Audit Strategy Memorandum

Tyne & Wear Fire and Rescue Authority

Year ending 31 March 2018

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Mazars LLP
Salvus House
Aykley Heads
Durham
DH1 5TS

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

14 March 2018

Dear Members

Audit Strategy Memorandum – Year ending 31 March 2018

We are pleased to present our Audit Strategy Memorandum for Tyne & Wear Fire and Rescue Authority for the year ending 31 March 2018.

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. As it is a fundamental requirement that an auditor is, and is seen to be, independent of its clients, Section 7 of this document also summarises our considerations and conclusions on our independence.

We consider two-way communication with you to be key to a successful audit and 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 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 may affect the audit, including the likelihood of those risks materialising and how they are monitored and managed.

This document, which has been prepared following our initial planning discussions with management, is the basis for discussion of our audit approach, and any questions or input you may have on our approach or role as auditor.

This document also contains specific appendices that outline our key communications with you during the course of the audit, and forthcoming accounting issues and other issues that may be of interest.

Client service is extremely important to us and we strive to continuously provide technical excellence with the highest level of service quality, together with continuous improvement to exceed your expectations so, if you have any concerns or comments about this document or audit approach, please contact me on 0191 383 6300.

Yours faithfully

Mark Kirkham
Mazars LLP

MAZARS

1. ENGAGEMENT AND RESPONSIBILITIES SUMMARY

Overview of engagement

We are appointed to perform the external audit of Tyne & Wear Fire and Rescue Authority (the Authority) for the year to 31 March 2018. The scope of our engagement is set out in the Statement of Responsibilities of Auditors and Audited Bodies, issued by Public Sector Audit Appointments Ltd (PSAA) available from the PSAA website: www.psaa.co.uk/audit-quality/terms-of-appointment/

Our responsibilities

Our responsibilities are principally derived from the Local Audit and Accountability Act 2014 (the 2014 Act) and the Code of Audit Practice issued by the National Audit Office (NAO), as outlined below.

Audit opinion

We are responsible for forming and expressing an opinion on the financial statements.

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

Reporting to the NAO

We report to the NAO on the consistency of the Authority's financial statements with its Whole of Government Accounts (WGA) submission. We expect that Tyne & Wear Fire and Rescue Authority will once again be below the thresholds required for this reporting to the NAO.

Value for Money

We are required to conclude whether the Authority has proper arrangements in place to secure economy, efficiency and effectiveness in it its use of resources. We discuss our approach to Value for Money work further in section 5 of this report.

Electors' rights

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

Our 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), we plan and perform our audit so as to obtain reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. Our audit, however, should not be relied upon to identify all such misstatements.

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.

The Authority is required to prepare its financial statements on a going concern basis by the Code of Practice on Local Authority Accounting. As auditors, we are required to consider the appropriateness of the use of the going concern assumption in the preparation of the financial statements and the adequacy of disclosures made.

2. YOUR AUDIT ENGAGEMENT TEAM

- Mark Kirkham, Partner and Engagement Lead
- Mark.Kirkham@mazars.co.uk
- 0191 383 6300

- Gavin Barker, Senior Manager
- Gavin.Barker@mazars.co.uk
- 0191 383 6300

- Ian Rutter, Assistant Manager
- ian.rutter@mazars.co.uk
- 0191 383 6300

3. AUDIT SCOPE, APPROACH AND TIMELINE

Audit scope

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

Our audit of the financial statements will be conducted in accordance with International Standards on Auditing (UK), relevant ethical and professional standards, our own audit approach and in accordance with the terms of our engagement. Our work is focused on those aspects of your business which we consider to have a higher risk of material misstatement, such as those affected 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.

