# The Annual Audit Letter for Merseyside Fire & Rescue Authority

Year ended 31 March 2019

15 January 2020

# Contents

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# Executive Summary

## Purpose

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at Merseyside Fire & Rescue Authority ( the Authority) for the year ended 31 March 2019.

This Letter is intended to provide a commentary on the results of our work to the Authority and external stakeholders, and to highlight issues that we wish to draw to the attention of the public. In preparing this Letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'. We reported the detailed findings from our audit work to the Authority's Policy & Resources Committee as those charged with governance in our Audit Findings Report on 19 December 2019.

## Respective responsibilities

We have carried out our audit in accordance with the NAO's Code of Audit Practice, which reflects the requirements of the Local Audit and Accountability Act 2014 (the Act). Our key responsibilities are to:

- give an opinion on the Authority's financial statements (section two)
- assess the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources (the value for money conclusion) (section three).

In our audit of the Authority's financial statements, we comply with International Standards on Auditing (UK) (ISAs) and other guidance issued by the NAO.

## Our work

| | |
|---|---|
| **Materiality** | We determined materiality for the audit of the Authority's financial statements to be £1,654,000, which is 2**%** of the Authority's gross revenue expenditure. |
| **Financial Statements opinion** | We gave an unqualified opinion on the Authority's financial statements on 20 December 2019. |
| **Whole of Government Accounts (WGA)** | We completed work on the Authority's consolidation return following guidance issued by the NAO. |
| **Use of statutory powers** | We did not identify any matters which required us to exercise our additional statutory powers. |
| **Value for Money arrangements** | We were satisfied that the Authority put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources. We reflected this in our audit report to the Authority on 19 December 2019. |
| **Certificate** | We certified that we have completed the audit of the financial statements of Merseyside Fire & Rescue Authority in accordance with the requirements of the Code of Audit Practice on 20 December 2019. |

We would like to record our appreciation for the assistance and co-operation provided to us during our audit by the Authority's staff.

Grant Thornton UK LLP
January 2020

# Audit of the Financial Statements

## Our audit approach

### Materiality

In our audit of the Authority's financial statements, we use the concept of materiality to determine the nature, timing and extent of our work, and in evaluating the results of our work. We define materiality as the size of the misstatement in the financial statements that would lead a reasonably knowledgeable person to change or influence their economic decisions.

We determined materiality for the audit of the Authority's financial statements to be £1,654,000, which is 2% of the Authority's gross revenue expenditure. We used this benchmark as, in our view, users of the Authority's financial statements are most interested in where the Authority has spent its revenue in the year.

### The scope of our audit

Our audit involves obtaining sufficient evidence about the amounts and disclosures in the financial statements to give reasonable assurance that they are free from material misstatement, whether caused by fraud or error. This includes assessing whether:

- the accounting policies are appropriate, have been consistently applied and adequately disclosed;
- the significant accounting estimates made by management are reasonable; and
- the overall presentation of the financial statements gives a true and fair view.

We also read the remainder of the financial statements and the narrative report, annual governance statement published alongside the financial statements to check it is consistent with our understanding of the Authority and with the financial statements included in the Annual Report on which we gave our opinion.

We carry out our audit in accordance with ISAs (UK) and the NAO Code of Audit Practice. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our audit approach was based on a thorough understanding of the Authority's business and is risk based.

We identified key risks and set out overleaf the work we performed in response to these risks and the results of this work.

# Audit of the Financial Statements

## Significant Audit Risks

These are the significant risks which had the greatest impact on our overall strategy and where we focused more of our work.

