Dimension 5: Standards of Conduct

TYNE & WEAR FIRE AND RESCUE AUTHORITY: GOVERNANCE COMMITTEE

MEETING 26th JUNE 2006 **Item No 4**

STATEMENT OF ACCOUNTS 2005/2006 AND REVIEW OF CORPORATE GOVERNANCE ARRANGEMENTS

JOINT REPORT OF THE CHIEF FIRE OFFICER AND FINANCE OFFICER

1. INTRODUCTION AND BACKGROUND

1.1 The report provides details of the process and outcome of the review of the Authority's Corporate Governance and internal control arrangements, and seeks approval to the Authority's Statement of Accounts for 2005/2006, subject to audit.

2. REVIEW OF CORPORATE GOVERNANCE ARRANGEMENTS

2.1 Background to Corporate Governance

2.1.1 The Code of Corporate of Governance, adopted by the Authority in 2003, requires reviews to be undertaken to ensure that, not only are the processes and documentation in place to support the Authority's Code of Corporate Governance, but also to ensure that actions on the ground deliver the expected outcomes.

2.1.2 There are 3 fundamental principles underpinning corporate governance and these must be reflected in all areas of the Authority's business. These are:

- openness and inclusivity;
- integrity;
- accountability.

2.1.3 The Code provides a comprehensive description of these principles. In working to them, systems and processes are monitored to ensure their effectiveness in practice and are subject to review on a continuing basis to ensure they are up to date.

2.1.4 A document published jointly by the Chartered Institute of Public Finance and Accountancy (CIPFA) and the Society of Local Authority Chief Executives and Senior Managers (SOLACE) entitled 'Corporate Governance in Local Government – A Keystone for Community Governance' provides guidance on how local authorities should demonstrate that they comply with the above principles.

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2.1.5 The CIPFA/SOLACE guidance sets out the five dimensions of an Authority's business, namely:

- Community Focus
- Service Delivery Arrangements
- Structures and Processes
- Risk Management and Internal Control
- Standards of Conduct

The guidance envisages the Authority examining each of these areas and

(a) producing, approving and adopting a Code of Corporate Governance (setting out best practice in each area)

(b) reviewing its systems, processes and documentation to:

(i) determine whether they meet the requirements of the Code
(ii) ensure any deficiencies are addressed
(iii) ensure they are monitored and reviewed continuously to demonstrate that they are both up-to-date and working effectively.

2.1.6 By doing this the Authority will be able to demonstrate publicly that it has passed the 'vowel test' of Corporate Governance:

- **a**ccountability
- **e**ffectiveness
- **i**ntegrity
- **o**penness and inclusivity
- **u**p-to-date arrangements

2.1.7 The guidance provided by CIPFA/SOLACE recommends that a statement of how the Authority has complied with the Code and monitored its effectiveness is expected in the financial statements for the current year and annually thereafter. The statement should also give a commitment to address any areas of non-compliance.

2.1.8 Members should note that the Authority complies with all aspect of the guidance.

2.2 Review of the Code of Corporate Governance

2.2.1 The review of the Code of Corporate Governance has now been completed. The first phase included a thorough examination of the Code to ensure that it is up to date, relevant and incorporated policies that have been enacted in the previous twelve months, such as the introduction of a partnership procedure.

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2.2.2 Phase two is primarily targeted at the application and effectiveness of the Code and all the supporting policies and processes in the workplace. This included a comprehensive exercise aimed at all levels within the Authority and involving questionnaires and workshops. This phase has also been completed and this report together with Appendix 1 provides an overview of the results.

2.3 Review Methodology

2.3.1 To undertake the review, Senior Managers and Middle Managers throughout the Authority, who are assigned with the ownership of risks and delivery of services, were actively involved. A comprehensive approach involving the aforementioned managers was taken and the methodology included the following stages:

- Functional Self Assessment
- Functional Controls Assurance Statement
- Corporate Governance Steering Group Review
- Preparation of an Action Plan to address any issues identified, including revision of Code of Corporate Governance as required
- Draft Statement of Internal Control.

2.3.2 This review is a major cornerstone in the Authority's corporate governance arrangements.

2.4 Functional Self Assessments

2.4.1 Functional Self Assessments were launched at a seminar attended by Senior and Middle Managers and then completed with the involvement of their management teams and any other staff considered appropriate (specifically those with the ownership of risks and delivery of services). The assessments were further reviewed by the appropriate Area Manager to ensure a consistency of approach and that the relevant evidence had been thoroughly analysed.