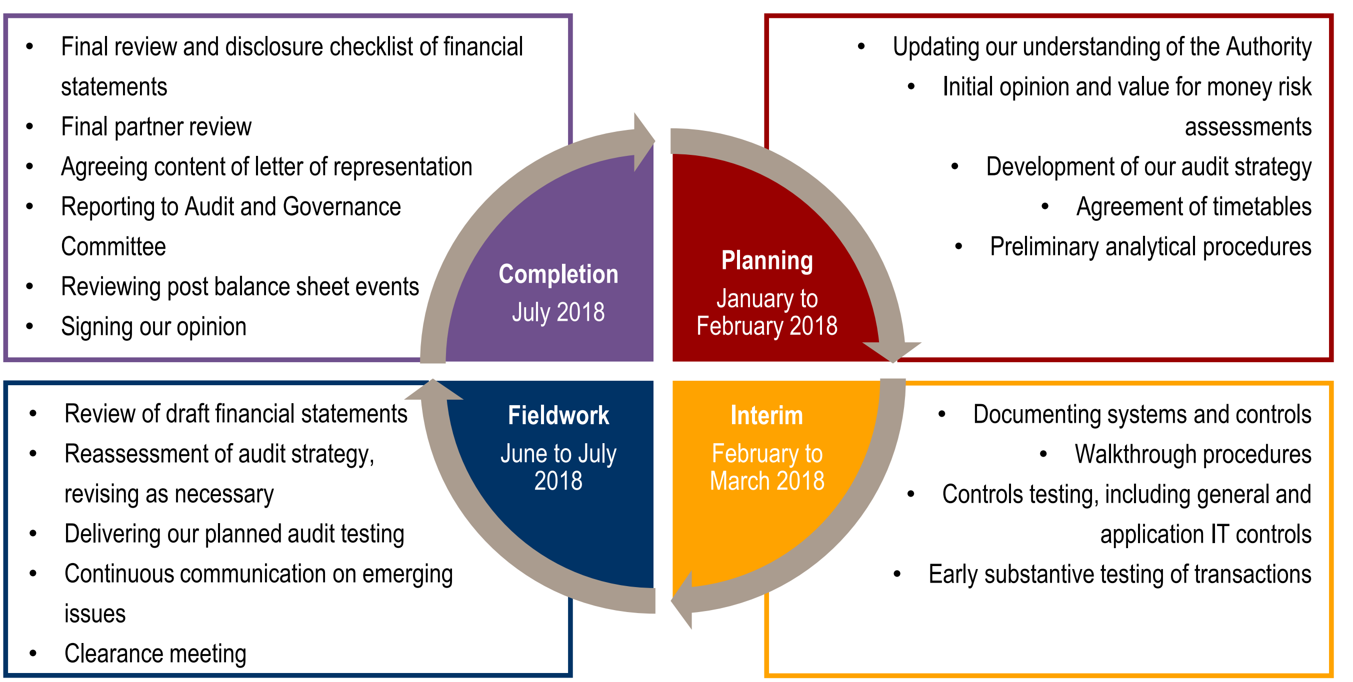
Audit approach

Our approach is risk-based and primarily driven by the factors we consider lead to a higher risk of material misstatement. Once we have completed our risk assessment, we develop our audit strategy and design audit procedures in response to this assessment.

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. Substantive procedures are audit procedures designed to detect material misstatements at the assertion level and comprise tests of details (of classes of transactions, account balances, and disclosures) and substantive analytical procedures. Irrespective of the assessed risks of material misstatement, which take into account our evaluation of the operating effectiveness of controls, we are required to design and perform substantive procedures for each material class of transactions, account balance, and disclosure.

Our audit will be planned and performed so as to provide reasonable assurance that the financial statements are free from material misstatement and give a true and fair view. The concept of materiality, and how we define a misstatement, is explained in more detail in section 8.

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



3. AUDIT SCOPE, APPROACH AND TIMELINE (CONTINUED)

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.

We do not intend to rely on the work on internal audit.

Management's and our experts

Management makes use of experts in specific areas when preparing the Authority's financial statements. We also use experts to assist us to obtain sufficient appropriate audit evidence on specific items of account.

Items of account	Management's expert	Our expert
Defined benefit liability	Aon Hewitt (actuary) – Tyne & Wear Pension Fund Government Actuaries Department (GAD) for the firefighters' pension scheme	NAO's consulting actuary (PWC)
Property, plant and equipment	External valuer provided by Sunderland City Council	NAO's consulting valuer (Gerald Eve)

Service organisations

International Auditing Standards define service organisations as third party organisations that provide services to the Authority that are part of its information systems relevant to financial reporting. We are required to obtain an understanding of the services provided by service organisations as well as evaluating the design and implementation of controls over those services. The table below summarises the service organisations used by the Authority and our planned audit approach.

Service organisation	Services provided	Audit approach
Sunderland City Council	Financial services, provision of key financial systems and IT services. Systems provided for the Authority include: • general ledger; • pensions and payroll; • accounts payable and accounts receivable; and • treasury management.	Although some officers are employed by Sunderland City Council, and some key systems are maintained by the Council, we have sufficient access to officers and systems, along with all of the relevant financial information we need, to conduct our audit of Tyne & Wear Fire and Rescue Authority.

