

Annual Audit Letter

December 2005



# **Annual Audit Letter**

**Buckinghamshire and Milton Keynes Fire Authority**

**Audit 2004-2005**

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## Key messages

### Performance

- 1 The Authority was categorised as 'weak' in a comprehensive performance assessment reported in August 2005.
- 2 The new management team has demonstrated strengths in leadership and has achieved some positive developments in driving forward the change agenda, although the Authority has still a significant way to go in embedding a culture of robust performance and risk management and securing appropriate resource capacity and effective governance arrangements.
- 3 The Authority has responded positively and has identified four key areas for improvement which will be incorporated into the corporate planning process. However, it also recognises the need to continually re-base, and monitor outcomes against its plans to ensure that they remain realistic and achievable.

### The accounts

- 4 We have issued an unqualified audit opinion on your 2003/04 accounts.
- 5 There were substantial gaps in evidence to support the 2004/05 financial statements presented for audit in October 2005. We have therefore delayed our audit of the 2004/05 financial statements. It is planned to commence in January 2006 once the issues mainly around reconciliations have been completed.
- 6 It is of significant concern to us that financial statements were prepared, presented and adopted by the Authority with such fundamental shortcomings. We have been given assurances that these matters are being addressed and will report further following the conclusion of our work.

### Financial position

- 7 The Authority's financial position is sound. Early indications for 2006/07 planning show budget pressures, although the Authority is working through the detailed implications following the recent Government provisional funding settlement. There are also detailed proposals which are being considered in order to assess what action is needed. There is also a deficit in the capital programme for each of the next three financial years which needs to be bridged.

## Other accounts and governance issues

- 8 The Authority has completed some innovative capital schemes to transfer residential property to housing associations, and to relocate its headquarters to a new site in Aylesbury. These schemes overall have and will result in significant benefits to the Authority and its staff.
- 9 However, a review of the process for agreement of these schemes has identified significant weaknesses in the Authority's corporate governance arrangements, in particular in discharging its duty to secure the best consideration reasonably obtainable on a site-by-site basis.

## Action needed by the Authority

- Ensure that your improvement plans for the future remain realistic and achievable, through effective and robust monitoring arrangements.
- Review and implement robust arrangements for the production of financial statements.
- Review your capital plans to ensure that the programme is fully funded.
- Introduce more robust arrangements to monitor the legality of transactions.

## Performance

The Authority was categorised as 'weak' in a Comprehensive Performance Assessment carried reported in August 2005.

The new management team has demonstrated strengths in leadership and has achieved some positive developments in driving forward the change agenda, although the Authority has still a significant way to go in embedding a culture of robust performance and risk management and securing appropriate resource capacity and effective governance arrangements.

The Authority has responded positively and has identified four key areas for improvement which will be incorporated into the corporate planning process. However, it also recognises the need to continually re-base, and monitor outcomes against its plans to ensure that they remain realistic and achievable.

### Comprehensive performance assessment (CPA)

- 10 The comprehensive performance assessment (CPA) was developed by the Audit Commission, in partnership with the fire service, Her Majesty's Fire Service Inspectorate and the Government. It is an assessment, at the corporate level, of how well a fire authority is being run. It does not give an opinion on how well the fire service responds to emergency incidents. Authorities receive an overall score by being placed in one of five categories (excellent, good, fair, weak and poor).
- 11 The report was issued in August 2005, and the results are detailed below. Scores are on a 1 to 4 basis, with 1 being the lowest and 4 the highest.

**Table 1 Summary of assessment scores**

<b>A - What is the authority trying to achieve?</b>	<b>Score</b>
Leadership and priorities	3
A balanced strategy	2
<b>B - How has the authority set about delivering its priorities?</b>	
Capacity: Governance and management	1
Capacity: Resources and value for money	1
Capacity: People	2
Performance management	1

<b>C - What has the authority achieved and, in the light of that, what does it plan to do next?</b>	
Achievement of objectives	2
Achievement of improvement	2
Future plans	3
<b>OVERALL CPA SCORE</b>	<b>Weak</b>