2.4.2 The self assessments detail a number of statements in relation to each of the five dimensions of corporate governance, and then give details of the policies, procedures or other documentation that the Authority has in place to meet the requirements of the Code. Senior Managers considered each statement in relation to their own particular service area and provided evidence of:

- Measures established by the Service
- Documents / Processes to support compliance
- Future plans for improvement

2.4.3 It was noted that all responsible officers have identified measures for improvement to their governance and control arrangements and that a large proportion of the future plans for improvement related to tasks which are already ongoing or which have already been included in existing action plans. Further, a number of actions were included which were purely Department based and not significant in terms of the Authority's overall governance and control environment. It was considered that

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none of the future plans for improvement were such that they would cause any concern regarding the adequacy of the current overall governance and control arrangements.

2.4.4 Notwithstanding the above, it was considered that some of the future plans for improvement are newly identified actions resulting directly from the combined governance and internal control review, which have corporate significance, and therefore require inclusion in a revised Code of Corporate Governance to facilitate monitoring and ensure that the planned actions are delivered within a reasonable timeframe bearing in mind the nature of the actions.

2.5 Key Controls Checklist

2.5.1 Senior Managers then completed a Key Controls Checklist. This Checklist is designed to expand upon the relevant issues relating to Risk Management and Internal Control. This is necessary in order to be able to prepare the Statement of Internal Control.

2.6 Controls Assurance Statements

2.6.1 Each responsible officer then undertook a Controls Assurance process using the information and evidence compiled through both the self-assessment process and the key controls checklist to come to an opinion on the internal control environment within their responsibility.

2.7 Internal Audit

2.7.1 Internal Audit Services (IAS) has an agreed procedure in place regarding the audit of key systems, both financial and non-financial. Following consultation with the Chief Fire Officer, IAS determines the annual internal audit coverage of each of these key systems as part of the usual risk based planning procedures. Whilst a number of the systems will be subject to internal audit every year, this does not necessarily mean that all controls will be tested every year. The level and scope of the work planned each year will be a matter of professional judgement based upon various factors, but all aspects of the key financial systems will be subject to audit review at least once within any three year period, with testing across all services where relevant. A separate annual report in respect of Internal audit's coverage of the Authority's activities in 2005/2006 is included as a separate item on today's agenda and has been considered within the review process.

2.7.2 The work of IAS is supplemented further by the review work undertaken by the Authority’s external auditors. The following extract from the Audit Commission’s annual letter of December 2005 states:

Accounts and Governance – *The overall standards of the financial statements was considered good and corporate governance arrangements sound in most key areas. The need for further progress in embedding risk management and the Local Code of Corporate Governance is recognised with plans in place to address these issues.*

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2.8 Risk Management Group

2.8.1 The Authority has in place a Corporate Risk Management Group which actively manages the Corporate Risks Strategy and monitors the Risk Profile of the organisation. In addition, the Group has developed and implemented an action plan to minimise corporate risks and this is reviewed on a quarterly basis.

2.9 Performance Management Framework (BVPI's)

2.9.1 The Authority has had in place for some years a comprehensive performance management framework. This framework is clearly laid out within the Authority's Strategic Plan and regular reports are made to Members. All of the current performance management targets and achievements were considered during the review and action has been taken to seek continual sustainable improvements in all areas.

2.10 The Statement of Internal Control

2.10.1 The Accounts and Audit Regulations 2003 require the Authority to conduct annual reviews of its system of internal control and publish a Statement on Internal Control (SIC) with its annual financial statements.

2.10.2 The format of the SIC is required to be in accordance with CIPFA proper practice. The CIPFA Finance Advisory Network has also recently issued detailed practical guidance on meeting the requirements of the Accounts and Audit Regulations 2003.

2.10.3 Central to CIPFA's guidance are the following steps:

- Identify statutory obligations and organisational risks
- Identify principal risks to the achievement of objectives
- Identify and evaluate key controls to manage principal risks
- Obtain assurance on the effectiveness of key controls
- Evaluate assurances and identify gaps in control / assurances

2.10.4 The guidance highlights the links and overlaps between the production of the SIC and the annual corporate governance review. There is a need to involve Senior Managers and Middle Managers assigned with the ownership of risks and delivery of services in both the annual review of corporate governance and in the production of the Authority's Statement on Internal Control. The Authority therefore complies with the guidance issued.

