

# Audit Strategy Memorandum

Tyne & Wear Fire and Rescue Authority  
– year ended 31 March 2014

March 2014



Mazars LLP  
The Rivergreen Centre  
Aykley Heads  
Durham  
DH1 5TS

Governance Committee  
Tyne & Wear Fire and Rescue Authority  
Fire Brigade Headquarters  
Nissan Way  
Sunderland  
Tyne & Wear  
SR5 3QY

4 March 2014

Dear Members

**Audit Strategy Memorandum for the year ending 31 March 2014**

We are delighted to present our Audit Strategy Memorandum for Tyne & Wear Fire and Rescue Authority for the year ending 31 March 2014.

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

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

This document will be presented at the Governance Committee meeting on 17 March 2014. If you would like to discuss any matters in more detail please do not hesitate to contact me on 0191 383 6300.

Yours faithfully

Mark Kirkham  
Director, for and on behalf of Mazars LLP

# Contents

01 Purpose and background .....	1
02 Audit scope, approach and timeline .....	2
03 Significant risks and key judgement areas .....	5
04 Value for Money Conclusion .....	8
05 Your audit team .....	9
06 Fees for audit and other services .....	10
Appendix A – Independence .....	11
Appendix B - Materiality .....	12
Appendix C – Key communication points.....	13
Appendix D – Forthcoming accounting and other issues .....	14

# 01 Purpose and background

## **Purpose of this document**

This document sets out our audit plan in respect of the audit of the financial statements of Tyne & Wear Fire and Rescue Authority (the Authority) for the year ending 31 March 2014, and forms the basis for discussion at the Governance Committee meeting on 17 March 2014.

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

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

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

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

## **Scope of engagement**

We are appointed to perform the external audit of Tyne & Wear Fire and Rescue Authority for the year to 31 March 2014. The scope of our engagement is laid out in the Audit Commission's Code of Audit Practice for Local Government bodies.

## **Responsibilities**

The Audit Commission's Statement of Responsibilities of Auditors and of Audited Bodies sets out our respective responsibilities as the auditor and the audited body. The Audit Commission has issued a copy of the Statement to you. The Statement summarises where the different responsibilities of auditors and of the audited body begin and end and we undertake our audit work to meet these responsibilities.

We comply with the statutory requirements governing audit work, in particular:

- the Audit Commission Act 1998; and
- the Code of Audit Practice for Local Government bodies.

We, as auditors to the Authority, are responsible for forming and expressing an opinion on the financial statements and reaching a conclusion on the arrangements you have put in place to secure economy, efficiency and effectiveness in the use of your resources (the Value for Money conclusion).

We are also required to report on the consistency of your Whole of Government Accounts submission with the audited financial statements. Our audit does not relieve management or the Governance Committee, as those charged with governance, of their responsibilities.

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

As part of our audit procedures in relation to fraud, we are required to enquire of those charged with governance as to their knowledge of instances of fraud, the risk of fraud and their views on management controls that mitigate the fraud risks.