- 12 Following on from the CPA process, the Authority is working hard on improvement planning and is developing an improvement planning matrix with four main improvement areas:
- strengthening the planning and control environment;
  - strengthening the ability to manage and identify risks;
  - improving the ability to manage change; and
  - laying the foundations for developing a performance management environment.
- 13 This process is being supported by the Government Office's Business Change Manager on behalf of ODPM and is aimed at identifying the top priorities for improvement and putting arrangements in place to address them. Meetings have already been held between auditors, HMFSI, representatives of the Office of the Deputy Prime Minister and the Authority to consider priorities further. Members will have a key role to play in terms of setting the priorities and monitoring progress against them.
- 14 The new management team has made a significant impact on the performance and delivery of the service, demonstrating strong leadership and ensuring that staff and stakeholders have a clear vision and understanding of what is and is not a priority and what needs to be done to implement and sustain the change agenda. However, there is still much to be done to embed this major culture change.
- 15 The Authority recognises that it has limited financial and officer capacity to deliver the changes needed and has set itself some challenging improvement targets. However, it also recognises the need to continually re-base, and monitor outcomes against its plans to ensure that they remain realistic and achievable.

## Other performance work

- 16 Our audit programme has set aside some time to support the Authority in delivering against its improvement agenda. Given the impact of the corporate assessment on officer resources, we have consciously limited our work to date. We will now use this time to support the improvement plan.

## Accounts and governance

We have issued an unqualified audit opinion on your 2003/04 accounts.

There were substantial gaps in evidence to support the 2004/05 financial statements presented for audit in October 2005. We have therefore delayed our audit of the 2004/05 financial statements. It is planned to commence in January 2006 once the issues mainly around reconciliations have been completed.

It is of significant concern to us that financial statements were prepared, presented and adopted by the Authority with such fundamental shortcomings. We have been given assurances that these matters are being addressed and will report further following the conclusion of our work.

The Authority's financial position is sound. Early indications for 2006/07 planning show budget pressures, although the Authority is working through the detailed implications following the recent Government provisional funding settlement. There are also detailed proposals which are being considered in order to assess what action is needed. There is also a deficit in the capital programme for each of the next three financial years which needs to be bridged.

The Authority has completed some innovative capital schemes to transfer residential property to housing associations, and to relocate its headquarters to a new site in Aylesbury. These schemes overall have and will result in significant benefits to the Authority and its staff.

However, a review of the process for agreement of these schemes has identified significant weaknesses in the Authority's corporate governance arrangements, in particular in discharging its duty to secure the best consideration reasonably obtainable on a site-by-site basis.

### Audit of 2003/04 accounts

- 17 In last year's letter we commented that further information was needed before our work could be concluded in relation to the accounting entries for:
  - the 'disposal' of properties at Beaconsfield and Gerrards Cross fire stations; and
  - the new headquarters and related land transfer.
- 18 We have since agreed the accounting entries required, following extensive discussions with the Authority's officers and the receipt of additional information. Consequently, we issued an unqualified audit opinion on 15 August 2005.
- 19 However, we were not able to complete the audit at that time pending consideration of whether the Authority had achieved best consideration reasonably obtainable in relation to the three transactions (see legality section for further details).

- 20 We are required by professional standards to report to those charged with governance (in this case Finance and General Purposes Committee) certain matters before we give an opinion on the financial statements. The table below sets out the areas reported on.

## **Table 2 Reporting to the Finance and General Purposes Committee**

Matters reported to the Committee on 29 July 2005

<b>Areas to be reported</b>	<b>Summary of matters reported to Committee</b>
Mis-statements	The approved accounts submitted for audit contained a number of material misstatements that management has adjusted. These were highlighted in the report accompanying the revised accounts.
Material weaknesses in accounting and internal control systems	We were concerned about the absence of clear documentary evidence and the level of technical advice sought at appropriate times for what are complex and unusual transactions (property disposals and land transfer), increasing the risk of the Authority not being able to demonstrate that it has acted effectively in its decision making processes.
Qualitative aspects of accounting practices and financial reporting	There were various items of expenditure included within 'non-distributable costs' in the Consolidated Revenue Account (estimated at £0.6 million). Many of these did not appear to comply with proper accounting practice. Given the need to 'revalue' the properties at Beaconsfield (reducing their carrying value by £0.4 million) there were potential concerns about the accuracy of the fixed asset valuations more generally (particularly as there is an annual revaluation process in place).

