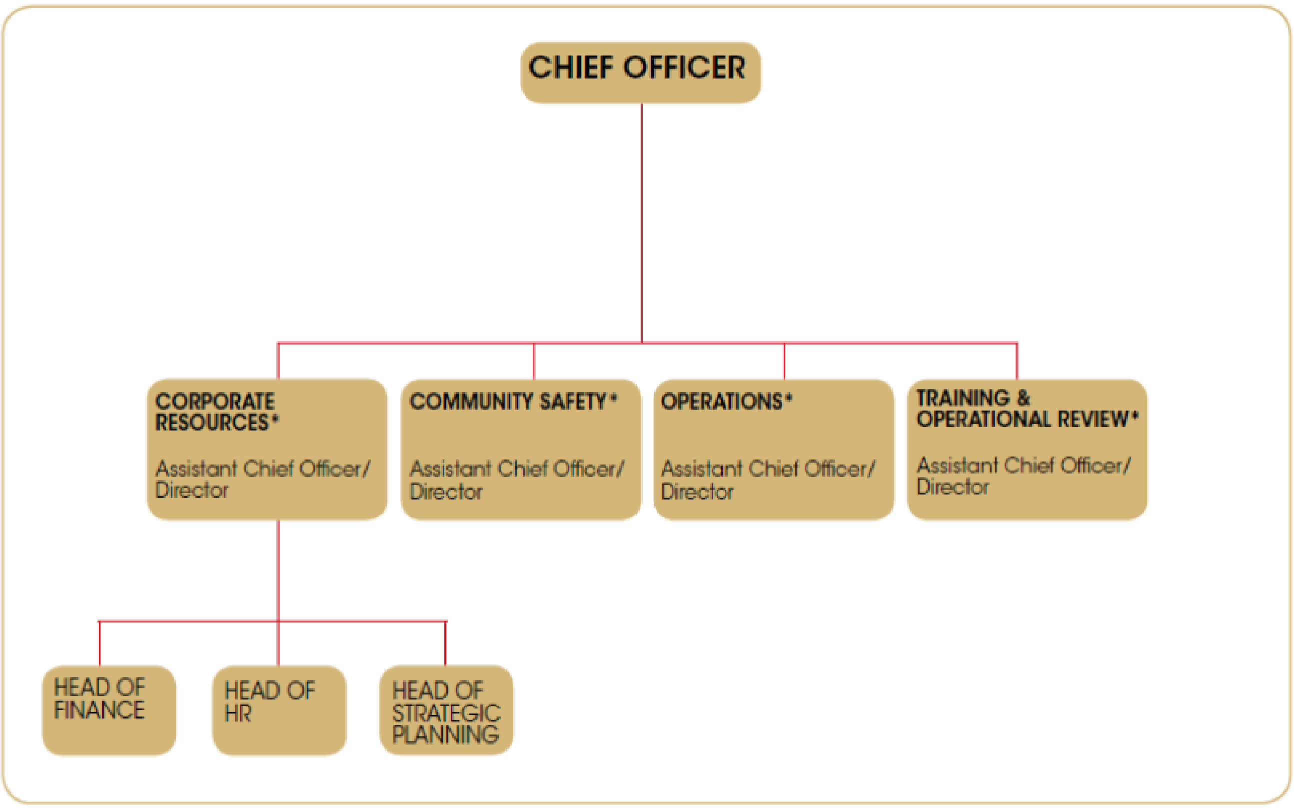
Overall Governance Arrangements

The various governance forums operating below the Board remain in place and are consistent with prior years. Key forums are: Performance and Audit Forum, the Budget Scrutiny Forum and the Employment and Equality Forum. These forums have met four times during the financial year in line with the Board's Scheme of Delegation.

The Corporate Management Team meets on a fortnightly basis, providing a link between the governance forums and operational departments. In 2009 a review was undertaken by management, on behalf of the Board to consider a revised Corporate Management Team structure. The aim of the restructure was to ensure succession planning within senior posts and achieve efficiency savings.

