

report

meeting	NOTTINGHAMSHIRE AND CITY OF NOTTINGHAM FIRE & RESCUE AUTHORITY	
date	24 February 2006	agenda item number

REPORT OF THE TREASURER

EXTERNAL AUDITORS MANAGEMENT LETTER

1 PURPOSE OF REPORT

The purpose of this report is to update Members regarding the contents of the External Auditors Management Letter and the Service's response to the auditors' recommendations.

2 BACKGROUND

2.1 The External Auditors to the Fire & Rescue Authority are required under the Audit Commission's code of practice to issue an annual management letter to the Authority on completion of the annual audit. This management letter is given in full as Appendix A to this report.

2.2 The purpose of this report is to allow the Auditors to present their management letter to the Authority and to give Members an opportunity to ask any questions arising from the letter.

2.3 As well as providing a Key Messages section, as a sort of executive summary, the Auditors go on to provide detailed comments in a number of areas, principally :

- Performance
- Accounts and Governance
- Other Work

3 MAIN ISSUES

PERFORMANCE

3.1 The Auditors comment at length about the Authority's Comprehensive Performance Assessment and are generally very positive about the Authority's capacity to improve performance management, business risk management and partnerships.

3.2 Management are taking an active role in driving improvements in the areas highlighted for attention via the CPA. The areas set out in Paragraph 10 of the Auditors' Report are all being addressed, a point which is acknowledged by the Auditors in Paragraph 11.

- 3.3 The Auditors have assisted the internal review of partnership arrangements by providing guidance documents etc. They have not however, undertaken a full review of partnerships preferring instead to await the outcomes of the internal best value review.
- 3.4 Recognising the role that Information Technology plays in the effective management of the organisation, the Auditors also carried out a baseline review of how information is captured, stored, used, and shared. This review also considered compliance issues around the relevant statutory framework.
- 3.5 This review was generally positive however, a number of recommendations for improvement were made. All of these are being addressed by the I.T. Department.
- 3.6 Crucially in this section on performance the Auditors confirm that they have issued a clear opinion on the Authority's best value performance plan.

ACCOUNTS AND GOVERNANCE

- 3.7 There are three major issues in this section which the Auditors draw to the attention of Members :
- Audit Opinion
 - Restatement of 2003/4 Accounts
 - SAS 610 report.
- 3.8 The Auditors have issued an unqualified opinion on the Accounts for 2004/5.
- 3.9 Members may recall that at the Fire Authority meeting on 29 July 2005 officers reported that a major error had been discovered within the 2003/4 Accounts which, if left uncorrected, would create difficulties and inconsistencies with the 2004/5 accounts. This error was concerned with the calculation and presentation of the FRS 17 adjustments and had not been discovered previously by either the Finance staff or the previous external auditors. The Fire Authority report of 29 July 2005 set this issue out for members and corrected the error.
- 3.10 In their Statement of Auditing Standard (SAS) 610 report the Auditors are required to bring certain matters to the notice of Members. They are reporting the reclassification of leases, not because there is any disagreement or failure to respond on behalf of the Authority, but because the changes which have been to the accounts have taken place after they were approved by Members.
- 3.11 Since at least 1980 the Fire Authority (then the County Council) has always taken out operating leases for appliances and has treated them as such within the accounts. This has been common practice nationally, but has recently become the subject of specific examination by the Audit Commission, most notably in Staffordshire. Again this is an area where previous auditors have made enquiries and have been satisfied that the arrangements were correct.
- 3.12 Nevertheless, a detailed examination by the audit commission concluded that these types of leases were in fact finance leases as defined by Statement of Standard Accounting Practice 21 and needed to be treated differently in the accounts. This reclassification has no effect on the revenue account of the authority but starts to reflect the value of these appliances within the Authority's balance sheet.

- 3.13 It is the view of the Head of Finance and Resources that since the inception of the prudential code these distinctions between finance and operating leases are less important as they have no impact upon financing or revenue account decisions and was therefore content to make these adjustments.
- 3.14 In terms of the financial standing of the Authority, the Auditors acknowledge that the control of finances is vitally important and are clearly content with the robustness of estimates, financial strategy and the adequacy of reserves. They have some reservations relating to the reporting of Capital Expenditure to Members which will be taking place from this meeting onwards on a quarterly basis.
- 3.15 With the exception of the capital reporting issue the Auditors are satisfied that the Authority is operating in full compliance with the prudential code.
- 3.16 In terms of systems of internal financial control, prevention of fraud and corruption and the legality of transactions, the Auditors have no issues to raise. They do suggest however, that Members should consider whether their detailed reports which are not required to be made public should be considered by the Finance Committee.