*Audit Commission*

## **Audit of 2004/05 accounts**

- 21 We received the draft financial statements on the 10 October 2005. However, following a review of the accounts and trial balance and discussions with the Head of Finance, we had serious concerns about the accuracy and completeness of the statements and we therefore withdrew to enable the Authority to carry out further work on the following areas:
- the trial balance contained a large number of manual adjustments that had not been posted to the ledger, eg capital accounting entries, FRS 17, opening balance adjustments. Also no reconciliation was provided between the trial balance (TB) and the accounts;

- the bank overdraft, creditors and income bank accounts had not been reconciled and there were large balances on the uncleared items codes which could impact on both revenue and capital;
  - the payroll account had been reconciled but entries had not been included in the trial balance; and
  - there were a number of other accounts included in the bank overdraft on the trial balance which needed to be reconciled or reclassified.
- 22 Due to the problems identified above, we have not yet commenced the audit of the 2004/05 financial statements. We plan to commence our audit in January 2006.
- 23 The published accounts are an essential means by which the Authority reports its stewardship of the public funds at its disposal and its financial performance in the use of those resources.

## Financial standing

- 24 The Authority's financial position is sound (based on 2004/05 unaudited financial statements).

## Revenue spending and balances

- 25 The draft financial statements show that the General Fund balance has increased to £1.7 million, which equates to 7 per cent of net operating expenditure. Total revenue reserves are £4 million, equivalent to 17 per cent of net operating expenditure.
- 26 As at the end of September, the Authority was predicting an under spend against its 2005/06 budget of £0.2 million, which is 0.9 per cent of the net revenue budget.

## Future years

- 27 The Authority is currently reviewing its medium-term financial plan. Currently, there is a projected increase in expenditure that would require a Council Tax increase of 9 per cent, which if implemented may result in a capping order. Assuming a capping limit of 5 per cent, this equates to a 'gap' of £528,000 (approximately 2.1 per cent of net projected expenditure). The Authority has noted that there is further work to do and in particular that budget projections do not include the impact of the new fire fighters pension scheme proposals; council tax base changes and any collection fund surplus/deficits. We will continue to monitor progress in the coming year.

## Capital programme

- 28 The Authority's capital programme for the next four years equates to a total spend of over £10 million, which is a significant increase on recent years. The latest projection shows a shortfall in funding of over £3 million from 2006/07 onwards. The deficit will need to be bridged by either reducing the programme, further borrowing, or a combination of both. Any additional borrowing will need to be in accordance with the prudential guidelines.

## Legality of transactions

- 29 In disposing of land and property the Authority is bound by the requirements of section 123 of the Local Government Act 1972 which requires it to secure the best consideration reasonably obtainable. The requirements of this enactment were subsequently modified in 2003, to allow an authority to dispose of assets for up to £2 million below market value, where it will promote or improve the economic, social or environmental well-being of its area or local inhabitants.
- 30 We have considered whether the Authority has achieved best consideration in relation to:
- the 'disposal' of properties at Beaconsfield and Gerrards Cross fire stations; and
  - the new headquarters and related land transfer.
- 31 This required detailed discussion and investigation as the necessary information was not immediately available, and had not been subject to a robust, open and transparent decision-making process with Members.
- 32 We have now concluded that, based on the information available to us, the disposal of properties at Gerrards Cross and the headquarters land transfer did meet best consideration requirements. The transfer of headquarters represented a particularly good deal, both in terms of strategic and operational benefits, as well as financially.
- 33 However, the disposal of properties at Beaconsfield appears to fall significantly short of the best consideration threshold. The estimated shortfall could be as high as £800,000, although the potential for an additional receipt from further development may reduce this to under £600,000.
- 34 We have now received the Authority's formal comments setting out the reasons for accepting less than best consideration on the disposal of properties at Beaconsfield. These relate to the promotion of social and economic well-being through aiding recruitment and retention for the Authority which has been a significant problem in recent years. It also argues that the active promotion of disposal to a housing association will also maintain their availability within the key worker sector, in line with government policy.

- 35 Whilst we have concluded that statutory requirements have been met, it is evident that the Authority's processes were not sufficiently robust to ensure that novel and/or complex deals were supported by clear, robust documentary evidence and that an appropriate level of technical advice was sought at the appropriate time.
- 36 The absence of such control leaves the Authority open to legal challenge as it cannot demonstrate that it took its decision based on a full examination of the evidence.
- 37 The need to improve overall governance arrangements was also a key conclusion from the recent CPA and action has already been taken by the Authority to appoint a full-time Treasurer role, and to improve access to legal advice. We will monitor the implementation of these actions carefully as part of our ongoing audit work.