2.10.5 The draft Statement of Internal Control for 2005/2006 is presented at page 18 of the Statement of Accounts.

2.11 Comprehensive Performance Assessment

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2.11.1 A comprehensive performance assessment was undertaken in 2005 which has led to the production of an action plan to address various items under the process. The action plan and progress therein were considered during the review and it is noted that items within the action plan have been included as appropriate in the revised Code of Corporate Governance.

2.12 Outcome of the Review

2.12.1 The review has identified that the evidence confirms the Authority's compliance to the Code of Corporate Governance. There are however, additional actions that are planned in order to further improve the delivery of services to the communities in Tyne and Wear.

2.12.2 Attached at Appendix 1, for the consideration and approval by Members, is the revised Code of Corporate Governance.

3. STATEMENT OF ACCOUNTS 2005/2006

3.1 Accounts and Audit Regulations 2003

3.1.1 The Statement of Accounts for 2005/2006 has been prepared in accordance with the 'Code of Practice on Local on Local Authority Accounting in the United Kingdom: A Statement of Recommended Practice 2005'. The Code of Practice constitutes 'proper accounting practice' under the terms of the Accounts and Audit Regulations 2003, and the Local Government and Housing Act 1989.

3.1.2 The Accounts and Audit Regulations 2003 provide that all adjustments to the Statement of Accounts can only be made with the permission of the External Auditor. This has, in practice, been the case in the past. When the External Audit has been completed and the external auditor feels that highlighting any adjustments would strengthen internal control, these will be reported to this Authority.

3.1.3 The Statement of Accounts is attached for Members approval but, as indicated, is still subject to audit.

3.1.4 Appendix 1 shows, for information, the key dates for the Statement of Accounts for 2005/2006 in accordance with the Regulations.

3.1.5 The final Statement of Accounts will be published following the conclusion of the Audit and will include a signed audit certificate.

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3.2 Statement of Recommended Practice (SORP) 2005 - Changes

3.2.1 The Code of Practice on Local Authority Accounting in the UK: A Statement of Recommended Practice 2005 (SORP) introduced the following main changes to the Statement of Accounts for 2005/2006:

- requirement to publish a Statement of Internal Control (SIC) in accordance with Regulation 4(2) of the Accounts and Audit Regulations 2003;
- other minor accounting changes in line with Financial Reporting Standards and Urgent Issues Taskforce Abstracts issued up to 30th September 2004.

3.2.2 The Statement of Accounts (subject to audit) and accounting Policies of the Authority for 2005/2006 fully complies with the Statement of Recommended Practice 2005, with any departures from the SORP being fully documented, including reasons for departure, where appropriate.

3.3 Statement of Accounts 2005/2006 - Main Financial Issues

3.3.1 The main financial issues are highlighted below:

The estimated net revenue expenditure for 2005/2006 to be met from local taxpayers was approved at £20,704,711. Band D council tax, after allowing for RSG and NNDR was set at £65.38.

The following table summarises the financial position for the year:

	2005/06 Original Estimate £000	2005/06 Revised Estimate £000	2005/06 Actual Outturn £000	2004/05 Actual Outturn £000
Community Fire Safety	5,491	5,447	8,184	4,091
Fire Fighting & Rescue Operations	53,186	54,285	45,977	44,938
Fire Service Emergency Planning and Civil Defence	0	0	(52)	(12)
Management and Support Services	0	0	0	0
Corporate and Democratic Core	338	347	328	300
Non Distributed Cost	335	20	568	635
NET COST OF SERVICES	**59,350**	**60,099**	**55,005**	**49,952**
Add / (Deduct) Balances	(639)	(602)	0	0
Cleaning DSO	0	0	(22)	58
Contingencies/Interest on Balances	935	(151)	(940)	(648)
Pension Interest Cost and Expected Return on Pensions Asset	0	300	24,370	21,520
	59,646	**59,646**	**78,413**	**70,882**
Transfer from Delegated Balances			61	313
Transfer from Asset Management Rev A/C			(303)	(335)
Insurance Fund			65	(998)
Pension Reserve			1,385	3,481
PFI Smoothing Reserve			2,321	1,840

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Early Retirement Reserve			(3)	0
Contribution to FRS 17 Pension Reserve			(22,990)	(18,640)
Contribution to Capital Reserve			(267)	(261)
	59,646	**59,646**	**58,682**	**56,282**
RSG, Non Domestic Rates and Precepts	59,646	59,646	59,722	57,217
REDUCTION / (INCREASE) TO BALANCES	**0**	**0**	**(1,040)**	**(935)**

Quarterly reports are made to the Authority which detail the outcome of the review of budgets and spending forecasts for both capital and revenue expenditure.