# 02 Audit scope, approach and timeline

## Audit scope

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

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

## Audit approach

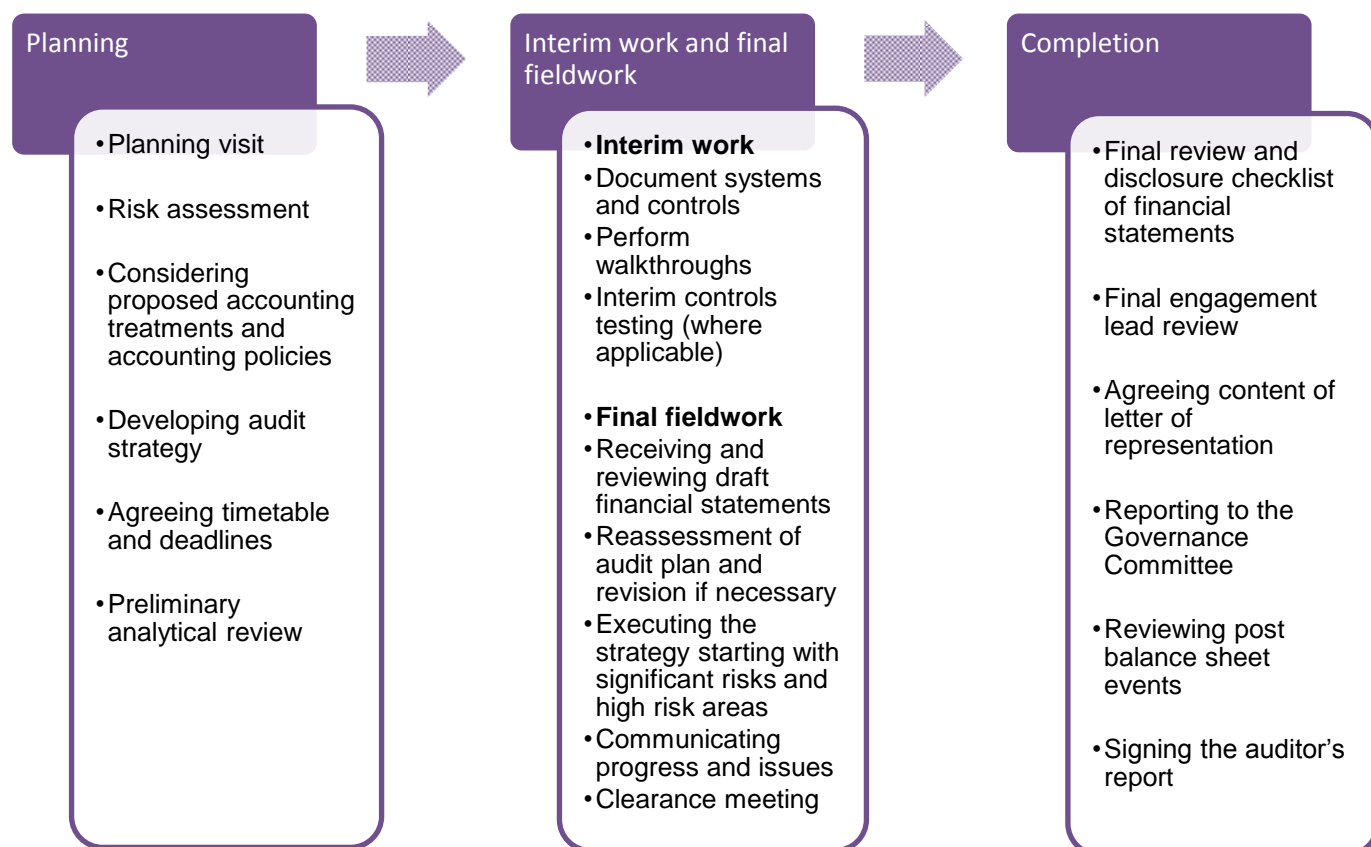
Our audit approach is a risk based approach primarily driven by the risks we consider to result in a higher risk of material misstatement of the financial statements. Once we have completed our risk assessment we develop our audit strategy and design audit procedures in response to this assessment. The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

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

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

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

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



### Reliance on internal audit

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

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

We do not have any current plans to specifically rely on the work of Internal Audit.

### Reliance on other auditors

We plan to place reliance on the work of another auditor in relation to pension entries, namely the auditor of the Pension Fund, PWC. We have agreed a work programme and timetable for the receipt of information with PWC.

### Service organisations

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

Nature of services provided and items of account	Name of service organisation	Audit approach to be adopted
<p>All areas of the financial statements.</p> <p>Systems provided for the Authority are:</p> <ul style="list-style-type: none"><li>• general ledger;</li><li>• payroll and pensions;</li><li>• accounts payable;</li><li>• accounts receivable;</li><li>• cash receipting; and</li><li>• treasury management.</li></ul> <p>The services include the preparation of the financial statements.</p> <p>Valuation of property, plant and equipment.</p>	<p>Sunderland City Council (the Council)</p>	<p>We are also the auditor of the Council. We will review the controls in place for production of the financial statements and also within the key financial information systems.</p>