Reporting deadlines

As we have previously discussed with the Audit and Governance Committee, the statutory timetable for the production and audit of the Authority's financial statements changes for 2017/18. The Authority is now required to produce accounts by 31 May 2018 (1 month earlier) and to publish audited accounts by 31 July 2018 (2 months earlier). The Authority successfully reduced the amount of time it needed to meet the earlier timetable in 2016/17 and the financial statements were produced and the audit completed to the new timetable last year. We continue to work with officers to ensure that the timetable can be met once again this year.

4. SIGNIFICANT RISKS AND KEY JUDGEMENT AREAS

Following the risk assessment approach discussed in section 3 of this document, we have identified relevant risks to the audit of financial statements. The risks that we identify are categorised as significant, enhanced or standard, as defined below:

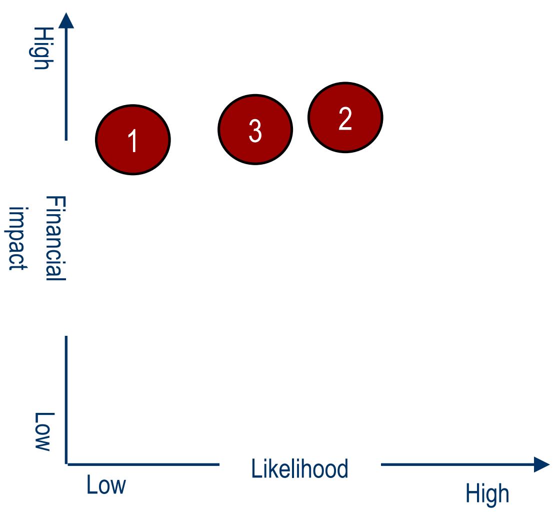
Significant risk A significant risk is an identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration. For any significant risk, the auditor shall obtain an understanding of the entity's controls, including control activities relevant to that risk.

Enhanced risk An enhanced risk is an area of higher assessed risk of material misstatement ('RMM') at audit assertion level other than a significant risk. Enhanced risks incorporate but may not be limited to:

- key areas of management judgement, including accounting estimates which are material but are not considered to give rise to a significant risk of material misstatement; and
- other audit assertion risks arising from significant events or transactions that occurred during the period.

Standard risk This is related to relatively routine, non-complex transactions that tend to be subject to systematic processing and require little management judgement. Although it is considered that there is a risk of material misstatement (RMM), there are no elevated or special factors related to the nature, the likely magnitude of the potential misstatements or the likelihood of the risk occurring.

The summary risk assessment, illustrated in the audit risk continuum below, highlights those risks which we deem to be significant and other enhanced risks. We have summarised our audit response to these risks on the next page.



	Risk
1	Management override of control
2	Property, plant and equipment revaluation
3	Defined benefit liability valuation

4. SIGNIFICANT RISKS AND KEY JUDGEMENT AREAS (CONTINUED)

We explain the identified risks and our testing approach in the table below. An audit is a dynamic process and if we change our view of risk or our approach to address the identified risks during the course of our audit we will report this to the Audit and Governance Committee.

Significant risks

	Description of risk	Planned response
1	**Management override of controls** 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 there is a risk of material misstatement due to fraud on all audits.	We plan to address the management override of controls risk through performing audit work over accounting estimates, journal entries and significant transactions outside the normal course of business or otherwise unusual.
2	**Property, plant and equipment valuations** The financial statements contain material entries on the Balance Sheet as well as material disclosure notes in relation to the Authority's holding of PPE. Although the Authority employs a valuation expert to provide information on valuations, there remains a high degree of estimation uncertainty associated with the revaluation of PPE due to the significant judgements and number of variables involved in providing revaluations. We have therefore identified the revaluation of PPE to be an area of risk.	We will consider the Authority's arrangements for ensuring that PPE values are reasonable and will engage our own expert to provide data to enable us to assess the reasonableness of the valuations provided by the Authority's valuer. We will also assess the competence, skills and experience of the valuer. Where necessary we will also perform further audit procedures on individual assets to ensure that the basis and level of revaluation is appropriate.
3	**Defined benefit liability valuation** The financial statements contain material pension entries in respect of the retirement benefits. The calculation of these pension figures, both assets and liabilities, can be subject to significant volatility and includes estimates based upon a complex interaction of actuarial assumptions. This results in an increased risk of material misstatement.	We will discuss with officers any significant changes to the pension estimates. 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 each Actuary's output, referring to an expert's report on all actuaries nationally which is commissioned annually by PSAA Ltd.