The general balances of the Authority as at 31st March 2006 after taking account of the above increase to balances, have increased by £1,039,787 from £5,379,758 to £6,419,545.

The increase in balances can be attributed to the following: -

	£000
Staffing Savings / Seconded Officers	299
Interest on Balances	450
Leasing	130
Capital Financing Savings	123
Other Items	38
	1,040

Capital Expenditure and Income

The Authority approved a capital programme for 2005/2006 of £2.235 million, which was subsequently revised to £0.852 million during the year. Actual expenditure for the year was £0.671 million, with the main areas of spending summarised below:

	£000
Replacement Communications Programme	10
Equipment – Operational and Information Technology	403
Minor Works Programme	124
Vehicles, Plant and Equipment	45
Occupational Health Unit	19
Community Safety Facilities	20
BMS	43
Life Skills Centre	7
	671

The capital expenditure was financed as follows:

	£000
Borrowing	671
	671

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The slippage of £1.56 million is, largely, a result of the delayed completion of the implementation of the PFI facilities. This, particularly, affected the planned alterations to the Occupational Health Unit premises and the PFI Firehouses Bullet Payment. Additional delays also occurred following difficulties in appointing contractors in respect of adaptations to Stations Echo and Golf for Community Safety Centres. Delays in the tendering process have resulted in slippage in the conversion of the existing Technical Services Centre to a Life Skills Centre under the Safety Works initiative.

Borrowing Facilities

The Lead Authority (Sunderland City Council) administers all of the Authority's borrowing through its Consolidated Advances and Borrowing Pool (CABP). As at 31 March 2006, the Authority has borrowing totalling £18.210 million.

Trading Account

The Authority operates a Cleaning Trading Account, which came into operation in 1989. Following the abolition of Compulsory Competitive Tendering with effect from 2nd January 2000, there is no longer a statutory requirement to achieve a rate of return. The Trading Account now needs to demonstrate Best Value and one method of showing this is through setting and achieving a requirement to break even. The Trading Account achieved this target during 2005/2006.

FMS Development

As disclosed in the Statement of Accounting Policies and the Statement on the System of Internal Control, which is used by the Fire and Rescue Service and Emergency Planning Service, Sunderland City Council, the Lead Authority, successfully implemented a new Financial Management System (SAP) with effect from 1st June 2004. This major development involved not only replacement of the General Ledger Financial System but also incorporated a number of key developments to automate and integrate the outdated in-house stores, costing and purchase ordering systems. This development was implemented on time and brings with it many improvements to both the financial management and the operational efficiency of the finance function within the Authority.

A post implementation review was undertaken by the external auditor in 2005/2006 and I am pleased to report the following main conclusion:

"The Council has adopted robust arrangements for implementing its new FMS system" and their report provided reassurance that the implementation was well managed. Given the size of the FMS project, the lack of recommendations can be viewed as an endorsement of the implementation process followed by the Authority.

Private Finance Initiative

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The Authority entered into a contract in March 2003 to provide 6 new Fire Stations, a Service Headquarters and a new Technical Services Centre. The construction programme commenced in May 2003 but because of the financial and commercial trading difficulties of the parent company (Jarvis plc) of the contractor, the construction programme suffered from significant delays that resulted in significant cost increases.

During the year, the Authority engaged in discussions with Barclays Bank plc, who are providing senior debt for the project, in order to agree a set of proposals including a programme for completion. These discussions culminated in the Authority entering into a Support Deed for the scheme in January 2006. As part of this agreement the equity holders and Barclays Bank plc undertook to provide significant additional finance, whilst the Authority undertook to contribute £500,000 towards the construction costs of the scheme, funded from savings that have accrued to the Authority as a consequence of the delay. The Authority contribution was conditional, principally in relation to the delivery of all of the new facilities including snagging and demolition works. The contract expires in May 2029.

The construction programme is now complete, with only snagging and demolition works remaining. The final facility (Low Fell Fire Station) was handed over to the Authority on 27th March 2006.

Developments in Accounting for Pensions

The accounts continue to be fully compliant with Financial Reporting Standard 17 (FRS17) however because this area is very complex in nature I have set out below the background to this important Reporting Standard and how it's requirements have been gradually phased into the Authority's Statement of Accounts in accordance with best accounting practice.

Full FRS17 reporting was required, for the first time in 2003/2004, in order to comply with the requirements of the Statement of Recommended Practice (SORP) as recommended by the Chartered Institute of Public Finance and Accountancy.