OTHER WORK

- 3.17 This section sets out the Auditors plans for auditing risk management in 2006 and comments on the National Fraud Initiative and the fact that officers had not responded to this initiative at the time of the audit. Nevertheless a response was made to the Audit Commission within their deadline for returns.

4 FINANCIAL IMPLICATIONS

The financial implications of the report are set out in Appendix 3 to the Audit Letter which detail the audit fees for the 2004/5 accounts and how these have changed from the estimate. There has been an increase in fees but this can be explained by the additional work that was required to resolve both the leasing and FRS17 issues.

5 RISK MANAGEMENT IMPLICATIONS

Although the External Auditors reviews of the Authority are largely of a statutory nature, they nevertheless provide Members with an independent assessment of the performance of the organisation under a number of categories. This in itself can be regarded as contributing significantly to the management of risk (particularly financial risk) within the organisation. The External Auditors work closely in co-operation with finance staff and internal audit staff to provide a measure of internal control over the affairs of the Fire Authority.

6 PERSONNEL IMPLICATIONS

There are no specific Personnel Implications arising from this report.

7 EQUALITY IMPACT ASSESSMENT

An initial impact assessment has revealed that there are no specific equality issues arising from this report.

8 RECOMMENDATIONS

8.1 That Members note the contents of the External Auditors' management letter.

8.2 That significant issues arising from future auditors letters be presented to the Finance Committee.

9 BACKGROUND PAPERS FOR INSPECTION

None.

Alan Sumbly
TREASURER TO THE FIRE & RESUCE AUTHORITY

Annual Audit Letter
December 2005

Annual Audit Letter

Nottinghamshire and City of Nottingham Fire Authority

Audit 2004-2005

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4 Annual Audit Letter | Key messages

Nottinghamshire and City of Nottingham Fire Authority

Key messages

Performance

1 This year has been one of significant change for fire authorities with the introduction of the Comprehensive Performance Assessment (CPA) providing a detailed analysis of authority performance. CPA is an assessment, at the corporate level, of how well the authority is run. It does not give an opinion on how well the fire service responds to emergency incidents.

2 The Authority was categorised as 'Fair' overall under CPA. There are strengths in key areas such as a clear vision and good communications which are reflected in policy matters and relationships with stakeholders. The Authority has the financial

capacity to deliver agreed priorities and key performance indicators show an improving performance.

3 The Authority is less strong in terms of its individual performance management arrangements and must improve the links with corporate objectives. There is also

a need to further develop the role of members, partnerships and business risk management arrangements.

4 In response to the CPA the Authority has identified its improvement priorities and

through the Government Office for the East Midlands, the CPA team and ourselves, all parties are committed to supporting this process. Progress in addressing these issues needs to be closely monitored by members. The priorities will also form an important element in the planning of future audit and inspection work.

The accounts

5 We have given an unqualified opinion on the Authority's accounts. However, this

was after a significant change to reflect in the balance sheet the reclassification of

leases of appliances.

Financial position

6 The Authority faces a challenge in maintaining its sound financial standing. Control over the Authority's finances will be vitally important during the changes taking place over the coming years. The Authority has adequate balances in hand, but faces pressure on its budget from the continuing drive to modernise the

service with limited resources and heightened public expectations.

Annual Audit Letter | Performance **5**

Nottinghamshire and City of Nottingham Fire Authority

Performance

The Authority demonstrated strengths in respect of its vision and communication with key stakeholders and has the capacity to deliver its priorities and continue to improve performance. It needs to improve performance management and further develop the role of members, partnerships and business risk management arrangements.

Comprehensive Performance Assessment (CPA)

7 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).

8 The results of your local assessment 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

A - What is the Authority trying to achieve? Score

Leadership and priorities 3

A balanced strategy 3

B - How has the Fire Authority set about delivering its priorities?

Capacity: Governance and management 1

Capacity: Resources and value for money 3

Capacity: People 2

Performance management 1

C - What has the Fire Authority achieved and, in the light of that, what does it plan to do next?