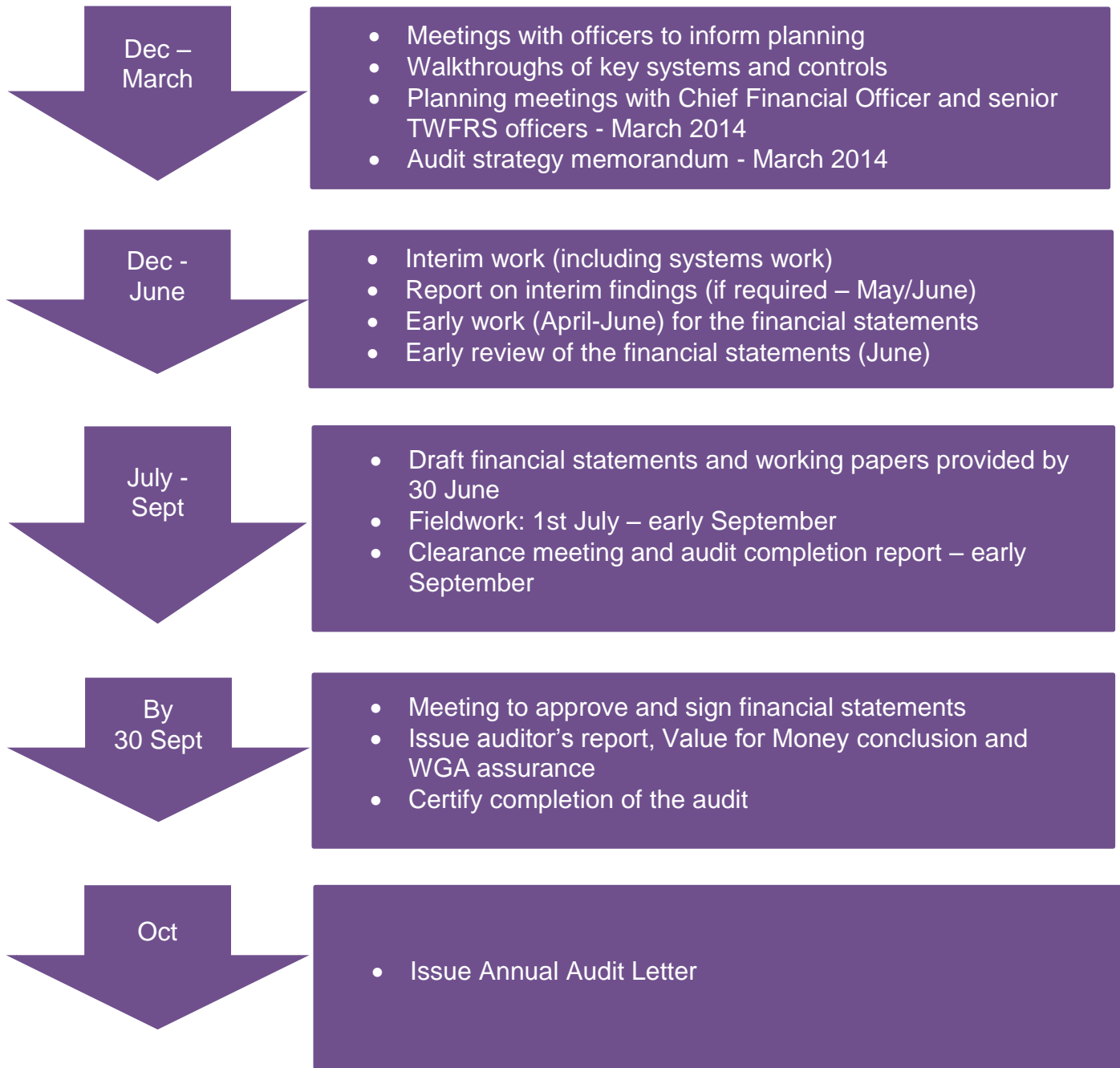
### The work of experts

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

Items of account	Management's expert	Our expert
<p>Asset valuations</p>	<p>External valuer from Sunderland City Council</p>	<p>Audit Commission's consulting valuer (Gerald Eve)</p>
<p>Pension liability</p>	<p>Government Actuaries Department (GAD) – Firefighters' pensions</p> <p>Actuary (Aon Hewitt) – Other staff pensions</p>	<p>Audit Commission's consulting actuary (PwC)</p>

### Timeline

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



# 03 Significant risks and key judgement areas

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

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

## Significant audit risks

### Management override of controls

#### Description of the risk

Auditing standards state that management at various levels within an organisation 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 override could occur, we consider there to be a risk of material misstatement due to fraud and thus a significant risk on *all* audits.