The revised structure resulted in a reduction in Directorates from six to four, with the Corporate Management Team reducing from seven to five at Strategic Manager level and will comprise a Chief Officer and four Assistant Chief Officers. The implementation of this restructuring will be on a phased basis from 1 November 2010 through to 2014 in order to account for retirements and required succession planning. An illustration of the change in structure is included below:

Revised structure introduced in November 2010:



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

Chief Officer's retirement and re-employment August 2011

The Board's Chief Officer retired on 14 July 2011, and was re-employed on 14 August 2011 in the same role as Chief Officer for an expected three year period, this allowed the Chief Officer to access his pension lump sum payment but not his annual pension, which has been abated whilst he is re-employed.

Under the fire-fighters pension scheme Chief Officers can only retire before the age of 55 if the Board has given permission for retirement. In December 2009 the Scottish Public Pensions Agency advised the Board, that Chief Officers at 6 April 2006, should they retire before the age of 55 would incur a personal liability relating to an employee unauthorised payment charge (in accordance with HMRC legislation), levied off the pension lump sum received. We understand that this impacted only 9 Chief Fire Officers across the UK, including the Board's Chief Officer.

In April 2011 the Board approved the action to set aside Board funding to meet the costs of the unauthorised payment charge incurred by the Chief Officer (employee element of £206,000) alongside the employer scheme sanction charge which would be incurred (employer element of £29,000).

We have reviewed the process followed by the Board to allow the Chief Officer to retire and be re-employed and the decision to subsequently pay the employee unauthorised pension charge, under our wider external audit obligations. Outlined below are the key decisions made by the Board in respect of this arrangement:

Decision taken by the Board in June 2009 to approve retirement and re-employment

A paper entitled *"Retention of Corporate Management Experience"* was presented to the Board in June 2009 by the Chief Officer and the Clerk to the Board (a joint paper signed in both names) covering the wider succession plans for the Corporate Management Team and the Chief Officer's own position.

In relation to the Chief Officer's arrangements, the paper outlined: *"The Clerk to the Board has discussed with the Chief Officer his future career plans, and while eligible to retire in July 2011, it is proposed the Chief Officer continue in post for a 3 year period beyond the eligible retirement date in accordance with the Board's return to work policy".* It is not explicit within the paper presented that the Board had to give specific approval for retirement as the Chief Officer was not 55 or that this meant that the Chief Officer would effectively retire and be re-employed.

Following this meeting a formal letter was written on 25 June 2009 by the Clerk to the Board outlining the Board's approval for the Chief Officer to take retirement and be re-employed.

Board's HR Return to work policy

The Board's *"Flexible retirement and re-employment uniformed and support staff"* procedure, dated April 2008, sets out arrangements for retirement and potential re-employment. In particular, the procedure outlines: *"The Service will write to all employees who are eligible to retire on the grounds of service to advise them of their options" also "Employees who wish to make an application to retire and be re-employed must submit their request in writing using the request to retire and return to employment letter as shown in appendix 4, at least 3 months before their expected retirement date and no earlier than one year before retirement, to the Assistant Chief Officer (HR)".* From a review of papers submitted to the Board on occasions where firefighters took retirement and were re-employed, we noted that this situation would be for no more than 2 years to facilitate succession planning.

In the case of the Chief Officer, no application in writing under this policy was submitted; the conversation noted in the June 2009 Board Paper (see above) between the Clerk to the Board and Chief Officer was not formally recorded; the decision was taken 2 years, rather than 1 year or less before potential retirement; and the Chief Officer has returned on an expected 3 year contract not on the usual 2 years or less contract.

We have been informed that this 3 year contract was considered necessary by the Board to cover planning for the Commonwealth Games in 2014, and a decision on the position of the Chief Officer was necessary at this point in time (June 2009) to facilitate succession planning, bringing stability to the Corporate Management Team.

Board approval in April 2011 to provide for the Chief Officer's unauthorised pension charge of £206,715

A paper *"to advise on a recent variation in interpretation of the Firefighters pension scheme which could impact on the Chief Officer's retirement",* was presented for approval to the Executive Sub Committee in February 2011, and subsequently to the Board at the start of April 2011. This paper was prepared by the Clerk to the Board included legal advice from a third party legal adviser.