5. VALUE FOR MONEY WORK

Our approach to value for money work

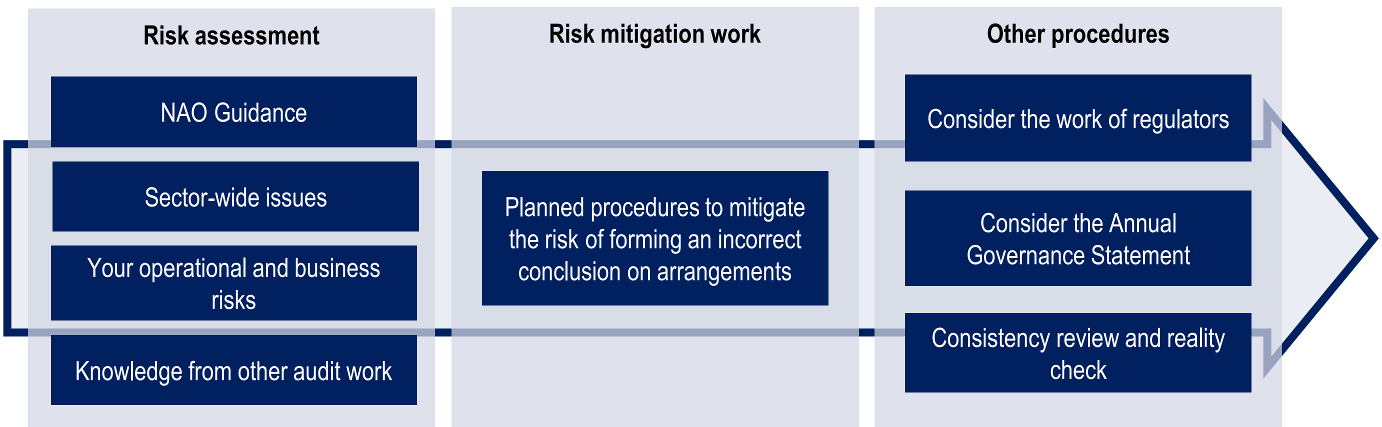
We are required to form a conclusion as to whether the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The NAO issues guidance to auditors that underpins the work we are required to carry out, and sets out the criterion and sub-criteria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

The overall criterion is that, ‘in all significant respects, the Authority had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.’

To assist auditors in reaching a conclusion on this overall criterion, the following sub-criteria are provided set out by the NAO:

- informed decision making;
- sustainable resource deployment; and
- working with partners and other third parties.

A summary of the work we undertake is provided below.



Significant value for money audit risk

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

For the 2017/18 financial year, we have identified the following significant risk to our VFM work.

Description of significant audit risk	Planned response
Pressures on financial resources Our audit work in previous years has concluded that the Authority has arrangements in place for managing its financial position. The Authority, however, continues to face financial pressure in the coming years. In addition, £10.5m of overpaid fire injury pensions are being recovered from the Authority by the Home Office. We need to ensure our knowledge of the Authority’s MTFS arrangements and its monitoring of the planned delivery of savings, remains up to date in order to ensure we give the correct VFM conclusion.	Building on our work in previous years, we will review the Authority’s updated MTFS to ensure it reflects the latest funding position and review and update our knowledge of the arrangements the Authority has in place to monitor progress against its savings plans and income projections that underpin the MTFS. We will assess the impact of the final position for repayment of fire injury pensions on financial sustainability.

6. FEES FOR AUDIT AND OTHER SERVICES

Fees for work as the Authority's appointed auditor

At this stage of the audit we are not planning any divergence from the scale fees set by PSAA as communicated in our fee letter of 24 April 2017.

Service	2016/17 fee	2017/18 fee
Code audit work	£30,636	£30,636

All fees exclude VAT

Fees for non-PSAA work

Currently, we have not been separately engaged by the Authority to carry out any additional work as set out in the table below. Before agreeing to undertake any additional work we consider whether there are any actual, potential or perceived threats to our independence. Further information about our responsibilities in relation to independence is provided in section 7.

Service	2016/17 fee	2017/18 fee
Non-audit work	£0	£0

All fees exclude VAT

7. OUR COMMITMENT TO INDEPENDENCE

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

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

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

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

We confirm, as at the date of this document, that the engagement team and others in the firm as appropriate, and Mazars LLP are independent and comply with relevant ethical requirements. However, if at any time you have concerns or questions about our integrity, objectivity or independence please discuss these with Mark Kirkham in the first instance.