Achievement of objectives 2

Achievement of improvement 3

Future plans 3

OVERALL CPA SCORE Fair

(Note: 1=lowest, 4= highest)

6 Annual Audit Letter | Performance

Nottinghamshire and City of Nottingham Fire Authority

9 The table shows that overall, the Authority was categorised as 'Fair'. The Authority demonstrated several strengths including:

- the vision of the Fire Authority is clearly articulated to stakeholders;
- The IRMP process has been used by the Authority to implement its vision through clear priorities cascaded into policies, strategies and action;
- strategically, the Authority's balance has already moved from intervention to prevention and protection and this is demonstrated through a long history of delivering good community safety activity;
- the Authority has an active role in local partnerships and is effectively using strategic and local partnership working to increase the capacity of its workforce;
- the Authority has demonstrated through its three-year financial strategy that it has sufficient financial capacity to deliver its priorities;
- the Authority has an effective purchasing policy and assets are effectively managed to support efficient service delivery;
- there are good arrangements for communicating its performance and members are involved in monitoring performance;
- there is continued improvement in performance in key areas; and
- the Authority has a relatively low cost of £32.49 per head of population in 2003/04.

10 However there are issues to address including:

- committees are not structured to meet the challenges facing the organisation;
- training to support the role of members is weak;
- there is no formal process to routinely consider value for money;
- an overarching strategy is needed to support the use and evaluation of partnerships;
- strategic business risk management is underdeveloped;
- there is a performance structure in place but it is not sufficiently

comprehensive;

- no performance system is in place to manage individual performance against agreed targets, objectives and linking personal achievement to corporate objectives; and
- there is lack of clarity among frontline staff about vision and strategy coupled with forthcoming changes resulting in some disengagement between management and workforce.

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Nottinghamshire and City of Nottingham Fire Authority

11 Following on from the CPA process, the Authority is working on improvement planning in which the weaknesses above are being actively addressed. The improvement planning process is aimed at identifying the top priorities for improvement and putting arrangements in place to address them. Meetings have been held between the CPA Team, representatives from the ODPM, auditors, and your Chairman to give support to the Authority with the process. Members will have a key role to play in terms of setting the priorities and monitoring progress against them.

Other performance work

Partnerships

12 We included in our audit plan a brief overview of partnership arrangements, however this was overtaken by the Best Value Review of Partnerships which the Brigade has been carrying out. We have provided guidance documents to officers

to will assist with the development of a strategy for partnerships, which has been identified as a need. The Authority's review found that there is much to do in order to strengthen the framework for partnerships so that they maximise the value to community safety.

Baseline IT assessment

13 Information, and the technology to support its effective management, is crucial to

helping the Authority achieve its aims. In order to deliver the efficient, accessible, joined-up, citizen-focused services required by Government's modernisation agenda, public authorities will have to improve the way in which they capture, store, use, and share information. At the same time, public authorities need to keep in step with the burgeoning set of requirements for effective information governance, including the Data Protection Act, the Freedom of Information Act, and the Civil Contingencies Bill.

14 IT needs to play an effective role in supporting the Fire Authority to deliver the type of service its customers want. This has been recognised by investment placed in the upgrading and modernisation of its systems and software platforms,

desktop systems and software, email, intranet and office systems.

15 Our review has highlighted some areas where potential risks have been identified

such as performance measurement, the adoption of a security policy and the

corporate application of formal project management methodologies.

16 The detailed findings from this review will be discussed with senior officers, and a

forward programme of action agreed to address our recommendations. The findings of this review will also be taken into account in planning our audit programme for 2006/07.

8 Annual Audit Letter | Performance

Nottinghamshire and City of Nottingham Fire Authority

Best value performance plan 2005/06 including performance information 2004/05

17 We issued a clear opinion on the Authority's best value performance plan after correction of some omitted and incorrect performance information data. The plan has been amended and republished. Quality control procedures for ensuring accurate data need to be strengthened. Detailed matters arising have been reported to officers.

Annual Audit Letter | Accounts and governance **9**

Nottinghamshire and City of Nottingham Fire Authority

Accounts and governance

We have given your accounts an unqualified audit opinion.

Your overall corporate governance arrangements are satisfactory in most key areas.

Audit of 2004/05 accounts

18 We gave an unqualified opinion on the Authority's accounts on 14 December 2005.

Matters arising from the final accounts audit

19 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. Members approved the Authority's accounts on 29 July 2005.

20 Following our audit review of the lease agreements for appliances, these were reclassified from operating leases to finance leases in the accounts. We have reported this in our SAS 610 report (see below).