The paper sets out that a potential unauthorised employee payment charge would be levied by HMRC in respect of the Chief Officer's retirement and asked the Board to consider four options, summarised as:

- no further action at this time;
- make provision for the employer charges arising;
- make provision for the employer and employee contribution arising; or
- the Convenor speaks to the Chief Officer regarding a proportion of the unauthorised charge being met by the Chief Officer.

The Board approved the option of making a budgetary provision for both the employer and employee charge.

As a result, a provision totalling £235,000 has been included in the 2010/11 financial statements. It is emphasised that this is an accounting provision only and no payment has so far taken place. As of July 2011, this provision has been confirmed as an accurate calculation, based on information received from the Scottish Public Pension's Agency calculated on the Chief Officer's pension lump sum.

From review of the Executive Sub Committee (February 2011) and Board paper (April 2011), we would highlight the following:

- The possibility of an employee unauthorised payment charge was first identified in December 2009 but was not presented to the Board for discussion until April 2011. We understand this was due to the Vice Convenor raising the issue at the National Firefighters' Pension Committee, aiming to seek resolution at a national level;

- The paper states that *"the Chief Officer has planned accordingly since the Board's confirmation of his retirement arrangements and in consideration of HMRC guidance has asked the Clerk to bring this matter before Members";*

- The paper did not explicitly consider the potential option of no longer allowing the Chief Officer to take retirement, and potential legal costs and implications in respect of this were not prepared at the time. However, we have been informed this was discussed with the Convenor and Vice Convenors at the time;

- The paper did not fully explore alternative options such as employing a Chief Executive rather than a Chief Fire Officer or that the post was no longer required due to possible national restructuring (efficiency argument), thereby potentially avoiding the unauthorised payment charge. However, the paper stated *"The Chief Officer and the Clerk to the Board have discussed the matter and do not consider a further organisational review to be appropriate nor to be in the best long term interests of SFR. The succession planning arrangements put in place by the Board in June 2009 have been progressed and considered by both officers to represent the best way forward for the service";* and

- The financial range of the potential liability presented in the Board Paper (£26,715 to £206,715) is wide and a likely scenario was not presented. The unauthorised charge would only be at the lower end of the scale (£26,715) if no lump sum was taken and this option seems somewhat unlikely.

Following discussion we have held with the Clerk to the Board, Convenor and members of Management we have been informed that the Board decision was discussed and questions were asked by Elected Members during the meeting. However, the relevant Board minutes are brief and do not reflect such questioning or challenge prior to Board approval. In addition, we understand that the Treasurer was not consulted over this decision, despite there being financial implications for the Board.

Summary of findings

We can see no formal consideration within this process that alternative options, other than retirement and re-employment of the Chief Officer were considered in June 2009, nor that further options were explored and considered in February and April 2011. In addition, the Board has been unable to demonstrate to us that the Chief Officer was fully independent of the decision making process due to his noted involvement and a lack of formal available evidence to the contrary.

Overall, the level of evidence made available to us does not readily support a best value decision concerning retirement, re-employment and the potential use of Board funds to pay the Chief Officer's £206,715 unauthorised payment charge.

Statement on Internal Control

The Code of Audit Practice requires us to review and report on the Board's Statement on Internal Control. The Board has used the format, set out within the SORP, for its Statement and has outlined the processes in place to identify and evaluate risks. In addition, key elements of the Board's control framework have been highlighted, such as the management information framework, financial regulations, segregation of duties and a system of delegation and accountability. Based on our normal audit procedures, we do not disagree with the disclosures contained in the Statement.

Systems of Internal Control

Over the term of our external audit appointment, we review those key financial processes and controls which could have a direct impact on the fair statement of balances within the financial statements. Our audit testing included individual walkthroughs of the specific financial processes in place. In addition, on a rotational basis, we undertake more detailed testing of certain key financial controls to ensure that these controls continue to operate as intended. For 2010/11 our external audit work was conducted over the following areas:

- Sales and Receivables;
- Purchasing and Payables;
- Treasury and Cash Management;
- Payroll; and
- Financial Accounting for Property, Plant and Equipment.

In addition, we reviewed the Board's IT general control environment, as it relates to the core financial systems.