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

8. MATERIALITY AND MISSTATEMENTS

Definitions

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.

Summary of initial materiality thresholds

Threshold	Initial threshold (£)
Overall materiality	£758,000
Specific materiality • Members allowances • Officers' remuneration • Senior officer emoluments • Exit packages	 • 10% of actual costs • Correct bandings only • Roundings only • Roundings only
Trivial threshold for errors to be reported to the Governance Committee	£23,000

Materiality

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

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

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

We consider materiality whilst planning and performing our audit based on quantitative and qualitative factors.

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 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.

8. MATERIALITY AND MISSTATEMENTS (CONTINUED)

Our provisional materiality is set based on a benchmark of gross revenue expenditure. We will identify a figure for materiality but identify separate levels for procedures designed to detect individual errors, and also a level above which all identified errors will be reported to the Governance Committee.

We consider that gross revenue expenditure remains the key focus of users of the financial statements and, as such, we base our materiality levels around this benchmark.

We expect to set a materiality threshold at 2% of gross revenue expenditure.

Based on last year's audited accounts we anticipate the overall materiality for the year ending 31 March 2018 to be in the region of £758k (£757k in the prior year).

After setting initial materiality, we continue to monitor materiality throughout the audit to ensure that it is set at an appropriate level.

Misstatements
We aggregate misstatements identified during the audit that are other than clearly trivial. We set a level of triviality for individual errors identified (a reporting threshold) for reporting to the Governance Committee that is consistent with the level of triviality that we consider would not need to be accumulated because we expect that the accumulation of such amounts would not have a material effect on the financial statements. Based on our preliminary assessment of overall materiality, our proposed triviality threshold is £23,000 based on 3% of overall materiality. If you have any queries about this please do not hesitate to raise these with Mark Kirkham.

APPENDIX A – KEY COMMUNICATION POINTS

ISA (UK) 260 'Communication with Those Charged with Governance', ISA (UK) 265 'Communicating Deficiencies In Internal Control To Those Charged With Governance And Management' and other ISAs (UK) specifically require us to communicate the following:

Required communication	Audit Strategy Memorandum	Audit Completion Report
Our responsibilities in relation to the audit of the financial statements and our wider responsibilities	✓	
Planned scope and timing of the audit	✓	
Significant audit risks and areas of management judgement	✓	
Our commitment to independence	✓	✓
Responsibilities for preventing and detecting errors	✓	
Materiality and misstatements	✓	✓
Fees for audit and other services	✓	
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		✓
Summary of misstatements		✓
Management representation letter		✓
Our proposed draft audit report		✓

APPENDIX B – FORTHCOMING ACCOUNTING AND OTHER ISSUES

Changes relevant to 2017/18

There are no significant changes to the Code of Practice on Local Authority Accounting (the Code) for 2017/18. Minor changes to the Code include:

- introduction of key reporting principles for the preparation and publication of the Narrative Report; and
- clarification of reporting requirements on accounting policies and going concern.

None of the above are anticipated to have a significant impact on the Authority.

Changes in future years

Accounting standard	Year of application	Implications
IFRS 9 – Financial Instruments	2018/19	The standard will replace IAS 39 and will introduce significant changes to the recognition and measurement of the Authority's financial instruments, particularly its financial assets. Although the accounting changes may be complex and may require the reclassification of some instruments, it is likely that the Authority will continue to measure the majority of its financial assets at amortised costs For authorities that hold instruments that will be required to be measured at fair value under the new standard, there may be instances where changes in these fair values are recognised immediately and impact on the general fund. At this stage it is unclear whether statutory provisions, over and above those already in place, will be put in place to mitigate the impact of these fair value movements on the Authority's general fund balance.
IFRS 16 – Leases	2019/20	We anticipate that the new leasing standard will be adopted by the Code for the 2019/20 financial year. IFRS 16 will replace the existing leasing standard, IAS 17, and will introduce significant changes, particularly for lessees. The requirements for lessors will be largely unchanged from the position in IAS 17. Lessees will need to recognise assets and liabilities for all leases (except short-life or low-value leases) as the distinction between operating leases and finance leases is removed. The introduction of this standard is likely to lead to significant work being required in order to identify all leases to which the Authority are party to.

The 2018/19 Code will also apply the requirements of IFRS 15 Revenue from Contracts with Customers, but it is unlikely that this will have significant implications for most local authorities.