## Other governance issues

- 38 A key component of the corporate assessment was corporate governance arrangements. We were aware of the scope and coverage of this work and liaised with the assessment team before, during and after their on-site work. In view of the close links we deferred our usual work on the Authority's financial aspects of corporate governance, and have recently commenced some work to assess the progress being made by the Authority in this area.
- 39 Whilst the corporate assessment itself highlighted that corporate governance arrangements were weak some positive comments were made.
  - The new management structure was seen as effective, with clear evidence of improved leadership and increased capacity.
  - Members and staff were fully aware of the new management team areas of responsibility, which clearly align to the delivery of corporate objectives.
  - Effective officer and member working relationships exist, in particular between the chair and CFO. Officers had conducted a number of member briefings strengthening this relationship, providing valuable information to members and reinvigorating their interest in the service.
  - Adequate committee structure to support decision-making and member scrutiny, strengthened with the introduction of the PAG. All committees have clear terms of reference giving clarity to their purpose.

- 40 However, key improvement areas identified included:
- there was no code of corporate governance, and the standards committee was not effectively performing a monitoring role;
  - policies and procedures were not being updated;
  - senior officer and member groups were ineffective (new arrangements should provide the basis for effective decision-making forums in the future);
  - arrangements for monitoring corporate and service objectives were not in place;
  - the effectiveness of support services and level of administrative support;
  - legal support was not consistent, increasing the risk of the Authority acting unlawfully or not giving due consideration to the legal implications of policy decisions; and
  - there were no documented job descriptions for members and the member scrutiny role was not fully effective, in particular for performance monitoring and approval or involvement in implementation or production of strategies.
- 41 Our ongoing audit work will monitor progress in these areas and report further as appropriate to the Overview and Performance Committee.

## Other work

### National Fraud Initiative

- 42 In 2004/05, the Authority took part in the Audit Commission's National Fraud Initiative (NFI). The NFI, which is undertaken every two years, aims to help identify and reduce fraud by bringing together data from NHS bodies, local authorities and government departments and other agencies, to detect a wide range of frauds against the public sector. These include payroll and housing benefit fraud, occupational pension fraud, tenancy fraud and payroll fraud as well as, new for 2004/05, right to buy scheme fraud and providing new contact details for former tenants with arrears in excess of £1,000.

## Looking forwards

### Future audit work

- 43 We have an agreed plan for 2005/06 and we have reported in this letter those aspects that have already been completed. The remaining elements of that plan, including our audit of the 2005/06 accounts, will be reported in next year's Annual Letter.
- 44 We have sought to ensure, wherever possible, that our work relates to the improvement priorities of the Authority. We will continue with this approach when planning our programme of work for 2006/07. We will seek to reconsider, with you, your improvement priorities in the light of the CPA assessment and your own analysis, and develop an agreed programme by 31 March 2006. We will continue to work with other inspectorates and regulators to develop a co-ordinated approach to regulation.

### Revision to the Code of Audit Practice

- 45 The statutory requirements governing our audit work are contained in:
  - the Audit Commission Act 1998; and
  - the Code of Audit Practice (the Code).
- 46 The Code has been revised with effect from 1 April 2005. Further details are included in our Audit Plan which was agreed with the Chief Fire Officer in April 2005. The key changes include:
  - the requirement to draw a positive conclusion regarding the Authority's arrangements for ensuring value for money in its use of resources; and
  - a clearer focus on overall financial and performance management arrangements.

## Closing remarks

- 47 This letter has been discussed and agreed with the Chief Fire Officer. A copy of the letter will be presented at the Finance and General Purposes Committee meeting in January/February 2006.
- 48 The Authority has taken a positive and constructive approach to our audit and I would like to take this opportunity to express my appreciation for the Authority's assistance and co-operation.

## Availability of this letter

- 49 This letter will be published on the Audit Commission's website at [www.audit-commission.gov.uk](http://www.audit-commission.gov.uk) and also on the Authority's website.