The results of our work on systems of internal control were communicated to the Performance and Audit Forum in our Interim Management Letter in May 2011. The report contained 5 recommendations to improve controls, none of which were graded as business critical or higher risk in nature.

Management has completed an action plan detailing those individuals responsible for implementing our recommendations and the timetable for completion. The implementation of these actions will be considered as part of follow-up procedures undertaken as part of the 2011/12 audit process.

Performance Management

The primary forum for monitoring performance is the Board's Corporate Performance Team. The team meets quarterly, includes the area commanders and is chaired by the Deputy Chief Officer. The team has two functions:

- To consider SFR's performance as a whole
- To consider the performance of each area within SFR, to share good practice and address weaknesses.

Approximately two weeks before each meeting, the team receives the SFR Performance Report. The detailed report shows performance against each performance indicator as compared to the target for the quarter, the target for the year, and the average performance over the preceding 5 years. The information is summarised for SFR as a whole, and broken down for each area.

The data is scrutinised in the meetings. The area commanders often challenge the Performance Report if they believe that the data isn't accurate, which can occasionally arise as a result of incidents being allocated to the wrong area. Therefore the Corporate Performance Team acts as a control to ensure the validity of the data.

Abbreviated versions of the Performance Report are also presented to the Performance & Audit Forum (a scrutiny forum of the Board). Area commanders are also given more detailed information, broken down to the level of individual stations, to help them identify and address any issues.

Follow up of outstanding recommendations

In addition to our work on internal controls we followed up the Board's progress in implementing external audit recommendations made in the prior year. We identified 24 recommendations of which 16 were fully implemented and 8 were partially implemented. Our Follow up of Prior Year Recommendations Report was contained within our Interim Management Letter and considered at the Performance and Audit Forum meeting on 16 May 2011.

Fraud

The Board suffered financial loss in the period of £0.007 million as a result of a fraud perpetrated by an external party in relation to a request to change supplier bank details. Information has now been received from the Police that an individual connected to this fraud and similar frauds have been arrested and successfully prosecuted.

Bank details were amended and payment made to a third party. While controls were in place to prevent this situation from arising, it was not effective in this instance and the fraud came to light following a query from the Board's bank.

Following the Fraud, management engaged internal audit to undertake a review of the circumstances surrounding the incident. Revised procedures have been implemented by management to avoid a repeat of fraudulent activity in this area.

National Fraud Initiative

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

The 2010/11 NFI project is a two year programme. The Board has run both payroll and creditors data sets and in February 2011 were notified of 156 recommended matches requiring further investigation. Management noted that these investigations have been completed with no fraudulent activity being uncovered. In addition, the Board's pension administrator has identified a number of NFI exceptions which are currently being investigated.

Best Value

During November 2010, Audit Scotland published a consultation paper on the proposed Best Value audit of Scottish fire and rescue authorities and services. Following the publication of this paper it was decided that the approach taken in conducting this audit would be to produce a national summary of Best Value in fire and rescue, based on focused Best Value audit work at all eight authorities.

Reflecting the potential changes taking place with the fire and rescue services nationally, the audit will help inform a single national report based on proportionate and targeted audit work at all eight authorities and services, supported by summary local audit reports with local findings and improvement recommendations.

Audit Scotland is scheduled to undertake its Strathclyde Fire and Rescue Best Value audit in November 2011. The outcomes will provide both the Board's management and those charged with governance an opportunity to benchmark performance against other Scottish Fire Board's.

National Performance Audits

Improving Public Sector Purchasing

At the request of Audit Scotland, we were required to perform targeted follow up work on one of their National Performance Reports: *Improving public sector purchasing* (published July 2009) during the year.

As per our review we can confirm that ongoing progress is being made by the Board to further refine and strengthen its procurement arrangements.

An improvement in the Board's purchasing procedures has been demonstrated by the results of the two recent Performance Capability Assessments (PCAs), with the Board's overall score moving from 48% ('Conformance'), in 2009/10, to 61% ('Improved Performance') in 2010/11. Improvement was recorded across all eight criteria headings and is reflective of the time management have spent identifying areas of weakness and devising appropriate action plans to strengthen purchasing processes. Particular improvement was noted in respect of performance measurement and contract and supplier management, with both criteria moving from a non-conformance PCA scoring, to one of conformance.