#### How we will address this risk

We have updated our understanding and evaluation of internal controls procedures as part of our audit planning, including completion of a fraud risk assessment. As part of this, we will seek written assurances from the Governance Committee and management on their controls and processes for assessing the risk of fraud in the financial statements and arrangements in place to identify, respond to and report fraud.

Our testing strategy for this significant risk due to fraud will include:

- journals recorded in the general ledger and other adjustments made in preparation of the financial statements;
- consideration and review of material accounting estimates impacting on amounts included in the financial statements;
- consideration and review of any unusual or significant transactions outside the normal course of business; and
- consideration of any other local factors.

### Revenue recognition

#### Description of the risk

Auditing standards include a rebuttable presumption that there is a significant risk in relation to the timing of income recognition and in relation to judgements made by management as to when income has been earned. Mazars' policy is that the scope to apply such a rebuttal is limited. As there is an inherent risk of fraud in revenue recognition we consider it to be a significant risk on *all* audits. This does not imply that we suspect actual or intended manipulation but that we continue to approach the audit with due professional scepticism.

#### How we will address this risk

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

- testing receipts in March and April 2014 to ensure they have been recognised in the right year;
- testing adjustment journals.



## Expenditure recognition

### Description of the risk

Auditing standards include a rebuttable presumption that there is a significant risk in relation to the timing of expenditure recognition and in relation to judgements made by management as to when expenditure has been incurred. As there is a risk of fraud in expenditure recognition we regularly consider it to be a significant risk. This does not imply that we suspect actual or intended manipulation but that we continue to approach the audit with due professional scepticism.

### How we will address this risk

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

- testing payments in March and April 2014 to ensure they have been recognised in the right year;
- testing adjustment journals.

## Pension entries (IAS 19)

### Description of the risk

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. This results in an increased risk of material misstatement.

### How we will address this risk

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

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

## Private Finance Initiative (PFI) schemes

### Description of the risk

The Authority has two PFI schemes and both are material to the accounts. It is therefore required to:

- model expected accounting entries on the contract;
- comply with IFRIC 12 requirements;
- include the assets and associated liabilities of the PFI schemes in the financial statements; and
- account for PFI grant funding in accordance with the Code.

### How we will address this risk

We will discuss the correct accounting treatment with officers and confirm that the PFI accounting entries are consistent with the operators' model.

## Key areas of management judgement

### Property, Plant and Equipment – depreciation, revaluations and impairments (where applicable)

#### Description of the area of judgement

Accounting standards and CIPFA's Code of Practice on Local Authority Accounting require that all property, plant and equipment are depreciated, unless there is a specific exception. There are also requirements to regularly revalue assets carried at fair value on the Council's balance sheet and to carry out impairment reviews.

These involve management judgements over the useful lives and valuations of assets.

#### Our planned audit approach

We will evaluate the design and implementation of controls in respect of depreciation, revaluations and impairments as part of our walkthrough of the property, plant and equipment system.

In addition, we will undertake a range of substantive procedures including:

- substantive sample testing of depreciation, revaluations and impairments per the disclosure note to the financial statements;
- review and evaluation of the work of the in-house valuer, including the valuer's report; and
- consideration of regional valuation trends.

# 04 Value for Money Conclusion

We are required to reach a conclusion on your arrangements to secure economy, efficiency and effectiveness in the use of your resources.

Our conclusion on your arrangements is based on two criteria, specified by the Audit Commission:

- securing financial resilience – focusing on whether you are managing your financial risks to secure a stable financial position for the foreseeable future; and
- challenging how you secure economy, efficiency and effectiveness – focusing on whether you are prioritising your resources within tighter budgets and the need to improve productivity and efficiency.

We set out below the significant risks that we will address through our work.

## VFM risks

### Description of the risks

The Authority faces financial pressures from reduced funding and continues to identify plans to deliver future savings. Without robust budgetary control and delivery of its action plans, the Authority's financial resilience and service performance could deteriorate.

### How we will address these risks

We will review budget monitoring and reporting, focusing on areas where action plans are in place to make savings and seek to minimise any adverse impact on service delivery. We will review the plans that are developed to deliver savings.

In particular, we will review the implementation of changes arising from the review of response and diversionary activities.

# 05 Your audit team

Below are your audit team and their contact details.