A P Burns  
District Auditor  
December 2005

## Appendix 1 – Background to this letter

### The purpose of this letter

- 1 This Annual Audit Letter summarises the conclusions and significant issues arising from our recent audit of the Authority.
- 2 We have issued separate reports during the year setting out the findings and conclusions from the specific elements of our programme. These reports are listed at Appendix 2 for information.
- 3 The Audit Commission has circulated to all audited bodies a statement that summarises the key responsibilities of auditors. Our audit has been conducted in accordance with the principles set out in that statement. What we say about the results of our audit should be viewed in the context of that more formal background.
- 4 Appendix 3 provides information about the fee charged for our audit.

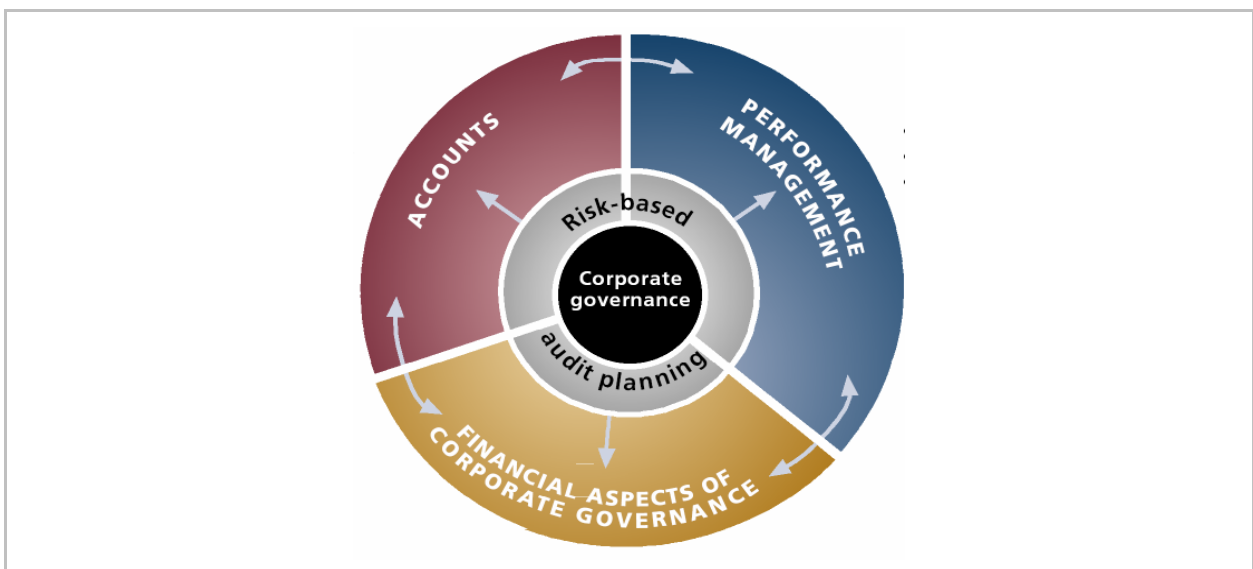
### Audit objectives

- 5 Our main objective as your appointed auditor is to plan and carry out an audit that meets the requirements of the Code of Audit Practice. We adopt a risk-based approach to planning our audit, and our audit work has focused on the significant risks that are relevant to our audit responsibilities.

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#### Figure 1 Code of Audit Practice

Code of practice responsibilities



- 6 Central to our audit are your corporate governance arrangements. Our audit is then structured around the three elements of our responsibilities as shown below.

### **Accounts**

- Opinion.

### **Financial aspects of corporate governance**

- Financial standing.
- Systems of internal financial control.
- Standards of financial conduct and the prevention and detection of fraud and corruption.
- Legality of transactions.

### **Performance management**

- Use of resources.
- Performance information.
- Best value performance plan.

## Appendix 2 – Audit reports issued

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**Table 3**

<b>Report title</b>	<b>Date issued</b>
Audit Plan	April 2005
Comprehensive Performance Assessment	August 2005
Report on the 2003/04 Financial Statements to Those Charged with Governance (SAS 610)	July 2005
Core Process Review	November 2005 (draft)

## Appendix 3 – Audit fee

**Table 4      Audit fee update**

<b>Audit area</b>	<b>Plan 2004/05 (£)</b>	<b>Actual 2004/05 (£)</b>
Accounts	16,250	19,000
Financial aspects of corporate governance	12,000	12,000
Performance	20,500	20,500
<b>Total Code of Audit Practice fee</b>	<b>48,750</b>	<b>51,500</b>