21 During our interim work on your accounts major errors were discovered in the audited accounts of the prior year in relation to pension liabilities. This has been reported to members in July. Entries in the 2004/05 accounts in respect of 2003/04 were restated. The error highlighted the need for more rigorous review procedures and stronger technical knowledge. This is being addressed with the recent appointment of a principal accountant.

22 For 2005/06 the Authority is required to approve its accounts a month earlier - by the end of June 2006. Officers are well placed to achieve this since we were able

to start our audit on the 2004/05 draft accounts in early June 2005.

Report to those with responsibility for governance in the Authority

23 We are required by professional standards (Statement of Auditing Standard (SAS) 610) to report to those charged with governance, in this case the Authority,

certain matters before we give an opinion on the financial statements.

24 We have reported on the reclassification of leases because this amendment to

the accounts was made after members had approved them. The revised classification means that the appliances are now included in fixed assets, reflecting that the Authority in substance bears the significant risks and rewards of ownership.

10 Annual Audit Letter | Accounts and governance

Nottinghamshire and City of Nottingham Fire Authority

Financial standing

25 The Authority faces a challenge in maintaining its sound financial standing. Control over the Authority's finances will be vitally important during the changes taking place over the coming years. The Authority has adequate balances in hand, but faces pressure on its budget from the continuing drive to modernise the

service with limited resources and heightened public expectations.

26 The Authority also needs to meet the efficiency savings targets set by the Government. Plans are in place to meet these targets and projections show that these will be achieved.

27 Revenue spending in 2004/05 was £38.5 million and was within the budget of £39.7 million. The net surplus of £1.2 million included a budgeted £0.9 million contribution to reserves. The increase in balances reflects the change to direct precepting and the need for the Authority to hold reserves independently from the

constituent authorities.

28 The Authority has generally sound arrangements in place to assess the risks associated with its financial strategy, and the Treasurer has reported on the robustness of budget estimates and the adequacy of reserves. Uncertainty over the future shape of the service requires sound risk management of the budget.

29 There was significant slippage in the capital budget of £2.7 million with only £0.9 million expenditure incurred during last year mainly because of changes to programmed replacement of vehicles to ensure that the most appropriate appliances are procured. We have recommended that members receive and consider regular reports monitoring capital spending.

30 The Authority's pension deficit grew by 20 per cent from £188 million to £226 million and the current service cost by 50 per cent from £4.6 million to £6.9 million. The Government has published proposals, which have been out for consultation and may be implemented in 2006/07, for a different method of funding pension costs which will help reduce the problem of volatility of the

pensions budget.

Prudential Code

31 The Prudential Code's objective is to ensure, within a clear framework, that the

capital investment plans of local authorities are affordable, prudent and sustainable and to ensure that treasury management decisions are taken in accordance with good professional practice.

32 Our review found that, in accordance with Code, members receive regular reports

monitoring the indicators against the targets set. However, the reports have not included monitoring of capital expenditure and the capital financing requirement and therefore we recommend that this is done.

Annual Audit Letter | Accounts and governance **11**

Nottinghamshire and City of Nottingham Fire Authority

Systems of internal financial control

33 We have not identified any significant weaknesses in the overall control framework.

Internal Audit

34 Our assessment is that Internal Audit provides an effective service overall. We have been able to place reliance on most of their work on the Authority's core processes (main accounting system, budgetary control and closedown procedures that ensure that your accounts are free from material misstatement). Internal Audit provides a valuable assessment of your systems of internal control which members, as those charged governance, are required to review annually. We have recommended, in order to further strengthen the arrangements, that Internal Audit produce their annual report in time to feed into members consideration of the Statement of Internal Control.

35 The Internal Audit annual report, which members received in July 2005, highlighted some important issues raised in their audit reports to which officers and the Authority have responded well in correcting the weaknesses identified. The need for stronger security with computer systems which comprises many of their recommendations is vital.

Other issues

36 We raise detailed matters arising from our audit with the Head of Finance and Resources. Members should consider whether, with the recent establishment of the Finance and Resources Committee (which is to act as the Audit Committee), they wish to receive our detailed reports on the interim and final accounts work which currently only go to officers.

Standards of financial conduct and the prevention and detection of fraud and corruption

37 We have not identified any significant weaknesses in your arrangements to prevent and detect fraud and corruption. We note that, in accordance with good practice, an updated Anti-fraud and Corruption Policy and a Gifts and Hospitality Policy have been approved this year.

Legality of transactions

38 We have not identified any significant weaknesses in the framework established

by the Authority for ensuring the legality of its significant financial transactions. However, two issues arose during the audit.