Engagement lead  
(Director)

- Mark Kirkham
- Tel: 0191 383 6300 or 07747 764 529
- Email: mark.kirkham@mazars.co.uk

Engagement Senior  
Manager

- Gavin Barker
- Tel: 0191 561 1917 or 07896 684 771
- Email: gavin.barker@mazars.co.uk

Team Leader (Assistant  
Manager)

- Ian Rutter
- Tel: 0191 561 1919 or 07881 283 347
- Email: ian.rutter@mazars.co.uk

# 06 Fees for audit and other services

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

Area of work	2013/14 Proposed Fee	2013/14 Scale Fee	2012/13 Actual Fee
Code audit work	£40,848	£40,848	£40,848

## Non-audit services

We do not currently plan any non-audit services, and no other audit or non-audit services are provided to the Authority by Mazars LLP associated entities.

# Appendix A – 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, that create any unacceptable threats to our independence within the regulatory or professional requirements governing us as your auditors.

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

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

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

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

No threats to our independence and associated safeguards have been identified.

# Appendix B - Materiality

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

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

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

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

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

We consider materiality whilst planning and performing our audit.

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

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 have set materiality at the planning stage at £867,000 with a clearly trivial threshold of £26,000 below which identified errors will not usually be reported. We have set lower materiality levels for the disclosure of officer remuneration and emoluments, members' allowances and the audit fee as we consider these items to be of specific interest to users of the accounts sufficient to warrant audit procedures which would not otherwise be applied based on the materiality level for the audit as a whole. The materiality determined at the planning stage does not necessarily establish an amount below which uncorrected misstatements, either individually or in aggregate, will be considered as immaterial.

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

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

# Appendix C – Key communication points

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

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

## **Form, timing and content of our communications**

We will present to the Governance Committee the following reports:

- our Audit Strategy Memorandum;
- our Audit Completion Report; and
- Annual Audit Letter (custom and practice is to report this to the full Authority).

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

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

- our responsibilities in relation to the audit of the financial statements;
- the planned scope and timing of the audit;
- significant audit risks and areas of management judgement;
- our independence;
- responsibilities for preventing and detecting errors;
- materiality; and
- fees for audit and other services.

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

- significant deficiencies in internal control;
- significant findings from the audit;
- significant matters discussed with management;
- our conclusions on the significant audit risks and areas of management judgement;
- unadjusted misstatements;
- management representation letter;
- our proposed draft audit report; and
- independence.



# Appendix D – Forthcoming accounting and other issues

The 2013/14 CIPFA Code of Practice on Local Authority Accounting (the Code) has made several changes, of which you should be aware. Officers from the Authority's finance function attended workshops that provided full details of the changes in the 2013/14 Code, as well as a forward look to potential future accounting changes that may be of relevance to the Authority. If you require detailed information on any of these changes or any other emerging issues, please contact any member of the engagement team.

## Forthcoming accounting issues

Employee benefits	How this may affect the Authority
<p>The Code includes changes as a result of the adoption of the amended IAS 19 Employee Benefits.</p>	<p>The main potential impacts of the changes are:</p> <ul style="list-style-type: none"> <li>• changes in terminology used for some entries in the Authority's Comprehensive Income and Expenditure Statement and disclosure notes;</li> <li>• minor changes to the recognition point for termination benefits that may either delay or bring forward the recognition of expenses such as redundancy payments;</li> <li>• significant changes to the format and content of relevant disclosure notes; and</li> <li>• changes to the classification, recognition and measurement of post-employment benefits.</li> </ul> <p>Where these changes have a material impact on the financial statements, it is likely the Authority will need to restate their 2012/13 comparative entries.</p>
Business rates appeals	How this may affect the Authority
<p>As a result of the introduction of the business rates retention scheme from 1 April 2013, local authorities are now responsible for meeting the costs of successful rating appeals from local businesses.</p>	<p>It is likely that the Authority will recognise a provision in its financial statements to recognise the cost of funding future successful rating appeals by local businesses.</p>
PFI/PPP arrangements	How this may affect the Authority
<p>The 2013/14 Code includes augmented provisions on service concession (PFI/PPP) arrangements. This clarifies that accounting requirements in respect of PFI assets under construction.</p>	<p>Potential for the recognition point for PFI assets (and associated liabilities) to be earlier than in previous years where the recognition criteria in section 4.1 of the Code have been met.</p> <p>It is not anticipated there would be any significant impact for the Authority.</p>