Despite being the top performing Scottish Fire Authority in the 2010 PCA, management are seeking to improve purchasing processes yet further and have set a target of achieving 'superior' performance – a PCA score in excess of 75% - during the 2011 assessment.

Appendices

Appendix 1: Action Plan

To assist management in assessing each audit finding and recommendation, we have assessed the risk to the organisation of each of the recommendations which have not yet been fully implemented and have categorised each recommendation according to the criteria shown below:

High	Significant control weakness requiring immediate attention by management
Moderate	Control weakness identified which needs to be rectified but where there is no material impact on the achievement of the control objectives
Low	Minor control weakness identified

The following recommendations have been raised within the body of this report:

Ref	Recommendation and Risk Rating	Management Response
1	**Action 2** Management wrote to staff in October 2010 in relation to the possibility of implementing a potential voluntary redundancy scheme and received 104 confirmations of interest. While a headcount reduction of this scale will give rise to significant cost savings, there may be a risk that the Board loses vital skill sets. We would recommend that management undertake a detailed Skills Gap analysis exercise to assure themselves and their constituent members that the implementation of this programme will not lead to a reduction in the quality of service delivery. **Risk Rating - Low**	Agree in principle. Each Directorate has undertaken its own review of the potential gap created by the voluntary redundancy scheme and is putting in place measures to ensure that an appropriate skills base is maintained. **Responsible Officer:** Assistant Chief Officers/Heads of Function **Implementation Date:** 31 March 2012
2	**Action 2** Management should seek confirmation from the Scottish Government as soon as possible that the general fund balance carry forward anticipated for 2011/12 can be carried into 2012/13, as the balance anticipated is greater than the 3% and 5% carry forward limits. **Risk Rating - Moderate**	Agree **Responsible Officer:** Head of Finance **Implementation Date:** 31 March 2012

Appendix 2: Communication to Management

International Standards on Auditing ("ISA") (UK&I) 260 – Reporting to those charged with Governance, requires that the External Auditor communicates certain matters to those charged with governance. Those charged with Governance is taken to be the Members of the Performance and Audit Forum with responsibility discharged through the regular meetings of the Forum during the year. Summarised below are the requirements set out within ISA 260 together with reference to the relevant communication with you during 2010/11 or comments as appropriate.

Communication Required under ISA 260	Reference/Comment
Engagement Letters	Signed Engagements Letter with Audit Scotland at the start of our 5 year appointment.
Independence	2010/11 External Audit Plan, as taken to the 14 February Performance and Audit Forum, confirmed no member of audit team has any direct interest, financial or otherwise, in the Board.
Audit Approach and Scope	2010/11 External Audit Plan (14 February Performance and Audit Forum). During the year there were no changes to our plan or risk assessment that we are required to communicate with you.
Materiality	2010/11 External Audit Plan: Performance and audit forum 14 February 2011.
Form and Timing of Communications	2010/11 External Audit Plan.
Accounting Policies/Estimates/Disclosures	Sections 2 of our Annual Report to Board Members and the Controller of Audit.
Correspondence with management on significant matters	Discussed and resolved matters arising with management throughout audit process. No unadjusted differences to report.
Letter of Representation	Signed by the Treasurer on 12 September 2011.
Financial Statements Audit Opinion	Signed by the Engagement Leader on 13 September 2011.
Other matters significant to the oversight of financial reporting process	None identified.
Material Uncertainties relating to Going Concern	None identified – see going concern comments in Section 2.
Related Parties	Other than those transactions disclosed in the financial statements we have not identified any further transactions requiring disclosure.
Fraud	Discussed fraud arrangements with the Performance and Audit Forum on 14 February 2011 and management throughout audit. One fraud identified during the year and included within Section 5 of this report.
Material Weaknesses in Internal Controls	Internal Controls findings reported in our Interim Management Letter, dated May 2011, and presented to the Performance and audit forum on 16 May 2011.
Improving Public Sector Purchasing: Follow-up	Reported to Audit Scotland –September 2011.