39 The Authority employed four officers who were also employed as police officers.

This is not lawful under the Fire and Rescue Services Act, and has been so for many years. The officers have since left the employment of the brigade.

12 Annual Audit Letter | Accounts and governance

Nottinghamshire and City of Nottingham Fire Authority

40 The Authority operates discretionary function-related trading activities covering Fire Extinguisher Maintenance (FEM) and Fire Safety Training. For both of these activities the Authority has a temporary exemption until 30 September 2007 from the provisions of the Local Government Act 2003 - which denied fire authorities freedom to trade until the CPA had been reported. An order removing the restriction is therefore expected. When the exemption lapses the Authority, with its 'Fair' CPA assessment, will then be allowed to undertake trading, but only through a company. Members will therefore need to decide on the future of these trading activities and, as with Fire Safety Training, approve a business case assessing the risks to tax payers' money, and monitor arrangements against a business plan.

Annual Audit Letter | Other work **13**

Nottinghamshire and City of Nottingham Fire Authority

Other work

Risk management

41 Risk management arrangements were in a state of change when we originally planned to carry out an audit review of this topic and we agreed to delay the work. We now plan to review your arrangements during 2006.

National Fraud Initiative

42 In 2004/05, the Authority took part in the Audit Commission's National Fraud Initiative (NFI 2004/05). 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, with the details of housing benefit fraudsters being passed back to the employing body to allow them to consider the implications and take action as appropriate.

43 Where little or no such fraud is identified, then the Authority can gain assurance

about internal arrangements for preventing and detecting fraud. The NFI 2004/05 results were distributed on CD-ROM on 31 January 2005 and participating bodies

are required to provide savings returns reporting progress made as at

31 May 2005, 30 September 2005 and 31 December 2005.

44 We have recently reported to officers that they had not yet carried out a review of

the results, but this has now been satisfactorily undertaken. We recommend that how the Authority responds on the NFI is incorporated in the Anti-fraud Policy.

14 Annual Audit Letter | Looking forwards

Nottinghamshire and City of Nottingham Fire Authority

Looking forwards

Future audit work

45 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.

46 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

47 The statutory requirements governing our audit work are contained in:

- the Audit Commission Act 1998; and
- the Code of Audit Practice (the Code).

48 The Code has been revised with effect from 1 April 2005. Further details are included in our Audit Plan which was agreed with officers in May 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.

Annual Audit Letter | Closing remarks **15**

Nottinghamshire and City of Nottingham Fire Authority

Closing remarks

49 This letter has been discussed and agreed with the Head of Finance and Resources. The Chief Fire Officer and Treasurer have had the opportunity to comment. A copy of the letter will be presented at the Authority meeting on 24 February 2006.

50 The Authority has taken a positive and constructive approach to our audit and |

would like to take this opportunity to express my appreciation for the Authority's assistance and co-operation.

Availability of this letter

51 This letter will be published on the Audit Commission's website at www.audit-commission.gov.uk and also on the Authority's website.

David Brumhead
District Auditor
December 2005

16 Annual Audit Letter | Appendix 1 – Background to this letter
Nottinghamshire and City of Nottingham Fire Authority

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.

Figure 1 Code of Audit Practice

Code of practice responsibilities

Annual Audit Letter | Appendix 1 – Background to this letter 17

Nottinghamshire and City of Nottingham Fire Authority

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.

**18 Annual Audit Letter | Appendix 2 – Audit reports issued
Nottinghamshire and City of Nottingham Fire Authority**

Appendix 2 – Audit reports issued

Table 2

Report title Date issued

Audit Plan June 2004
Interim Memorandum May 2005
Performance Information October 2005
Baseline IT Risk Assessment November 2005
Final Accounts Memorandum November 2005
Report on the 2004/05 Financial Statements to Those Charged with Governance (SAS 610) December 2005
Opinion on the Best Value Performance Plan December 2005
Annual Audit Letter | Appendix 3 – Audit fee **19**
Nottinghamshire and City of Nottingham Fire Authority

Appendix 3 – Audit fee

Table 3 Audit fee update

Audit area Plan 2004/05

(£)

Actual 2004/05

(£)

Accounts 15,000 18,500
Financial aspects of corporate governance 11,500 12,500
Performance 13,500 13,500

Total Code of Audit Practice fee 40,000 44,500

Additional voluntary work (under section 35) 0 0

Total 40,000 44,500

Note that the costs of the CPA are not included above