| Risks identified in our audit plan | How we responded to the risk | Findings and conclusions |
|---|---|---|
| **Valuation of land and buildings**<br>The Authority values land and buildings on a rolling five-yearly basis. This valuation represents a significant estimate by management in the financial statements due to the size of the numbers involved and the sensitivity of the estimate to changes in key assumptions. Additionally, management need to ensure the carrying value in the Authority's financial statements is not materially different from the current value at the financial statements date, where a rolling programme is used.<br>We therefore identified valuation of land and buildings, particularly revaluations and impairments, as a significant risk of material misstatement. | As part of our audit work we have:<br>• evaluated management's processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work<br>• evaluated the competence, capabilities and objectivity of the valuation expert<br>• written to the valuer to confirm the basis on which the valuation was carried out<br>• challenged the information and assumptions used by the valuer to assess completeness and consistency with our understanding<br>• tested revaluations made during the year to see if they had been input correctly into the asset register<br>• Evaluated the assumptions made by management for those assets not revalued during the year and how management has satisfied themselves that these are not materially different to current value at year-end. | As part of our initial procedures to consider whether the carrying value of land and buildings was not materially different to current value, we identified a potential material misstatement due to the fact that substantially all of the Authority's asset base had not been valued since 2015. This potential material error was identified following application of typical land and building valuation movements from 2015 to 2019 using indices provided to us by our own auditor expert. Following consultation internally with audit quality and technical colleagues and discussion with the Authority regarding the potential impact of this on our audit report on the financial statements, management decided to engage an independent external valuer to value the whole property portfolio of the Authority.<br>This work was completed in September 2019 and resulted in valuation adjustments of £17m within the financial statements as adjusted.<br>Following receipt of the updated valuation, we carried out procedures to review and challenge the underlying assumptions and to understand the approach taken by the valuer, referencing information provided by the independent valuer commissioned by PSAA to support local government audit teams.<br>Following completion of the procedures as set out above, we have gained assurance that Authority land and buildings are fairly stated.<br>We will engage with management and their independent valuer going forward into 2019-20 in order to establish the future approach to asset valuation and to agree form and nature of supporting evidence we require from the independent valuer in supporting our audit procedures.<br>There were no further matters to report. |

# Audit of the Financial Statements

## Significant Audit Risks (continued)

| Risks identified in our audit plan | How we responded to the risk | Findings and conclusions |
|---|---|---|
| **Valuation of net pension liability**<br>The Authority's net pension fund liability, as reflected in its balance sheet as the net defined benefit pension liability, represents a significant estimate in the core financial statements.<br><br>The pension fund net liability is considered a significant estimate due to the size of the numbers involved and the sensitivity of the estimate to changes in key assumptions.<br><br>We therefore identified valuation of the Authority's net pension fund liability as a significant risk, which was one of the most significant assessed risks of material misstatement. | As part of our audit work we have:<br>• updated our understanding of the processes and controls put in place by management to ensure that the Authority's pension fund net liability is not materially misstated and evaluate the design of the associated controls;<br>• evaluated the instructions issued by management to their management expert (the actuary) for this estimate and the scope of the actuary's work;<br>• assessed the competence, capabilities and objectivity of the actuary who carried out the Authority's pension fund valuation;<br>• assessed the accuracy and completeness of the information provided by the Authority to the actuary to estimate the liability;<br>• tested the consistency of the pension fund asset and liability and disclosures in the notes to the core financial statements with the actuarial report from the actuary;<br>• confirmed the reasonableness of the actuarial assumptions made by reviewing the report of the consulting actuary (as auditor's expert) and performing any additional procedures suggested within the report; and<br>• obtained assurances from the auditor of the Merseyside Pension Fund as to the controls surrounding the validity and accuracy of membership data; contributions data and benefits data sent to the actuary by the pension fund and the fund assets valuation in the pension fund financial statements. | Performance of the stated procedures has not identified any significant matters to report to you other than in relation to material changes to the liability following the outcome of a legal case relating to pensions.<br><br>**<u>Impact of the McCloud transitional protection pensions ruling</u>**<br><br>Following publication of the draft financial statements, management responded to the outcome of legal proceedings relating to the McCloud case by obtaining revised IAS 19 valuations from pension scheme actuaries. As a result of the current legal position, the Authority's gross pension liability has increased by £46m.<br><br>In conjunction with auditor's experts, we reviewed the analysis performed by the actuaries for both the Firefighter Pension Scheme and the Local Government Pension Scheme, and consider that the approach taken to arrive at these estimates is reasonable. Amendments were required to the Comprehensive Income and Expenditure statements, Balance Sheets and Movement in Reserve Statements, as well as a number of the notes to the financial statements including the Expenditure and Funding Analysis and explanatory note, Adjustments between Accounting Basis and Funding Basis under Regulation, Unusable Reserves and Defined Benefit Pension Schemes. Management have adjusted the financial statements with regard to these findings. |