FRS17 replaced SSAP 24 'Accounting for Pension Costs' which most local authorities did not comply with, and it was also never fully incorporated into the SORP, because of the implications for council tax of compliance. Authorities generally used to make pension charges to the revenue account based on employer's pension contributions payable and payments made to pensioners in the year they related to rather than benefit entitlements earned by employees.

The adoption of the new standard means that local authority accounts not only comply with UK GAAP but also meet International Accounting Standards Board (ASB) requirements, two years earlier than listed companies which had to comply with the new standard from 1st January 2005. FRS17 was introduced into local authority accounts in three phases commencing in 2001/2002 when a memorandum note to the accounts was required to disclose the authority's net asset or liability conferred under defined benefit schemes which includes the Local Government Pension Scheme and the Firefighters Pension Scheme.

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In 2002/2003 the accounts were required to show, in addition to the note to the accounts already set out, the movement in the year on the net asset / liability relating to defined benefit schemes, analysed across different classification of gains and losses as defined by FRS17.

Finally, 2003/2004 saw full adoption of the Standard including recognition of the net asset / liability, the inclusion of a pensions reserve in the Balance Sheet and accounting entries in the Consolidated Revenue Account for movements in the asset / liability relating to defined benefit schemes. The new requirements represented a very substantial change in the way that retirement benefits were accounted for by local authorities although the net impact of adopting FRS17 has a neutral effect on the council tax level.

Although FRS17 is regarded as a complex accounting standard it is based on a simple principle, namely that an organisation should account for retirement benefits when it is committed to giving them, even if the actual payment of those benefits will be many years into the future. FRS17 is a better reflection of the economic reality of the relationship between an employer and the pension fund than the previous standard it replaces, SSAP 24. Inclusion of the pension fund assets and liabilities in the accounts does not mean that the legal title or obligation has passed from the trustee to the employer. Instead it represents the employer's commitment to increase contributions to make up any shortfall in attributable net assets, or its ability to benefit (via reduced contributions) from a surplus in the scheme.

Future Changes to Accounting for Pensions

From 1st April 2006, Fire and Rescue Authorities will continue to administer and pay firefighters pensions, as well as any future pensions for new entrants, but will do so from a new separate local firefighters pension fund.

The underlying principle of the new arrangements is that employer and employee contributions together will meet the full costs of pension liabilities being accrued in respect of currently serving employees while central government will meet the costs of retirement pensions in payment, net of employee and the new employer contributions.

The purpose of the employee and employer contribution rates under the new arrangements is to meet the accruing pension liabilities of currently serving firefighters. This means that Fire and Rescue Authorities will meet all the costs of employing a firefighter, including the cost of future pension liabilities, at the time of employing them.

Early ill-health retirements are possible under the 1992 Scheme and remain possible under the 2006 Scheme also. From 1st April 2006, ill-health provisions will be paid from authorities' new pension fund. To ensure equity between FRAs, employer payments towards the future cost of ill-health retirements will come from a combination of a flat rate employer contribution applicable to all authorities and from an individual charge payable by the relevant authority where an ill-health retirement occurs.

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Revised employer and employee contribution rates will apply with effect from 1st April 2006. These rates have been set using the SCAPE (Superannuation Contributions Adjusted for Past Experience) methodology, which adjusts for changes in mortality, trends in pay, shifts in retirement ages, and the incidence of ill-health retirement.

Employee and employer contributions will be paid into the pension fund, with the fund being topped up by Government grant if the contributions are insufficient to meet the cost of pension payments. Any surplus in the fund will be recouped by Government. Overall, the change to the financial arrangements for firefighters pensions is cost neutral to central Government.

The pension fund will appear as a separate income and expenditure statement in an Authority's Statement of Accounts, with a separate Balance Sheet also required. The pension fund will be ring-fenced to ensure accounting clarity.

Whilst the impact of the new regulations will be considerable in 2006/2007, there is no impact on the Authority's Accounts for 2005/2006.

The Pensions Reserve was created in 2001/2002 to even out the impact of future year's firefighters pension liabilities. The Pension Account within the revenue account is ringfenced with any year-end balances being transferred to the reserve. The new funding arrangements for firefighter pensions are at a very early stage and may be subject to a further review in the near future. The position will be closely monitored and decisions taken with regard to the future and level of this reserve as appropriate.

4 RECOMMENDATIONS

4.1 The Authority is recommended to :-

a) approve the Statement of Accounts for the financial year ended 31st March 2006, subject to audit;

b) endorse the action to review corporate governance and internal control for 2005/06.