# Audit of the Financial Statements

## Significant Audit Risks (continued)

| Risks identified in our audit plan | How we responded to the risk | Findings and conclusions |
|---|---|---|
| **Valuation of net pension liability (continued)**<br>The Authority's net pension fund liability, as reflected in its balance sheet as the net defined benefit pension liability, represents a significant estimate in the core financial statements.<br><br>The pension fund net liability is considered a significant estimate due to the size of the numbers involved and the sensitivity of the estimate to changes in key assumptions.<br><br>We therefore identified valuation of the Authority's net pension fund liability as a significant risk, which was one of the most significant assessed risks of material misstatement. | As per previous page | **Impact of Guaranteed Minimum Pension (GMP) equalisation ruling**<br>The High Court has ruled that defined benefit pension schemes must remove any discriminatory effect that guaranteed minimum pension entitlements had had on members' benefits. The Government has announced an "interim solution" for members in public service schemes, including the Firefighter Pension Scheme and the Local Government Pension Scheme. We performed specific work to ensure that the impact had been sufficiently included within the Authority's pensions liability calculations.<br>We are satisfied that all material liabilities arising from the GMP ruling have been included for both schemes in the Authority Balance Sheet, having already been considered in the original actuarial valuations obtained for the draft financial statements, or otherwise having an immaterial impact. No amendment to the financial statements has been required as a result of this issue.<br>**Conclusion**<br>Based on the procedures performed, we identified no further material issues to report in respect of this risk. |

# Audit of the Financial Statements

## Significant Audit Risks (continued)

| Risks identified in our audit plan | How we responded to the risk | Findings and conclusions |
|---|---|---|
| **Management override of internal controls**<br>Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities. The Authority faces external scrutiny of spending and use of reserves and  this could potentially place management under undue pressure in terms of how they report performance.<br>We therefore identified management override of control, in particular journals, management estimates and transactions outside the course of business as a significant risk of material misstatement | As part of our audit work we completed;<br>• evaluated the design effectiveness of management controls over journals<br>• analysed the journals listing and determined the criteria for selecting high risk unusual journals<br>• tested unusual journals recorded during the year and after the draft accounts stage for appropriateness and corroboration<br>• gained an understanding of the accounting estimates and critical judgements applied made by management and consider their reasonableness with regard to corroborative evidence<br>• evaluated the rationale for any changes in accounting policies, estimates or significant unusual transactions. | Based on procedures completed, we did not identify any material issues in relation to this risk and have no matters to report. |

# Audit of the Financial Statements

## Significant Audit Risks (continued)

| Risks identified in our audit plan | How we responded to the risk | Findings and conclusions |
|---|---|---|
| **Accounting for PFI**<br>The risk of material error in the accuracy and presentation of the Private Finance Initiative (PFI) liability and associated disclosures. You lead a North West PFI project to replace 16 fire stations across Merseyside, Lancashire and Cumbria. Mersey Fire and Rescue Service built 7 new PFI stations, the last station opening in 2013. The net book value of the PFI assets stood at £17.4m at 31 March 2018, and the long term creditor relating to the PFI contract stood at £18.5m. Under IFRS13 the long term liability in relation to the PFI contract should have been included at fair value in the 2017/18 financial statements. This was not completed.<br>We therefore identified the risk of material error in the accuracy and presentation of the Private Finance Initiative (PFI) liability and associated disclosures as a significant risk. | As part of our audit work we completed;<br>• Evaluated your accounting policy for the PFI contract and whether the accounting treatment adopted in the financial statements is consistent with the accounting policy:<br>• Assessed how management have accounted for the transactions, assessing whether the accounting treatment is in line with IFRS requirements:<br>• Evaluated the disclosure of the transactions in the financial statements to confirm that they accurately represent the arrangements. | Based on procedures completed, we gained assurance that the PFI has been accounted for in line with IFRS and Code guidance and that supporting disclosures are appropriate.<br>The draft financial statements did not include required disclosure of the fair value of the PFI liability within the financial instruments note.<br>Management subsequently calculated the fair value in line with requirements and disclosed this within the revised financial statements. We reviewed the disclosure and underlying calculations and had no further matters to report. |

# Audit of the Financial Statements

## Audit opinion

We gave an unqualified opinion on the Authority's financial statements on 20 December 2019.

## Preparation of the financial statements

The Authority presented us with draft financial statements in accordance with the national deadline, and provided a good set of working papers to support them. The finance team responded promptly and efficiently to our queries during the course of the audit. The McCloud-Sargeant pensions ruling required additional actuarial work to be carried out impacting significantly on the financial statements, which required re-auditing. The additional work on this matter impacted the progress of the audit on other areas, due to the additional time commitment required. However, this court judgement matter was outside the control of the finance team. The quantum of audit work required also increased in respect of Property, Plant and Equipment to satisfy regulatory requirements and was further delayed given the need to perform a further full revaluation of the property portfolio.

## Issues arising from the audit of the financial statements

We reported the key issues from our audit to the Authority’s Performance and Resources Committee on 19 December 2019.

## Annual Governance Statement and Narrative Report

We are required to review the Authority’s Annual Governance Statement and Narrative Report. It published them on its website in the Statement of Accounts in line with the national deadlines.

Both documents were prepared in line with the CIPFA Code and relevant supporting guidance. We confirmed that both documents were consistent with the financial statements prepared by the Authority and with our knowledge of the Authority.

## Whole of Government Accounts (WGA)

We carried out work on the Authority’s Data Collection Tool in line with instructions provided by the NAO . We issued an assurance statement which confirmed the Authority was below the audit threshold.

## Certificate of closure of the audit

We certified that we have completed the audit of the financial statements of Merseyside Fire & Rescue Authority in accordance with the requirements of the Code of Audit Practice on 20 December 2019.

# Value for Money conclusion

## Background

We carried out our review in accordance with the NAO Code of Audit Practice, following the guidance issued by the NAO in November 2017 which specified the criterion for auditors to evaluate:

*In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.*

## Key findings

Our first step in carrying out our work was to perform a risk assessment and identify the risks where we concentrated our work.

The risks we identified and the work we performed are set out below.

## Overall Value for Money conclusion

We are satisfied that in all significant respects the Authority put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2019.

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## Value for Money Risks

| Risks identified in our audit plan | Findings and conclusions |
| --- | --- |
| **Arrangements to secure medium and long term financial sustainability, including delivery of the reserves and estates strategies** | Based on the review of the arrangements in place during 2018/19 for the compilation of the MTFS, monitoring and delivering financial performance, reserves strategy and interaction with estates strategies, we concluded that the overall risk was sufficiently mitigated and that the Authority have proper arrangements in these areas. |

# Value for Money conclusion

## Value for Money Risks

| Risks identified in our audit plan | Findings and conclusions |
|---|---|
| **Arrangements to secure medium and long term financial sustainability, including delivery of the reserves and estates strategies** | Based on the review of the arrangements in place during 2018/19 for the compilation of the MTFS, monitoring and delivering financial performance, reserves strategy and interaction with estates strategies, we concluded that the overall risk was sufficiently mitigated and that the Authority have proper arrangements in these areas. |

# A. Reports issued and fees

We confirm below our final reports issued and fees charged for the audit. There are no non-audit fees to report.

### Reports issued

| Report | Date issued |
|---|---|
| Audit Plan | April 2019 |
| Audit Findings Report | December 2019 |
| Annual Audit Letter | January 2020 |

### Fees

| | Planned £ | Actual fees £ | 2017/18 fees £ |
|---|---|---|---|
| Statutory audit | 24,966 | 32,966 | 32,424 |
| **Total fees** | **24,966** | **32,966** | **32,424** |

### Audit fee variation

As outlined in our audit plan, the 2018-19 scale fee published by PSAA of £24,966 assumes that the scope of the audit does not significantly change. There are a number of areas where the scope of the audit has changed, which has led to additional work. These are set out in the following table.

| Area | Reason | Fee proposed |
|---|---|---|
| **Assessing the impact of the McCloud ruling** | The Government's transitional arrangements for pensions were ruled discriminatory by the Court of Appeal last December. The Supreme Court refused the Government's application for permission to appeal this ruling. As part of our audit we have reviewed the revised actuarial assessment of the impact on the financial statements along with any audit reporting requirements. | £2,000 |
| **Pensions – IAS 19** | The Financial Reporting Council has highlighted that the quality of work by audit firms in respect of IAS 19 needs to improve across local government audits. Accordingly, we have increased the level of scope and coverage in respect of IAS 19 this year to reflect this. | £2,000 |
| **PPE Valuation – work of experts and audit of second valuation** | As above, the Financial Reporting Council has highlighted that auditors need to improve the quality of work on PPE valuations across the sector. We have increased the volume and scope of our audit work to reflect this. In addition, we undertook additional work on your restated PPE balances following receipt of the updated valuation report as at 31 March 2019. | £4,000 |
| **Total** | | £8,000 |

**Fee variations are subject to PSAA approval.**

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